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Reflection on the Normative Intent of Article 16 of China's Company Law

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Abstract: *The ultra vires guarantee by the legal representative of a company not only involves the general rules of the Contract Law, the Guarantee Law and the Civil Code of the People's Republic of China, but also should consider its nature as a commercial act and take into account the legislative intent of the Company Law. In judicial practice, the regulation of the company's ultra vires guarantee is scattered and blurred, still needing improvement. Before the advent of the judicial interpretation of the Guarantee Law, the system of legal interpretation and application process was confusing and lacked legal basis. Article 16 of the Company Law affirms the company's ability to provide external guarantees. In the academic circle, the dispute on the effectiveness of the company's ultra vires guarantee often revolves around the nature of Article 16 of the Company Law. But in essence, Article 16 is a rule to regulate corporate governance, and its legislative purpose is to regulate the process of intention formation of the company's external guarantee. To examine the effectiveness of the legal representative's ultra vires guarantee, one must take into account the interpretation of the intention expression process. The process from the company's intention formation to the intention expression is not only a significant part to judge the validity of the ultra vires guarantee contract, but also the true representation of the normative intent of Article 16 of the Company Law.*

Keywords: *Article 16 of China's Company Law, Ultra Vires External Guarantee, Company Resolution*

1. Introduction

As a common means of credit enhancement in the market economy, the guarantee system has the function of realizing creditors' rights and financing. The situation where a company act as a civil subject to provide guarantee for others is of certain significance in commercial law. Different from the guarantee provided by a natural person, the collective intention of the company to make the guarantee needs to depend on the legal representative. Therefore, cases of ultra vires guarantee by the legal representative are rather common. The legal representative's ultra vires guarantee violates the company's true intention expression and fabricates the company's will to conclude a contract of guarantee. As this legal act involves both the interests of the company and the creditors, protecting either side means harming the interests of the other side. Therefore, a law needs to be introduced to make a trade-off. Article 16 of the Company Law recognizes the company's ability to provide guaranty for others [1], while its specific application has aroused much controversy due to the lack of legal effect elements, affecting the realization of article 16's normative objective [2], resulting in the occasional occurrence of different judgments for identical cases. On November 14, 2019, the Supreme People's Court issued the Minutes of the National Court Work Conference on Civil and Commercial Trials (hereinafter referred to as "the 9th Conference Minutes"), in which the contents of Articles 17-23 stipulate issues related to the company's external guarantee, providing thoughts of trial and special circumstances of the company's ultra vires guarantee cases. The external guarantee of a company is a typical type of civil and commercial issue, which is related to the provisions of the Company Law, the Civil Law and the Guarantee Law. Article 16 of the Company Law has been interpreted in a variety of ways by academic scholars because it is required to do so in order to understand how the law will be applied.This paper aims to analyze the application of the law on this issue in order to provide ideas and suggestions for relevant judicial practice.

2. Research Status

Theoretically, the traditional views include the theory of authority restriction, the theory of normative

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nature identification, and the theory of internal restriction [3]2-3. Before the Civil Code and the interpretation of relevant Guarantee Law came out, the court usually proceeded from these three perspectives and drew different interpretation conclusions, which has led to many different judgments for the same kind of case. The 9th Conference Minutes proposes that both the provisions of the Company Law and provisions of Civil Code's guarantee section and contract section should be considered, with the former to judge whether the legal representative has acted beyond legal authority, the latter to determine the validity of the contract.

2.1. Theory of Authority Restriction

This theory starts its interpretation from the normative nature of Article 16 of the Company Law, judging the validity of the company's guarantee by whether the article is a mandatory management provision or an effective mandatory provision. As Article 16 adopts the wording with mandatory meanings such as "shall" and "shall not", its mandatory nature is reflected [4]. The first point of view regards it as a mandatory management provision in that Article 16 does not stipulate that the company's violation of this provision results in the invalidity of the contract, and in that the internal resolution shall not bind the third person, but only the company's internal behavior. As this provision is not regarded as an effective mandatory provision, it cannot serve as the basis to invalidate the guarantee contract; otherwise, it would be detrimental to the stability of the contract and the security of the transaction. In actual judicial practice, some courts view Article 16 of the Company Law as a mandatory management provision that addresses the company' s internal procedures. Moreover, since the company' s resolutions are internal management matters of the company, there is no requirement that the trading counterparty have the duty to review them. It is believed that the duty of review affects the order and efficiency of the transaction [5]. The second point of view regards it as an effective mandatory provision. According to this statement, Article 16 of the Company Law is intended to strictly restrict the company's external representation and agency behavior. If the ultra vires guarantee behavior is effective, then there will be more and more cases of company's illegal guarantee, damaging the interests of creditors and shareholders [6]. In judicial practices, the court holds that this act violates Article 16 of the Company Law, thus invoking Item 5 of Article 52 of the Contract Law to deny the effectiveness of the action [7]. The third point of view holds that while the provision on related party guarantee in Article 16's second paragraph is effective and mandatory, the provision in the first paragraph is not. The reason is that the legislation intent is to restrict directors, supervisors and senior executives to ensure transaction security [3]3.

2.2. Theory of Normative Nature Identification

This theory holds that whether a resolution is made or not does not affect the validity of the contract. The basis for judging the effectiveness of a guarantee contract is the distinction between internal governance relationship and external transaction relationship. It holds that the resolution is a matter of the company's internal management, and when signing the contract, the counterparty has no obligation to clarify whether the company has a legal and effective decision-making process. As a legal organ, the legal representative is an inherent part of a legal person, and its act made in the name of a legal person should be regarded as the act of a legal person [8]. Some courts also hold this view in judicial decisions, that if the basis for determining the invalidity of the guarantee contract is on whether the company has a legal and valid shareholders' resolution when guaranteeing, it will inevitably affect the efficiency of the transaction. It will also allow the company to claim the invalidation of the contract on the grounds of violating internal procedures to avoid the guarantee liability, which is against the principle of good faith. Even if the guarantee resolution involved in the case is not approved by the shareholders' meeting, the validity of the contract is not affected [9].

2.3. Theory of Internal Restriction

This theory holds that Article 16 of the Company Law is a restriction on corporate representation, which should be analyzed according to different situations. Viewpoint 1 thinks that if the legal representative has no right to represent, then the guarantee is invalid. Article 16 of the Company Law has made a explicit legal restriction on the company guarantee, and the law presumes that the counterparty is aware of it. Thus, it is presumed that the counterparty knows that the representation is defective when lacking in resolutions, and the guarantee is invalid [10]. Viewpoint 2 thinks that the legal representative has no authority to enter into a guarantee contract on behalf of the company and the contract therefore has not taken effect [11]. Viewpoint 3 believes it necessary to distinguish between general guarantee and related party guarantee. The general guarantee does not affect the effectiveness of the contract, but the

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related party guarantee is of its particularity and importance. In legislation, representation is restricted by law to regulate related party guarantee. In addition, the counterpart's reasonable duty of review is introduced to confirm the effectiveness of the company guarantee.

3. Reflections on Current Mainstream Theory

The theory of authority restriction makes the application of law more difficult. The reasons are as follows. Firstly, this theory causes disputes on the nature of Article 16 of the Company Law, which brings trouble to judicial practice, increases the uncertainty of law application, and increases the difficulty of application [12]. Secondly, the theory is difficult to determine the effectiveness of the ultra vires guarantee contract. For those that violate mandatory management provisions, the people's court would determine their validity according to the concrete situation, rather than determining directly. Thirdly, this theory recognizes Article 16 of the Company Law as an effective mandatory provision. It is not convincing to determine the invalidity of the contract on this basis, without explaining the reasons why it is invalid. The company, as an organization system, relies on certain institutions or personnel to make major internal decisions, supervise management and express intent. In terms of company governance, the company cannot act outside of the scope of authority of shareholders, legal representatives, directors and managers [3]3. Therefore, the validity of the contract signed by the legal representative on behalf of the company should not be based solely on the Contact Law, but should also take into account the Company Law, which is of its particularity [13]. Providing guaranty, which is a process of intention formation, is determined by the company's authority, thus should be adjusted by the Company Law. Additionally, the intention of external guaranty shall be executed by the legal representative, and the guarantee contract is signed with the counterparty in accordance with company's bylaw and the resolutions, touching on the common areas of the company law, contract law, and guarantee law. Examining Article 16 of the Company Law in the context of the civil law paradigm's dividing management norms and effectiveness norms will make law application more challenging and overlook the unique features of the Company Law.

The external nature of the company's guaranty resolution is ignored in the internal restriction theory. According to Article 16 of the Company Law, a company's external guarantee shall need a resolution, which is external in nature in that the company's guaranty resolution involves external transaction. As a result, the company's external guaranty is no longer related to the company's internal affairs, but involves the transaction counterparty outside the company, thus affecting the effectiveness of external guaranty. First, it is presumed that the counterparty needs to review the guarantee resolution. Article 16 of the Company Law clarifies that the company's external guaranty is of procedural steps, and that the company's resolution is what gives legal representatives the right to provide external guaranty. This requirement is based on the external nature of the legal norm and the hope for the low cost of the counterparty's review. The "good faith" of the counterparty in Article 7 of the judicial interpretation of the Guarantee Law requires that evidence has been provided to prove that the company's resolution has been reasonably reviewed [14]. It reflects the legislator's concern about the problems of ultra vires external guaranty, and affirms that the company's resolution is what needs to be reviewed in the situation of the counterparty's "good faith". Second, the effectiveness of the guarantee resolution on the counterparty is for balancing interests, which is necessary for protecting the interests of the company, rather than emphasizing agriculture over business like the laws of ancient China. The Company Law is a legal norm that puts the company's interests in the first place in terms of protecting legal interests. It cannot focus on the principle of transaction security maintenance or the commercial rechtsschein theorie to prioritize the protection of the counterparty, putting the interests of the company and shareholders in danger. Presuming that the counterparty should fulfill the review obligation in accordance with the law has many benefits. It helps to take into account the interests of all parties, maintain the security of market transactions, and promote a stable and harmonious relationship of commercial transactions. This viewpoint over-emphasizes the interests of the counterparty, stating that the resolution is only effective to internal management and not affecting the counterparty, deviating from the legislative intent of Article 16 of the Company Law.

The authority restriction theory breaks away from the dispute over the normative nature of Article 16 of the Company Law, and defines this article as the limitation on the representation right of the legal representative. This theory emphasizes the function of the company's resolution, regarding it as the definition of source of the legal representative's power to sign external guarantee contract. It further introduces the provisions on ultra vires representatives from Article 61 and Article 504 of the Civil Code to solve the problems about the validity of the ultra vires guarantee contracts [15,16]. Whether the counterparty is of "good will" becomes the key to the question, which is advantageous because the

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invalidity of the contract and the company's responsibility for the legal representative's ultra vires act are separated from each other to determine the effectiveness of ultra vires guarantee acts on the company.

There are still some problems in the authority restriction theory. The reference to the Civil Code to determine the validity of the contract according to the counterparty's "good will" is built on the premise that the legal representative has the right to guarantee decision-making, ignoring the logical premise that the legal or corporate restrictions on representation is the basis of the legal representative's right to make decisions. However, the legal representative does not have the decision-making power on company guarantee. Paragraph 1 of Article 16 of the Company Law is neither a mandatory nor an empowering provision [17], therefore, it does not mean that the legal representative has the right to conclude a guarantee contract with others. This is a reminder to the company at the legislative level from the Company Law that in non-related party guaranty, the company can independently grant the decision-making power on guarantee to the shareholders' meeting or the board of directors in the company's articles of association [18]12. Therefore, the legal representative does not have the chance to make independent decisions in external guaranty matters, whose only role is to convey the company's true intention to the counterparty and does not have the right to independently represent the company's external guarantee, let alone reaching the mention of "restriction". Hence, the "restriction on the legal representative's right of representation shall not be set up against bona fide opposite parties" in Article 61, paragraph 3 of the Civil Code is no longer applicable [19,5]. The determination of whether the contract is effective for the company depends on the evaluation of the "good will" of the counterparty, according to Article 7 of the judicial interpretation of the Guarantee Law [18]17, which is based on the legal restriction theory, and the article does not explain how to determine whether the contract is valid, which is different from what is written in Article 17 of the 9th Conference Minutes [20]. Therefore, Article 7 of the judicial interpretation of the Guarantee Law is ambiguous on the validity and invalidity of the contract.

4. Interpreting the Core Provisions of Guarantee in Corporate Governance: Article 16 of the Company Law

4.1. Function of Article 16 of the Company Law

The legislative purpose, as well as the core of the Company Law is to regulate corporate governance, focusing on the internal management and organizational structure, rather than corporate transaction behaviors. Article 16 of the Company Law should be understood as the company's internal control and management of its foreign business, which is different from the Contract Law is its management and procedural characteristics [21]114-115. Therefore, Article 16 is not a provision on guaranty transaction, but a provision on the resolution of company guaranty. Its core is to make it explicit that the company needs legal institutions when making decisions on external guaranty, and that the expression of intent of external guaranty is legitimate and authentic [21]121.

On the one hand, Article 16 of the Company Law recognizes the company's ability to provide guarantees for others. If the company is to provide guarantees for others, a resolution shall be made through the board of directors, shareholders' meeting or shareholders' assembly.

Paragraph 1 of Article 16 does not specify which authority should make the resolution to provide guaranty, so the company can just make the resolution in accordance with its bylaw. In addition, it also does not specify what to do when its bylaw does not regulate. According to the principle that "all is permissible unless law prohibited", both the board of directors and shareholders' meeting can be the resolution authorities. Paragraph 2 stipulates and emphasizes that the resolution of the related party guaranty can only be made through the shareholder's meeting or shareholders' assembly.

On the other hand, Article 16 of the Company Law shows the importance of the guaranty resolution. The Company Law places the interests of the company and shareholders in the first place, aiming to prevent losses of the company property and safeguard the interests of other shareholders of the company. The legislative intent of Article 16 of the Company Law is that a company's external guarantee needs to go through a real and legitimate intent formation process. The company's external guaranty behavior differs greatly from its general business operations. The firm will be responsible for the related guarantee obligation if the debtor is unable to pay the debt. This could result in the company losing property or possibly becoming bankrupt due to insolvency. What's worse, the rights and interests of other shareholders of the company may also be affected if the legal representative and a third party try to pursue personal interests by transferring corporate property under the guise of security. Article 16 is formulated so that the company provides external guaranty after careful consideration, providing opportunities for shareholders to make comments and give suggestions to external guaranty behavior.

4.2. Identifying the Company's Ultra Vires Guarantee — from the Intent Expression Rules

The effectiveness of the company's external guarantee contract needs to fulfill the important condition of the truthful intention expression, as the company's external expression behavior is only effective when it truly reflects the company's will. Therefore, on judging the effectiveness of the company's external guarantee contract, it is necessary to examine both the process of intent formation and intent expression, that is, the company's resolution and the legal representative's act of concluding a contract with others according to the resolution. Resolution is the collective intent of the company members, that is to say, the resolution behavior is a mechanism for the formation of the group's intent [22], and externally, it functions as an important part of intent expression. The history and initial legislative intention of Article 16 of the Company Law indicate that this article is essentially intended to regulate the formation of the internal intention of the company and make the external guaranty conform to the logic of the group legal action [23]. Professor Wang points out, "The resolution of the association is the expression of will made by a certain number of holders present at the meeting with voting rights, and the agreed joint act is an act to form the collective will. [24]" According to the regulation of the intent expression process, the formation and expression of the company's intent do not come from the same organ. The former, which is the formation of the company's intent, is through the board of directors, shareholders' meeting or shareholders' assembly to express the group's intent, then forming the company's intent. The latter, the company's intent expression is a civil act made by the company's legal representative in the name of the company. Thus, the formation and expression of the company's intent will be inconsistent. The ultra vires guaranty by the legal representative is the act that the legal representative provides external guarantee privately on behalf of the company either without going through the process of forming a collective intent expression or the formation of intent is not passed, which reflects the inconsistency between the formation and the expression of the company's intent of providing external guaranty. Therefore, the company's resolution should be understood as the final collective expression of intent after the convening of the shareholders' meeting or the board meeting, which can be seen as the formation of the whole company's intent. Article 16 stipulates the procedure of forming the company's internal will, separates the company's external guaranty behavior from its general business operations, restricts the legal representative's representation rights, protecting the interests of shareholders. It also stipulates the formation process of the company's intent to provide external guarantee. Ultra vires behavior means that the legal representative violates the provision of Article 16 of the Company Law to provide external guarantee, without going through the true and effective formation process of the company's intention.

However, the resolution is only a form of intent expression. A resolution is mandated by Article 16 of the Company Law, but this does not obligate one to be made. The autonomy of the corporation is respected by the Company law. Whether or not a resolution is produced is only a matter of form as long as a true representation of the company's intent can be formed. For instance, the company's decision to provide a guaranty for others is sufficiently represented by the will of more than two-thirds of the shareholders who have the ability to vote on it. Even though the board of directors or shareholders' meeting is not convened to form a resolution of the authority organ, the legislative intent of Article 16 of the Company Law is also reflected.

4.2.1. Identifying the Company's Ultra Vires Guarantee Without Resolution

The legislative purpose of Article 16 of the Company Law is to make sure that the expression of the company's intent of external guaranty is truthful, as long as this is guaranteed, even without a resolution, it does not constitute an ultra vires act of the company. According to Article 8 of the interpretation of relevant Guarantee Law, under the following three circumstances, the company's presumption of external guaranty has a true intent expression. First of all, a letter of guarantee is issued by a financial institution or a guarantee is provided by a guarantee company; second, the company provides guaranty for business activities carried out by its wholly-owned subsidiaries; Third, the guarantee contract is signed and agreed upon by more than two-thirds of the company's shareholders who have voting rights on the guarantee matters, individually or jointly.

To determine whether the company's external guaranty without a resolution is an ultra vires guaranty depends on whether the company's external guaranty behavior can be presumed that the company has the guaranty intent; if not, the external guaranty made by the legal representative is an ultra vires guaranty.

4.2.2. Determining the Company's Ultra Vires Guarantee with Resolution

Paragraphs 1 and 2 of Article 16 of the Company Law clearly specify the company's decision-making

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organs for the its external guarantee. In the case of non-related party transactions, the board of directors, the shareholders' meeting and the shareholders' assembly are chosen to make the resolution of general guaranty according to its bylaw. In the case of related-party transactions, the shareholders' meeting or assembly shall make the resolution on related party guaranty. In practical application, how to determine the effectiveness of the resolution when the actual resolution organ with the right to provide external guarantee is different from the resolution organ for external guarantee regulated by its bylaw? When the company's bylaw does not specify the resolution organ to make decisions on external guarantees, how to determine which is the resolution organ and how is the effectiveness of the resolution? The analysis is as follows.

(1) When the Company's Bylaw Does Not Regulate Matters of External Guaranty

For related-party guarantee, only the shareholders' meeting and shareholders' assembly have the right to vote on guarantee matters. Whether or not the company's bylaw has regulated the subject of decision-making organs of guaranty only affects the decision-making right of the board of directors, the shareholders' meeting and shareholders' assembly regarding non-related guaranty.

For non-related guaranty, if the company's bylaw does not provide relevant regulations, the shareholders' meeting and assembly have the right to decide on non-related external guaranty issues, but it needs the agreement of more than two thirds of shareholders who have the voting rights on guaranty to form a valid resolution. The reasons are as follows. 1. The shareholders' meeting or assembly is the highest authority organ of the company as it reflects the will of all shareholders. 2. According to Article 8 of the interpretation of relevant Guarantee Law, if no effective resolution is obtained, but the guarantee contract is signed and agreed by more than two-thirds of the company's shareholders, individually or jointly, who have voting rights on the guarantee matters, then the guarantee contract is not invalid. It can be seen that the will of shareholders who hold more than two-thirds of the voting on the guarantee matters can be taken as the will of the company to provide external guarantees.

If the company's bylaw does not provide for guarantee matters, does the board of directors have the authority to make the resolution on external guarantee matters? From the perspective of corporate autonomy, with the authorization of the shareholders' meeting or assembly, the board of directors has the right to make decisions on external guarantees, which can become effective resolutions.

(2)When the Company's Bylaw Regulates Matters of External Guaranty

When the company's bylaw regulates matters of external guaranty, how to determine the effectiveness of the resolution when the actual resolution organ to provide external guarantee differs from the resolution organ for external guarantee regulated by its bylaw? The analysis is as follows.

According to Paragraph 2 of Article 16 of the Company Law, for related-party guaranty, the shareholders' meeting and the shareholders' assembly are the company's organs that have the right to make resolutions on the related party guaranty. If the company's bylaw appoints the board of directors to make resolutions, then this appointment is against the Company Law, and the resolution is thus invalid. Under this circumstance, if the board of directors makes a resolution on external guarantee, and the legal representative makes external guarantee according to this resolution, then this is an ultra vires guaranty. On the contrary, if the shareholders' meeting makes the resolution, then the guarantee made according to this resolution does not constitute an ultra vires guarantee. The reason is that even though the actual resolution authority for making resolutions is different from the one regulated by the company's bylaw, the resolution made by the actual resolution authority (which is the shareholders' meeting or assembly in this case) in accordance with the voting procedure and limited amount of guaranties as prescribed is still valid.

For non-related party guaranty, the board of directors, the shareholders' meeting and shareholders' assembly have the right to vote on guarantee matters. In the first scenario, the company's bylaw appoints the shareholders' meeting and the shareholders' assembly as the resolution organs to approve guarantees. In this case, the two resolution organs have the true right to make resolutions. If the actual resolution organ is the board of directors, then the authorization of the shareholders' meeting or shareholders' assembly is needed; otherwise, the board of directors has no right to make the resolution on external guaranty. In the second scenario, the board of directors is appointed by the company's bylaw to be the resolution organ to provide guaranties. If now the actual resolution organ is the shareholders' meeting or shareholders' assembly, which is inconsistent with the company's bylaw, as long as the resolution conforms with the voting procedure and within the limited amount of guaranties, then the resolution made is valid. If now the actual resolution organ is the board of directors, which is consistent with its bylaw, then the board of directors has the legitimate decision-making right to both the related guaranty and non-related guaranty.

5. Conclusion

The company's ultra vires guarantee, which is a violation of the guaranty-related procedural provision in Article 16 of the Company Law by the company's legal representative. Without forming a truthful expression of the company's intent, the legal representative signs a guarantee contract with the counterparty of the transaction, constituting the ultra vires external guaranty. Article 16 of the Company Law has been wrongly interpreted in many judicial practices and the normative spirit hidden in the legislation has been ignored, causing difficulties in the application of the law. The process of law application is a process of interpreting law. Article 16 of the Company Law should be interpreted according to the original legislation purpose so that it can be properly applied in judicial practices.

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