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## ***Analysis of the responsibility of the representative of a foreign company in international contracts: a case study of shipbuilding***

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### **Abstract**

With the increasing development of the shipbuilding industry in the global arena, the need for the presence of foreign companies in this field and especially investment in it was felt more than ever. The benefits of the presence of foreigners and the existence of sanctions against Iran gave special importance to how the contract was concluded. However, considering that the contract is considered an indefinite contract and its limits and limits are agreed upon between the parties according to the freedom of will (Article 10 of the Civil Code of Iran). In this research, we considered the conditions of the representative and the duties of its parties against the third party to be important and examined. The authors have tried to process the subject by using a descriptive-analytical research method and library data collection method. What was obtained from this research is the need to pay attention to the representative's behavior and the limits of authority granted to the representative by the principle. Considering all the aspects mentioned in this research, a relatively reliable contract can be concluded.

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### Introduction

The International Maritime Organization (IMO) was established to facilitate cooperation and exchange of information between member countries on technical issues related to shipping and to establish the highest maritime safety standards. (Ziaei Bigdeli, 2015, p. 231) The organization set up committees to achieve its goals and advance its activities. One of these committees is the Ship Design and Construction Sub-committee (SDC). “The Sub-Committee on Ship Design and Construction (SDC) considers a wide range of technical and operational matters related to ship design and construction, including subdivision and stability. The Sub-Committee also covers testing and approval of construction and materials, load lines, tonnage measurement, safety of fishing vessels and the carriage of industrial personnel.”<sup>3</sup> “The Sub-committee aims to improve the shipboard environment taking into account hydrodynamic aspects and the human element.”<sup>4</sup> The existence of this committee shows the importance of the shipbuilding industry.

The contract for ordering and building the ship is signed and created by agreement between the customer and the shipbuilder. The purpose of arranging and signing this contract is to build and launch various types of ships, including travel, recreational, cargo, and fishing.

The advancement of technology and the need for capital made most of the countries consider foreign investment as an important and fundamental factor in the development of their country and solving the roots of financial and economic

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<sup>3</sup> <https://www.imo.org/en/MediaCentre/MeetingSummaries/Pages/SDC-Default.aspx> Last visited 10/4/2022

<sup>4</sup> <https://www.itfglobal.org/en/sector/seafarers/sub-committee-ship-design-and-construction-sdc#:~:text=The%20Sub%2Dcommittee%20on%20Ship,and%20the%20carriage%20of%20industrial> Last visited 10/4/2022



problems. Likewise they are looking to attract more foreign investors and believe that these investments can reduce the deficiencies and gaps in foreign resources, technology, and exchanges, may lead to the economic development of their countries. (Mosoti, 2005,2006, pp. 95-97)The United Nations Conference on Trade and Development, as a permanent subsidiary of the General Assembly of the United Nations, (UNCTAD) suggests: "Developing countries, to fill their gaps ... and the growth that is necessary to overcome their widespread poverty, and to raise standards to acceptable levels, need a substantial and powerful inflow of capital from external sources." (UNCTAD, 2000, p. 1) The International Monetary Fund defines foreign direct investment money as: "An investment that is made to gain a lasting profit in an economic enterprise operating in an economy other than the economy of the investing country, and the investor's goal is to have an effective role in the management of the enterprise." (IMF) Such material investments may take the form of the construction of new production facilities, the acquisition of a foreign company to take over its management, or the participation in a joint venture through the establishment or the purchase of shares in a strategic business alliance with a domestic company in a foreign country.

The need for technology and foreign capital was also felt in the shipbuilding industry. Based on this, foreign companies were present in this industry. The contract for the construction of the ship, as well as the conditions related to it, are not specified in Iranian law, and this contract is regulated based on the authority that the principle of freedom of contracts gives to individuals. It should be noted that according to paragraph 10 of Article 2 of the Commercial Code, shipbuilding is an inherently commercial transaction. Therefore, the person engaged in shipbuilding is also a trader and is subject to the provisions of the Commercial Code.<sup>5</sup> The customer

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<sup>5</sup> <https://rokla.ir/blog/shipbuilding-contract/>. Last visited 11/4/2022

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of the ship as the employer and the shipbuilder as the contractor will sign the contract for the construction of the ship.

This freedom of will in the contracting contract and in addition to the agency contract that the foreign company concludes with an Iranian company, raises the question in the mind that what are the limits of the obligations and duties of the foreign company as the principal and the Iranian company as the representative?

### 1. Generalities

#### 1.1. Contracting

Contracts are Transactions in which the contractor receives a fee for performing an activity or achieving the goals requested by the employer. The General Conditions of Contract define the contractor as follows: “means the real or legal entity mentioned in the Contract who signs the Contract as a party on the other side and responsible for the implementation of the Contract. The legal representatives and successors of the contractor are considered the contractor.”

Basically, in the contracts of the shipbuilding industry, the employer is a public company, and the contractor can be public or private. Contracting is usually in the form of executive operations, and the contract amount is determined in the form of a price list. The rules governing contracting are the General Conditions of Contract, and since Iranian shipbuilding companies are considered state-owned, it is mandatory for them to follow the General Conditions of Contract, and not attaching it to the contract is considered a violation.

#### 1.2. Concept and status of Representation (Agency)

In English, the word agent is used to mean representative. This word is derived from the two Latin verbs Agree and Ago. The words Agency and Representation are also used to mean representation in English.



In 1986, the Council of Ministers of Europe issued guidelines for the standardization of representation agreements at the level of the European Communities. Accordingly, European countries were required by 1996 to foreign their domestic laws with this directive. Paragraph 2 of Article 1 of this Instruction defines a business representative as follows: “For the purposes of this Directive, a business representative is a self-employed intermediary who has a continuing authority to negotiate the sale or purchase of goods by another person who is hereinafter referred to as the original party or to negotiate and enter into such transactions on behalf of the original party.” (Bogaert & Lohmann, 2000, pp. 6-9)

"The 1983 Geneva Convention on Agency in the International Sale of Goods" does not explicitly define representation, but what is clear from the provisions of this convention is the recognition of commercial representation. For example, Article 1 of this Convention lists the characteristics of representation:

- “1. This Convention applies where, one person, the agent, has authority or purports to have authority on behalf of another person, the principal, to conclude a contract of sale of goods with a third party.
2. It governs not only the conclusion of such a contract by the agent but also any act undertaken by him for the purpose of concluding that contract or in relation to its performance.
3. It is concerned only with relations between the principal or the agent on the one hand, and the third party on the other.
4. It applies irrespective of whether the agent acts in his own name or in that of the principal.”

The purpose of concluding this convention is to harmonize the rules governing international trade law in the world arena.

## 2. The status of representation in domestic laws

The Iranian Commercial Code defines agency as: "Commercial representation, representation and representation in commercial affairs, whether as a commercial deputy (Articles 395 et seq. Of the Commercial Code) or otherwise (Article 401 of

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the Commercial Code)." In fact, according to the law of commerce, if the performance of all activities of a business or one of its branches is authorized by a person, that person is considered a commercial deputy. However, if only part of the affairs is given to a person, that person is not considered as a deputy, and the general rules of attorney ship apply to their relationship. (Naimi, 2010, p. 336) Regarding the representation of foreign companies, it should be said that this type of representation has been recognized by the agency contract, and the natural or legal person of the representative has undertaken some of the duties and activities of the company on this basis. Basically, the representative is a resident of the host country and must do all the work under the law of the host country. The important point to note is that the agency contract alone (the relationship between the original party and the agent) is not enough to do things, and the rules of the host country must be observed in order to be considered a legal agency.

#### 2.1. Reciprocal duties of the representation parties and the third party

What is important about the representation and the contract with the representative is that the representation and its type are well defined. This clarifies the limits of the obligations of the parties to the agency contract, especially in the contract with a third party.

Chapter 3 PECL (Authority of Agents) distinguishes in Article 3:102 two categories of representation, namely direct and indirect representation:

'(1) Where an agent acts in the name of a principal, the rules on direct representation apply (Section 2). It is irrelevant whether the principal's identity is revealed at the time the agent acts or is to be revealed later.

(2) Where an intermediary acts on instructions and on behalf of, but not in the name of, a principal, or where the third party neither knows nor had reason to know that the intermediary acts as an agent, the rules on indirect representation apply (Section 3).' (Kortmann, 2016, p. 492)



The manner in which the agent/intermediary acts towards the third party is decisive for the application of the rules relating to direct or indirect agency.

Basically, the direct agency rules apply if the agent is acting "in the name of the principal." In cases where an intermediary is acting on the instructions and on behalf "but not in the name" of a principal, the rules of indirect agency apply. (Kortmann, 2016, p. 492)

On the other hand, the UNIDROIT Convention, BW, and DCFR do not make any For example, the ruling of the People's Court of China states that in some contracts, the representation is hidden or false, and this issue has caused disputes between the parties to the contract and led them to go to court:

“When the parties conceal their true intentions through closed-loop trading or false representation under other forms of complex transaction, the people's court shall, through comprehensive examination of the content of the contract involved in the entire transaction, the actual performance of the contract and other factors, as well as the false manifestation of intentions directly embodied under the appearance of the transaction, reveal the true intentions of the parties and the true purpose of the transaction reflected under the terms of the contract, and then determine the true legal relationship between the parties and the validity of their contractual relationship. If the court finds that the contract is invalidated due to the parties' circumvention of law through conspired false manifestation of intentions and all the parties are at fault, they shall be held legally liable therefor.” (Zhang, 2022, p. 123)

Agency theory is generally concerned with two problems that may arise in the principal-agent relationship: (1) conflicting interests between the principal and the agent; and (2) how the principal can control what the agent does. (Schillemans & Bjurstrøm, 2020, p. 653)

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Since shipbuilding companies are considered third parties in the contract, the duties of the parties to the agency with third parties will be examined.

### 2.1.1. Original party assignments to third parties

By concluding a contract between the agent and the third party, a contractual relationship has been established between the original party and the third party. (Fridman, 1979, p. 137) This makes him the original party, responsible, and main obligee of the contract in return for the act or omission of the representative. The essence of the agency is basically that the transactions that the agent makes with a third party are in the name and account of the original party, therefore, all its effects include the original party condition, and the agent is not responsible for any rights or obligations. (Convention on Agency in the International Sale of Goods) When a person behaves in such a way that she presents herself as genuine and the other as her representative if she concludes a contract with an apparent representative based on the same third-party behavior, the genuine is considered responsible. (Borzoo, 2015, p. 92) In confirmation of this, we can refer to paragraph 2 of Article 14 of the Convention on Representation in the International Sale of Goods:

“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.”

Another point that should be noted in this regard is that the original party can permit the representative to perform guaranteeing actions. Given the principle and nature of representation, it should be said that in such circumstances, the representative's ignorance of the binding nature of her actions does not negate the original party guarantee. (Smith & Roberson, 1971, p. 32) Of course, the mistake made by the



representative must have been during the representation affairs in order to be held responsible.

#### 2.1.2. Third-party assignments to the original party

In the contractual relationship that is created between the agent and the third party, the third party is considered the original party to the contract therefore the third party also accepts obligations. In support of this, we can refer to Article 12 of the 1983 Geneva Convention:

“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.”

#### 2.1.3 Assignments of the representative to the third party

As mentioned earlier, in a contractual relationship between a representative and a third party, the representative is considered outside the contract, and a contractual relationship is established between the original party and the third party. For this reason, the agent is not liable to a third party and is free from any liability of the contract. The only cases in which liability can be assumed for the agent is when the agent has guaranteed the fulfillment of obligations from the original contract or has essentially concealed his representation. This guarantee may include the performance of obligations by the agent or compensation for damages. (Nouri Zamanabadi, 2010, p. 68)

#### 2.1.4 Third party duties towards the representative

In confirming that the agent is out of contract, subsequently, the agent cannot hold the third party responsible for fulfilling the contractual obligations. (Katouzian, 2004, p. 113) However, regarding the right to sue, it should be said that since the representative has concluded the contract on behalf of the original party, the

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representative cannot file a lawsuit against a third party. Only in two cases can the representative file a claim in his own name: First, when the original party has granted such authority to the representative. Second, if the agent is the beneficiary of the original contract. In the first case, the representative has again filed a lawsuit on behalf of the original party, so the effects of filing a lawsuit on the original party are also arranged. (Anderson, 1975, p. 635)

### 2.2. Legal requirements in registering the representation of foreign companies

In general, any company or a foreign legal entity that intends to operate outside its territory is required to be recognized as a legal entity in the destination country. This is subject to the laws and regulations of the destination country and determines the legal and international status of the company. (Ebrahimi, 2004, p. 254) Article 3 of the Iranian Companies Registration Law describes the most basic requirement for a foreign company to be present in Iran as follows:

“From the date of implementation of this law, any foreign company to be able to conduct commercial, industrial, or financial affairs in Iran through a branch or representative must be recognized as a legal company in its home country and registered with the Tehran Registry Office.”

In line with this article, it should be noted that these rights are ultimately recognized for a foreign company when the country of the foreign company reciprocally grants these rights to Iranian companies in their own country.<sup>6</sup> Of course, the registration of companies in Iran is ultimately done for two purposes: first, identifying the residence and country of the foreign company, and second, determining the local owner's authority to file a lawsuit in case of disputes. (Ebrahimi, 2004, p. 258) According to Article 1 of the amendment to the instructions for organizing the

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<sup>6</sup> Law on Registration of Branches or Representations of Foreign Companies approved in 1997:

Article 1 - Foreign companies that are recognized as legal companies in the country of registration, subject to reciprocal action by the country, can register their branch or representative office in the fields determined by the Government of the Islamic Republic of Iran within the framework of laws and regulations.



activities of natural and legal persons providing foreign goods and services in the country:<sup>7</sup>

“Representation of foreign natural and legal persons who have already been registered in Iran will be required to obtain the necessary certificate from the Ministry of Commerce as described above in a note, an article states that foreign companies and their branches operating in Iran, as well as Iranian natural and legal persons representing foreign companies: A) The formal agreement (contract) for the sale or after-sales service of the foreign company's products between the foreign company and the Iranian representative is one of the documents that need to be received from the applicant for registration of the representative. This agreement (contract) must be issued by the main company or agency with the authority to sell or after-sales service and contains clear and transparent information related to the period, how to terminate and settle the account, referral to arbitration, responsibilities accepted by the parties and ..., The framework of which has been prepared under the general conditions of international agreements (contracts). B) In case of removal or replacement of the Iranian representative and there is a dispute, obtaining the official consent of the Iranian representative or the opinion of the arbitration authority specified in the assignment agreement and settlement of the account is necessary for the registration of the next representation.”

Of course, it should be noted about the registration of foreign agencies that first, the foreign company must be registered and approved by the competent authorities in Iran, and then the agency must be announced. However, in the executive regulations of the law, the permission to register branches or representative offices of foreign companies has specified the field of activities in which foreign companies and their representatives are allowed to operate and can be represented in it. Of course, it should be noted that any activity of foreign companies or their representatives should be carried out under the banner of law and also not contrary to public order and good morals in Iran. Of course, the activities are specified in Article 1 of the regulations.

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<sup>7</sup> Instruction for the implementation of the provisions of part (paragraph (r) of Note 19 of the Budget Law of 2003 of the whole country, the subject of organizing the activities of natural and legal persons providing foreign goods and services in the country

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## Conclusion

As mentioned in this study, the presence of prominent foreign companies is necessary to facilitate and accelerate the development of the domestic shipbuilding industry. However, due to the prevailing conditions, i.e., the existence of sanctions against Iran, the possibility of the presence and investment of foreigners has faced problems.

One of the solutions that were considered to solve this problem was to conclude a contract to grant the representation of a foreign company to an Iranian company. By using this method, the Iranian company is required to enter into a contract (contract for the construction and equipment of a ship) with a third party (for example, the Ports and Maritime Organization of Iran) as an employer.

When concluding a contract, one of the most important points is to check the identity of the contractor. The first step in the contract is to review the agency contract concluded between the foreign and Iranian companies to conclude the contract based on the limits and powers set for the agent. In the next step of the contract, what is important is to know and also to determine the limits of the original party and representative obligations to the employer.

What needs to be said in this regard is that the original party is responsible for fulfilling the obligations, or in the event of a dispute, the original party can file a lawsuit. However, if this is to be done by the agent, it must be done under certain conditions, otherwise, the agent is considered out of contract and has no right to interfere in these matters. Also, based on what we have discussed before, in two cases, liability to a third party can be considered for the representative: The first is when the representative has guaranteed the original party, and the second, when the agent has hidden his representation from a third party, and the third party has not noticed such a matter.



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