Reflection on the Normative Intent of Article 16 of China’s Company Law

Kunyuan Jiang\textsuperscript{1,a,*}

\textsuperscript{1}Faculty of Law, Macau University of Science and Technology, Macau, China
\textsuperscript{a}2909159416@qq.com
\textsuperscript{*}Corresponding author

Abstract: The ultra vires guarantee by the legal representative of a company not only involves the general rules of the Contract Law, the Guarantee Law and the Civil Code of the People’s Republic of China, but also should consider its nature as a commercial act and take into account the legislative intent of the Company Law. In judicial practice, the regulation of the company’s ultra vires guarantee is scattered and blurred, still needing improvement. Before the advent of the judicial interpretation of the Guarantee Law, the system of legal interpretation and application process was confusing and lacked legal basis. Article 16 of the Company Law affirms the company’s ability to provide external guarantees. In the academic circle, the dispute on the effectiveness of the company’s ultra vires guarantee often revolves around the nature of Article 16 of the Company Law. But in essence, Article 16 is a rule to regulate corporate governance, and its legislative purpose is to regulate the process of intention formation of the company’s external guarantee. To examine the effectiveness of the legal representative’s ultra vires guarantee, one must take into account the interpretation of the intention expression process. The process from the company’s intention formation to the intention expression is not only a significant part to judge the validity of the ultra vires guarantee contract, but also the true representation of the normative intent of Article 16 of the Company Law.

Keywords: Article 16 of China’s Company Law, Ultra Vires External Guarantee, Company Resolution

1. Introduction

As a common means of credit enhancement in the market economy, the guarantee system has the function of realizing creditors’ rights and financing. The situation where a company act as a civil subject to provide guarantee for others is of certain significance in commercial law. Different from the guarantee provided by a natural person, the collective intention of the company to make the guarantee needs to depend on the legal representative. Therefore, cases of ultra vires guarantee by the legal representative are rather common. The legal representative’s ultra vires guarantee violates the company’s true intention expression and fabricates the company’s will to conclude a contract of guarantee. As this legal act involves both the interests of the company and the creditors, protecting either side means harming the interests of the other side. Therefore, a law needs to be introduced to make a trade-off. Article 16 of the Company Law recognizes the company’s ability to provide guaranty for others \cite{1}, while its specific application has aroused much controversy due to the lack of legal effect elements, affecting the realization of article 16’s normative objective \cite{2}, resulting in the occasional occurrence of different judgments for identical cases. On November 14, 2019, the Supreme People’s Court issued the Minutes of the National Court Work Conference on Civil and Commercial Trials (hereinafter referred to as “the 9th Conference Minutes”), in which the contents of Articles 17-23 stipulate issues related to the company’s external guarantee, providing thoughts of trial and special circumstances of the company’s ultra vires guarantee cases. The external guarantee of a company is a typical type of civil and commercial issue, which is related to the provisions of the Company Law, the Civil Law and the Guarantee Law. Article 16 of the Company Law has been interpreted in a variety of ways by academic scholars because it is required to do so in order to understand how the law will be applied. This paper aims to analyze the application of the law on this issue in order to provide ideas and suggestions for relevant judicial practice.

2. Research Status

Theoretically, the traditional views include the theory of authority restriction, the theory of normative
nature identification, and the theory of internal restriction \[3\]. Before the Civil Code and the interpretation of relevant Guarantee Law came out, the court usually proceeded from these three perspectives and drew different interpretation conclusions, which has led to many different judgments for the same kind of case. The 9th Conference Minutes proposes that both the provisions of the Company Law and provisions of Civil Code’s guarantee section and contract section should be considered, with the former to judge whether the legal representative has acted beyond legal authority, the latter to determine the validity of the contract.

2.1. Theory of Authority Restriction

This theory starts its interpretation from the normative nature of Article 16 of the Company Law, judging the validity of the company’s guarantee by whether the article is a mandatory management provision or an effective mandatory provision. As Article 16 adopts the wording with mandatory meanings such as "shall" and "shall not", its mandatory nature is reflected \[4\]. The first point of view regards it as a mandatory management provision in that Article 16 does not stipulate that the company’s violation of this provision results in the invalidity of the contract, and in that the internal resolution shall not bind the third person, but only the company’s internal behavior. As this provision is not regarded as an effective mandatory provision, it cannot serve as the basis to invalidate the guarantee contract; otherwise, it would be detrimental to the stability of the contract and the security of the transaction. In actual judicial practice, some courts view Article 16 of the Company Law as a mandatory management provision that addresses the company’s internal procedures. Moreover, since the company’s resolutions are internal management matters of the company, there is no requirement that the trading counterparty have the duty to review them. It is believed that the duty of review affects the order and efficiency of the transaction \[5\]. The second point of view regards it as an effective mandatory provision. According to this statement, Article 16 of the Company Law is intended to strictly restrict the company’s external representation and agency behavior. If the ultra vires guarantee behavior is effective, then there will be more and more cases of company’s illegal guarantee, damaging the interests of creditors and shareholders \[6\]. In judicial practices, the court holds that this act violates Article 16 of the Company Law, thus invoking Item 5 of Article 52 of the Contract Law to deny the effectiveness of the action \[7\]. The third point of view holds that while the provision on related party guarantee in Article 16’s second paragraph is effective and mandatory, the provision in the first paragraph is not. The reason is that the legislation intent is to restrict directors, supervisors and senior executives to ensure transaction security \[3\],

2.2. Theory of Normative Nature Identification

This theory holds that whether a resolution is made or not does not affect the validity of the contract. The basis for judging the effectiveness of a guarantee contract is the distinction between internal governance relationship and external transaction relationship. It holds that the resolution is a matter of the company’s internal management, and when signing the contract, the counterparty has no obligation to clarify whether the company has a legal and effective decision-making process. As a legal organ, the legal representative is an inherent part of a legal person, and its act made in the name of a legal person should be regarded as the act of a legal person \[8\]. Some courts also hold this view in judicial decisions, that if the basis for determining the invalidity of the guarantee contract is on whether the company has a legal and valid shareholders’ resolution when guaranteeing, it will inevitably affect the efficiency of the transaction. It will also allow the company to claim the invalidation of the contract on the grounds of violating internal procedures to avoid the guarantee liability, which is against the principle of good faith. Even if the guarantee resolution involved in the case is not approved by the shareholders’ meeting, the validity of the contract is not affected \[9\].

2.3. Theory of Internal Restriction

This theory holds that Article 16 of the Company Law is a restriction on corporate representation, which should be analyzed according to different situations. Viewpoint 1 thinks that if the legal representative has no right to represent, then the guarantee is invalid. Article 16 of the Company Law has made a explicit legal restriction on the company guarantee, and the law presumes that the counterparty is aware of it. Thus, it is presumed that the counterparty knows that the representation is defective when lacking in resolutions, and the guarantee is invalid \[10\]. Viewpoint 2 thinks that the legal representative has no authority to enter into a guarantee contract on behalf of the company and the contract therefore has not taken effect \[11\]. Viewpoint 3 believes it necessary to distinguish between general guarantee and related party guarantee. The general guarantee does not affect the effectiveness of the contract, but the
related party guarantee is of its particularity and importance. In legislation, representation is restricted by law to regulate related party guarantee. In addition, the counterpart’s reasonable duty of review is introduced to confirm the effectiveness of the company guarantee.

3. Reflections on Current Mainstream Theory

The theory of authority restriction makes the application of law more difficult. The reasons are as follows. Firstly, this theory causes disputes on the nature of Article 16 of the Company Law, which brings trouble to judicial practice, increases the uncertainty of law application, and increases the difficulty of application. Secondly, the theory is difficult to determine the effectiveness of the ultra vires guarantee contract. For those that violate mandatory management provisions, the people’s court would determine their validity according to the concrete situation, rather than determining directly. Thirdly, this theory recognizes Article 16 of the Company Law as an effective mandatory provision. It is not convincing to determine the invalidity of the contract on this basis, without explaining the reasons why it is invalid.

The theory of authority restriction breaks away from the debate over the normative nature of Article 16 of the Company Law, and defines this article as the limitation on the representation right of the legal representative. This theory emphasizes the function of the company’s resolution, regarding it as the definition of source of the legal representative’s power to sign external guarantee contract. It further introduces the provisions on ultra vires representatives from Article 61 and Article 504 of the Civil Code to solve the problems about the validity of the ultra vires guarantee contracts. Whether the counterpart is of “good will” becomes the key to the question, which is advantageous because the...
invalidity of the contract and the company’s responsibility for the legal representative’s ultra vires act are separated from each other to determine the effectiveness of ultra vires guarantee acts on the company.

There are still some problems in the authority restriction theory. The reference to the Civil Code to determine the validity of the contract according to the counterparty’s “good will” is built on the premise that the legal representative has the right to guarantee decision-making, ignoring the logical premise that the legal or corporate restrictions on representation is the basis of the legal representative’s right to make decisions. However, the legal representative does not have the decision-making power on company guarantee. Paragraph 1 of Article 16 of the Company Law is neither a mandatory nor an empowering provision, therefore, it does not mean that the legal representative has the right to conclude a guarantee contract with others. This is a reminder to the company at the legislative level from the Company Law that in non-related party guaranty, the company can independently grant the decision-making power on guarantee to the shareholders’ meeting or the board of directors in the company’s articles of association. Therefore, the legal representative does not have the chance to make independent guaranty to the shareholders’ meeting or the board of directors in the company’s articles of decisions. However, the legal representative does not have the decision-making power on company actions if the debtor is unable to pay the debt. This could result in the company losing property or possibly becoming bankrupt due to insolvency. What’s worse, the rights and interests of other shareholders of the company may also be affected if the legal representative and a third party try to pursue personal interests by transferring corporate property under the guise of security. Article 16 is formulated to prevent losses of the company property and safeguard the interests of other shareholders of the company. The legislative intent of Article 16 of the Company Law is that a company’s external guarantee needs to go through a real and legitimate intent formation process. The company’s external guaranty behavior differs greatly from its general business operations. The firm will be responsible for the related guarantee obligation if the debtor is unable to pay the debt. This could result in the company losing property or possibly becoming bankrupt due to insolvency. What’s worse, the rights and interests of other shareholders of the company may also be affected if the legal representative and a third party try to pursue personal interests by transferring corporate property under the guise of security. Article 16 is formulated so that the company provides external guaranty after careful consideration, providing opportunities for
4.2. Identifying the Company’s Ultra Vires Guarantee — from the Intent Expression Rules

The effectiveness of the company’s external guarantee contract needs to fulfill the important condition of the truthful intention expression, as the company’s external expression behavior is only effective when it truly reflects the company’s will. Therefore, on judging the effectiveness of the company’s external guarantee contract, it is necessary to examine both the process of intent formation and intent expression, that is, the company’s resolution and the legal representative’s act of concluding a contract with others according to the resolution. Resolution is the collective intent of the company members, that is to say, the resolution behavior is a mechanism for the formation of the group’s intent \[22\], and externally, it functions as an important part of intent expression. The history and initial legislative intention of Article 16 of the Company Law indicate that this article is essentially intended to regulate the formation of the company’s intent expression. If the company’s external guaranty contract is an ultra vires guaranty contract, it does not constitute an ultra vires act of the company. According to Article 8 of the interpretation of relevant Guarantee Law, under the following three circumstances, the company’s presumption of external guaranty has a true intent expression. First of all, a letter of guarantee is issued by a financial institution or a guarantee is provided by a guarantee company; second, the company provides guaranty for business activities carried out by its wholly-owned subsidiaries; Third, the guarantee contract is signed and agreed upon by more than two-thirds of the shareholders who have voting rights on the guarantee matters, individually or jointly.

To determine whether the company’s external guaranty without a resolution is an ultra vires guaranty depends on whether the company’s external guaranty behavior can be presumed that the company has the guaranty intent; if not, the external guaranty made by the legal representative is an ultra vires guaranty.

4.2.1. Identifying the Company’s Ultra Vires Guarantee Without Resolution

The legislative purpose of Article 16 of the Company Law is to make sure that the expression of the company’s intent of external guaranty is truthful, as long as this is guaranteed, even without a resolution, it does not constitute an ultra vires act of the company. According to Article 8 of the interpretation of relevant Guarantee Law, under the following three circumstances, the company’s presumption of external guaranty has a true intent expression. First of all, a letter of guarantee is issued by a financial institution or a guarantee is provided by a guarantee company; second, the company provides guaranty for business activities carried out by its wholly-owned subsidiaries; Third, the guarantee contract is signed and agreed upon by more than two-thirds of the shareholders who have voting rights on the guarantee matters, individually or jointly.

4.2.2. Determining the Company’s Ultra Vires Guarantee with Resolution

Paragraphs 1 and 2 of Article 16 of the Company Law clearly specify the company’s decision-making
organs for the its external guarantee. In the case of non-related party transactions, the board of directors, 
the shareholders’ meeting and the shareholders’ assembly are chosen to make the resolution of general 
guaranty according to its bylaw. In the case of related-party transactions, the shareholders’ meeting or 
assembly shall make the resolution on related party guaranty. In practical application, how to determine 
the effectiveness of the resolution when the actual resolution organ with the right to provide external 
guarantee is different from the resolution organ for external guarantee regulated by its bylaw? When the 
company’s bylaw does not specify the resolution organ to make decisions on external guarantees, how to 
determine which is the resolution organ and how is the effectiveness of the resolution? The analysis is as 
follows.

(1) When the Company’s Bylaw Does Not Regulate Matters of External Guaranty

For related-party guarantee, only the shareholders’ meeting and shareholders’ assembly have the right 
to vote on guarantee matters. Whether or not the company’s bylaw has regulated the subject of decision-
making organs of guaranty only affects the decision-making right of the board of directors, the 
shareholders’ meeting and shareholders’ assembly regarding non-related guaranty.

For non-related guaranty, if the company’s bylaw does not provide relevant regulations, the 
shareholders’ meeting and assembly have the right to decide on non-related external guaranty issues, but 
it needs the agreement of more than two thirds of shareholders who have the voting rights on guaranty 
to form a valid resolution. The reasons are as follows. 1. The shareholders’ meeting or assembly is the 
highest authority organ of the company as it reflects the will of all shareholders. 2. According to Article 
8 of the interpretation of relevant Guarantee Law, if no effective resolution is obtained, but the guarantee 
contract is signed and agreed by more than two-thirds of the company’s shareholders, individually or 
jointly, who have voting rights on the guaranty matters, then the guarantee contract is not invalid. It can 
be seen that the will of shareholders who hold more than two-thirds of the voting on the guaranty matters 
can be taken as the will of the company to provide external guarantees.

If the company’s bylaw does not provide for guarantee matters, does the board of directors have the 
authority to make the resolution on external guarantee matters? From the perspective of corporate 
autonomy, with the authorization of the shareholders’ meeting or assembly, the board of directors has the 
right to make decisions on external guarantees, which can become effective resolutions.

(2) When the Company’s Bylaw Regulates Matters of External Guaranty

When the company’s bylaw regulates matters of external guaranty, how to determine the effectiveness 
when the actual resolution organ to provide external guaranty differs from the 
resolution organ for external guarantee regulated by its bylaw? The analysis is as follows.

According to Paragraph 2 of Article 16 of the Company Law, for related-party guaranty, the 
shareholders’ meeting and the shareholders’ assembly are the company’s organs that have the right to 
make resolutions on the related party guaranty. If the company’s bylaw appoints the board of directors to 
make resolutions, then this appointment is against the Company Law, and the resolution is thus invalid. 
Under this circumstance, if the board of directors makes a resolution on external guarantee, and the legal 
representative makes external guarantee according to this resolution, then this is an ultra vires guaranty. 
On the contrary, if the shareholders’ meeting makes the resolution, then the guarantee made according to 
this resolution does not constitute an ultra vires guarantee. The reason is that even though the actual 
resolution authority for making resolutions is different from the one regulated by the company’s bylaw, 
the resolution made by the actual resolution authority (which is the shareholders’ meeting or assembly in 
this case) in accordance with the voting procedure and limited amount of guaranties as prescribed is still 
valid.

For non-related party guaranty, the board of directors, the shareholders’ meeting and shareholders’ 
assembly have the right to vote on guarantee matters. In the first scenario, the company’s bylaw appoints 
the shareholders’ meeting and the shareholders’ assembly as the resolution organs to approve guarantees. 
In this case, the two resolution organs have the true right to make resolutions. If the actual resolution 
organ is the board of directors, then the authorization of the shareholders’ meeting or shareholders’ 
assembly is needed; otherwise, the board of directors has no right to make the resolution on external 
guaranty. In the second scenario, the board of directors is appointed by the company’s bylaw to be the 
resolution organ to provide guaranties. If not the actual resolution organ is the shareholders’ meeting or 
shareholders’ assembly, which is inconsistent with the company’s bylaw, as long as the resolution 
conforms with the voting procedure and within the limited amount of guaranties, then the resolution 
made is valid. If now the actual resolution organ is the board of directors, which is consistent with its 
bylaw, then the board of directors has the legitimate decision-making right to both the related guaranty
and non-related guaranty.

5. Conclusion

The company’s ultra vires guarantee, which is a violation of the guaranty-related procedural provision in Article 16 of the Company Law by the company’s legal representative. Without forming a truthful expression of the company’s intent, the legal representative signs a guarantee contract with the counterparty of the transaction, constituting the ultra vires external guaranty. Article 16 of the Company Law has been wrongly interpreted in many judicial practices and the normative spirit hidden in the legislation has been ignored, causing difficulties in the application of the law. The process of law application is a process of interpreting law. Article 16 of the Company Law should be interpreted according to the original legislation purpose so that it can be properly applied in judicial practices.

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