SPC Guiding Case No. 15: XCMG Construction Machinery Co., Ltd. v. Chengdu Chuanjiao Industry and Trade Co., Ltd. et al. (Sales Contract Dispute)

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Unofficial English translation prepared for reference only. The official Chinese text prevails.

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Keywords

Civil / affiliated companies / commingling of corporate personality / joint and several liability

Holding

1. Where affiliated companies have overlapping or commingled personnel, business, finances, or other aspects, resulting in the inability to distinguish their respective properties and the loss of independent personality, this constitutes commingling of corporate personality.

2. Where commingling of corporate personality among affiliated companies seriously harms the interests of creditors, the affiliated companies shall bear joint and several liability to each other for external debts.

Basic Facts

The plaintiff, XCMG Construction Machinery Co., Ltd. ("XCMG Machinery Company"), alleged that Chengdu Chuanjiao Industry and Trade Co., Ltd. ("Chuanjiao Industry and Trade Company") was in arrears on goods payment, while Chengdu Chuanjiao Construction Machinery Co., Ltd. ("Chuanjiao Machinery Company") and Sichuan Ruilu Construction Engineering Co., Ltd. ("Ruilu Company") had commingled corporate personality with Chuanjiao Industry and Trade Company; that the personal assets of Wang Yongli, the actual controller of the three companies, and the shareholders of Chuanjiao Industry and Trade Company were commingled with company assets; and that all of them should bear joint and several liability for repayment. It requested an order that Chuanjiao Industry and Trade Company pay the outstanding goods payment of RMB 10,916,405.71 plus interest, and that Chuanjiao Machinery Company, Ruilu Company, and individuals such as Wang Yongli bear joint and several liability for repayment of the above debts.

The defendants Chuanjiao Industry and Trade Company, Chuanjiao Machinery Company, and Ruilu Company argued that although the three companies were affiliated, they were not commingled, and that Chuanjiao Machinery Company and Ruilu Company should not bear repayment liability for Chuanjiao Industry and Trade Company's debts.

Wang Yongli and others argued that Wang Yongli's and others' personal property was not commingled with Chuanjiao Industry and Trade Company's property, and that they should not bear repayment liability for Chuanjiao Industry and Trade Company's debts.

Upon trial, the court found as follows. Chuanjiao Machinery Company was established in 1999, with shareholders including the Second Company of Sichuan Provincial Highway and Bridge Engineering Corporation, Wang Yongli, Ni Gang, and Yang Honggang. In 2001, the shareholders changed to Wang Yongli, Li Zhi, and Ni Gang. In 2008, the shareholders changed again to Wang Yongli and Ni Gang. Ruilu Company was established in 2004, with shareholders Wang Yongli, Li Zhi, and Ni Gang. In 2007, the shareholders changed to Wang Yongli and Ni Gang. Chuanjiao Industry and Trade Company was established in 2005, with shareholders Wu Fan, Zhang Jiarong, Ling Xin, Guo Shengli, Tang Weiming, Wu Jing, and Guo Yin, with He Wanqing joining as a shareholder in 2007. In 2008, the shareholders changed to Zhang Jiarong (holding 90% of the shares) and Wu Fan (holding 10% of the shares), where Zhang Jiarong

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was Wang Yongli's wife. As to company personnel, the manager of all three companies was Wang Yongli, the financial officer was Ling Xin, the cashier and accountant was Lu Xin, and the person handling industrial and commercial formalities was Zhang Meng. The management personnel of the three companies had overlapping appointments: for example, Guo Shengli concurrently served as deputy general manager of Chuanjiao Industry and Trade Company and sales department manager of Chuanjiao Machinery Company, and the decision to remove Guo Shengli from the post of deputy general manager of Chuanjiao Industry and Trade Company was made by Chuanjiao Machinery Company; Wu Fan was both the legal representative of Chuanjiao Industry and Trade Company and the comprehensive department administrative manager of Chuanjiao Machinery Company. As to company business, the business scopes registered by the three companies with the administration for industry and commerce all involved construction machinery and partially overlapped, and the business scope of Chuanjiao Industry and Trade Company was completely covered by that of Chuanjiao Machinery Company. Chuanjiao Machinery Company was the sole distributor of XCMG Machinery Company in the Sichuan region (excluding Panzhihua), but all three companies engaged in related business, and there were circumstances of shared use of a uniformly formatted Sales Department Business Manual, Secondary Distribution Agreement, and settlement accounts. The three companies were indistinctly distinguished in external publicity. A Notarial Certificate issued by the Chongqing Notary Public Office on December 4, 2008 recorded that, through an internet search, Chuanjiao Industry and Trade Company and Ruilu Company jointly recruited employees on relevant websites with the same contact telephone numbers, fax numbers, and other contact information; the recruitment information of Chuanjiao Industry and Trade Company and Ruilu Company included a large amount of promotional content about Chuanjiao Machinery Company's development history, main business, and corporate spirit; and in some recruitment information of Chuanjiao Industry and Trade Company, the company profile consisted entirely of an introduction to Ruilu Company. As to company finances, the three companies shared settlement accounts; the bank cards of Ling Xin, Lu Xin, Tang Weiming, and Guo Shengli had seen transactions of up to RMB 100 million, with the sources of funds including the funds of the three companies, and the basis for external payments was solely Wang Yongli's signature. Among the receipts issued by Chuanjiao Industry and Trade Company to its customers, some were stamped with its financial special seal, while others were stamped with Ruilu Company's financial special seal. In circumstances where all three companies had signed contracts and had business dealings with XCMG Machinery Company, the three companies jointly issued a Statement to XCMG Machinery Company in August 2005, stating that the other two companies had been registered because of Chuanjiao Machinery Company's business expansion, requesting that all creditor's rights, debts, and sales volumes be calculated under Chuanjiao Industry and Trade Company's name, and expressing that business dealings would thereafter be conducted under Chuanjiao Industry and Trade Company's name as much as possible. In December 2006, Chuanjiao Industry and Trade Company and Ruilu Company jointly issued an Application to XCMG Machinery Company, requesting, on the ground of unified accounting, that the 2006 performance and accounts be calculated under Chuanjiao Industry and Trade Company's name.

It was further found that on May 26, 2009, Lu Xin, when questioned by the Economic Crime Investigation Detachment of the Xuzhou Public Security Bureau, stated that Chuanjiao Industry and Trade Company had already collapsed but had not been deregistered. It was also found that the goods payment actually unrecovered by XCMG Machinery Company was RMB 10,511,710.71.

Judgment

On April 10, 2011, the Xuzhou Intermediate People's Court of Jiangsu Province rendered Civil Judgment (2009) Xu Min Er Chu Zi No. 0065: (1) Chuanjiao Industry and Trade Company shall pay XCMG Machinery Company goods payment of RMB 10,511,710.71 and overdue payment interest within 10 days of the judgment taking effect; (2) Chuanjiao Machinery Company and Ruilu Company shall bear joint and several liability for repayment of the above debts of Chuanjiao Industry and Trade Company; and (3) the claims of XCMG Machinery Company against Wang Yongli, Wu Fan, Zhang Jiarong, Ling Xin, Guo Shengli, Tang

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Weiming, Guo Yin, He Wanqing, and Lu Xin were dismissed. After the judgment was pronounced, Chuanjiao Machinery Company and Ruilu Company appealed, arguing that the first-instance judgment's finding of commingling of corporate personality among the three companies was based on unclear facts, and that the finding that Chuanjiao Machinery Company and Ruilu Company bore joint and several liability for Chuanjiao Industry and Trade Company's debts lacked legal basis. XCMG Machinery Company responded, requesting affirmation of the first-instance judgment. On October 19, 2011, the Jiangsu Provincial High People's Court rendered Civil Judgment (2011) Su Shang Zhong Zi No. 0107, dismissing the appeal and affirming the original judgment.

Reasoning

The effective judgment of the court held as follows. With respect to the scope of the appeal, the focal points of dispute in the second instance were whether Chuanjiao Machinery Company, Ruilu Company, and Chuanjiao Industry and Trade Company had commingled corporate personality, and whether they should bear joint and several liability for repayment of Chuanjiao Industry and Trade Company's debts.

Chuanjiao Industry and Trade Company, Chuanjiao Machinery Company, and Ruilu Company had commingled corporate personality. First, the personnel of the three companies were commingled. The managers, financial officers, cashiers and accountants, and persons handling industrial and commercial formalities of the three companies were the same persons, other management personnel also had overlapping appointments, and personnel appointments and dismissals of Chuanjiao Industry and Trade Company were decided by Chuanjiao Machinery Company. Second, the business of the three companies was commingled. In actual operation, all three companies were involved in construction machinery-related business, and there were circumstances of sharing sales manuals and distribution agreements in the course of distribution, with commingled information in external publicity. Third, the finances of the three companies were commingled. The three companies used common accounts, used Wang Yongli's signature as the specific basis for the use of funds, and could not prove that the funds and their disposition had been distinguished; the creditor's rights, debts, performance, accounts, and rebates between the three companies and XCMG Machinery Company were all calculated under Chuanjiao Industry and Trade Company's name. Therefore, the factors characterizing the personality of the three companies (personnel, business, finances, and the like) were highly commingled, resulting in the inability to distinguish their respective properties and the loss of independent personality, constituting commingling of corporate personality.

Chuanjiao Machinery Company and Ruilu Company should bear joint and several liability for repayment of Chuanjiao Industry and Trade Company's debts. The independence of corporate personality is the premise for a company to independently bear liability as a legal person. Article 3, paragraph 1 of the Company Law of the People's Republic of China ("the Company Law") provides: "A company is an enterprise legal person, has independent legal person property, and enjoys legal person property rights. A company bears liability for its debts with all of its property." The independent property of a company is the material guarantee for a company to independently bear liability, and the independent personality of a company is also prominently manifested in the independence of property. When the property of affiliated companies cannot be distinguished and they lose independent personality, they lose the basis for independently bearing liability. Article 20, paragraph 3 of the Company Law provides: "Where a shareholder of a company abuses the independent legal person status of the company and the limited liability of shareholders to evade debts and seriously harm the interests of creditors of the company, the shareholder shall bear joint and several liability for the company's debts." In this case, although the three companies were registered with the industrial and commercial registration authorities as mutually independent enterprise legal persons, in reality their boundaries were blurred and their personalities commingled. Among them, Chuanjiao Industry and Trade Company bore the debts of all the affiliated companies yet was unable to repay them, while the other affiliated companies evaded huge debts, seriously harming the interests of creditors. The above conduct violated the purpose of the legal person system and the principle of good faith, and its nature and harmful

consequences were equivalent to the circumstances prescribed in Article 20, paragraph 3 of the Company Law. Therefore, by reference to Article 20, paragraph 3 of the Company Law, Chuanjiao Machinery Company and Ruilu Company should bear joint and several liability for repayment of Chuanjiao Industry and Trade Company's debts.

Relevant Legal Provisions

Article 4 of the General Principles of the Civil Law of the People's Republic of China.

Article 3, paragraph 1 and Article 20, paragraph 3 of the Company Law of the People's Republic of China.

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