SPC Guiding Case No. 168: China CITIC Bank Co., Ltd. Dongguan Branch v. Chen Zhihua et al. (Financial Loan Contract Dispute)

Dan Young Business Consultancy — www.danyoungcpa.com

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

Discussed and adopted by the Judicial Committee of the Supreme People's Court; issued on November 9, 2021.

Keywords

Civil / financial loan contract / failure to register mortgage / compensation liability / fault

Holding

Where immovable property is provided as mortgage security, the failure of the mortgagor to complete mortgage registration in accordance with the mortgage contract does not affect the validity of the mortgage contract. Where the creditor, based on the mortgage contract, claims that the mortgagor should bear liability for breach-of-contract compensation within the scope of the value of the mortgaged property, the people's court shall support the claim. Where the mortgagee is at fault for the failure to complete the mortgage registration, the mortgagor's compensation liability shall be reduced accordingly.

Basic Facts

On December 31, 2013, China CITIC Bank Co., Ltd. Dongguan Branch ("CITIC Bank Dongguan Branch"), Dongguan Huafengsheng Plastics Co., Ltd. ("Huafengsheng Company"), Dongguan Yiyang Xintong Group Co., Ltd. ("Yiyang Company"), and Dongguan Gaolixin Plastics Co., Ltd. ("Gaolixin Company") entered into a Comprehensive Credit Grant Contract, agreeing that CITIC Bank Dongguan Branch would provide a comprehensive credit line of RMB 400 million to Yiyang Company, Gaolixin Company, and Huafengsheng Company, with a credit period from December 31, 2013 to December 31, 2014. To secure the contract, CITIC Bank Dongguan Branch on the same day separately entered into Maximum-Amount Guarantee Contracts with Chen Zhibo, Chen Zhihua, Chen Zhiwen, Yiyang Company, Gaolixin Company, Huafengsheng Company, Dongguan Yilian Trading Co., Ltd. ("Yilian Company"), Dongguan Lihong Trading Co., Ltd. ("Lihong Company"), and Dongguan Tonghui Trading Co., Ltd. ("Tonghui Company"), agreeing that Gaolixin Company, Huafengsheng Company, Yiyang Company, Lihong Company, Tonghui Company, Yilian Company, Chen Zhibo, Chen Zhihua, and Chen Zhiwen would provide joint and several guarantee liability to CITIC Bank Dongguan Branch, within their respective guarantee limits, for the loan principal and interest and the expenses of realizing the claims during the above period. At the same time, CITIC Bank Dongguan Branch separately entered into Maximum-Amount Mortgage Contracts with Chen Zhihua, Chen Zhibo, Chen Renxing, and Liang Caixia, under which Chen Zhihua, Chen Zhibo, Chen Renxing, and Liang Caixia agreed to provide maximum-amount mortgages for the claims arising from the credit granted by CITIC Bank Dongguan Branch to Yiyang Company and others during the period from December 31, 2013 to December 31, 2014, with the main-claim amount secured being RMB 400 million each, and the secured scope including the loan principal and interest and related expenses. The mortgaged property included: 1. Chen Zhihua's real estate in Dongpo Village, Zhongtang Town, Dongguan City, and a comprehensive building next to the Zhongtang bus station in Dongpo Village, Zhongtang Town, Dongguan City (for which no real estate registration certificate had been obtained); 2. Chen Zhibo's land-use right of 4,667.7 square meters and the buildings thereon at Dongyi Lane, Dongxing Road, Chenwu, Dongpo Village, Zhongtang Town, Dongguan City, the land-use right of 30,801 square meters in Wujiachong, Zhongtang Town, Dongguan City, and the land-use right of 12,641.9 square meters in Dongpo Village, Zhongtang Town, Dongguan City (for all of which no real estate registration certificates had been obtained); 3. Chen Renxing's house in Zhongtang Town, Dongguan City; and 4. Liang Caixia's real estate in Chenwu New Village, Dongpo Village, Zhongtang

Source: https://www.danyoungcpa.com/spc-guiding-case-168-china/

Town, Dongguan City. None of the above immovable properties had undergone mortgage registration.

In addition, CITIC Bank Dongguan Branch on the same day entered into a Maximum-Amount Pledge Contract of Rights and a Registration Agreement for Pledge of Accounts Receivable with Yiyang Company.

Based on the Comprehensive Credit Grant Contract, CITIC Bank Dongguan Branch and Huafengsheng Company on March 18 and 19, 2014 separately entered into Renminbi Working Capital Loan Contracts, agreeing that CITIC Bank Dongguan Branch would provide Huafengsheng Company with working capital loans of RMB 25 million, RMB 25 million, and RMB 20 million, with loan terms from March 18, 2014 to March 18, 2015, from March 19, 2014 to March 15, 2015, and from March 19, 2014 to March 12, 2015 respectively.

The Dongguan Municipal Real Estate Administration Bureau issued a Letter on Clarifying Matters Relating to Real Estate Mortgage Registration (Dong Fang Han [2011] No. 119) to the various financial institutions in Dongguan on June 29, 2011, the content of which was: “To the various financial institutions in Dongguan: Due to historical legacy issues, there exist in our city some houses in which the land-use right holder is inconsistent with the house property right holder. In 2008, the Ministry of Housing and Urban-Rural Development issued the Measures for House Registration (Ministry of Construction Order No. 168), Article 8 of which clearly provides that ‘house registration shall follow the principle that the subject of the house ownership right and the subject of the land-use right within the house’s occupation area shall be consistent.’ Therefore, when the above houses apply for registration of transfer of ownership, the house ownership right and the land-use right must first be made consistent before registration can be handled. In order to avoid a situation where, when realizing the mortgage over such houses, a mortgagor’s lawful interests cannot be safeguarded because the house ownership transfer registration cannot be handled at the housing administration department, and in accordance with the Property Law, the Measures for House Registration, and other relevant provisions, our bureau further clarifies the matters relating to real estate mortgage registration and hereby informs you as follows: 1. Houses in which the land-use right holder is inconsistent with the house property right holder, if they need mortgage registration, may only be registered after the subjects of the house ownership right and the land-use right are made consistent. 2. At present, some financial institutions in our city, because they first disburse loans and then apply to the real estate administration department for mortgage registration, have generated some unnecessary disputes. In order to reduce the credit risks and credit disputes of financial institutions, our bureau suggests that financial institutions, when handling applications for real estate mortgage loans in their daily work, carefully examine whether the subjects of the house ownership right and the land-use right of the mortgaged real estate are consistent before deciding whether to disburse the loan. If there are doubts about the real estate ownership, they may consult the real estate administration department. 3. In order to better safeguard the interests of the parties, our bureau will, from August 1, 2011, require all applicants applying for mortgage registration of self-built houses to submit the land-use right certificate at the same time.”

CITIC Bank Dongguan Branch disbursed RMB 70 million in loans to Huafengsheng Company as agreed. However, Huafengsheng Company failed to pay interest on time from August 21, 2014. CITIC Bank Dongguan Branch brought this lawsuit, requesting: Huafengsheng Company shall repay the entire loan principal of RMB 70 million and pay loan interest; and Chen Zhibo, Chen Zhihua, Chen Renxing, and Liang Caixia shall bear joint and several compensation liability within the scope of the value of the mortgaged property.

Judgment

The Intermediate People’s Court of Dongguan City, Guangdong Province rendered Civil Judgment (2015) Dong Zhong Fa Min Si Chu Zi No. 15 on November 19, 2015: 1. Dongguan Huafengsheng Plastics Co., Ltd. shall repay to China CITIC Bank Co., Ltd. Dongguan Branch the loan principal of RMB 70 million, interest and compound interest, and pay penalty interest; 2. Dongguan Huafengsheng Plastics Co., Ltd. shall compensate China CITIC Bank Co., Ltd. Dongguan Branch for the lawyer’s fees of RMB 130,000 incurred; 3. Dongguan Yiyang Xintong Group Co., Ltd., Dongguan Gaolixin Plastics Co., Ltd., Dongguan Lihong Trading

Co., Ltd., Dongguan Tonghui Trading Co., Ltd., Dongguan Yilian Trading Co., Ltd., Chen Zhibo, Chen Zhihua, and Chen Zhiwen shall, within the limits agreed in their respective Maximum-Amount Guarantee Contracts, bear joint and several repayment liability within the scope of the debts owed by Dongguan Huafengsheng Plastics Co., Ltd. to China CITIC Bank Co., Ltd. Dongguan Branch as determined under Items 1 and 2, and the guarantors, after bearing guarantee liability, shall have the right to seek recovery from Dongguan Huafengsheng Plastics Co., Ltd.; 4. Chen Zhihua, within the scope of the value of the comprehensive building next to the Zhongtang bus station in Dongpo Village, Zhongtang Town, Dongguan City, and Chen Zhibo, within the scope of the value of the land-use right of 4,667.7 square meters and the buildings thereon (three residential buildings with an area of 3,000 square meters) at Dongyi Lane, Dongxing Road, Chenwu, Dongpo Village, Zhongtang Town, Dongguan City, the land-use right of 30,801 square meters in Wujiachong, Zhongtang Town, Dongguan City, and the land-use right of 12,641.9 square meters in Dongpo Village, Zhongtang Town, Dongguan City, shall bear joint and several compensation liability for one-half of the unsatisfied portion of the debts owed by Dongguan Huafengsheng Plastics Co., Ltd. to China CITIC Bank Co., Ltd. Dongguan Branch as determined under Items 1 and 2; 5. The remaining claims of China CITIC Bank Co., Ltd. Dongguan Branch were dismissed. China CITIC Bank Co., Ltd. Dongguan Branch appealed. The Higher People's Court of Guangdong Province rendered Civil Judgment (2016) Yue Min Zhong No. 1107 on November 14, 2017: dismissing the appeal and affirming the original judgment. China CITIC Bank Co., Ltd. Dongguan Branch, dissatisfied, applied to the Supreme People's Court for retrial. The Supreme People's Court rendered Civil Ruling (2018) Zui Gao Fa Min Shen No. 3425 on September 28, 2018, deciding to try the case by retrial. On December 9, 2019, the Supreme People's Court rendered Civil Judgment (2019) Zui Gao Fa Min Zai No. 155: 1. Revoke Civil Judgment (2016) Yue Min Zhong No. 1107 of the Higher People's Court of Guangdong Province; 2. Uphold Items 1, 2, 3, and 4 of Civil Judgment (2015) Dong Zhong Fa Min Si Chu Zi No. 15 of the Intermediate People's Court of Dongguan City; 3. Revoke Item 5 of Civil Judgment (2015) Dong Zhong Fa Min Si Chu Zi No. 15 of the Intermediate People's Court of Dongguan City; 4. Chen Zhihua, within the scope of the value of the house in Dongpo Village, Zhongtang Town, Dongguan City, Chen Renxing, within the scope of the value of the house in Zhongtang Town, Dongguan City, and Liang Caixia, within the scope of the value of the house in Chenwu New Village, Dongpo Village, Zhongtang Town, Dongguan City, shall bear joint and several compensation liability to China CITIC Bank Co., Ltd. Dongguan Branch for one-half of the unsatisfied portion of the debts owed by Dongguan Huafengsheng Plastics Co., Ltd. as determined under Items 1 and 2 of Civil Judgment (2015) Dong Zhong Fa Min Si Chu Zi No. 15 of the Intermediate People's Court of Dongguan City; 5. The remaining claims of China CITIC Bank Co., Ltd. Dongguan Branch were dismissed.

Reasoning

The Supreme People's Court held: Article 15 of the Property Law of the People's Republic of China provides that "a contract entered into between the parties concerning the creation, alteration, transfer, and extinction of a real right in immovable property shall become effective upon its establishment, unless otherwise provided by law or agreed by the parties; failure to complete real right registration does not affect the validity of the contract." In this case, the Maximum-Amount Mortgage Contracts entered into by CITIC Bank Dongguan Branch with Chen Zhihua and the other two persons stipulated that Chen Zhihua would provide security for the debts in issue with his house in Dongpo Village, Zhongtang Town, Dongguan City, Chen Renxing with his house in Zhongtang Town, Dongguan City, and Liang Caixia with her house in Chenwu New Village, Dongpo Village, Zhongtang Town, Dongguan City. The content of the above contracts was the true expression of the intent of the parties, and the content did not violate the mandatory provisions of laws and administrative regulations, and should be lawful and valid. Although the mortgaged property had not undergone mortgage registration, according to Article 15 of the Property Law of the People's Republic of China, this fact did not affect the validity of the mortgage contracts.

A lawfully formed contract is legally binding on the parties, and the parties shall perform their respective obligations as agreed; a party that fails to perform a contractual obligation or performs a contractual

obligation not in conformity with the agreement shall bear the corresponding liability in accordance with the contract or the law. Article 6, “Declarations and Warranties of Party A,” of the Maximum-Amount Mortgage Contracts stipulated: “6.2 Party A has complete, effective, and lawful ownership of or disposal rights over the mortgaged property under this contract; mortgaged property for which ownership certificates must be obtained in accordance with the law has already obtained all ownership certificate documents in accordance with the law, and the mortgaged property has no disputes or any defects in ownership… 6.4 The establishment of this mortgage will not be subject to any restriction or cause any unlawful situation.” Article 12, “Liability for Breach of Contract,” stipulated: “12.1 After this contract takes effect, both Party A and Party B shall perform the obligations agreed in this contract; a party that fails to perform or fails to fully perform the obligations agreed in this contract shall bear the corresponding liability for breach of contract and compensate the other party for the losses caused thereby. 12.2 If Party A’s declarations and warranties under Article 6 of this contract are untrue, inaccurate, incomplete, or deliberately misleading, and cause losses to Party B, Party A shall compensate.” According to the above agreements, Chen Zhihua and the other two persons should ensure that the houses in issue could undergo mortgage registration in accordance with the law; otherwise they should bear the corresponding liability for breach of contract. In this case, Chen Zhihua and the other two persons had not yet obtained the land-use right certificates for the houses in issue. Because the real estate ownership and the land-use right were inconsistent, the houses in issue could not undergo mortgage registration and the mortgage right was not established in accordance with the law. Chen Zhihua and the other two persons thereby constituted a breach of contract and should, in accordance with the above agreements, compensate for the losses caused to CITIC Bank Dongguan Branch.

Article 113, paragraph 1 of the Contract Law of the People’s Republic of China provides that “where a party fails to perform a contractual obligation or performs a contractual obligation not in conformity with the agreement, causing losses to the other party, the amount of compensation for losses shall be equivalent to the losses caused by the breach, including the benefits obtainable after performance of the contract, but shall not exceed the losses that the breaching party foresaw or should have foreseen at the time of entering into the contract as possibly caused by the breach.” Article 6.6 of the Maximum-Amount Mortgage Contracts stipulated: “Party A undertakes: when the debtor under the main contract fails to perform its due obligations or circumstances arise for realizing the security interest as agreed, regardless of whether Party B has other security over the claims under the main contract (including but not limited to property security provided by the debtor under the main contract itself, guarantees, mortgages, pledges, letters of guarantee, standby letters of credit, and other forms of security), Party B has the right to directly request Party A to bear security liability within the scope of its security, without needing to exercise other rights (including but not limited to first disposing of the property security provided by the debtor under the main contract).” Article 8.1 stipulated: “Where, upon the expiration of the debt performance period determined under Article 2, Clause 2.2 of this contract, the debtor fails to perform all or part of the obligations as agreed in the main contract, Party B has the right to dispose of the mortgaged property in accordance with this contract.” In the normal performance of the Maximum-Amount Mortgage Contracts, when the debtor under the main contract fails to perform its due obligations, CITIC Bank Dongguan Branch could directly request priority compensation from the mortgaged property. In this case, because the mortgage right was not established due to the failure to register, CITIC Bank Dongguan Branch could not realize the mortgage right, and its loss objectively existed; the scope of its loss was equivalent to the portion of Huafengsheng Company’s unsatisfied debts within the scope of the value of the mortgaged property, and it could, as agreed, directly request Chen Zhihua and the other two persons to compensate. At the same time, according to the facts found in this case, CITIC Bank Dongguan Branch was also at fault for the failure to perform the Maximum-Amount Mortgage Contracts. The Dongguan Municipal Real Estate Administration Bureau had already clearly notified the financial institutions within its jurisdiction by letter in 2011 that houses with inconsistent real estate ownership and land-use rights could no longer undergo mortgage registration. Accordingly, it can be found that CITIC Bank Dongguan Branch, when signing the Maximum-Amount Mortgage Contracts in 2013, should have known or should have been able to foresee the situation that the houses in issue could not undergo mortgage registration.

CITIC Bank Dongguan Branch, as a professional financial institution whose main business is credit operations, should possess a higher review capability than ordinary creditors. Compared with Chen Zhihua and the other two persons, who had previously handled mortgage registration over the mortgaged property in issue, CITIC Bank Dongguan Branch had a higher capability of judgment and bore a higher duty of review. CITIC Bank Dongguan Branch failed to fulfill its reasonable duty of review and care and was also at fault for the failure to establish the mortgage right. At the same time, according to Article 119 of the Contract Law of the People's Republic of China, which provides that "after one party breaches the contract, the other party shall adopt appropriate measures to prevent the expansion of the loss; where the other party fails to adopt appropriate measures and causes the loss to expand, it may not claim compensation for the expanded loss," after CITIC Bank Dongguan Branch knew that the houses in issue could not undergo mortgage registration, it did not adopt measures to prevent the expansion of the loss, such as reducing the credit line or requiring supplementary security, and the compensation liability of Chen Zhihua and the other two persons could be appropriately reduced. Comprehensively considering the degree of fault of both parties and the specific circumstances of this case, it was discretionarily found that Chen Zhihua and the other two persons should, limited to the value of the mortgaged property, bear joint and several compensation liability to CITIC Bank Dongguan Branch for one-half of Huafengsheng Company's unsatisfied debts.

Relevant Legal Provisions

1. Article 15 of the Property Law of the People's Republic of China (Note: the currently effective provision is Article 215 of the Civil Code of the People's Republic of China).

2. Article 107, Article 113, paragraph 1, and Article 119, paragraph 1 of the Contract Law of the People's Republic of China (Note: the currently effective provisions are Articles 577, 584, and 591, paragraph 1 of the Civil Code of the People's Republic of China).

Disclaimer: This translation is provided for reference and informational purposes only. In the event of any discrepancy, the official Chinese text issued by the Supreme People's Court shall prevail. This translation does not constitute legal advice.