SPP Guiding Case No. 223: Protest Case — a Rural Commercial Bank v. Zhang Mouze, Cao Mouhuan and Xing Moumei (Private Lending Dispute)

Dan Young Business Consultancy — www.danyoungcpa.com

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

SPP Guiding Case No. 223 (Procuratorial Example No. 223)

Keywords

Supervision of effective civil judgments; guarantee in private lending; affixing of company seal; unauthorized representation; the counterparty's duty of reasonable examination; liability for culpa in contrahendo.

Holding

In determining the legal nature of a legal representative's act of affixing an enterprise legal person's seal to an IOU, the true intention of the parties shall be comprehensively judged on the basis of analyzing the specific circumstances of the seal affixing, in combination with factors such as the position of the seal, the nature of the contract and its purpose. Where a counterparty fails to fulfill the duty of reasonable examination as to whether the legal representative's provision of a guarantee in the name of the enterprise legal person constitutes authorized representation, the counterparty is not a bona fide counterparty, and the guarantee act is void. Where the legal person is at fault for the invalidity of the guarantee act, it shall bear liability for culpa in contrahendo in accordance with the law.

Basic Facts

In 2008, Xing Moumei, then the legal representative of a rural credit cooperative, borrowed money from Zhang Mouze and Cao Mouhuan, who transferred a total of RMB 11.8 million to the cooperative's account on multiple occasions. Xing Moumei transferred the funds to a personal bank account she controlled and used them personally, and repaid part of the loan principal and interest to Zhang Mouze and Cao Mouhuan.

In early 2009, Cao Mouhuan urged Xing Moumei to repay the debt, but she failed to do so. On May 1, 2009, Xing Moumei issued an IOU to Cao Mouhuan: "Borrowed from Cao Mouhuan cash of RMB 9.5 million, at 1% monthly interest." Zhang Mouze requested Xing Moumei to affix a company seal to the IOU, and Xing Moumei affixed the seal of "a township credit cooperative." One seal was affixed over the words "borrowed from Cao Mouhuan cash of RMB 9.5 million," and another was affixed over "guaranteed by the credit cooperative" and Xing Moumei's signature. Upon investigation, the seal of "a township credit cooperative" was an obsolete seal of the rural credit cooperative, kept by Xing Moumei all along.

On May 8, 2009, Xing Moumei was removed from her post as director of the rural credit cooperative.

In 2012, pursuant to the approval of a regulatory bureau of the then China Banking Regulatory Commission, a rural commercial bank company succeeded to the claims and debts of the rural credit cooperative.

On May 16, 2018, Zhang Mouze and Cao Mouhuan sued in the Taiyuan Intermediate People's Court (the court of first instance), requesting an order that the rural commercial bank company repay loan principal of RMB 9.5 million plus interest. During the proceedings, the court of first instance added Xing Moumei as a defendant at the company's application. The court of first instance held that the funds were remitted to the cooperative's account, and that Xing Moumei, as the then legal representative, issued the IOU and actually possessed, controlled and used the funds, so she should bear repayment liability; and that, pursuant to the regulatory bureau's approval, the company succeeded to the cooperative's claims and debts and should bear corresponding liability for debts during the cooperative's operation. Accordingly, it ordered: first, Xing Moumei to repay principal of RMB 7.986 million plus interest; second, the company to bear joint and several

Source: https://www.danyoungcpa.com/spp-guiding-case-223-china/

liability for the above amount, with recourse against Xing Moumei.

After the first-instance judgment, all parties appealed to the Shanxi Provincial High People's Court (the court of second instance). The court of second instance re-examined the principal and determined that Xing Moumei should repay principal of RMB 8.064 million. It held that Xing Moumei, as borrower, actually received and used the funds and should repay; and that the company, as successor to the cooperative, had lent its account in the legal representative's personal borrowing and failed to destroy the obsolete seal for more than nine years, and should bear corresponding liability for the unreturned loan. Accordingly, it ordered Xing Moumei to repay principal of RMB 8.064 million plus interest, and the company to bear joint and several liability with recourse.

The company then applied for retrial to the Supreme People's Court, which directed the Shanxi Provincial High People's Court to retry. On retrial, the court held that a de facto private lending relationship existed between Xing Moumei and Zhang Mouze and Cao Mouhuan; that the company had failed to strictly manage its account, objectively causing the lending of its account, and should bear corresponding liability; and that its poor seal management meant it should bear joint and several liability for the unreturned loan. It upheld the second-instance judgment.

Judgment

Acceptance and review. The rural commercial bank company, dissatisfied with the retrial judgment, applied for supervision to the Shanxi Provincial People's Procuratorate, arguing that the order of joint and several liability lacked legal basis. Upon review, the Shanxi Provincial People's Procuratorate requested the Supreme People's Procuratorate to lodge a protest. The Supreme People's Procuratorate, upon review, found that Xing Moumei had affixed the cooperative's seal to the IOU at Zhang Mouze's request.

Supervision opinions. On July 11, 2022, the Supreme People's Procuratorate lodged a protest with the Supreme People's Court. It argued, first, from the content of the IOU, that one seal was affixed over "borrowed from Cao Mouhuan cash of RMB 9.5 million" and another over "guaranteed by the credit cooperative" and Xing Moumei's signature. By common sense, the cooperative could not be both borrower and guarantor, so the nature of the seal affixing needed further analysis. Since there was no borrowing agreement between the cooperative and the lenders, no evidence that the cooperative intended to join the debt, and the IOU expressly stated "guaranteed by the credit cooperative," it could be determined that Xing Moumei, at Zhang Mouze's request, sought to make the cooperative provide a guarantee for her personal debt by affixing the seal. Second, as the then legal representative, Xing Moumei, unable to repay her large personal debt, sought to shift her personal debt risk to the cooperative at Zhang Mouze's request; Zhang Mouze and Cao Mouhuan were aware of this and were not bona fide. Moreover, the cooperative, as a financial institution mainly operating deposits and loans, savings and settlement, did not normally provide guarantees for personal loans, and Xing Moumei's seal affixing was not performance of her duties and did not produce the effect of apparent representation. Taken together, the cooperative's guarantee act should be void. Finally, although the company had weak seal supervision, pursuant to Article 7 of the then-effective Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Guarantee Law of the People's Republic of China, the company's civil liability should not exceed one-half of the portion that the debtor could not repay; the retrial judgment's determination of joint and several liability was an erroneous application of law.

Result of supervision. On November 16, 2023, the Supreme People's Court adopted the protest opinions and rendered a judgment: first, Xing Moumei shall repay principal of RMB 8.064 million plus interest; second, the company shall bear compensation liability to Zhang Mouze and Cao Mouhuan for one-half of the loan principal and interest that Xing Moumei cannot repay, with recourse against Xing Moumei after bearing liability.

Reasoning

Source: https://www.danyoungcpa.com/spp-guiding-case-223-china/

(1) The nature of a seal affixing act shall be comprehensively judged on the basis of analyzing the specific circumstances, combined with other factors. A legal representative's act of affixing an enterprise legal person's seal to an IOU has multiple legal possibilities — debt transfer, debt joining, debt guarantee and the like — and in judicial practice the substantive legal relationship shall be accurately grasped according to the specific circumstances of the seal affixing. Where the parties make different claims about the nature of the seal affixing, the true intention of the parties shall be comprehensively judged in combination with the position of the seal, the nature and purpose of the contract, so as to accurately determine the liability that the legal person should bear.

(2) A counterparty bears a duty of reasonable examination as to whether a legal representative's provision of a guarantee in the name of the enterprise legal person constitutes authorized representation. Providing guarantees externally is a major matter in the operation of an enterprise legal person, closely related to the lawful rights of investors. To balance the interests of investors and creditors, when a legal representative provides a guarantee in the name of the enterprise legal person, he or she shall provide the counterparty with authorization documents such as resolutions of the board of directors or the shareholders' meeting; the counterparty also bears a duty of reasonable examination of the authorization documents and whether the legal representative is an authorized representative. If the counterparty fails to fulfill that duty, it is not a bona fide counterparty and the guarantee act is void.

(3) Where the enterprise legal person is at fault for the invalidity of the guarantee act, it shall bear liability for culpa in contrahendo in accordance with the law. Although a counterparty's failure to fulfill the duty of reasonable examination renders the guarantee void, if the enterprise legal person is at fault in the improper selection of the legal representative, inadequate supervision, chaotic seal management or lack of supervision over large-value transactions in corporate accounts, it shall bear liability for culpa in contrahendo. The scope of such liability shall be reasonably determined in light of the degree of the legal person's fault and the causative effect on the invalidity of the guarantee contract.

Relevant Legal Provisions

Article 7 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 (applicable to this case; now Article 17 of the Interpretation of the Supreme People's Court on the Application of the Relevant Guarantee System of the Civil Code of the People's Republic of China).

Articles 207, 215 and 216 of the Civil Procedure Law of the People's Republic of China (as amended in 2021, applicable to this case; now Articles 211, 219 and 220 of the 2023 amendment).

Articles 78 and 90 of the Rules for Civil Litigation Supervision by People's Procuratorates.

Disclaimer: This translation is provided for informational purposes only and is not an official translation. In the event of any discrepancy between this English version and the official Chinese text, the official Chinese text shall prevail. This translation does not constitute legal advice.