# SPC Guiding Case No. 53: The Fuzhou Wuyi Sub-branch of Fujian Haixia Bank Co., Ltd. v. Changle Yaxin Sewage Treatment Co., Ltd. and Fuzhou Municipal Engineering Co., Ltd. (Financial Loan Contract Dispute)

Dan Young Business Consultancy — www.danyoungcpa.com

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

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## Keywords

Civil / financial loan contract / pledge over revenue right / pledge registration / realization of pledge

## Holding

1. The revenue right under a franchise right may be pledged, and may be registered as accounts receivable.

2. Where the revenue right under a franchise right is by its nature unsuitable for discounting, auction or sale, and the pledgee claims the right of priority payment, the people's court may order the debtor of the pledged claim to pay the accounts receivable of the revenue right to the pledgee in priority.

## Basic Facts

The plaintiff, the Fuzhou Wuyi Sub-branch of Fujian Haixia Bank Co., Ltd. ("Haixia Bank Wuyi Sub-branch"), alleged as follows. After signing an entity loan contract with the defendant Changle Yaxin Sewage Treatment Co., Ltd. ("Changle Yaxin"), it lent RMB 30 million to the defendant. The defendant Fuzhou Municipal Engineering Co., Ltd. ("Fuzhou Municipal Engineering") provided a joint and several liability guarantee for the aforesaid loan. The plaintiff Haixia Bank Wuyi Sub-branch, the defendant Changle Yaxin, Fuzhou Municipal Engineering, and the outsider Changle Construction Bureau signed a Franchise Right Pledge Guarantee Agreement, under which Fuzhou Municipal Engineering provided pledge guarantee with the franchise right of the Changle sewage treatment project. Because Changle Yaxin failed to repay the loan principal and interest on time, it sued and requested the court to order: Changle Yaxin to repay the plaintiff the loan principal and interest; to confirm that the Franchise Right Pledge Guarantee Agreement was lawful and valid, and to auction and sell the pledged property under the Agreement, with the plaintiff enjoying the right of priority payment; to apply the sewage treatment service fees paid by Changle Construction Bureau to the two defendants in priority to repay all amounts payable to the plaintiff; and Fuzhou Municipal Engineering to bear joint and several liability.

The defendants Changle Yaxin and Fuzhou Municipal Engineering argued that the franchise right of the Changle urban sewage treatment plant was not a right that could be pledged by law, and that the franchise right had not undergone pledge registration, so the plaintiff's request to auction and sell the franchise right of the Changle urban sewage treatment plant was without legal basis.

The court found upon trial as follows. In 2003, with Changle Construction Bureau as the transferor, Fuzhou Municipal Engineering as the transferee, and Changle Finance Bureau as the witness, the three parties signed the Franchise Construction and Operation Contract for the Changle Urban Sewage Treatment Plant, agreeing that Changle Construction Bureau granted Fuzhou Municipal Engineering the franchise to invest in, construct, operate and maintain the Changle urban sewage treatment plant project and its ancillary facilities, and made detailed agreements on the rights and obligations of both parties under the contract. On October 22, 2004, Changle Yaxin was established. It was the project company set up by Fuzhou Municipal Engineering to perform the Franchise Construction and Operation Contract for the Changle Urban Sewage

Treatment Plant.

On March 24, 2005, the Wuyi Sub-branch of Fuzhou Commercial Bank and Changle Yaxin signed an Entity Loan Contract, agreeing that Changle Yaxin would borrow RMB 30 million from the Wuyi Sub-branch of Fuzhou Commercial Bank; that the purpose of the loan was the BOT project of the Changle urban sewage treatment plant; that the loan term was 13 years, from March 25, 2005 to March 25, 2018; and made express agreements on the calculation of interest and overdue penalty interest. Fuzhou Municipal Engineering provided a joint and several liability guarantee for the aforesaid loan of Changle Yaxin.

On the same day, the Wuyi Sub-branch of Fuzhou Commercial Bank, Changle Yaxin, Fuzhou Municipal Engineering and Changle Construction Bureau jointly signed a Franchise Right Pledge Guarantee Agreement, agreeing that Fuzhou Municipal Engineering would provide pledge guarantee with the franchise right granted under the Franchise Construction and Operation Agreement for the Changle Urban Sewage Treatment Plant for Changle Yaxin's loan from the Wuyi Sub-branch of Fuzhou Commercial Bank, and that Changle Construction Bureau consented to the guarantee; that Fuzhou Municipal Engineering agreed to apply the revenue of the franchise right in priority to repay Changle Yaxin's debts under the loan contract, and Changle Construction Bureau and Fuzhou Municipal Engineering agreed to apply the sewage treatment fees in priority to repay Changle Yaxin's debts under the loan contract; and that if the Wuyi Sub-branch of Fuzhou Commercial Bank was not repaid, it had the right to realize the pledged right by auction or other means in accordance with the law.

After the aforesaid contracts were signed, the Wuyi Sub-branch of Fuzhou Commercial Bank issued the loan of RMB 30 million to Changle Yaxin as agreed. From October 21, 2007, Changle Yaxin failed to repay principal and interest in full and on time as agreed.

It was further found that the name of the Wuyi Sub-branch of Fuzhou Commercial Bank was changed to the Wuyi Sub-branch of Fuzhou Commercial Bank Co., Ltd. on April 28, 2007, and was changed again to the Wuyi Sub-branch of Fujian Haixia Bank Co., Ltd. on December 1, 2009.

## Judgment

On May 16, 2013, the Intermediate People's Court of Fuzhou City, Fujian Province rendered Civil Judgment (2012) Rong Min Chu Zi No. 661: (1) Changle Yaxin Sewage Treatment Co., Ltd. shall, within ten days from the effective date of this judgment, repay Fujian Haixia Bank Co., Ltd. Fuzhou Wuyi Sub-branch the loan principal of RMB 28,714,764.43 and interest (RMB 2,142,597.6 provisionally calculated to August 21, 2012, with subsequent interest calculated in accordance with the Entity Loan Contract until the date the loan principal and interest are fully repaid); (2) Changle Yaxin Sewage Treatment Co., Ltd. shall, within ten days from the effective date of this judgment, pay Fujian Haixia Bank Co., Ltd. Fuzhou Wuyi Sub-branch attorney agency fees of RMB 123,640; (3) Fujian Haixia Bank Co., Ltd. Fuzhou Wuyi Sub-branch shall, from the effective date of this judgment, have the right to directly collect from Changle Construction Bureau the sewage treatment service fees payable by Changle Construction Bureau to Changle Yaxin Sewage Treatment Co., Ltd. and Fuzhou Municipal Engineering Co., Ltd., and to exercise the right of priority payment over such sewage treatment service fees with respect to the debts determined in items (1) and (2) of this judgment; (4) Fuzhou Municipal Engineering Co., Ltd. shall bear joint and several liability for the debts determined in items (1) and (2) of this judgment; and (5) the other claims of Fujian Haixia Bank Co., Ltd. Fuzhou Wuyi Sub-branch were dismissed. After the judgment was pronounced, both defendants appealed. On September 17, 2013, the Higher People's Court of Fujian Province rendered Civil Judgment (2013) Min Min Zhong Zi No. 870, dismissing the appeal and affirming the original judgment.

## Reasoning

The effective judgment held as follows. The defendant Changle Yaxin failed to repay the plaintiff's loan principal and interest as agreed, which already constituted a breach of contract, and should repay the plaintiff the loan principal and pay interest and the expenses of realizing the claim. Fuzhou Municipal



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Engineering, as a joint and several liability guarantor, should bear joint and several liability for the disputed debt. The focal points of dispute in this case mainly concerned whether the pledge over the franchise right of the sewage treatment project was valid, and how the pledge should be realized.

I. On whether the franchise right of the sewage treatment project could be pledged

The franchise right of a sewage treatment project is the right to operate and maintain the sewage treatment plant and to obtain the corresponding revenue. The operation and maintenance of the sewage treatment plant are the obligations of the operator, while its revenue right is the right of the operator. Since the operation and maintenance of the sewage treatment plant are not a transferable property right, the pledge over the franchise right of the sewage treatment project in dispute is in essence a pledge over the revenue right of the sewage treatment project.

On the question of whether the revenue right of a sewage treatment project or other franchise could be pledged, the following aspects should be considered. First, the Franchise Right Pledge Guarantee Agreement for the sewage treatment project in dispute was signed in 2005. Although the laws, administrative regulations and relevant judicial interpretations at that time did not provide that the revenue right of a sewage treatment project could be pledged, the revenue right of a sewage treatment project is similar in nature to the revenue right of a highway. Article 97 of the Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Guarantee Law of the People's Republic of China provides that "where revenue rights over immovable property such as highway bridges, highway tunnels or highway ferries are pledged, they shall be handled in accordance with Article 75(4) of the Guarantee Law," expressly clarifying that highway revenue rights are other rights that may be pledged by law, and the similar sewage treatment revenue right should likewise be permitted to be pledged. Second, the Implementation Opinions of the State Council Leading Group for Western Development on Certain Policies and Measures for the Large-Scale Development of the Western Region, forwarded by the General Office of the State Council on September 29, 2001 (Guo Ban Fa [2001] No. 73), proposed to "explore the gradual introduction of the business of issuing loans with the project revenue right or toll collection right as pledge for water conservancy development projects and urban environmental protection projects (such as urban sewage treatment and garbage treatment) that have a certain debt-servicing capacity," expressly clarifying for the first time that the pledge of the revenue right of a sewage treatment project may be tried. Third, although the revenue right of a sewage treatment project is a future monetary claim, its period of exercise and the amount of revenue are both determinable, and it is a determined property right. Fourth, after the promulgation and implementation of the Property Law of the People's Republic of China (the "Property Law"), because the revenue right of a sewage treatment project is a future monetary claim arising from the provision of sewage treatment services, it may, by its nature, also be brought within the category of "accounts receivable" that may be pledged by law. Therefore, the revenue right of the sewage treatment project in dispute, as a specified property right, may be permitted to be pledged.

II. On the publicity of the pledge over the revenue right of the sewage treatment project

As to the publicity of the pledge over the revenue right of the sewage treatment project, after the Property Law took effect on October 1, 2007, because the revenue right had been brought within the category of "accounts receivable" under Article 223(6) of the Law, pledge registration should be carried out in the publicity registration system for pledge over accounts receivable of the Credit Reference Center of the People's Bank of China in order for the pledge to be established by law. Since the pledge guarantee agreement in this case was signed in 2005, before the implementation of the Property Law, the unified registration system for accounts receivable under the Property Law did not apply. As there was no unified provision on registration publicity at that time, it should, by reference to the then-current provisions on the registration of pledges over highway toll collection rights, be registered for filing by its competent department, so that relevant interested parties could learn through the competent department whether the revenue right was subject to a pledge, and the right thereby possessed the effect of publicity of property rights.



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In this case, Changle Construction Bureau affixed its seal to the Franchise Right Pledge Guarantee Agreement, and Article 7 of the Agreement expressly agreed that “Changle Construction Bureau agrees to handle the pledge registration formalities for the plaintiff and Fuzhou Municipal Engineering.” It can therefore be found that the competent department of the sewage treatment project in dispute already knew of and recognized the pledge of the right, and that relevant interested parties could also inquire through Changle Construction Bureau about the pledge of the relevant rights of the sewage treatment plant in dispute. Therefore, the pledge of the right in dispute in this case already satisfied the publicity requirement, and the pledge was established.

III. On the method of realizing the pledge over the revenue right of the sewage treatment project

Neither the Guarantee Law nor the Property Law of our country specifically provides for the specific method of realizing a pledge over a right, and only makes general provisions on the realization of a pledge, namely, that when exercising the pledge, the pledgee may agree with the pledgor to discount the pledged property, or be paid in priority from the proceeds of auctioning or selling the pledged property. However, the revenue right of a sewage treatment project is a future monetary claim, and the pledgee may request the court to order that it directly collect money from the debtor of the pledgor and exercise the right of priority payment over such money, so there is no need to adopt the method of discounting, auctioning or selling. Moreover, the revenue right is subject to certain burdens, and its operating entity is specific, so by its nature it is also unsuitable for auction or sale. Therefore, the plaintiff’s request to auction and sell the pledged property under the Franchise Right Pledge Guarantee Agreement and exercise the right of priority payment was not supported.

According to the agreement, the plaintiff Haixia Bank Wuyi Sub-branch had the right to directly collect the sewage treatment service fees from Changle Construction Bureau and to exercise the right of priority payment over the collected sewage treatment service fees. Since the defendant should still operate and maintain the sewage treatment plant properly as agreed, and if it could not operate normally, this would affect the treatment of sewage in Changle’s urban area and would also affect the plaintiff’s collection of the sewage treatment fees, the plaintiff, when collecting the sewage treatment service fees from Changle Construction Bureau, should exercise its rights reasonably and reserve the necessary and reasonable expenses for the defendant to operate the sewage treatment plant.

(Judges of the effective judgment: He Zhong, Zhan Qianghua, Zhu Honghai)

## Relevant Legal Provisions

Articles 208, 223 and 228(1) of the Property Law of the People’s Republic of China.

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