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On the Legal Effect of Corporate Representatives' Unauthorized Guarantee in China

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Abstract

The Article 16 of the Company Law was recognized as a loop hole among scholars of law in China. However, through a scrutiny of its modification and evolution from 1993 till today, we can assert that Article 16 should be a administrative and mandatory provision, the breach against of which does not necessarily entails loss of legal effect for unauthorized guarantee contracts as confirmed by the Company law. To settle issues about the effect of corporate representatives' unauthorized guarantee, several categories should be divided for different situations. When the counterpart is bona fide, the guarantee contract should be deemed as valid; if the counterpart is malicious or when the company fails to ratify with follow-up authorization, then the guarantee contract should be null or invalid. For this purpose, judicial organs may learn from the systems of Germany or Taiwan region in deciding whether the counterpart is bona fide or not, or joint liability should be imposed on the corporate representative to reach a fair judgement that protects the interests of both the company and the counterpart.

Keywords: Corporate guarantee, Ultra vires actions, Legal effect, Corporate representative, Liability sharing.

Introduction

With ever-increasing values of transactions among big companies, their business scales are so greatly enlarged that corporate representatives may provide outward guarantee contracts in various forms. But then, for sound protection of normal development and operations of a company, under this circumstance some do not implement guarantee actions through internal conventional proceedings in the company. According some normal characteristics specified in legal articles, the nature and the effect of such corporate guarantees ultra vires cannot be analyzed from a fair perspective. The establishment of ultra vires doctrine started in 1970s by a British court in the case of Riche¹ [1]. In 1993, in Article 60 of the Company Law of P.R.China, it was stipulated that company directors and managers should not use the capital of companies for the purpose of providing guarantee for individual debtor shareholders of the company or other companies without authorization. Thereafter, experts and scholars realized that the ambiguity of ultra vires doctrine in P.R. China law is incompatible with the socialist market economy that is rapidly growing and developing in China. Such ambiguity is not good for effective protection of the fair exchanges and the market order,

¹Ashbury Railway Carriage and Iron Co Ltd v Riche [(1875) LR 7 HL 653].

destroying the security and hindering valid safeguard of bona fide third parties. For a long period of time, the academic circle has diverse opinions and voices concerning the direct impacts on the effect of a company's contracts imposed by corporate representatives' unauthorized guarantee actions. For example, a wide difference remains among the so-called "internal restriction theory"², "regulatory characteristics identifying theory"³ and "limited representation theory"⁴ [2]. Until November 8, 2019, the Supreme Court of the PRC convoked in Beijing the 9th national court meeting on trials of civil and business cases, and the Meeting Memorandum (simplified as "9th Civil Memo" hereinafter) was issued. From different perspectives the effect of unauthorized guarantees is analyzed in the Memo, which acts as a positive guidance for courts' recognition of the nature of cases in unauthorized guarantees.

In China, the normative nature of Article 19 of the Company Law is not sufficiently clarified in stipulations. It can be interpreted together with Article 11 in *The Supreme Court Explanation on Issues for the Applicability of the P.R.China Guarantee Law* (hereinafter referred to as "Guarantee Law Interpretation")⁵. An integrated grasp of relevant provisions in the Company Law, the Contract Law and the Guarantee Law Interpretation finds that there are diverse perspectives and judgments on the legal effect of unauthorized guarantee contracts of agreements. The analytical spotlight of the present thesis is on the probability and risks of substantial damages to individuals or companies exposed by the legal representatives and their unauthorized guarantees. A solution is attempted to tackle unauthorized guarantees, with rational analysis and interpretations for potential disputed guarantee cases in practical corporate operations, in order that a definite standard can be provided to classify ultra vires actions and their legal consequences on the part of the counterparts or the legal representatives. Therefore, it is conducive for the protection of interests for guarantee enterprises or their counterparts.

1. A analytical survey of theories about unauthorized guarantee

For years, China has been promoting innovations and start-ups among the general public. Data published by the National Market Supervision Administration Bureau reveal that by 2018, mainland China had a total of 29.0723 million registered entity enterprises, with a total investment upon registration up to RMB 274.31 trillions. The increase accelerated after a year, only the business income of the 500 biggest enterprises for 2019 had reached RMB79.1 trillions, with assets total of a staggering RMB 299.15 trillions.^[3] The said 20 million plus enterprises covered all sectors and trades. Individual private business or multinational corporations alike play a key role in the market economy. When transactions among companies are huge, they tend to use credit to finance and circulate capital. For small enterprises, outward guarantee is a superb solution to optimize the assets allocation. This approach cannot only develop business, but also increase transactions and opportunities in meeting demands through market competition. Meanwhile, the financial pressure on banks can be alleviated accordingly. When the bank loan chain is disrupted, small enterprises may turn to guarantee companies for assistance. In this case, guarantee contracts are indispensable for follow-up transactions and the sustainable corporate operations. Then, the situation below frequently comes up. Individuals in senior positions like big shareholders or board directors that represent a company tend to skip the voting ratification procedure by the shareholder meetings, and sign guarantee contracts without acknowledging from other company representatives, which constitutes unauthorized guarantee by the said representative.

²Civil Judgment of the Supreme People's Court of the People's Republic of China (2016) Civil Retrial SCC No. 194. Civil Ruling of the Supreme People's Court of the People's Republic of China (2016) Appeal SCC No. 1007.

³ Civil Ruling of the Supreme People's Court of the People's Republic of China (2016) Appeal SCC No. 607.

⁴ He Xiaorong (ed.), *Summary of the Meeting of Judges of the Second Civil Trial Court of the Supreme People's Court*, Beijing: People's Court Press, 2018, p. 192. Civil Ruling of the Supreme People's Court of the People's Republic of China (2017) Appeal SCC No.4565.

⁵The unauthorized guarantee agreements or contracts entered into by a legal person or a legal representative or a bailman or a person in charge of an individual's economic organization, are legally valid as an act of guarantee, unless upon signing the said contract the third party knows about it or should know the ultra vires action of the corporate representative.

The consequences brought by unauthorized guarantee may be destructive in some cases. When a company fails to repay debts, the interests of its creditors will be damaged. Moreover, the gigantic guarantees frequently amount to be in millions, when disruptions occur in any link of the corporate debt chain in mutual guarantees, the companies face an increased market risk, which in turn brings a negative impact on the enterprises involved or on the market environment.

1.1 Unauthorized guarantee: debates between the mandatory provision of effectiveness VS the mandatory provision of management

With the growth of free market, the legislature makes more precise response to claims for protection of concerned parties, and the ultra vires doctrine in Company Law is actually weakening. This is closely related with both the state control expectations of corporate activities and the perfection in the legal protection of private interests.^[4] Based on diverse characteristics of civil regulations, and the lively burst of power liberated in the autonomy of private laws, the interpreter connecting the “Should Be” and “Be”, in making each explanation, should act like a minor legislator. For different functions of each regulation, an optimal interpretative method is selected to a favorable, dialectical integration of the state compulsiveness and social livelihood.^[5] Concerning the nature of regulation in Article 16 of the Company Law about guarantee agreements, the legal circle has numerous debates between the mandatory provision of effectiveness VS the mandatory provision of management.^[6] Hereby, I want to discern the difference between the two mandatory provisions first. In accordance with Article 14 of *The Supreme Court Interpretation on Issues in Application of P.R. China Contract Law (II)* (hereinafter as Contract Law Judicial Interpretation) and Article 52 of the Contract Law, both the mandatory provisions of effectiveness and the mandatory provisions of management are classified under the mandatory provision category in state laws and administrative departments regulations. The mandatory feature for both differs as below: the mandatory provisions of effectiveness mean that clear null or impotency for those contracts in which parties go against legal prohibitions, the state or public interests are directly damaged. While if there are no unequivocal provisions that after offending this provision by parties concerned will directly lead to nullification of the contract, and the consequence of such offence will directly harm the interests of parties concerned, such provisions are administrative mandatory ones. There are roughly two kinds of mandatory provisions of effectiveness: one that does not clearly stipulate that after the offence by parties concerned it necessarily entails the invalidity of the mandatory contracts, but the offence may directly damage the interests of the state or the public; while the other kind clearly stipulates that after the offence necessarily and directly nullify or invalidate the potency of such contracts.

Some scholars hold the belief that Article 16 of the Company Law on guarantee agreements should be the mandatory provisions of management, they quote Item 1 of the said article with a definite stipulation that when a company provide outward debt guarantees, the procedure should be based on resolutions made by the board of directors or by the shareholder meeting. This should be of the same in nature with administrative charter details.^[7] However, company charters are only effective within companies, resolutions made by shareholder meetings, shareholder plenary meetings, or board directors are only potent documents within companies as internal proceedings. The counterparts to guarantee agreements have no obligations to conduct a serious investigation into the internally potent files of the guarantee company. If it is unknown to the counterparts that the management of the company signed unauthorized guarantee agreements, the guarantee contract being applicable for the Article 11 of the Guarantee Law Interpretations should be recognized as a valid contract of the company, moreover, Article 16 does not plainly provide that if the said article is offended the guarantee contract shall directly invalidate the guarantee contract made by the company. The scholars who believe that Article 16 of the Company Law is de facto the mandatory provision of effectiveness claim that counterparts in guarantee contracts should actually know that the unauthorized guarantee agreements signed have been ratified by the shareholder meetings or the board of directors. When in fact the signature is made by ultra vires management of the company, it is not recognized as valid guarantee agreements compatible with the provisions in Article 11 of the Guarantee Law

Interpretations, so the said agreements should be confirmed as invalid even though they are signed by the company.

1.2 A historical survey: unauthorized guarantees in transition of legal provisions

On July 1, 1979, China pushed out and implemented the P.R.China Sino-foreign Joint Venture Enterprise Law, the first modern corporate law in modern Chinese history. In 1988, the Sino-foreign Cooperative Enterprise Law marked the gradual formation and establishment of joint venture enterprise law system with distinct Chinese socialist characteristics. For better adjustment to a rapid growth of economy and the market, as well as a rapid transition of enterprises, the P.R. China Company Law was passed by voting in 1993 on the 5th plenary session of the standing committee of the 8th National People's Congress. This was a landmark in the modernization of Chinese enterprises, as they gradually interacted with global economy. Article 60 of the Company Law of 1993 prohibit corporate representatives from making outward guarantee for others in the stipulations below: Directors, managers and other individuals shall not loan the funds of the company to others, and provide assets of the company as guarantee for the debts owed by shareholders of the company or by others. Article 214 of the 1993 Company Law also clearly requires that if the decision-making organs of a company provide loans or guarantees to others, not only the contracts should be canceled compulsorily, but also such directors or managers should shoulder correspondent legal consequences⁶. In other words, the 1993 Company Law obviously adopts a mandatory measure, holding prohibition of companies' providing outward guarantee for others as a principle. Corporate representatives are not allowed to make outward guarantees for others. However, in transactions it is very common for corporate representatives to make outward guarantees, there are numerous economic disputes arise from outward guarantees. The loan guarantee case of China Fujian International Economic and Technology Cooperation Company and Fujian Province Zhongfu Holdings Co. Ltd.⁷ was a famous example.

Six years later, in 1999 Article 50 of the Company Law it is clearly ruled that security such transactions should be protected: when the legal representative or the person-in-charge of a legal person or an organization of any other nature entered into a contract acting beyond his scope of authority, the contracts are generally valid with exceptions that when the counterparts know or should know the ultra vires behavior. If the article above is put side-by-side with the regulations in Article 43 of the 1986 Civil Law General Principles⁸, there is no response to the question whether company legal representatives' ultra vires actions are potent or not, instead there is merely complementation for the protection obligations of the transaction security concerning the counterparts of the company. Therefore, some experts often consider the expression that "such act of representation is valid" neglecting the need of judging the validity and constitutive requirements in the apparent representation behavior itself.¹⁸¹ If an apparent representation behavior falls short of valid essential conditions required by legal behaviors, and it can still be directly ruled by a court as an impotent or revocable civil behavior, only that the legal consequences of such a behavior should be borne by the legal representative or other organizations themselves. Therefore it is more appropriate to substitute the wording "such act of representation is valid" with "the legal consequences of this representation behavior shall be borne by this legal person or other organization".

If company directors and managers or other such individuals go against the Item 3 of Article 60 in the 1993 Company Law, in accordance with the Guarantee Law Judicial Interpretations issued by the Supreme Court in December, 2001, the company loan guarantee contracts signed shall be

⁶It is provided in Article 214 of the 1993 Company Law that if board directors, managers break regulations in this law and give outward guarantee based on the assets of the company for its main shareholders or other companies or individuals in debt, then the company should ask for the cancellation of such outward guarantees, and require liabilities be borne by other people, all the economic income from illegal outward guarantee for others should be returned to the company.

⁷ Judgment Civil Judgment of the Supreme People's Court of the People's Republic of China (2000) Economic Final No.186.

⁸ The Article 43 of the 1986 Civil Law General Principles rules that "an enterprise as legal person shall bear civil liability for the operational activities of its legal representatives and other personnel."

invalid, except that the creditor to the contracts should know or theoretically should know, debtors, guarantee providers should be obliged to compensate for the economic damages inflicted on the creditors. On the other hand, Article 60 of the 1993 Company Law is stipulated to limit the outward guarantee actions by directors and managers. The aim of the law drafting is set to prevent from the loss of company assets, damages to the interests of company shareholders and company creditors. While the Guarantee Law is aimed at securing the realization of debt rights, focusing on the protection of debt, while balancing the rights of creditors, debtors and guarantee providers respectively is not underlined. Therefore, there is an internal tension in the nature of the regulations in Article 4 of the Guarantee Law Judicial Interpretations by the Supreme Court and Article 60 of the 1993 Company Law. This issue drew much social attention at that time. Because by early 2001, the company loan guarantee total in the form of shareholders' common guarantee amounted to RMB160 billion, plus RMB110 billion loan guarantees provided by guarantee companies for other individuals or debtor organizations, the scale was a phenomenal RMB 270 billion in total loans. If the judicial interpretations of the Supreme Court is seriously and systematically followed in implementation, then, for the creditors, the huge creditor loan depends on guarantees which should be invalid if Article 4 of the Guarantee Law Judicial Interpretations was applicable.^[9] The staggering credit rights of creditors would again be exposed to gigantic dangers for not being protected by guarantee-providing enterprises. From the civil and business law perspective, today we already have a clear idea that when the Supreme Court prohibits creditors from providing limited guarantees for shareholders' outward transactions, such an idea is complete opposite to intention of encourage circulation and transactions in the business guarantee system, it is also a direct denial of the idea of "giving priority to efficiency with due consideration to fairness". Along with heated theoretical debates among various schools of experts, opportunities and impacts for commercial limited transaction reform and development frequently concurred with infringement on the interests of shareholders and their creditors. The fact that the content of the restricted guarantee regulations was emptied indeed finally led to modifications of relevant articles in the Company Law in consequent law revising process.

Eventually, in Article 16.1 of the Company Law promulgated on October 27, 2005, the previous company prohibited guarantee rules were clearly modified, standardizing company shareholder representatives' executive procedures to provide guarantee for other companies or individuals in accordance with respective company charters of association, confirming the legitimacy of providing guarantee for shareholders or other companies.^[10] That is to say, it was the basic tenet of embracing company autonomy in Article 16 that it is rigidly stipulated that "if a company intends to provide guarantee to a shareholder or actual controller of the company, it shall make a resolution through the shareholder's meeting or shareholders' convention." The legitimacy of the executive procedures and voting mechanisms of shareholder's meeting was specified and regulated. Provisions in Article 16.2 are similar to Article 60.3 of the Company Law prior to the modification, which shows that there remains a state-controlled companies' providing guarantees for others. Besides, Article 149 and Article 150 of the active Company Law clearly prohibit companies' directors and senior management members to skip shareholder meetings, shareholder plenary meetings or consent from other board directors to provide guarantees in business for others. If damages occurred to company assets the said director or manager should be liable to compensate for such losses caused. The active Company Law was modified and passed on December 28, 2013 in the 6th plenary session of the standing committee of the 12th National People's Congress. Article 16 of the active Company Law has something in common with relevant regulations of the 2005 Company Law.

In 2017, Article 61.2 of General Provisions of Civil Law⁹ was a formal expression based on the perspective of corporate organization. It is completely confirmed that the ultra vires actions by companies' legal representatives belong to the companies as a basic foundation of the legal system. Article 61.3 of the Company Law reads "the restriction on the scope of the legal representative's right of representation imposed by a legal person's articles of association or its authoritative body

⁹Article 61 of General Provisions of Civil Law: Where the legal representative of a legal person engages in civil activities in the name of the legal person, the legal consequences incurred shall be undertaken by the legal person.

shall not challenge any bona fide other party”, by denying right of defense to legal persons the private law effects are endorsed for company legal representatives in their ultra vires actions.

2. Effect in private law of company representatives’ unauthorized guarantee

First and foremost, it should be made clear that Article 16 of the Company Law can only determine the legal purview of company representatives, rather than confirming the legal effectiveness of unauthorized guarantee by representatives in accordance with the legal regulation nature of the said article.^[11] Special attention should be paid to the requirements in the Contract Law to decide first whether the unauthorized guarantee behavior by the corporate representatives belongs to the representatives’ company, before deciding the specific private law nature and the effect of the behavior.

2.1 A comparative case study of legal regulations and practices concerning unauthorized guarantee effect between China and other regions

In China the judicial practice mainly adopts three approaches. The first approach sets its departure from the regulations in Article 50 of the Contract Law, and decides whether the action of signing guarantee contracts by the legal representatives constitutes apparent representation, before judging whether the counterparts to the contracts express goodwill, and eventually the effect of the contracts can be judged.^[12] For example, in the private loan dispute case between Henan Henghe Real Estate Co. Ltd. and Pan Liantang etc¹⁰. the Supreme Court followed regulations of Article 50 of the Contract Law and decided that Henghe should be liable for Pan Liantang as a bona fide third-party.^[13] Wang Fengbo was the legal representative of Henghe company when he signed a repayment agreement with Pan Liantang in the case. When Henghe company failed to provide enough legal evidences to prove that the bona fide third-party Pan Liantang knew or any third-party individual should know that Wang Fengbo’s legal actions was ultra vires, his ultra vires actions should be legally valid for Henghe company of which he was the representative. The Supreme Court stated that Henghe company should be liable for any third party.

The second approach is mainly based on Article 61 of the General Provisions of Civil Law in which it is pointed out that resolutions within a company have no direct legal relation with the counterparts outside a company. The behavioral regulations of internal administration in a company cannot be directly binding for counterpart third parties outside a company. For example, the purchase contract dispute case between Chongqing Zanli Real Estate Co. Ltd. and He Xiaoping¹¹ and the compensation rights dispute case between Guizhou Xinyuan Mining Co. Ltd.¹² and Hunan Province Small Enterprise Credit Guarantee Co., Ltd. , after investigations the courts believe that regulations in Article 16 of the Company Law stipulate that internal resolutions and behavior administrative rules of a company cannot be directly potent for a company’s outward actions.[14] Meanwhile, it shows that a company has no restrictions over counterparts in a transaction, therefore in transactions counterparts’ investigating of charter of association or shareholder meeting memorandum does not affect the civil legal liabilities borne by a company. In the compensation rights dispute case between Guizhou Xinyuan Mining Co. Ltd. and Hunan Province Small Enterprise Credit Guarantee Co., Ltd., the initial court verdict eventually judged that the unauthorized guarantee that Wang Xingshu made on behalf of Diwang Holdings Co.Ltd. to the money he owed to Li Zongyin did not have legal conditions under Article 52 of the Contract Law for invalid guarantee contracts, and finally judged that Diwang company are jointly liable for compensating the debt borne by Wang Xingshu. Statistics of Beijing University Fabao database of companies’ unauthorized guarantee cases as per the sentencing path, so far in 2017, there are 100 cases tried by the “internal administrative regulation approach”, i.e., 21.83% of all such cases.

¹⁰P.R.China Supreme Court Civil Case Rulings Appeal SCC No. 1475 (2017) .

¹¹ Civil Ruling of the Supreme People's Court of the People's Republic of China (2017) Appeal SCC No. 1475.

¹² Civil Judgment of the Supreme People's Court of the People's Republic of China (2016) Civil Final SCC No. 380..

The third path starts from the regulations stipulated in Article 52 of the Contract Law and Article 14 of the Contract Law Judicial Interpretations (II). This approach analyzes the normative attribute of Article 16 of the Company Law to decide the validity of the guarantee. If the regulation is the mandatory provision of effectiveness, then the guarantee contract should be deemed invalid. While if the regulation is the mandatory provisions of management, then the guarantee should be recognized as valid. This path of deciding the nature of guarantee makes the largest part in the year 2017, in all 495 cases, as high as 65.94% are confirmed as guarantees, and in this nature analysis approach, 83.11% or 251 cases are judged as the mandatory provisions of management. For example in the case of financial loan contract dispute between Anhui Province Investment Group Holdings Co. Ltd. and Zhongyuan Bank Corp's Puyang Kaizhou Road Branch¹³, it is mentioned in the sentence that Article 16 of the Company Law is established concerning the nature of guarantee mainly to effectively restrict corporate activities as a business entity, and to prevent actual controllers or senior management members from damaging legal interests of the company, small shareholders or other corporate creditors.^[15]

In contrast with mainland China, Germany, Japan and China's Taiwan region etc. mostly directly or derivatively adopt the rule that a company's ultra vires representation is unauthorized representation of the company, a detailed distinction is made between unauthorized representation and apparent representation in the narrow sense of the terms. A similar legal representation concept in German law is *Anscheinsvollmacht* (apparent representative rights), which is termed as apparent or ostensible authority in the Anglo-saxon system,^[16] i.e., the legal action of the representative is unauthorized representation in itself, but if counterparts or any bona fide third party whether base on certain facts or good reasons it is decided that the representative have authority of representation and sign contracts with the representative, the final consequences and legal liabilities should be borne by the party represented, such legal actions are called apparent representation. The corporation is estopped from denying the authority of the agent to do on behalf of the corporation an act which the corporation is not permitted by the corporation to do itself.^[17]

In the Anglo-saxon system, ultra vires system first started in the 1875 Riche case, limiting mainly British public corporations incorporated in accordance with the 1862 Company Law, the scope of ultra vires transactions was only directly restricted within the definite boundaries prescribed in the said company law. If transactions occurred beyond the rules and regulations of the company, they were invalid from the beginning.^[18] That is to say, in Britain at that time, no matter counterparts were kind or malicious in intention, whether there were pursuant confirmations or not, such contracts were judged as having no legal validity. The First Council Directive on Company Law promulgated by the European Economic Community in 1968 was a milestone in this process,¹⁴ in which members of community were banned from the company ultra vires system, it was stipulated that shareholders of companies in member countries should subject to all actions conducted by its units.^[19]

After giving up the ultra vires doctrine, the British changed mind and turned to use the company representation theory in the common law for a solution of ultra vires representation actions. The second modification of the British Company Law in 1989 ultra vires behaviors of both the company and the board directors were separately put into administration of the company. The ultra vires actions of board directors were defined that the company's lawful transactions with third parties bona fide should be recognized by the company. Article 31 and Article 39 of the 2006 version of British Companies Act show that the company should not be restricted in any way in its aim to close lawful deals with third parties. Both the company and the third party are not subject to any restrictions of the British company's charter of association, and lack of lawful transaction capability cannot be a reason for a direct denial of the effect of the transaction contract, with the exception that the third party is a charity company or other corporate legal persons or groups not regulated by the 2006

¹³P.R.China Supreme Court Civil Case Rulings Appeal SCC No. 370 (2017) .

¹⁴First Council Directive 68/151/EEC of 9 March 1968 on Co-Ordination of Safeguards which, for the Protection of the Interests of Members and Others, Are Required by Member States of Companies within the Meaning of the Second Paragraph of Article 58 of the Treaty, with a View to Making Such Safeguards Equivalent Throughout the Community, OJ L 65, 14.3.1968.

Companies Law. The U.S. law in the transition from the 19th century and the 20th century also underwent great reforms to solve the security issue of corporation transactions. In 2002, the U.S. Model Business Corporation Act clearly prescribed that companies have unrestricted authority to engage in lawful transactions, and the companies should not directly lose its validity due to the current or past lack of competence for unrestricted authority to engage in lawful transactions.

While the German corporation unauthorized guarantee law distinguish the internal and external legal relations for the company, as per the Article 37 of the German Limited Liability Companies Act¹⁵, the directors shall be obligated vis-à-vis the company to observe those restrictions which have been set out in the articles of association as regards the extent of their power to represent the company or by resolutions passed by the shareholders. This regulation is invalid for any third parties (*keine Rechtlichewirkung*) outside the limited liability company. Scholars in China coined a new term for it as Inside/Outside Distinction (*neiwaiyoubie*), i.e., unauthorized guarantee contracts with German company representatives were deemed as invalid due to the fact that lack of previous authorization by the company.

Article 16 of the Company Law of China's Taiwan region puts restrictions on companies' guarantee capacity for others¹⁶. The said article means that for guarantee provided by companies via the ultra vires agents concerned, unless with follow-up ratification by the board of the guarantee companies, have no legal effects on the companies. As a deduction the rule is applicable for unauthorized proxy companies.^[20] Identically, Article 265 of the Japanese Business Law Codes also has clear stipulations¹⁷ that abuse of contract representative authority is not applicable in Article 108 of the Japanese Civil Law Codes about "self-contract and representatives of both sides", the legal effect mainly depends on whether the board of directors would confirm in its resolutions.

To sum up, a contrastive analysis of mainland China's Company Law and those laws of Taiwan region, German Limited Liability Company Law, and Japanese Civil Law Codes, Chinese unauthorized guarantee system still has room for improvement.

2.2 Effect recognition of corporate representatives' ultra vires guarantee in the 9th Civil Law Memo

On November 14, 2019, the Supreme Court of the PRC formally promulgated National Court Civil and Business Trials Meeting Memo and put it in effect immediately. This is the 9th trial work meeting transcript and the focus is on the trials of civil and business cases by courts across the nation, so it is called in short The 9th Civil Law Memo. In the memo Point (6) of Part II clearly mentioned provisions for trying cases of companies' providing of guarantees for others in Article 17, which stipulates that the ultra vires representation is constituted if it is against Article 16 of the Company Law. To prevent legal representatives of companies from unauthorized representation of companies in providing guarantees for others thus causing damages to the companies, while jeopardizing the interests of small shareholders, Article 16 of the Company Law clearly restricted the scope of representation of the legal representatives of companies.^[21] In accordance with the regulations in the said article, actions of guarantee are not affairs authorized by companies to be decided independently by the corporate legal representatives, and resolutions by the companies' authority organs such as shareholder (plenary) meetings, and board of directors shall be the basic source of authorization. Without authorization by the companies, the fact that their legal representatives freely provide guarantees for others constitutes the necessary presumption for ultra vires representation. The people's court may refer to regulations for recognizing ultra vires representation by the legal representatives in Article 50 of the Contract Law and decide whether such ultra vires contracts are

¹⁵Gesetz betreffend die Gesellschaften mit beschränkter Haftung vom 20. April 1892 (RGBl. S. 477) in der Fassung vom 20. Mai 1898 (RGBl. S. 846), zuletzt geändert durch Gesetz vom 17.07.2017 (BGBl. I S. 2446).

¹⁶ Item 1 of Article 16 of the 1967 Company Law of China's Taiwan region stipulates that "Unless required by laws or charters of association, company should not guarantee for others. When people in charge break this rule, the liabilities should be borne by themselves, if damages are done to the company, the person responsible should be liable for compensation.

¹⁷ Business Law, Law No.48 for March 9, 1899, modified in 2000.

valid or not by discerning whether the creditors are honest or not and bona fide or not upon signing the contracts or agreements: if the creditors are honest or bona fide, then the contracts are valid; otherwise, the contracts are deemed invalid.

Article 20 of the 9th Civil Law Memo prescribes civil law liabilities for unauthorized guarantees as follows: if the guarantee contract is valid, when the creditor appeals the company to be responsible for the guarantee liabilities, the court should uphold such claims in accordance with relevant laws and regulations; if the guarantee contract is invalid, when the creditor appeals the company to be responsible for the guarantee liabilities, the court should turn down the appeal. The court may deal with such cases following the Guarantee Law and other relevant judicial interpretations for recognizing invalid guarantee contract.^{18 [22]} The providing of evidences refers to the situation that the creditor's pleading that it is clearly known that the legal representatives go beyond its legal purview or the recognition of the resolutions by the agents are forgeries or cooked deliberately, and when the creditor pleads civil liabilities for invalid contracts from the company in the place of others, the court may evade applicability or support.

3. Recognition of the bona fide in unauthorized guarantee by company representatives

In order to ensure that companies not missing as many ultra vires transaction time and opportunities, it is highly probable that company representatives and their counterparts in transactions do not go through strict legal investigations in signing guarantee contracts. Unless the counterparts clearly know or should know that the actions of the corporate representatives are ultra vires, otherwise the potency of the guarantee contracts cannot be impacted. But to ensure the lawfulness and security of the transactions, when the contracts are certainly potent, how can we distinguish the kindness or malice of the counterparts in ultra vires transactions, whether the counterparts have executed the responsibility of investigations, and to what extent the investigation by the creditor should be conducted, these are the main questions facing unauthorized guarantee contracts.

3.1 Definition of Bona fide in the 9th Civil Law Memo

In the 9th Civil Law Memo, the term "bona fide" basically refers to the status that the creditor "do not know or should not know" about the legal representative's ultra vires signing of the guarantee contract. Very ostensibly, the definition of the representative's action is based on Article 50 of the Contract Law. If we choose an direction as a definition scope opposite to bona fide, the bona fide status can be demonstrated that the bona fide counterparts are ignorant while signing unauthorized guarantee contracts. But then based on this some scholars may propose that in guarantees irrelevant with the company if the counterparts are obviously not liable for investigations, the regulations in Article 61 of the General Provisions of Civil Law can be used for a generalized expression standard for bona fide to decide whether the counterparts in transactions are bona fide or not in signing the contracts.^[23] The generalized expression standard for kindness in Article 61 of the General Provisions of Civil Law is based on the regulations and restrictions imposed on the legal representatives by the legal person organization charter of association or other legal person authority organs, which bona fide counterparts should not be challenged. In other words, the fact that the counterparts know or should know that the legal representative of the company provide unauthorized guarantee does not imply that it is 100% malicious, in some logic sense, this is only a partial evidence or standard to decide the subjective kindness, rather than evidence and sufficient conditions for judging malice.^[24] Since the awareness or should-be awareness of the counterparts is merely a status reflecting the fact, instead of the subjective kind intentions of the counterparts themselves. Therefore the chief evidence and the point of departure should be focused on whether the counterparts themselves can or can not

¹⁸Liu Bin. "The 9th Civil Law Memo and Institutionalization of Private Laws", in *Shanghai Law Studies* (collection), Vol. 24, 2019, Shanghai Law Society, 2019, pp. 129 -131.

abuse their own subjective awareness to damage or potentially damage the company with which they enter into guarantee service contracts or legal interests of any other parties to the said contracts. Hence Article 18 of the 9th Civil Law Memo proposes that correct recognition of kindness mainly depends on the distinction between related-party guarantee and unrelated-party guarantee: if the guarantee company is not a shareholder or an actual controller of the company in providing unrelated-party guarantee, i.e., when a company provide outward guarantees, whether the transaction counterparts have investigated the voting meeting and the number of voters in such meetings, and the people who signed on the meeting resolution, if the counterparts fulfilled the duties of investigation, then they are subjectively bona fide. When a transaction company provides outward related-party guarantee, i.e., the company's internal guarantee, counterparts of transactions should conduct appropriate investigations, to prove with evidence that when the guaranteed shareholder's votes are excluded, as per Article 16 of the Company Law, at least half of the other voters at the meeting voted for the pass of the resolution, and the people who signed should meet the regulations in the charter of association of the company, if there are enough evidences, then the counterparts' kindness can be directly recognized.

3.2 Creditor's duty for investigation of the corporate guarantee purview

In Article 18 of the 9th Civil Law Memo there are contents and implications about recognition of corporate creditor's duty for investigation out of bona fide purposes. This is a de facto admission that in some lawful outward guarantee cases by companies, whether creditors is under obligation to investigate the qualification of corporate guarantee.^[25] There was a big international academic controversy over the respective investigative duties for company counterparts, some experts even believe that company counterparts' investigative duties should be conducted sufficiently to the degree of "prudence", i.e., the relevant requirements for company guarantee purview in Article 16 of the Company Law should be investigated in the very basic sense for qualification, while it is also a qualification requirements for the company's role as a guarantee right-holder; some experts even consider that the rules for the decision-making organs of a company belong to the company's internal charter, so they cannot challenge any third parties, if so the investigation duty on the company's charter of association can be really very complex and time-consuming in execution, the counterparts' enthusiasm for transactions is probably greatly reduced due to this and thus the economic development of the company can be hindered; hence some scholars think that Article 11 of the Company Law may reach the conclusion below: the charter of association of the company do not necessarily have any binding for management members except public corporations, board directors and shareholders. Merely due to the publicity and requirements for guarantee in operational charter of a company it should not jump at conclusion that the guarantee right-holder is aware of the ultra vires representation of the company; since the nature and variety of guarantees, similarly due to discrepancy in publicity requirements for public listed corporations and non-public listed corporations, so the legal potency are not completely identical.^[26] Generally speaking, the first view has reached a unanimous consensus that the guarantee right-holder should strictly follow the relevant regulations prescribed and promulgated in the Company Law, due qualification investigation should be conducted to protect the security and reliability of transactions through the said regulations.

Meanwhile of the conditions prescribed in Article 19 of the 9th Civil Law Memo, there are two exceptional situations that a creditor is not responsible for investigating the guarantee purview of the company: in the first situation the investigation duty is preempted for internal resolutions of company's organs, i.e., an exception to the regulations provided in the first two items of the Article 16 of the Company Law; the second situation is a preemption of investigative duty for the company's organs of creditor's internal resolutions, in this exceptional situation, even if the creditor clearly know or should know that the resolution from company's organs is not acquired, the guarantee contract still should be recognized as an truthful intention expression of the guarantee company, and the contract is valid. Its specific situations can include the four types below: first of all, the guarantee companies whose main business is providing guarantee service to others, or banks or non-bank

financial organizations that conduct guarantee business; secondly, when a company provides guarantee for enterprises directly or indirectly controlled by it, or a company provides guarantee to a creditor for its own business operations; thirdly, when a company or an enterprise has mutual guarantee relationship as well as other commercial financial service cooperation with the chief creditor; lastly, the guarantee contract is signed and agreed by shareholders holding more than two thirds of the voting rights of the company individually or jointly.^[27] The citation of the first three situations in the Article 19 of the 9th Civil Law Memo is based on the inference that the guarantee is a normal business of the company, the majority shareholder has little probability of damaging the rights of small shareholders in the form of guarantee. While the fourth situation is based on not strictly demanding the investigative duty of the creditor as well as the fact that there is actually an absolute majority in voting rights.

4. Sharing of liability in unauthorized guarantee by company representatives

4.1 Analysis of liability sharing in unauthorized guarantee by company representatives

Generally speaking, the recognition of effect of a contract signed by the company representative determines the results of liability sharing. The liability of unauthorized guarantee is mainly shared between the company and a third party that signed contract with the company.

According to the internal relation theory, unless there are no circumstances for invalid contracts listed in Article 52.1 of the Contract Law as an exception, e.g., one party induced conclusion of the contract through fraud or duress; those contracts damaging legal interests of state, collective or any third party; the contracts with illegal interests under the guise of legitimate forms; or contracts violate mandatory provisions of any law or administrative regulation, all the consequences of the company's legal representative actions should be borne by the company of the representative. That is to say, the guarantee contract is valid. In case the interests of any third party out of the company are damaged, the company shall bear the liability of compensation for such third parties. By the recognition theory of the nature of regulations, the regulations in Article 16 of the Company Law is the mandatory provisions of management, i.e., for a third party in transactions outside a company the internal charters of the company are not binding at all, so the company should take on responsibilities to effectively protect the interests of the third party in the transaction and the security of transactions. But there are probably some exceptions, when the legal company representative can provide sound evidence to prove that the counterpart signs the guarantee contract without bona fide intention, then the guarantee contract is invalid, the liabilities in the guarantee contract should be borne by the counterpart himself. From the perspective of the representative authority restriction theory, when without a legal authorization acquired by the company's organ, the company legal representative's signing of guarantee contract constitutes in itself an unauthorized proxy,^[28] if the company representative's actions pass for apparent proxy, i.e., the legal representative's actions are beyond his purview in implementing the civil law actions, a bona fide counterpart should provide some warranted reasons based on objective facts that there are no ultra vires representations, the representation actions of the company representative should be valid. Even if the actions are not consequently confirmed by the authoritative organs of the company, the legal representative's actions are still valid, the legal person or other profit organizations should not challenge by claiming that the company legal representative's actions are ultra vires, i.e., the final conclusion is that the liabilities should be borne by the company.

The Article 20 and the Article 21 of the 9th Civil Law Memo specify the creditor company's bearing of liability for compensation to damages and the issue of company right remedies: when the counterpart is deemed as compatible with the "bona fide" standard, the guarantee liability is on the company; when the counterpart failed to fulfill legal investigation duties which lead to invalidation of guarantee contracts, the company can draw on the Guarantee Law and other relevant judicial interpretations about invalid guarantee contracts; if the company thinks that there are facts or sufficiently sound legal evidences to prove that the creditor obviously know that the representative

signed guarantee contracts in an ultra vires way or that the resolutions of the company's organ are forgery or frauds, the guarantee contract is recognized as invalid, the court shall not accept or support the creditor's claims of civil liabilities from the company after it is proved invalid. That is to say, no matter guarantee liabilities or other civil liabilities should not be borne by the company.

When the counterpart is malicious, the sharing of liabilities should infer the legal effect of unauthorized representation rules, when the contract validity is pending, if the legal person makes a follow-up confirmation of the contract validity, then the guarantee contract is potent and the company shall take the responsibilities for its representative. It is clearly prescribed in Article 171 of the General Provisions of Civil Law that if the counterpart knows or should know about the ultra vires representation of an agent, agents from both parties shall take on respective liabilities in due proportions.

4.2 Specific design for liability sharing in unauthorized guarantees by company representatives

The design of unauthorized guarantee rules can be made so that all and end-game internal legal liabilities should be borne by the company legal representatives who conducted ultra vires guarantee. With research conclusions of other experts and scholars in sight, I hereby suggest two solutions for consideration.

The first solution is borrowing from relevant regulations in Taiwan region to lay down special "internal liability bearing provisions for legal representatives". The directors we usually refer to in limited companies may also be directly called "natural liability bearer" in the Company Law of Taiwan region.^[29] However there is also another kind of legal representatives that can be called as "positional liability bearer" in Taiwan. Article 23 of Taiwan's Company Law has clear definitions that "positional liability bearer" should be honestly aware of the bona fide obligations in carrying out business of the company, in case their violating of rules causes damages to the interests of the limited company itself the compensation liabilities shall be borne jointly by them. The said law also prescribes that if the person in charge in the company fails to operate as required and cause damages to others, he should bear joint and several liability to compensate with the company. If the person in charge in the company executes operations for the interests of himself or others and his occupational job or bona fide awareness obligations are neglected, resolutions shall be made by the company shareholder meeting to affirm that all the actions of the person in charge on behalf of the company are valid if they occur within a year per the resolutions. In relevant regulations concerning the company law in Taiwan, the person in charge of a company is not necessarily the representative of the company, the term "person in charge" refers to a wider range of people, it may mean shareholders of joint liability companies or unlimited liability companies, executive directors in limited liability companies or stock corporations, or even managers and supervisors in a company, but his actions are recognized by the company to represent the company,^[30] and the definition of a "company representative" in the P.R.China Company Law is obviously different from the "person in charge" in Taiwan. In accordance with the current corporate legal person system in China, a company's legal representative is seen as the only legal agent of the company in outward actions, i.e., without consent or authorization of the legal representative of a company, other subjects in the company cannot act as a proxy of the company. But the legal representative system in P.R.China Company Law may arise problems of corporation governance structure, because the legal representative of a company is just a single natural person, the representation authority is so over-focused that bigger legal risks usually accompany with it. This goes against the principle of will autonomy in a company, and may hinder the internal decision-making order to some extent.^[31]

The second solution involves borrowing from the liability attribution principles for companies being established. More specifically, we can learn from the German regulations of guarantee and draw on the "inside/outside distinction" as a basis for attributing liabilities, the liabilities borne by the legal representatives in internal transactions should be gradually externalized, while protecting bona fide counterparts in transactions and change the indirect liabilities to be direct liabilities of the company representatives. Meanwhile, the organizational liabilities and positional

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liabilities as a representative are combined. Through drawing up laws the company legal representative shall join the company in taking guarantee liabilities in outward guarantees. The transaction counterparts can be roughly classified into three categories, one category of counterparts are entirely bona fide, they do not know or shouldn't know that the company legal representatives who signed contracts with them may conduct ultra vires actions without the company's authorization, this situation may have valid guarantee contracts, and the liability shall be borne by the company. The second category is the counterpart who know or should know the fact that the company representative conducts unauthorized guarantee, under the precondition that the counterpart has fulfilled the formal investigation obligations, the effect of such unauthorized guarantee contracts is pending, if later the guarantee company follows up with a confirmation, then the guarantee contract is effective, if the company denies subsequent confirmation, then the guarantee contract shall be deemed as invalid from the beginning. The third category refers to malicious counterparts, they are subjectively fraudulent, malicious or colluding with others etc., this type of guarantee contracts are invalid from the beginning.

However, in the theory and judicial practice of the unauthorized guarantee system, more attention should be paid to balance interests of the company and the third parties, through strengthening the responsibility of the legal representatives to realize the protection of the interests of both the creditor and the company, the legal representative and the company may jointly bear the liabilities,^[32] in this way the company's claim for compensation can be protected. Both parties need an appropriate mode to distribute the liabilities so as to develop in a balanced way. Only in this way can the security of market transactions and market economy order be maintained, and more favorable opportunities will be created.

Conclusions

In recent years, issues arose with Article 16 of the Company Law attracted much attention of the law circle in China due to a high frequency of occurrence of unauthorized guarantee and potential consequent risks exposed to transactions. The real cause of this lies in the conflict between corporate autonomy and protection of transactions. In signing unauthorized guarantee contracts by company representatives companies tend to acquire more benefits while this may mean injustice for the counterparts of such transactions outside the company. Through analysis of many sentences, it is not difficult to see that for unauthorized guarantee under different conditions, courts should adopt separate approaches in deciding the effect of guarantee contracts. For example, Article 50 of the Contract Law and Article 61 of General Provisions of Civil Law can be applied to approach the nature of representative behaviors of the company representatives and the bona fide status of the counterparts before making a decision. If problems arise in judicial practice, more protection of third parties is a more likely outcome. By reviewing the history and original target of the drafting of the Company Law, we can obviously feel the propelling of the society toward improvement in the system. By the time the 9th Civil Law Memo was promulgated in 2019, giving a definite direction for the legal issues of unauthorized guarantees by company representatives. Hence we should first affirm that Article 16 of the Company Law is a mandatory provision of management rather than a mandatory provisions of effectiveness. Therefore, the posture toward the regulatory characteristics identifying theory should be positive. It is rationale to say that guarantee contracts are potent if only counterparts are bona fide. The 9th Civil Law Memo also sets out detailed prescriptions about the standard of bona fide counterparts, thus inward guarantees and outward guarantees are distinguished as two different categories, with conducive regulation of the investigative obligations for the counterparts, the market environment betterment will be doubtlessly secured.

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