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International Institute for the Unification of Private Law

WORKING GROUP FOR THE PREPARATION OF
PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS

Comments
on the Revised draft Chapter on Authority of Agents (Study L – Doc. 63)
by Professors D. DeMott and F. Reynolds

Rome, December 1999

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Professor of Law

September 23, 1999

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Dear Allan:

I write in response to your letter of April 6, 1999 concerning the March 1999 Working Paper from the UNIDROIT Principles Working Group. You enclosed some antecedent material along with the draft. Your letter asked several questions, all of which I have considered and attempted to answer. When I reviewed the March 1999 draft and the antecedent material, a couple of questions occurred to me. They follow my responses to your questions.

Undisclosed principals

Your letter reports that the Working Group may omit what is presently Article 4 in the draft on the basis that, in international commerce, an undisclosed principal's appearance and assertion of rights contravene most parties' expectations. This aspect of agency doctrine is well established in this country, as evidenced by Restatement Second of Agency § 302 and cases applying that section. It is also reflected in some statutory codifications, such as Cal. Civ. Code § 2330. That said, I do not think that deleting this aspect of the doctrine represents a major loss. When the principal (hereinafter "P"; "T" and "A" likewise appear shortly) is undisclosed because that is how P has chosen to proceed in its dealings, it does not seem unfair to hold P to the consequences of T's belief that A's is the sole interest involved. When P is undisclosed because A has, intentionally or otherwise, contravened P's instructions to disclose P's existence and interest, P's predicament is not so directly the result of a choice it has made. It is relevant, though, that P elected to deal through an agent, chose a particular agent, and had rights of control over that agent.

The preceding argument justifies deletion of subsection (2)(a) in bracketed Article 4. I am more troubled by the prospect that the proposed deletion extends to subsection (2)(b) as well. Deleting subsection (2)(b) would eliminate T's right to sue P when A defaults and P's existence becomes known. The third party has this right unless the contract specifically excludes any undisclosed principal as a party. The third party's right is reflected in Restatement § 186, in cases applying it, as well as in the statutory codifications. The importance of this doctrine is especially strong when T has dealt with an actor over some time, and when, without informing T, the actor transfers business assets to a newly-formed limited liability vehicle and becomes its agent, while continuing to deal with T. The leading case is *Grinder v. Bryans Road Bldg. & Supply Co.*, 432 A.2d 453 (Md. App. 1981). Unless T has a claim against the undisclosed principal and can reach its assets, T's prospect of recovery may be limited. To be sure, T could protect itself by searching the identity or organizational status of those with whom it deals prior to

each individual transaction, but it may appear too costly to do so in dealings of a routine nature with what appear to be repeat customers. In Grinder, for example, a building contractor incorporated his business mid-stream in his open account relationship with a general supplier.

I am curious how other systems deal with the Grinder scenario. Perhaps mechanisms apart from agency law protect the third party. Moreover, I do not see a precise parallel or symmetry between the doctrine in subsection (2)(b) and that in subsection (2)(a). In (2)(a) the problem arises typically as a result of a choice P has made, and restricting P's claims is consistent with T's expectations. In contrast, in (2)(b) the fact of the undisclosed principal's existence runs counter to T's expectations. I question whether T's ability to protect itself is comparable to that of P in the situation encompassed by subsection (2)(a).

Measure of damages for breach of warranty of authority

Your letter notes that Restatement §§ 329 and 330 do not appear to determine conclusively what measure of damages is applicable when an agent breaches the implied warranty of authority. Article 6(l) in the Working Group's draft provides for reliance damages, while I note that the Bonell draft provides for an expectation measure ("such compensation as will place the third party in the same position as it would have been in if the agent had acted with authority"). This is not a point on which my work is as far along as it is in some other respects, so my suggestions here are more tentative. Restatement §§ 329 and 330 seem to focus primarily on defining causes of action, with the specification of remedy as a secondary or ancillary concern. The third party's cause of action under section 329 is based on an implicit agreement between T and A that A has authority bind P to a contract, conveyance, or representation. It is not a defense to A that A reasonably believed himself to be authorized. See Comment b. I read Restatement § 330 to give T an additional claim, and additional remedial options, when A's misstatement of authority constitutes a tortious misrepresentation. If A, without negligence, erroneously believes that she has authority, T should be limited to a claim under Section 329. It may be to T's advantage to investigate reliance damages as an alternative to expectation damages. Comment a to Restatement (Second) of Contracts § 349 uses the example of a plaintiff who has contracted to provide services and who may not be able to establish anticipated profit with reasonable certainty. If A leads T to believe that A has authority to bind P to a contract under which T will construct a building, the analysis in Comment a all seems applicable.

If A misstates authority, intending to mislead T, there is case support for a claim for punitive damages. See *Coldwell Banker Commercial Real Estate Services v. Wilson*, 700 F. Supp. 1340 (D.N.J. 1988). Punitives are not recoverable when the misstatement is only negligent. Reliance and expectation measures may operate similarly, for example in cases in which an insurance agent misstates authority to procure a particular line or amount of coverage. The would-be insured can recover damages equal to the amount of coverage had the policy been obtained as promised, but only when the type of policy was in fact available from some insurer at the time.

Ratification: (1) To whom must it be directed; and (2) Must T be allowed to withdraw prior to ratification?

(I) As you note, Restatement § 93(1) is silent on the first question and uses illustrations of manifestation to A and to T. My suggestion is to consider the degree to which the requisites for ratification should be consistent with the requisites for creating actual authority. The starting point is Restatement § 88, Comment b, which states that "ratification is not a form of authorization but its peculiar characteristic is that ordinarily it has the same effect as authorization . . ." Restatement § 26, Creation of Authority, states in Comment a that P's unexpressed intent to confer authority is irrelevant; "there must be a manifestation by conduct coming front P and coming to the knowledge of A." At least one venerable case supports a broader formulation. In *Ruggles v. American Central Insurance Co.*, 114 N.Y. 415 (1889), the court treated A's act as authorized when P posted a letter conferring the requisite authority that had not arrived by the time A acted. However, the formulation in Restatement § 26 is consistent with the treatment of revocation of authority in Restatement § 119, which provides that revocation is effective only when communicated to A or when A has reason to know of it.

Section 93(1) may reflect a deliberate departure from the treatment of actual authority, a departure that protects T when it is evident that P consented to A's act. In creating actual authority, it matters whether P's manifestation was made to or known by A because the presence of actual authority – at least in the Anglo-based systems – creates rights and duties that run between A and P, as well as rights and duties as between P and T. The determinative question is whether, at the time A acted, A reasonably believed P wished A so to act on P's behalf. Thus *Ruggles* falls outside the Restatement definition of actual authority. P might argue in *Ruggles* that ratification (did not occur because P "was ignorant of material facts, and was unaware of his ignorance," a defense provided by Restatement § 91(1), but the rejoinder would be that P took the risk that the mail might move rapidly to A! P has consented, not knowing that A committed a particular act, but to the prospect that A might commit the act and thereby bind P. Acts by P sufficient to constitute ratification, and to create mutually enforceable obligations between P and T, do not always or necessarily release claims that P has against A.

Further questions arise when P manifests consent neither to A nor T, but only within P's own organization. Suppose T can establish that the manifestation occurred within P's organization but was not communicated to the particular A with whom T interacted. Should T be protected, assuming that A did not act with apparent authority? I have not yet researched this point. My hunch is that T is protected because the point of the manifestation is to evidence P's consent in some objectively-observable manner. See Restatement § 93, Comment a ("conduct . . . indicating that the purported principal accepts the original act as having been done on his account."). The black letter of Section 95 supports this point directly, but all of the Illustrations explore other factual variations.

(2) Permitting T to withdraw prior to ratification, as in Restatement § 88, has case support, including *Bardusch v. Hofbeck*, 51 A.2d 231 (N.J. Eq. 1947). If P can ratify by communicating affirmance to A, or maybe even by a subsequently-provable affirmance within P's own organization, perhaps P enjoys an opportunity to speculate at T's expense if T is unable to withdraw. If the transaction turns out not be to P's advantage, P (or A) would not notify T of the affirmance. This possibility in effect

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gives P an option to hold T, but T does not have a comparable position because T would be unaware of P's internally-manifested affirmance. Enabling T to withdraw gives P an incentive to notify T promptly of the affirmance if P wants to keep T on the hook.

Effect of apparent authority

This is a question that occurred to me in reading Article 5. As subsection 2 is drafted, apparent authority, when present, operates only against P. I do not read the section to permit P to hold T to a contract, when A acted with apparent authority but lacked actual authority. This is counter to Restatement § 292 and to Cal. Civ. Code § 2330. Why should T be able to hold P but P not be able to hold T?

Why is the agent's intention controlling?

Under Article 3(2), A's intent controls whether A's acts affect the legal relations of P or those of A in connection with T. Why is this determination A's alone to make? I would think this places P in some jeopardy of losing good deals, especially if it is not necessary for A to communicate its intention to renounce the agency to P.

I enjoyed working with these materials and hope my musings will be of some help. I'd be glad to look at additional drafts or to explore further any of the points in this letter.

Sincerely yours,

DAD:jma



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12 December 1999

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Dear Joachim,

Principles of International Commercial Contracts
Authority of Agents: your ref. 3645/S50

Here is a second attempt to answer your first letter of 17 November. Some of my first letter, I understood immediately from your reply, was open to being misunderstood: also, I had not entirely grasped the thrust of what you were asking, with the result that some of my comments may also have been misdirected. So it should be withdrawn. As I said then, I have been rather occupied here and I have not been able to give your papers the full attention they require. In any case, though I am of course familiar with the 1983 Convention and your article on it, I am coming in from the outside on a project on which a distinguished committee has been working for a considerable time. It is unlikely that just by reading minutes of meetings I can completely orientate myself, and even less likely that I can say anything that your committee has not thought of.

These comments follow the numbering of what I take to be the final draft, numbered by you "IV".

1. Article 1(1)- The five English words "acts in his own name" have in my view no agreed meaning for a common lawyer (at any rate outside the United States, for the law of which I have no competence to speak). I find civil lawyers (I appreciate that this is a very loose term) very reluctant to believe this, though Kurt Grönfors once said to me that the meaning of the phrase is not so clear elsewhere either. I do not know what if anything you would do with this provision if you abolished Article IV, and I appreciate that it is intended actually to get rid of a distinction between direct and indirect representation. Nevertheless, if the words are to have meaning for common lawyers, I would think you need something like "whether he purports to act for another or on his own account." The main problem for common lawyers is as to whether a person can be said to act "in the name of" another when he acts for a principal whose name is not given (cf Professor Furmston, para 63, 64).

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2. Article 2: I do not think the relation between (1) and (2) is clear. (2) simply states a type of implied authority: at least in common law, there are others. Is (1) simply prefatory to (2), in which case the notion of implied authority is quite narrow? Or are other types of implied authority envisaged, in which case why is only one spelt out in (2)?

I would think that 2(1) makes it clear that the grant of authority is a unilateral act (cf Professor Schlechtriem, para 82). With every respect, I am not sure it is quite right to say, as you are reported as saying (para 83), that agency in common law is based on a contract between principal and agent: there are plenty of cases where there is no contract. In international commerce a contract is likely: but I still think the authority is based on a unilateral act even in common law.

3. Article 3(2) (plus repeat in 4(1)(a)): I agree with Professor DeMott that it is very odd to rely only on the intentions of the agent. Following from that I find 4(1) extremely difficult: but in view of the question you ask about the complete abolition of Article 4 I say no more.

4. Article 4: in view of paras 273 and 274 I understand that your main question is that relating to this Article. Here I agree with Professor DeMott that if the common law doctrine of the undisclosed principal were abandoned, nothing very dramatic would be lost. Like the doctrine of consideration, it tends to be taken much more seriously by civil law comparative lawyers than by common lawyers, many of whom are quite surprised to be told of its existence. (I think the comparative law attention is partly derived from some work done by Müller-Freienfels in the 1950s.) Outside the United States at least (where it gained some strength by being incorporated into the Restatement) it is of most uncertain scope and it is not even clear in what situations it applies. It seems often to be taken by civil lawyers as applying to the indirect representation situation: i.e., the undisclosed principal is the person using the services of a commissionnaire or equivalent. I am not at all sure on the English cases at any rate that this is correct. Here is a progression.

(i) The agent says that he is dealing as agent for a principal whom he names. This is the clearest case of direct agency.

(ii) The agent says that he is dealing as agent for a principal whom he does not name. In common law, if the third party is willing to deal on this basis, this is another case of direct agency. (I see from your minutes that this may not be so everywhere.)

(iii) The agent does not say he is dealing for anyone, but from the nature of the agent's occupation the third party should realise that he has a principal behind him, who is not to be directly involved in the transaction. (Is this not a case of indirect representation?)

(iv) The agent does not say that he is dealing for anyone, and the third party knows that the agent sometimes deals as a pure agent for an unnamed principal (as in (ii)) and sometimes as in (iii) - or even sometimes as a merchant completely on his own account. (This is

the situation of the nineteenth century "factor" in English law, to whom the origin of the undisclosed principal doctrine is sometimes attributed.)

(iv) The agent does not say that he is dealing for anyone, but he has a principal who is in fact willing to enter into contractual relations through him. The principal however does not want his involvement in the market disclosed; or though he is willing for such disclosure, the agent at the time of acting does not want to disclose that he has such a person behind him. (Probably a case for the undisclosed principal doctrine.)

(v) The agent does not say he is dealing for anyone, but he has a principal in whose affairs he is acting. The principal however is not willing to enter into contractual relations with third parties. (Another case of indirect representation? but only possibly for the undisclosed principal doctrine.)

(vi) The agent does not say he is acting for anyone, and indeed is acting on his own account: but someone else is really "behind" him. I think this is the sort of situation to which Professor DeMott is referring in her mention of the Grinder case, though there I think the principal (the agent's company) came on the scene later. English law would be unlikely to bring this situation within the undisclosed principal doctrine: see (though not on that fact situation) The Rialto [1998] 1 Lloyd's Rep. 322.

I think all these complexities are very difficult to bring under a general provision such as Article 4, so I can see that it might well be best to consider abolishing that provision. That would carry with it the provisions of 4 (2). Within that, however, Professor DeMott would incline to preserve 4(2)(a). I would think that if 4 goes, to retain 4(2)(a) would be illogical. I hazard that she is reluctant to abandon the undisclosed principal doctrine for providing a solution to situation (vi) above, which I would think is its weakest case for its application.

5. Article 5(2) (what in common law is called apparent authority). I personally do not agree with Professor DeMott (and Professor Farnsworth) on this point: I think the principal should be liable only, and cannot sue unless he ratifies.

6. Article 6: the falsus procurator. I personally would have preferred the old draft and do not like the restriction to negative/reliance interest. But neither view is demonstrably wrong and I appreciate that in a body such as yours you may simply have to vote.

Professor DeMott takes a point about punitive damages. I would think that this is a matter for national law; or for some general part of your Principles if they cover such matters.

7. Article 7. As the comments show, this provision will be very incomplete without the rules for the internal relationship. I wonder why you have substituted "could not have been unaware of" for "ought to have known". This will surely create potential difficulties of interpretation, as Justice Finn says. He or Professor Furmston can introduce you to the degrees of knowledge listed in the English Baden Delvaux case, which seem to me still to have some relevance in this country at least.

8. Article 8. Is it clear from the second sentence that Article 5 applies to this situation?

9. Article 9: it seems to me odd not to say what ratification means. Although it has internal significance, the internal and external significance can differ - as where I ratify externally to preserve my commercial reputation, but internally hold the agent to a breach of duty, a point also made by Professor DeMott.

10. Article 10: again, it seems odd to me not to say anything about how authority is terminated: cf Professor Schlechtriem, para 246. The termination may internally be a breach of contract or of some other duty: but there is surely an external principle about termination.

11. Article 10(2) could be extremely valuable (though its internal aspect will need careful thought in some appropriate context). It may also give rise to considerable disputes in practice. Often an agent may continue to act in the interests of other principals, or a group of principals including the principal referred to. There have been (and still are) very difficult questions regarding resignation or death of underwriting members of Lloyd's (fortunately solved by the fact that the Corporation of Lloyd's has power to make delegated legislation). Another context is that of share offers. The first and probably the second may be outside the sort of situations you are addressing, but your provision could be useful in general. However, there could again be internal problems: is it a breach of duty so to act?

Yours sincerely,



Francis Reynolds