CORPORATE LAW ISSUE, CIVIL LAW SOLUTIONS: RESOLVING DISPUTES ARISING FROM UNAUTHORIZED CORPORATE SECURITY CONTRACTS IN PEOPLE'S REPUBLIC OF CHINA HIGH COURTS

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CONTENTS

I. INTRODUCTION

A case is a 'hard case' 'when no settled rule dictates a decision either way.'[1] An example is one where the dispute is caused by a third party's fault and there is no point in suing

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[1] RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 83 (6th ed. Durckworth 1991).

that third party.[2] A difficulty besetting the Chinese courts in the recent decade is how to resolve disputes over a company's liability under an unauthorized contract that gives a security.

The number of this category of disputes has increased significantly after the enactment of Article 16 of the Company Law of the People's Republic of China ('PRC Company Law') in 2005, which, for the first time, confirms that the company has the capacity to act as surety.[3] Under the predecessor provision, Article 60, directors and managers were prohibited from providing security for shareholders or other individuals with the company's assets.[4] Article 16 confirms the company's capacity to act as surety by stipulating, *inter alia*, that the company may make a contract giving security through one of its power organs.[5]

A difficulty in resolving Article 16 disputes is the lack, or the disorganized form, of the requisite legal infrastructure. The representative power of a company, under the PRC legal system, is formally vested in the company's Legal Representative (LR)[6], although the company can also be represented by an agent.[7] The rights of the person seeking to deal with the company should accordingly be determined by rules on the effect of the *unauthorized* acts of the LR or a purporting agent.

The PRC Contract Law (hereinafter 'the Law') provides for unauthorized agency (无权代理)[8] but not unauthorized LR (无权代表). It is uncertain whether the provisions on unauthorized *agency* apply where the unauthorized transaction is made by the *LR*, as the relationship between the company and its LR is not seen as one of agency.[9] The same Law provides for the apparent authority of both a purporting agent and the LR.[10] These provisions, however, have arguably been neutered by Article 16.[11] In any event, the provision on the LR's apparent authority only applies where the LR has acted beyond authority, not without authority.[12]

The lack of the requisite legal infrastructure leaves one wonder how courts have decided Article 16 cases. A 2014 Supreme People's Court (SPC) judgment, which was subsequently listed in the SPC Gazette as a 'typical case' (the typical case),[13] provides a surprising answer. There, the SPC held the alleged corporate surety liable where the creditor failed to make inquiries where the transaction was, to a reasonable creditor, transparently irregular.[14]

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[2] An example is Lord Mayor of Sheffield v. Barclay [1905] AC 392 (one of the joint shareholders had transferred the shares, through a forgery of the other shareholder's signature, for the purpose of obtaining a loan, to a bank, which, upon registration as a member, transferred the shares to a third party. The fraudster had passed away when the innocent shareholder discovered the truth).

[3] The word 'surety' is used in this paper to mean provider of (all forms of) security.

[4] This suggests that, until the enactment of Article 16, the company did not have the capacity to act as surety (Zuigao Renmin Fayuan Guanyu Shiyong Zhonghua Renmin Gongheguo Danbao Fa Ruogan Wenti De Jieshi（最高人民法院关于适用〈中华人民共和国担保法〉若干问题的解释）[Supreme People's Court's Interpretation on Certain Issues Relating the Application of the PRC Guaranty Law] (promulgated by SUP. PEOPLE'S CT., Dec 8, 2000, effective Dec 13, 2000), Article 4 (a security contract made in contravention of the former Article 60 was unenforceable (无效)); (2000) Jing Zhong Zi No. 186; (2004) Min Er Zhong Zi No. 95).

[5] *See infra* note 21.

[6] *See infra* note 29.

[7] (2017) Zui Gao Fa Min Zai No. 209.

[8] Article 48.

[9] *See infra* note 32.

[10] Articles 49, 50.

[11] *See infra* note 41.

[12] *See infra* note 37.

[13] Typical cases are selected cases publicized in the Gazette. They are considered to be 'authoritative': ALBERT CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 166 *ff.* (4th ed. LexisNexis Butterworths 2011).

[14] *See infra text in* Part II F.

The abovementioned typical case raises a question on whether Chinese courts would typically decide similarly under circumstances similar to those in the typical case. If the answer is 'yes', a further question for the courts is whether their decisions make sense in the context of the PRC legal framework and in the world. If the answer is 'no', given the difficulty associated with legislative reforms, a follow-up question for courts would be how Article 16 cases *should* be decided under the existing statutory framework.

The significance of answering the above questions lies in the fact that (i) the number of loan disputes coming before the first instance courts in China had increased by close to 150% between 2005 (when Article 16 was enacted) and 2014, and (ii) since 2012, the number of loan disputes has exceeded that of divorce cases to become the largest category of disputes brought before courts,[15] and many of the loan transactions would have involved a company as the surety.[16]

This paper makes an attempt to answer the questions raised above. This will be done through (i) providing a snapshot on the ways in which Article 16 disputes have been resolved in the High People's Courts (HPCs), (ii) an evaluation of the policy basis upon which, and the techniques with which, the issue has been resolved, and (iii) a debate on the optimal way in which the issue raised may be resolved under the existing legal framework. The debate will be carried out through a consideration of how the same issue is resolved in Japan and Taiwan, where similar corporate authority-delegation mechanisms are adopted. The snapshot will be obtained through a review of ten years' worth of HPC Article 16 decisions listed in a respected database for, *inter alia*, PRC court decisions. HPCs are the most important appeal courts in China. Given that litigants in China are entitled to one appeal only, most private law proceedings end at the HPC level.

The snapshot obtained shows that the HPCs have not taken a uniform stance on the allocation of the risks for unauthorized transactions. In most of the cases (the majority line cases), the risk is wholly or partially allocated to the alleged surety. In the remainder of the cases (the minority line decisions), that risk is allocated to the creditor. In terms of the avenues through which courts' decisions were reached, the case review reveals that the decisions of majority line of cases have reached by two methods. The first is to hold unauthorized transactions nonetheless enforceable, in which case the alleged surety is held liable.

The second, which is relevant where the transaction is held unenforceable, is to hold the surety liable on the ground of Article 7 of the SPC's interpretation of the Guaranty Law of the People's Republic of China (Guaranty Law Interpretation). Under Article 7, the surety may be held wholly or partially liable where the transaction is held unenforceable, depending on whether the creditor is 'at fault.'[17] In the minority line of cases, in contrast, the courts' decisions were arrived at through, *inter alia*, an application of agency rules (the agency rule approach). The paper argues that the law should aim to provide a balanced protection to both the alleged surety and the creditor and that, as confirmed by an analysis of the ways in which the same issue is resolved in Japan and Taiwan , that aim is best achieved through the agency rule approach.

The remainder of this paper is organized as follows. Part II examines the relevant context of PRC legal system. Part III discusses the research methodology and analytical

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[15] Jian Ma, *Shixian Shenpan Fu Jingji Shehui Fazhan de Xin Changtai [Towards the Realization of a New Norm in Adjudication to Facilitate Economic Development]*, RENMIN FAYUAN BAO (PEOPLE'S COURT DAILY), May 14, 2015, at 5 (China).

[16] According Ms C, an experienced lawyer of a law firm based in City J, Z Province, whom the author interviewed on 16 May 2019, estimated that the debtor's liability in seventy to eighty percent of loan disputes coming before the court was secured, mostly by a company. A judge of the HPC of G province, whom the author interviewed on April 25, 2019 put the figure at fifty percent.

[17] For a discussion on the effect of Article 7 *see infra* note 44.

framework. Part IV identifies the generic question facing the court[18] through an analysis of the data obtained from the case review. Part V discovers how the HPCs have answered the generic question, also through an analysis of the information obtained from the case review. Part VI evaluates various ways in which the HPCs have answered the generic question. Part VII debates the optimal way of resolving the issue through a consideration of the ways in which similar issues are resolved in Japan and Taiwan, where a similar corporate authority-delegation system is adopted. Part VIII concludes.

II. THE CONTEXT OF THE LEGAL SYSTEM

A typical defense of an alleged surety is that the company is not liable because it has not authorized the transaction in accordance with Article 16.[19] Surety/creditor disputes are therefore typically resolved according to the court's view on how Article 16 interacts with statutory norms governing, *inter alia*, third parties' rights. The relevant context of the legal system is therefore constituted by Article 16, the overarching principle of good faith, as well as rules on the LR (or the purporting agent), and those on third parties' rights. Given their guiding functions,[20] the cases published in the SPC Gazette can also be seen as a constituent of the legal context. A further discussion of the typical case referred to is therefore also incorporated in this part of the paper.

A. Article 16

Article 16 stipulates rules on how the company wills its will on committing itself as a surety. Article 16.1 provides that (i) a decision to act as a surety where the borrower is a company outsider is to be made by the board of directors or the general meeting, as is provided in the company's constitution,[21] and (ii) where the company's constitution limits the liability of the company to a given amount under a security contract in favor of an outsider, that amount must not be exceeded where the company decides to act as a security provider.[22]

Article 16.2 stipulates that where the borrower is a shareholder or 'actual controller,'[23] the decision must be made by the general meeting.[24] The combined effect of Articles 16.1 and 16.2 is that only the company, through its organs, has the power to commit itself as surety. That is, the type of transaction under consideration cannot be made by the LR or a purporting agent.[25] Under Article 16.3, where the borrower is a shareholder, that person is prohibited from participating in the voting process.[26] An important change that Article 16 has brought about is

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[18] For the need to identify the 'generic question,' *see infra* note 55.
[19] This was the defense that the company pleaded in virtually all the cases under review.
[20] ALBERT H. Y. CHEN, AN INTRODUCTION TO THE LEGAL SYSTEM OF THE PEOPLE'S REPUBLIC OF CHINA 167 (4th ed. LexisNexis 2011).
[21] Gongsi Fa （公司法）[Company Law] (amended by the Standing Comm. Nat'l People's Cong., Dec. 28, 2013), Article 16.1 (China).
[22] *Id.*
[23] 'An 'actual controller' means a person, while not a shareholder, who is able to control the 'behavior' of the company pursuant to an investment relationship, an agreement, or other arrangements.' *Id.* Article 216 (3).
[24] *Id.* Article 16.2.
[25] This view is supported by the SPC's ruling in more than one case that Article 16 'restricts' the LR's 'representative power' in entering into transactions giving security. *See, e.g.*, (2012) Min Ti Zi No. 208; (2017) Zuigao Fa Min Zai No. 209.
[26] *Id.* Article 16.3. Before 2005, when Article 16 was enacted, the only provision regulating corporate security transactions was Article 60 of the PRC Company Law (1999). Article 60, which was enacted in 1999, prohibited directors and managers from providing security with the company's assets in favour of shareholders or other individuals.

that the provision confirms the company has the capacity to act as a surety. Under the preceding Article 60, the company did not have this capacity.[27]

B. The good faith principle

Article 7 of the General Principle of Civil Code (GPCC) stipulates that civil subjects engaging in civil activities must follow the principles of good faith, act honestly, and keep their promises. The good faith principle may provide a basis for resolving Article 16 disputes, at least where the creditor has acted fraudulently or with actual knowledge as to the irregularity of the transaction.[28]

C. Rules on the corporate representation mechanism: the LR

In common law jurisdictions, the delegates of the company's powers are treated as the company's agents and the issue raised for this paper is resolved through, *inter alia*, an application of agency rules (e.g., those on apparent authority).[29] The corporate authority-delegation mechanism under the PRC legal framework, as mentioned, is the LR system.[30]

The LR may be the chairperson of the board or an executive director, or the general manager of the company.[31] GPCC Article 61.2 provides that the legal consequence of the civil juristic act that the LR undertakes in the name of the company shall be borne by the company. Article 61.3 states that the restriction stated in the company's constitution or imposed by the power organs of the legal entity on the LR's representative power, if any, may not be asserted against third parties acting in good faith.

The perceived view on the LR among Chinese jurists and commentators alike appears to be that the LR is not the company's agent. Wei, a well-known civil law professor, for example, comments that, '[i]n an agency relationship, the act of an agency is that of the agent, not that of the principal . . . but a corporate organ (referring to LR)'s act is that of the principal . . . .'[32] Wei, a corporate law expert, echoes that, 'the relationship between the company and the LR is not one of agency but one of the legal representation (代表关系), and the source of the LR's authority is not the legal person's authorization but the express statutory authorization.'[33] A similar view is expressed in a 2015 SPC judgment, where the SPC observed that the act of the LR should be seen as the act of the company.[34] The received view is likely

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[27] *See supra* text accompanying note 4.
[28] *See infra* note 72.
[29] ROBERT CHARLES CLARK, CORPORATE LAW 113-4 (Little, Brown and Co., Boston 1986) ('…officers may unquestionably be labeled agents of their corporations, as are lesser executives and ordinary employees…); PAUL L DAVIES & SARAH WORTHINGTON, GOWER: PRINCIPLES OF MODERN COMPANY LAW 7-16 (13th ed. Sweet & Maxwell 2016).
[30] *See supra* text accompanying note 6.
[31] Gongsi Fa [Company Law] Article 13 (China).
[32] ZHENYING WEI (ed.), CIVIL LAW 86 (Peking University Press 2000).
[33] Danyang He, *Guanyu Fading Daibiaoren – 'Daibiao Faren de Ziran Ren de Faxue Sikao [A Legal Reflection on the Legal Representative 'the Individual Representing the Legal Person']*, 3 FAZHI YU SHEHUI (LEGAL SYSTEM AND SOCIETY) 241, 241 (2013).
[34] Min Yi Zhong No. 72 (2015). Representative directors under the pre-1949 Company Law and the current legal framework of Taiwan was/is treated the same way as statutory agents (法定代理). Wang, for example, expressed the view, one year after the enactment of China's first Company Law (1929) that representative power of the directors is that of 'statutory agents'. XIAOWEN WANG, ZHONGGUO GONGSIFA LUN 214 (republished ed. China Fangzheng Press 2004). In the Taiwan case (1979) Tai Shang Zi No. 2012, the court held that the rules on apparent authority did not apply where the purporting middleman is a 代表 (representative director) or a statutory agent. See Wang-Ruu Tseng, *Gongsi Neibu Yisi Xingcheng Zhi Qianque huo Xiaci dui Gongsi Waibu Xingwei Xiaoli*

to cause uncertainties as to the statutory basis on which issues raised from an unauthorized Article 16 transaction are to be resolved. An example is whether rules on unauthorized *agency* apply where the transaction is executed by an unauthorized *LR*.

D. GPCC Article 61.3

GPCC Article 61.3 protects third parties acting in good faith when the LR acts outside the scope of her representative power delineated by the company's power organs. This rule, however, does not provide for third parties' rights when the LR acts *without authority*. Article 61.3 largely duplicates Article 50 of the PRC Contract Law, which is discussed below.

E. Rules on unauthorized agency and apparent authority

1. Unauthorized agency

Article 48 of the PRC Contract Law provides that, *inter alia*, the contract entered into in the name of the purporting principal without or beyond authority, or where the authority has lapsed, unless ratified, is ineffective *vis-à-vis* the purporting principal. The liability under the contract shall be borne by the professed agent. The third party has the right to request ratification within a month of the contract. The failure of the alleged principal to respond (within the prescribed period) to the request is deemed to be a refusal to ratify.[35] These rules are, by and large, restated in Article 171 of the recently enacted GPCC.

2. Apparent authority

PRC Contract Law Article 49 provides that where the purporting agent has entered into a contract in the name of the principal without authority or in excess of her authority, or when her authority has lapsed, the contract made is enforceable if the third party had reason to believe that the purporting agent had been duly authorized.

A distinguishing feature of Article 49 is that a representation on the part of the putative principal on the agent's authority is not required for the creation of an apparent authority. In common law and some civilian jurisdictions, a basic condition for establishing apparent authority in the purporting agent is the representation by the principal (or someone with actual authority) to the contractor as to the agent's authority to enter into a contract of the kind sought to be enforced.[36]

Zhi Yingxiang: Jianlun Dongshi (zhang) yu Jingliren Zhi Daibiaoquan yu Daili Quan (The Effect of the Lack or Defects of the Formation of the Company's Intention on External Acts of the Company: Also on the Representative Power of the Directors/the Board Chairperson and the Manager), 47(2) NTU LAW JOURNAL 707, 733 (2018). In the abovementioned case, representative directors are put into the same category as statutory agents for the purposes of determining the applicability of rules on apparent authority. A statutory agent is a person who acts for persons lacking capacity or persons whose capacity is restricted. Civil Code arts. 1086, 1098, 1114 (Taiwan); GPCC Article 23 (China).

[35] Hetong Fa （合同法）[Contract Law] (Promulgated by Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), Article 18 (China). For discussions on this article, *see* SHIYUAN HAN, HETONG FA ZONGLUN (THE LAW OF CONTRACT) 205 *ff* (3rd ed. Law Press 2011).

[36] Freeman & Lockyer v. Buckhurst Park Properties (Mangal) Ltd [1964] 2 QB 480; General Overseas Films Ltd v. Robin International Inc 1982 542 F Supp 684; MINPŌ [Civ. C.] Article 109 (Japan); Civil Code Article 169 (Taiwan).

3. Apparent authority of the LR

Under PRC Contract Law Article 50, where the LR, in entering into a corporate contract, has acted beyond her authority, the act of the LR is effective unless the third party knew or ought to have known that the LR had acted beyond authority. As will be argued, Article 16 has neutralized the function of both Article 49 and Article 50.[37] It should be noted, however, that the power referred to in Article 16 and the apparent authority under Articles 49 and 50 are in both cases those of *making decisions* to enter into a transaction. This power is distinguishable from the power to *execute* a corporate contract. The former is a *substantive* power whereas the latter is a *formal*, or *ministerial*, power.[38]

Providing for the LR's apparent authority is a unique feature of the rules on apparent authority under the PRC civil law framework. The Civil Code of neither Japan nor Taiwan, where similar corporate authority-delegation system has been adopted,[39] has provided for the representative director (RD)'s apparent authority. Issues arising from unauthorized corporate transactions are resolved by an analogous application of either the rules on unauthorized agency and apparent authority, or the rules on 'concealment of intention' (Japan).[40]

The unique arrangement on the apparent authority of the LR under Article 50 has seemingly given rise to a unique problem, i.e., the uncertainty as to the applicability (by analogy) of the rules relating to agency where the purporting corporate representative is the LR.[41] The applicability of agency rules by analogy is relevant where the unauthorized transaction is made by the LR. This is because Article 50 does not cover situations where the transaction is entered into *without authority*, whereas both Article 48 and 49 provide for third parties rights in this situation.

4. The effect of Article 16 on arts 49 and 50

A difficulty in resolving the issue raised through rules on apparent authority is that Article 49 and 50 have arguably been neutralized by Article 16. As argued, the effect of the latter is that the decision to make the type of corporate contract under consideration may only be made by the company directly as principal.[42] It follows that this species of contracts may not be made through agents or the LR since nobody could have apparent (substantive) authority to make Article 16 contracts.[43]

F. The Typical case: SPC decision (2012) Min Ti Zi No 156

This is the case referred to in Part I. There, the putative surety had eight members, six of whom were corporate. The borrower was one of the corporate members. The security that the surety had purportedly agreed to provide included, *inter alia*, a guarantee. The document represented as the resolution of the general meeting bore the imprint of the corporate seals of five corporate members, including that of the borrower. The seals of all of the other four corporate shareholders were forged. In the imprint of one of these, the word 'Ltd' was missing. The imprint of the seal of another corporate member bore the name that the firm ceased to use nine years before (because of a change of the company name).

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[37] *See infra* text in Part II E 4.
[38] STEFAN HC LO AND CHARLES Z QU, LAW OF COMPANIES IN HONG KONG 578 (3rd ed. Sweet & Maxwell 2018).
[39] *See infra* text in Part VII A.
[40] ZEJIAN WANG, GENERAL PRINCIPLES OF CIVIL LAW 473 (supplementary ed. CUPL Press 2001); *See* note 142.
[41] *Supra* note 107. 155
[42] *Supra* note 25.
[43] Although the LR or the agent may have an apparent authority to *execute* the transaction.

The borrower defaulted on repayment. The company denied liability as surety on the ground that, *inter alia*, (i) the transaction was made without authority because no general meeting had been held as required under Article 16, and (ii) the lender failed to fulfil its 'duty of inquiry' (审查义务).[44] The trial court ruled that the security agreement was unenforceable, but held the company liable for fifty percent of the unpaid debt on the basis of the Guaranty Law Interpretation Article 7. Article 7 provides that (i) where the loan contract is valid but the security contract is unenforceable, if the creditor is not at fault, the debtor and the surety are jointly liable, and (ii) where both the surety and the creditor are at fault, the liability of the surety should not exceed fifty percent of the unpaid part of the debt. The HPC upheld the trial court's decision on appeal.

The SPC overruled the decision of the HPC and held the company wholly liable for the unpaid part of the debt. The SPC's decision concluded that the contract was enforceable and the creditor, in any case, was not at fault. In upholding the enforceability of the transaction, the SPC based its decisions on three points of view.

First, the SPC adopted the view that the only purpose of Article 16 is to protect shareholders and (other) creditors from company controllers' abusive activities.[45] According to this view, Article 16 regulates internal relations and does not affect a party external to the company. A contract made in contravention of Article 16 therefore does not affect a creditor's enforcement right.[46] The second says that, given the authenticity of the company seal and LR signature affixed on the loan instrument, the bank had reasons to believe the credibility of the LR's representative act (reason to believe (RTB)).[47] The last says that a contract formed in contravention of Article 16 (e.g. where the transaction has not been approved by the company in accordance with the procedure prescribed in Article 16) is not unenforceable because Article 16 is not a 'validity', but a 'management', mandatory rule. A contract formed in violation of the latter, under this approach, is not unenforceable (the validity approach).[48]

The validity approach has been developed through an interpretation of the PRC Contract Law Article 52.5 and Article 14 of the SPC's Judicial Interpretation of the PRC Contract Law II (Contract Law Interpretation II). Article 52.5 provides that a contract made in contravention of a mandatory statutory or administrative rule is unenforceable. Article 14 narrows the scope by stating that a 'mandatory rule' referred to in Article 52.5 refers only to one that, if breached, renders a contract formed through contravention unenforceable (效力性强制规定 or validity mandatory rules). According to the SPC, validity mandatory rules are those that contain a provision that a contract formed in contravention is unenforceable and those, although containing no such a provision, the violation of which would harm the state's or public interest. [49]

The SPC's reason for ruling that the lender was not at fault (for the purposes determining the surety's liability under the Guaranty Law Interpretation Article 7) was that requiring the creditor to find out about the irregularity of the transaction, in the matter's specific

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[44] *See* note 102.

[45] This is the typical case, *supra* note 13.

[46]Feifei Wu, *Gongsi Danbao Anjian Sifa Caipan Lujing de Pianshi yu Jiaozheng [The Incorrect Paths in the Adjudication of Corporate Security Cases and the Correction]*, 2015 DANGDAI FAXUE (MODERN LEGAL SCIENCE) 56 at 56-7.

[47] The three grounds on which the SPC's decision on the enforceability of transaction was made will be further considered when the avenues through which HPC's decisions were reached are discussed. *See* note 75 *ff*.

[48] For discussion on the externality and validity approaches *see* note 84 *ff*; Shengping Gao, *Gongsi Danbao Xiangguan Falv Yanjiu [A Study on the Law Relating to Corporate Security Transactions]*, 2 ZHONGGUO FAXUE (CHINESE LEGAL SCIENCE) 104 (2013); Wu, *supra* note 47. 46

[49] DEYONG SHEN AND XIAOMING XI (eds), ZUIGAO RENMIN FAYUAN GUANYU HETONG FA SIFA JIESHI ER DE LIJIE YU SHIYONG (THE UNDERSTANDING AND APPLICATION OF THE SUPREME PEOPLE'S COURT'S JUDICIAL INTERPRETATION ON PRC CONTRACT LAW (II)) 131 *ff* (People's Courts Press 2009).

circumstances, would be too taxing on the bank. The SPC held that (i) the flaws in the company's resolution could only be discovered by forensic experts and through an inspection of the records held by the company registration authority, and (ii) the creditor could avoid the risks associated with lending only if it, the creditor, was familiar with the relevant legal rules.

III. RESEARCH METHODS AND ANALYTICAL FRAMEWORK

A. Facts gathering

A discovery of how courts have allocated risks for unauthorized corporate security contracts involves a discovery of a number of facts. These include (i) the generic question[50] that courts need to answer to adjudicate Article 16 disputes, (ii) the percentage of cases where the transaction was entered into with(out) authority, (iii) the percentage of cases where the creditor was provided with documents evidencing the company's authorization of the transaction, (iv) the percentage of cases where the security contract was upheld, (v) the avenues through which unauthorized transactions were enforced, and (vi) the percentage of cases where the alleged surety was held wholly or partially liable for an unauthorized transaction.

The facts enumerated above were discovered through a review of HPC's decisions of Article 16 cases collected from a respected database, *pkulaw*.[51] Each article of the PRC Company Law listed in that database includes hyperlinks to, *inter alia*, decisions by the PRC courts of all levels where the article was mentioned. The cases were collected through the hyperlinks to Article 16 decisions. A total of 279 HPC cases were collected. Twenty-four of these were discarded either because the case did not involve a surety-creditor dispute or because the decision at the HPC level did not involve the decision of an Article 16 issue. The dataset therefore consists of a total of 257 cases involving 260 transactions. These cases were decided between 21 September 2009[52] and 9 March 2018.[53]

B. Analytical framework

As mentioned, in resolving Article 16 disputes, one challenge for courts is the inadequacy of the requisite legal infrastructure.[54] The 'consequentialist' approach developed by Neil MacCormick helps resolve the problem. MacCormick believes that a common law court, when facing a legal lacuna, may, and does, adjudicate through the abovementioned approach. Under this approach, the first task is to formulate a generic question.[55] The judges' mission is to do justice according to law.[56] Formal justice requires that similar cases be treated similarly and different cases be dealt with differently.[57] Since cases are hardly ever identical, the best option for courts is to formulate a generic question, the answer of which governs all generically similar cases. A proposed answer to the generic question can then be chosen through a consideration of possible consequences of upholding a proposed rule.[58]

How, then, are the consequences of a proposed rule assessed? According to MacCormick, this may be done through a consideration of the extent to which a given option

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[50] *See* note 21. 55

[51] Each article of the PRC Company Law in that database includes hyperlinks to, *inter alia*, decisions by the PRC courts of all levels where the article was mentioned.

[52] (2009) Zhe Shang Zhong Zi No. 269.

[53] (2017) Xiang Min Zhong Zi No. 755.

[54] *Supra* note 21. 56

[55] NEIL MACCORMICK, LEGAL REASONING AND LEGAL THEORY 100 *ff* (Clarendon 1978).

[56] 55 *Id.* at 73.

[57] JOHN RAWLS, A THEORY OF JUSTICE 58 (OUP 1971); MACCORMICK, *supra* note 57. 55

[58] MACCORMICK, *supra* note 56 at 79, 86. 55

makes sense both in the world and in the context of the legal system in question.[59] The preferred rule must make sense in the world because:

> [L]aws must be conceived of as having rational objectives concerned with securing social goods or averting social evils in a manner consistent with justice between individuals; and the pursuit of these values should exhibit a sort of rational consistency, in that the consequences of a particular decision should be consonant with the purposes ascribed to related principles of law . . . .[60]

The preferred legal proposition must make sense in the context of the legal system because there must be some basis for the decisions that a party seeks in the legal system as it already stands.[61] This is plainly right, as '[j]udicial discretion is used within the framework of a system and must fit into it.'[62]

The tests that MacCormick proposes for determining whether a proposed rule makes sense in the world and in the context of the legal system will be discussed when the HPCs' decisions are evaluated.[63]

IV. THE GENERIC QUESTION

Prima facie, a resolution of Article 16 disputes depends on (i) whether the transaction is validly entered into and (ii) if not, the creditor's (imputed) knowledge on the irregularity of the transaction. The generic question can therefore be identified on the basis of the common features of the Article 16 cases in relation to the abovementioned facts. This section presents and discusses the findings on these facts, which are obtained from the case review.[64]

A. Regularity of the transaction

Prima facie, the validity of an Article 16 transaction hinges on the court's findings on two facts: (i) whether the company has authorized the transaction in accordance with Article 16 (or perhaps through shareholders' unanimous consent, where appropriate[65]); and (ii) whether the contract has been duly executed. In resolving a dispute between a company and the contractor, an answer to question (i) is arguably more crucial. If the answer to that question is 'no,' there would be no need to consider question (ii) because there would be no *corporate* contract to execute. [66] What is the most typical scenario of the cases under review in terms of this crucial factor?

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[59] MACCORMICK, *supra* note 56, at 73. 55

[60] *Id.* at 149.

[61] *Id.* at 120.

[62] AHARON BARAK, *The Nature of Judicial Discretion and Its Significance for the Administration of Justice*, *in* O WIKLUND (ed), JUDICIAL DISCRETION IN EUROPEAN PERSPECTIVE 23 (Kluwer Law International and Norstedts Juridik AB 2003).

[63] *See* below text accompanying notes 82, 110.

[64] Irrespective of the effect of Article 16 on apparent authority provisions (which may govern where the transaction is unauthorized), factors pointing to the creditor's (imputed) knowledge will be relevant to the court's decision. The third party, for example, would contravene the good faith principle if she seeks to enforce a transaction knowing that it is unauthorized. *See* text accompanying notes 27, 37.

[65] A power of shareholders' meeting may be exercised, if supported by members' unanimous consent recorded in the requisite format, without a meeting. Company Law (promulgated by the Ministry of Commerce, Oct. 17, 2019) Article 37 (China).

[66] Although, in common law, the company may be estopped from saying so if it has created an apparent authority in the purporting agent. *Northside Developments Pty Ltd v. Registrar-General* (1990) 170 CLR 146 (Austl.).

Table 1: Patterns of cases: percentage of (un)authorized transactions

		(A)	(B)	(C)	(D)	(E)
Total number	Transactions involved	Transactions authorized according to Article 16	Transactions authorized by unanimous consent or the only member of the company	Transactions authorized but LR acted in excess of authority	Transactions not authorized	Whether transaction authorized unclear
257	260	4 (1.5%)	15 (5.8%)	2 (0.8%)	227 (87.3%)	12 (4.6%)

The picture presented in Table 1 is clear. Eighty seven percent of the transactions in the cases under review were made without authority.[67]

B. Creditor's knowledge

As facts presented in Table 2 indicate, apart from the less than two percent of cases listed in column D, the facts in 'unauthorized' cases either 'make it obvious to a reasonable person that something was certainly wrong' (as in cases summarized in column C), or are likely to 'raise a question in the mind of a reasonable person as to whether something is wrong.'[68] (as in cases summarized in columns A and B).

Table 2: Patterns of case (unauthorized transactions): factors pointing to the creditor's knowledge

	(A)	(B)	(C)	(D)
Number of unauthorized transactions	Resolution not provided to the creditor	Corporate seal affixed on the security instrument no longer in use (change of seal was announced in a major newspaper)	'Resolution' provided to creditor indicates that transaction unauthorized[69]	Unclear
227	203 (89.5%)	1 (0.4%)	20 (8.8%)	3 (1.3%)

The conclusion that can be drawn from Table 1 and Table 2 is twofold: (i) in the bulk of these cases the transactions were entered into without authority; and (ii) the facts in these cases at least raised a question to a reasonable creditor concerning the regularity of the

[67] There are only two out of 257 cases subject to review where the LR has acted *in excess of* his/her *authority* (rather than *without authority*). Su Min Zhong No. 552 (2016); Lu Min Zhong No. 527 (2017). Given the space constraint, the decision of this type of cases is not discussed in this paper.

[68] ROBERT P. AUSTIN & IAN M. RAMSAY, FORD'S PRINCIPLES OF CORPORATIONS LAW 1034 (17th ed. 2018).

[69] That the transaction is unauthorized may be inferred from the content of the resolution. This would be the case where, for example, (i) the company's resolution shows the company's decision to grant the creditor a charge but not to act as a guarantor. Wan Min Er Zhong Zi No 00234 (2015). *See below* text accompanying note 72 or (ii) the resolution, read together with the company's constitution, shows that the meeting at which the relevant decision was made was inquorate. Yue Gao Fa Min Er Zhong No. 19 (2012).

transaction. It follows that the generic question for the court concerns the liability of the alleged surety for an unauthorized security transaction[70] where the facts at least raise a question to a reasonable creditor concerning the regularity of the transaction.

V. THE HPCS' ANSWERS TO THE GENERIC QUESTION

A. HPCs' decision outcomes

Given the generic question for the judge, the concern of this section is HPCs' decision on the company's liability for unauthorized transactions. Since a decision on this issue may hinge on the court's decision on the enforceability of the transaction, the percentage of cases where the contract is held enforceable constitutes part of the information on the outcomes of court decisions. The answers to these questions, as indicated in Tables 3 and 4, are surprising: close to eighty percent of the *unauthorized* transactions in the cases subject to review were held *enforceable* (Table 3, column A) and in more than eighty percent of these cases the company was held wholly or partially liable (Table 4, columns A and B).

Table 3: Unauthorized cases decision outcomes: contract enforceability.

		(A)	(B)
Number of unauthorized cases	Number of transactions involved	Contract held enforceable	Contract held unenforceable
226	227	180 (79.3%)	47 (20.7%)

Table 4: Unauthorized cases decision outcomes: company liability.

		(A)	(B)	(C)	(D)
unauthorized cases	unauthorized transactions	Company held wholly liable	Company held partially liable	Company held not liable	Pending - case remitted for retrial
226	227	177 (78.0%)	12 (5.3%)	33 (14.5%)	5 (2.2%)

B. How did HPCs decide hard Article 16 cases?

Not all Article 16 cases coming before the court are hard cases. Of the cases under review, a small number of cases are easy cases in the sense that they can be decided on the basis of an existing rule. Where, for example, there is clear evidence as to the creditor's actual knowledge or what common lawyers call inferred notice[71] that the transaction in dispute is not

[70] As is in *Northside*, 170 CLR, as distinguished from cases where the transaction is executed in disregard of a condition that must be satisfied before *an authority conferred* on a corporate organ or an agent may be exercised. Royal British Bank v. Turquand (1856) 6 Ellis & Blackburn 327 (UK)..

[71] The concept of 'inferred notice' is used here in the same sense as it is used in common law (as distinguished from what is known as 'constructive notice' in equity): 'When a man has statements made to him, or has knowledge of facts, which do not expressly tell him of something which is against him, and he abstains from

authorized, or the creditor colluded with the LR, the decision can be made on the basis of the good faith principle.[72] Most of the cases under review, however, are hard cases, where evidence on the creditor's actual knowledge or fraud is not immediately available. In terms of the outcomes of decisions, hard cases can be divided into two groups. The first includes cases where the alleged surety was held wholly or partially liable. The second consists of those where the company was held not liable. As can be expected, the decision outcomes in these two groups of cases were reached by different methods. Given that most of the hard cases fall into the first group, in the remainder of this paper, this group of cases is referred to as the majority line of decisions, whereas the group two cases are referred to as the minority line of cases. How the decision outcomes of these two lines of cases have been reached is examined below.

1. Majority line of decisions

In this line of cases, the court reached their decision primarily by two methods. The first is to hold an unauthorized transaction enforceable, in which case the company will be held wholly liable. How did courts hold unauthorized transactions enforceable? As the information presented in Table 5 shows, in eighty-five percent of instances where the unauthorized transaction was held enforceable, the court's decision was made through one or more of the three approaches that the SPC adopted in the typical case mentioned previously.[73]

making further inquiry because he knows what the result would be — or, as the phrase is, he 'wilfully shuts his eyes' — then judges are in the habit of telling juries that they may infer that he did know what was against him. It is an inference of fact drawn because you cannot look into a man's mind, but you can infer from his conduct whether he is speaking truly or not when he says that he did not know of particular facts. There is no question of constructive notice or constructive knowledge involved in that inference; it is actual knowledge which is inferred.' English and Scottish Mercantile Inv. Co. Ltd. v. Brunton [1892] 2 QB 700 per Lord Esher MR at 707-8. For an example of inferred notice, *see* Wan Min Er Zhong Zi No 00234 (2015) discussed in note 72, although the court just held that the creditor had actual knowledge (明知) without saying that the conclusion that creditor had actual knowledge was inferred from a set of existing facts.

[72] In Wan Min Er Zhong Zi No 00234 (2015), the court held that the creditor had acquired an actual knowledge on the LR's lack of authority to commit the company as guarantor where the company's resolution showed the company's decision to grant the creditor a charge but not to act as a guarantor. The court held that since the creditor knew that no guarantee transaction was authorized, *that* transaction was unenforceable, and the company was not liable. *Id.* The court did not discuss the reason why the creditor's actual knowledge affects its decision on the company's liability. *Id.* The decision, however, can be rationalized on the basis of the good faith principle. Suing the company as a guarantor with the knowledge that the company has not committed itself as guarantor contravenes the good faith principle. In Lu Min Zhong No 2074 (2016), the Shandong HPC upheld the decision of the court below that the transaction was enforceable and did not take legal effect on the alleged surety on the ground of collusion between the LR and the creditor. The decision was made on the basis of PRC Contract Law Article 52.2, which provides that a contract formed through collusion, etcetera, for the purposes of harming the interest of, *inter alia*, the third party, was unenforceable. *Id.* The decision in this case, it should be noted, suffers from the same problem as those where the validity and externality approaches and Guaranty Interpretation Article 7 were applied. By applying Article 52.2, the court falsely presumes the existence of a contract between the surety and the creditor. The decision, however, can be justified on the basis of the good faith principle. In Su Shang Zhong Zi No 00560 (2015), the court refused, on the basis of Contract Law Article 50, to hold the company liable for a transaction made through a collusion of the company's actual controller and the lender. Article 50 did not apply here, as the controller was not the LR. *Id.* The same outcome can be reached through an application of the good faith principle.

[73] *See* text accompanying note 48 *ff*.

Table 5: Methods with which unauthorized transactions are enforced.

(A)	(B)	(C)	(D)	(E)
unauthorized transactions held enforceable	cases decided through the externality, validity, or RTB approaches	cases decided through any two of the three approaches	cases decided through all of the three approaches	cases decided through other approaches
178[74]	55 (40.9%)	78 (43.8%)	19 (10.7%)	26 (14.6%)

The second is to hold the transaction unenforceable (on the basis that the contract is made in contravention of Article 16), in which case the company may be held, through an application of Guaranty Law Interpretation Article 7.[75]

2. Minority line: the agency approach

In this line of cases, the alleged surety is held not liable on the ground of the rules on unauthorized agency.[76] In most of the cases of this group, the court's application of rules on unauthorized agency entails an application of rules on apparent authority. In doing the latter, courts apparently have not turned their minds to the neutralizing effect of Article 16 on the rules on apparent authority.

A typical minority line of case is (2016) Su Min Shen No. 5421. There, the Jiangsu HPC held that, on the basis of Article 48, an unauthorized transaction made by a purporting agent did not take legal effect on the company. The question then was whether the purporting agent acted with apparent authority, which turns on whether the creditor had fulfilled his duty of inquiry. The court held that he did not, as he proceeded with the contract without making an inquiry where the facts of the case put him on inquiry.

In some of the minority line of cases, the court decided the case on the basis of the rules on unauthorized agency without referring to each link in the chain of reasoning. In a couple of cases,[77] for example, the court held the transaction did not take effect on the surety without referring to Article 48. The court reached its decision on the basis that no apparent authority had been created in the purporting agent. As the question on apparent authority is raised only where the transaction is found to be unauthorized, the court's decision must have been made on the bases of, *inter alia*, Article 48.

There is also a minority line of cases in which the only basis for the court's decision is the creditor's failure to fulfil her duty of inquiry. In a 2015 case,[78] the creditors (also shareholders in the alleged surety) proceeded with the transaction where the deal had not been approved through a company meeting. The court gave the judgment to the alleged surety on

[74] In one of these cases the transaction was held to be enforceable, but the company was held *partially* liable on the ground that both parties were responsible for the failure to register the charge (over the surety's land use right). Lu Min Zhong No. 1076 (2016).

[75] This provision was enacted on the basis of Dan bao Fa （担保法） [Guaranty Law] (promulgated by the Standing Comm. Nat'l People's Cong., 30 June, 1995, effective Oct. 1, 1995), Article 5 (China).

[76] Zhe Shang Zhong Zi No 270 (2009); Liao Min Er Zhong Zi No 15 (2010); Yu Gao Fa Min Zhong Zi No 00385 (2014); Su Min Zhong Zi No 00373 (2014); Xiang Gao Fa Min Yi Zhong Zi No 40 (2015); Zhe Shang Ti zi No 51 (2015); Su Min Zhong Zi No 00508 (2015); Su Min Zhong No 1093 (2016); Su Min Shen No 5421 (2016).

[77] Su Min Zhong Zi No 00373 (2014); Su Min Zhong Zi No 00508 (2015).

[78] Zhe Shang Ti Zi No 51 (2015).

the basis, *inter alia*, that the creditors, being company insiders, failed to perform their 'substantive duty of inquiry'.[79]

In a series of inter-related cases, the Jiangsu HPC held the surety contract did not take legal effect on the company because, *inter alia*, the lender failed to require the purporting corporate representative to produce the company's resolution.[80] The court did not refer to the rules on unauthorized agency or apparent authority. This group of decisions can be understood as having been made on the basis of unauthorized agency indirectly. The purpose of a ruling on the creditor's duty of inquiry is to decide whether apparent authority has been created in the professed corporate representative. It was only necessary to decide the case on the point of apparent authority because the transaction was entered into without authority.

VI. WHICH LINE OF DECISIONS MAKES BETTER SENSE?

Given that the analytical tool selected is MacCormick's 'consequentialist' approach, the two lines of cases will be evaluated by considering which one makes better sense in the context of the PRC legal system and in the world.

A. Which line of decisions makes better sense in the context of the legal system?

1. The majority line of decisions

According to MacCormick, the test for determining whether the decision contended for makes sense in the context of the legal system is one of coherency:

> The point rather is to show that the decision contended for is thoroughly consistent with the body of existing legal rules, and is a rational extrapolation from them, in the sense that the immediate policies and purposes which existing similar rules are conceived as being aimed at would be *pro tanto* controverted and subject to irrational exceptions if the instant case were not decided analogously with them.[81]

If coherency is to be the test, the majority line of decisions does not make sense. In this line of cases, it will be remembered, the court held the alleged surety liable either by ruling the unauthorized transaction enforceable or, where the transaction is held unenforceable, by activating Guaranty Law Interpretation Article 7.[82] Both these methods rest on the premise that a security contract subsists between the putative surety and the creditor.

In most of the majority line of cases, the HPCs have held unauthorized transactions enforceable through the three court-made approaches.[83] Two of these, namely, the validity and externality approaches, rest on the premise that a contract subsists between the putative surety and the creditor. The validity approach says, that a security contract *formed* in contravention of Article 16, which is a 'management mandatory rule', is nonetheless enforceable. According

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[79] Where the other party to the transaction was one of the company's directors, Lord Simmonds held that the director could not rely on the indoor management rule on the basis that, inter alia '[i]t is the duty of directors … to look after the affairs of the company, to see that …its transactions are regular and orderly.' Morris v. Kanssen (1946) AC 459 (HL) 476 (appeal taken from Eng.) (UK). For the concept of indoor management rule, *see* text accompanying note 102.

[80] Su Min Shen No 2350 (2016); Su Min Shen No 2351(2016); Su Min Shen No 2353 (2016); Su Min Shen No 2613 (2016).

[81] MacCormic, *supra* note 55 at 120.

[82] *See supra* text accompanying note 44.

[83] *Id.*

to the externality approach, Article 16 only regulates the surety's internal relationships and that *a contract was made* in contravention of Article 16 does not affect the enforcement right of the creditor, who is an external party.

In some of the majority line decisions, the company was held liable even where the transaction was held unenforceable. The basis of this group of decisions, is, as mentioned, Guaranty Law Interpretation Article 7. Again, this provision determines the alleged surety's liability according to whether the creditor is at fault *in the formation of the contract*. Article 7 is therefore applicable only where a contract has been formed. No contract, however, would exist between the disputants if the company has not authorized transaction *ex ante* or, *ex post*, by ratification. Where the transaction is unauthorized, no contract would subsist between the disputants. Holding the alleged surety liable through an application of the validity or externality approaches or Article 7 therefore does not make sense in the context of the PRC legal system.

One might ask, what about RTB? The answer is that this approach also does not make sense in the context of the PRC legal system, albeit for a different reason. First, RTB is not supported by any rules in the PRC legal framework. None of the statutory structures entitle third parties to presume that the company has authorized the transaction merely because of the imprint in the security instrument of what appears to be the firm's corporate seal or the LR's signature. Further, in asserting RTB on behalf of the creditor, the court either does not mention which party should bear the burden of proof,[84] or treats the company as the bearer of the burden.[85] This is inconsistent with the principle of 'he who asserts bears the burden of proof.'[86]

Some may argue that RTB may be justified on the basis of the so-called 'organic theory' of the company.[87] In the Australian High Court case of *Northside Development Pty Ltd* v *Registrar-General*,[88] for example, Mason CJ,[89] opined, in a different context, that:

> [I]f the person dealing with the company receives a document to which the common seal has been affixed in the presence of individuals designated in the articles of association, he is entitled to rely on its formal validity.[90]

In his Honor's view, 'it is the presence of the seal on the document that gives rise to the presumption that the seal has been affixed with the authority of the directors.' [91] and that '[t]he affixation of the seal to an instrument makes the instrument that of the company itself; the affixing of the seal is in that sense a corporate act…'[92]

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[84] *E.g.*, SPC decision Min Tizi No 156 (2012) and Zhe Shang Ti Zi No 31 (2011).
[85] *E.g.*, Yu Fa Min Yi Zhong Zi No 78 (2015).
[86] This principle is embodied in the PRC Civil Procedure Law, Article 64. For the purposes of Article 49, the outsider bears the burden to prove that she has reasons to believe that purporting agent is authorized. ZHENYING WEI (ed), CIVIL LAW 189 (Peking University Press 2000); DEYONG SHEN AND XIAOMING XI (eds), ZUIGAO RENMIN FAYUAN GUANYU HETONG FA SIFA JIESHI ER DE LIJIE YU SHIYONG (THE UNDERSTANDING AND APPLICATION OF THE SUPREME PEOPLE'S COURT'S JUDICIAL INTERPRETATION ON PRC CONTRACT LAW (II)) 99 (People's Courts Press 2009).
[87] That theory was developed by Otto von Gierke. That theory says that human association is 'a living organism and as such a real person both in and outside the law.' S. J. STOLJAR, GROUPS AND ENTITIES: AN INQUIRY INTO CORPORATE THEORY 184-5 (ANU Press 1973). According to that theory, 'the company [i]tself can will, itself can act; it wills and acts by the men who are its organs . . . . It is not a fictitious person; . . . it is a group-person, and its will is a group-will' OTTO VON GIERKE, F W, POLITICAL THEORIES OF THE MIDDLE AGE xxvi (Translator's Introduction by F W Maitland) (F W Maitland tr, CUP 1900).
[88] *Northside*, *supra* note 66.
[89] IMR entitles the person seeking to deal with the company in good faith to assume that that acts within the company's constitution and powers have been properly and duly performed (HALSBURY'S LAWS OF ENGLAND vol 14, para 266 (5th ed. 2014) (citations omitted)).
[90] *Northside*, *supra* note 66, at 160.
[91] *Id.* (Mason, CJ.).
[92] *Id*.

Mason CJ's stance, however, may be hard to defend. As Dawson J pointed out in the same case, Mason CJ's view is based on the so-called 'organic theory.' That theory treats 'the act of affixing the seal as an act, not simply of an agent, but of an organ of the company itself.'[93] The organic theory, however, has no application where the transaction was made without authority. As Dawson J puts it,

> But the organic theory merely extends the scope of an agent's capacity to bind a company and there must first be authority, actual or apparent. It is only then that a person may be regarded not only as the agent of the company but also the company itself – an organic part of it.[94]

Dawson J's words on this issue were cited with approval by Lord Neuberger NPJ in a more recent decision of Hong Kong's Court of Final Appeal.[95]

If Dawson J's view is right, the RTB approach cannot be justified on the basis of the organic theory of the company. For the purpose of a transaction that gives a security, the LR, who Article 16 says does not have the relevant authority, cannot be regarded as the company itself. In any event, no rules are provided under the PRC legal framework or corporate constitutions on the ways in which corporate documents are to be executed. In other words, there is no uniform standard of the so-called 'formal validity' under the PRC legal framework. It is therefore impossible to justify the RTB approach even with Mason CJ's 'formal validity' approach.[96]

2. The minority line of decisions

To form a view on the extent to which the minority line of decisions makes sense on the test of coherency, it is necessary to look at the roadmap of the minority approach. This roadmap is as follows. First the unauthorized transaction, unless ratified, does not take legal effect on the company.[97] Second, notwithstanding the first point, the company may still be held liable if the third party had reason to believe that the agent had been authorized (but for the effect of Article 16).[98] Finally, whether the third party had reason to believe depends on, *inter alia*, whether that person had fulfilled her duty of inquiry when she was put on inquiry.

The first two steps of this reasoning process are based squarely on Contract Law arts 48 and 49. The third requires some explanation. Whether the third party had reason to believe, etcetera, (for the purposes of Article 49) may be difficult to determine.[99] However, there can be little doubt that the outsider would have no reason to believe that the purporting agent is authorized where the former has acted negligently in entering into the transaction.[100] But what

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[93] *Id*. at 201 (Dawson, J.).
[94] *Id*. at 201-2 (Dawson, J.).
[95] Thanakharn Kasikorn Thai Chamkat v. Akai Holdings Ltd (2010) 13 HKCFAR 479 [59].
[96] This conclusion is fortified by Article 2 of the draft SPC judicial interpretation on the adjudication of Article 16 cases, which signifies the SPC's formal disapproval or RTB. Article 2 provides that where the contract in dispute was not made in accordance with Article 16, the creditor may not contend that the contract is enforceable merely on the basis that the security instrument is affixed with the company's seal or the LR's signature or chop.
[97] Contract Law Article 48 (China).
[98] Contract Law Article 49 (China).
[99] SU CHEN, MINFA ZONGZE PINGZHU Vol 2, 1230 *ff* (COMMENTARY ON GENERAL PRINCIPLES OF THE CIVIL CODE) (Law Press 2017); KOJI OMI, CIVIL LAW LECTURES I: GENERAL PRINCIPLES OF CIVIL LAW 267-8 (Tao Qu tr, 6th ed. Peking University Press 2015). Note, however, the company bears the burden to prove that the third party has no reasons to believe, etcetera. CHEN, *supra* note 100, at 1234.
[100] DEYONG SHEN AND XIAOMING XI (eds), ZUIGAO RENMIN FAYUAN GUANYU HETONG FA SIFA JIESHI ER DE LIJIE YU SHIYONG (THE UNDERSTANDING AND APPLICATION OF THE SUPREME PEOPLE'S COURT'S JUDICIAL

does 'negligence' mean in the context under consideration? No definitive and consistent answer can be found in the cases subject to review. The common law, however, provides an answer.

Courts within Commonwealth jurisdictions, for the purposes of the so-called Indoor Management Rule (IMR),[101] impute a constructive notice of the irregularity to a person if the latter is negligent in failing to make an inquiry when she is 'put on inquiry.'[102] The contractor will be put on inquiry 'if the circumstances are such that the person, if acting reasonably, ought to have investigated whether the requirements of internal management were complied with.'[103] The person will then lose her right to avail herself of IMR if she is taken to have notice as to the fact that she is otherwise entitled to presume.

It is by now clear that the 'put on inquiry' exception also applies to cases of apparent authority. As Lightman J confirmed in a 2005 decision, where the apparent authority of a purporting agent was at issue, '[i]f there are suspicious circumstances or abnormalities, then the third party should make such inquires as ought reasonably to be made to ensure that the authority is sufficient to bind the principal.'[104] Similarly, a failure to make an inquiry when having been put on inquiry should amount to 'negligence' for the purposes of establishing apparent authority under Article 49.

For the purposes of Article 16 cases, the creditor would be acting negligently if she proceeds without making an inquiry where the matrix of the case at least raises a question to a reasonable creditor as to whether something is wrong (on the regularity of the transaction).[105] The creditor who has acted negligently should be taken to have notice as to the true fact. It follows that the creditor would not have a reason to believe that the agent acted with apparent authority and the contract therefore does not take effect.

The minority line of decisions makes better sense in the context of the legal system because the approach adopted in that line of decisions is more coherent with the existing civil law framework. It should be noted, however, that the agency approach has been applied mostly in cases where the 'middleman' is not the LR.[106] This suggests that courts are reluctant to invoke Article 48 where the middleman is the LR. The reasons for this will be considered shortly.[107] It should also be noted that the second and third steps in the reasoning roadmap discussed above are arguably otiose if the neutralizing effect of Article 16 on arts 49 and 50 is taken into consideration.[108] That notwithstanding, the minority approach, to the extent that the decision is based on Article 48, would still be superior to the majority approach in terms of coherency.

INTERPRETATION ON PRC CONTRACT LAW (II)) 99 (People's Courts Press 2009); CHEN, *supra* note 100, at 1231; See also Minshu Vol 20, No 4 at 752; KOJI OMI, *supra* note 100, at 266; WANG, *supra* note 40, at 321.

[101] IMR entitles the person seeking to deal with the company in good faith to assume that that acts within the company's constitution and powers have been properly and duly performed (HALSBURY'S LAWS OF ENGLAND vol 14, para 266 (5th ed. 2014) (citations omitted)).

[102] STEFAN HC LO & CHARLES Z QU, LAW OF COMPANIES IN HONG KONG [12.071] (3rd ed. Sweet & Maxwell 2018).

[103] LO & QU, *supra* note 103, at [12.070].

[104] Hopkins v. T L Dallas Group Ltd [2005] 1 BCLC 543 94.

[105] AUSTIN AND RAMSAY, *supra* note 68.

[106] (2016) Su Min Shen No 5421; (2014) Su Min Zhong Zi No 00373; (2015) Su Min Zhong Zi No 00508. *But see* Su Shang Zhong Zi No 00560 (where the court based its decision on Article 50 (which applies where the 'middleman' is the LR), where the transaction was made by a *purporting agent*, to hold that the contract did not take legal effect on the alleged surety).

[107] AUSTIN AND RAMSAY, *supra* note 68

[108] CHEN, *supra* note 20.

B. Which lines of decisions make better sense in the world?

According to MacCormick, whether a proposed rule makes sense in the world is determined by three tests. The first is whether it is preferable in terms of public interests. Second is whether it is preferable in terms of principles of justice. The last ground is 'common sense,' which 'depends on an appeal to contemporary positive morality as understood by the judge.'[109]

1. Public interests

In the context of corporate contracting, there is a public interest in protecting the contractor. Requiring the contractor to investigate internal proceedings to satisfy herself about the authority of officers and validity of instruments would likely make transactions with companies inconvenient and costly.[110] Rules based on a policy that protects parties dealing with companies therefore help promote commercial transactions by maximizing the number of exchanges. Encouraging the maximization of wealth through exchanges is necessary for any exchange-driven society.[111] In other words, net social efficiency calls for the protection of the third party.[112]

On the other hand, two competing public interests can be identified. First, there is the public interest in protecting property rights. '[L]egal protection of property rights creates incentives to use resources efficiently.'[113] The longstanding common law judicial policy of property protection,[114] as well as the guarantee for the protection of private property under China's Constitution,[115] reflects the importance lawmakers give to property protection.

Second, there is the public interest in preserving the integrity of the centralized corporate management system:

> The shareholders expect – or rationally ought to want it to be the case – that their elected representatives, the directors, will have ultimate control over the allocation of power within the corporation. For efficiency's sake, corporate presidents should not be able to unilaterally expand the scope of their jobs.[116]

In the context of corporate contracting, the public interest in protecting third parties may clash with the two aforementioned competing public interests. The court's challenge is how to determine its policy positioning. The answer, at least where the transaction is unauthorized, is that the court should lean towards the company. The outsider is in a better position to enforce the company's system of delegated authority. The board is not in a position to constantly monitor the directors' (or the LR's) actions to see whether they exceed their authority,[117] not to mention ensuring that no transactions are made in the company's name without authority. On the other hand,

> [A] third party negotiating a particular deal cannot help but notice what the corporation's officer is purporting to be able to do. He will

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[109] MACCORMICK, *supra* note 56, at 111.
[110] PAUL REDMOND AM, CORPORATIONS AND FINANCIAL MARKET LAW [5.310] (6th ed. Lawbook 2013).
[111] MICHAEL BRIDGE, PERSONAL PROPERTY LAW 196 (4th ed. OUP 2015).
[112] ROBERT CHARLES CLARK, CORPORATE LAW 121 (Little, Brown and Co, Boston 1986).
[113] RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 32 (4th ed. Little Brown 1992).
[114] Bishopsgate Motor Finance Corporation, Limited v. Transport Brakes, Limited [1949] 1 KB 322, [336] (Denning J).
[115] XIANFA (CONSTITUTION) Article 13 (1982) (China).
[116] CLARK, *supra* note 113, at 121.
[117] CLARK, *supra* note 113, at 121. (*id)*

> usually notice when the president is attempting to do something quite unusual in terms of the customary practice of the corporation or the industry. His marginal cost, at that point, of making further inquiries or seeking proof of authority to do unusual acts is rather small.[118]

Moreover, it is not taxing to allocate the risk to the creditor. The creditor has an interest to ensure the regularity of the security transaction, which helps to guarantee the return of her investment. On the other hand, it would likely be overly taxing to allocate the risks to the company. Allocating the risk to the company is tantamount to treating the firm as a free-of-charge insurer for the creditor's loan investment.

The case review undertaken for this project indicates that the majority line of decisions leans towards the creditor. The position of the majority line is consistent with, and perhaps based on, the SPC's decision in the typical case.[119] In that case, it will be remembered, the SPC enforced an unauthorized transaction where the general meeting's resolution tendered to the creditor was visibly forged. The SPC's decision in that case is based on the view that imposing a duty to make inquiries on an outsider would increase the transaction costs for dealing with companies.

The SPC's policy reason stated above is illogical in that it is based entirely on the need to protect the creditor. This policy positioning ignores the need for protecting the shareholders or other creditors of the company. In most of the cases subject to review, the security was purportedly provided to facilitate borrowings by a shareholder, the LR, the LR cum shareholder, or the company's actual controller.[120] Holding the company responsible for the defaulting insider borrowers' liability is to enable controlling insiders to fleece the minority shareholders and the company's other creditors. Where security is provided to facilitate borrowings by outsiders, and where the borrowing does not advance the company's interest, holding the company liable has the effect of siphoning off corporate assets in the interest of outsiders.

Additionally, the SPC's policy stance in the typical case is also unhelpful to the enforcement of the company's system of delegated authority. Allocating the risks for unauthorized corporate contracts to the company disincentivizes the outsider to make inquiries when the latter's suspicion is awakened, thereby switching off the more efficient, or sometimes the only, viable mechanism for enforcing a company's system of delegated authority.

The loss of the only viable enforcement mechanism may result in calamitous consequences for the company and its stakeholders. For example, in both （2014）Yue Gao Fa Min Er Po Zhong Zi No. 110 and the *ST KMK* case,[121] liability for repeated unauthorized security transactions has resulted in the downfall of a large corporate group. In any event, allocating the risks to the company does not reduce costs for dealing with the company. A company, knowing that it would bear the costs for unauthorized security transactions, is likely to externalize the costs incurred to all parties it deals with, thereby increasing transaction costs for dealing with the company.

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[118] CLARK, *supra* note 114, at 121. *(id)*

[119] *See supra* text accompanying notes 13, 44.

[120] In 41.9% (36/86) of the cases subject to review, the borrower is a company outsider. Case reports generally do not provide information on the relationship between the company outsider, who is the borrower, and the alleged surety or its officers or controllers. In the remaining cases, the borrowers were company insiders. They include shareholders (30/86 or 34.9%), LR *cum* shareholder (15/86 or 17.4%), LR (2/86 or 2.3%), or the company's actual controller (3/86 or 3.5%).

[121] SHIBING CAO, ZHONGGUO DANBAO ZHIDU YU DANBAO FANGFA (THE SYSTEM AND METHODS OF SECURITY IN CHINA) 83 (4th ed. China Legal Publishing House 2017).

The minority line, in contrast, makes better policy sense. A distinguishing feature of the minority line is that the creditor is put on inquiry when her suspicion, judging against an objective test, is awakened, and she will not be able to plea a case of apparent authority if she has failed to make an inquiry.[122] This approach protects both the company's assets and the outsider's interests by allocating the task of enforcing the company's system of delegated authority to the outsider, who is in a better position to accomplish the task. Asking for a copy of the company's resolution, for example, does not cost the creditor a fortune. By refusing to hold the company liable for unauthorized transactions where the creditor is negligent, the minority position also helps protect various stakeholders from being fleeced by controlling insiders.

2. Principles of justice and common sense

(a) Principles of justice

The court answers the generic question to determine the creditor's right against the alleged surety. The notion of corrective justice is therefore pertinent in assessing the courts' answer to the generic question:

> Corrective justice involves rectification between two parties where one has taken from the other or harmed the other. Modern discussions of corrective justice often occur within the context of arguing about appropriate standards within tort law and contract law.[123]

Corrective justice requires the wrongdoer to restore the party who has suffered a loss because of the former's wrong to status quo *ex ante*. Therefore, the liability of the alleged surety depends on whether the creditor has a corrective right against the surety.

The answer of the majority line does not follow in terms of corrective justice. In none of the unauthorized cases where the company was held liable did the company appear to have done anything or failed to fulfil a duty that would have given the creditor a corrective right. A holding out by the company that the professed LR/agent as having authority to execute contracts in its name, for example, would, in the language of the civilians, have created a right on the contractor ('设权行为' or rights-setting act[124]) to assume that the professed company representative has been authorized to act in the name of the company. The requirement of a 'holding out' for the purposes of the abovementioned civilian version of apparent authority is comparable to the same requirement for the purposes of establishing apparent authority in common law. In the common law, absent apparent authority that the company has created in the unauthorized agent, there would be nothing that could estop the company from setting up the true facts.[125]

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[122] But see *supra* text accompanying note 109 on the 'caveat' on the minority approach.

[123] BRIAN BIX, JURISPRUDENCE: THEORY AND CONTEXT 103 (4th ed. Thomson Sweet & Maxwell 2006).

[124] SHANGKUAN SHI, ZHAIFA ZONGLUN (GENERAL PRINCIPLES OF THE LAW OF OBLIGATIONS) 50 (China University of Politics and Law Press 2000); Civil Code Article 169 (Taiwan). A holding out by the alleged principal is also a condition for establishing apparent authority under the Japan's Civil Code. Article 109. The requirement of a holding out for the purposes of Japanese/Taiwanese version of apparent authority is comparable to the same requirement for the purposes of creating an apparent authority in common law. In the common law language, absent apparent authority that the company has created in the unauthorized agent, there would be nothing that could estop the company from setting up the true facts. Freeman, 2 QB.

[125] South London Greyhound Racecourses Ltd v. Wake [1931] 1 Ch 496, 506 (Clauson J); *Northside*, *supra* note 66, at 195.

A counterargument might be that the putative principal may be held liable under Article 49 where the third party has reason to believe that the purporting agent is authorized. Holding out, under Article 49, is not a pre-condition for establishing apparent agency. The answer to this view is that the contractor is unlikely to have reason to believe that the purporting agent was authorized where nothing in the conduct of the alleged principal gives the contractor a reason to believe this. The *Opinions on Adjudicating Contractual Disputes* promulgated by the SPC states that the contractor may have reason to believe that the professed agent was acting with authority if 'the conduct of agent showed an objective manifestation of the agent's authority.'[126] Whether the agent's conduct showed such a manifestation, however, is often determined by 'factors (i.e., the conduct, etcetera) closely related to the principal.'[127] This suggests that, absent a 'rights-setting act'[128] on the part of the putative principal, it would be hardly possible to prove that the contractor has reasons to believe that the agent has been authorized to act.

The minority line is consistent with the notion of corrective justice as it does not hold the company liable where the creditor has no corrective right against the company. It therefore makes sense in terms of the theory of justice.

(b) Common sense

According to McCormick, so-called common sense depends on 'an appeal to contemporary positive morality as understood by the judge.'[129] The judge is a lawyer and 'a lawyer's view of what is 'common sense' must be heavily colored by the whole set of attitudes which belong to him as a lawyer.'[130] So whether a legal proposition accords with common sense depends on whether '[p]eople at large, 'right minded people,' so the judge thinks,' would assent to the proposition, as well as whether a right minded lawyer would assent to the view.[131] Right minded people and lawyers would not agree that a company should be held to the actions of an unauthorized purporting representative, unless there is something in the conduct of the company that warrants a conclusion to the contrary.[132] Both the civilian rights-setting based apparent authority rules and the common law estoppel-based doctrine[133] of apparent authority appear to be based on such a common sense.

The majority line's answer to the generic question does not make common sense. This is because it holds the putative surety liable without proving that there is anything in the latter's conduct that should hold it to the action of the purporting LR/agent where a reasonable creditor should become suspicious as to the regularity of the transaction. The minority position, in contrast, does not do this and for this reason it satisfies common sense.

VII. THE WAY FORWARD

The minority approach, although superior, has its own difficulty and limitation. The main difficulty is that it may involve the operation of rules on apparent authority, which operation Article 16, as argued, has ruled out. The limitation is, even if Article 16 is not seen as having neutralized the rules on apparent authority, courts may be hesitant to apply arts 48

[126] For a discussion on the Opinion, see CHEN, *supra* note 100, Vol 2, 1230.
[127] CHEN, *supra* note 100, Vol 2, 1231.
[128] SHI, *supra* note 125, at 50.
[129] MCCORMICK, *supra* note 55, at 111.
[130] *Id.* at 112.
[131] *Id.* at 111.
[132] *Northside*, *supra* note 66, at 208 (Toohey J) ('there was nothing in the conduct of the appellant which would hold it to the actions of Robert Sturgess (the unauthorized director) in mortgaging its land.')
[133] Freeman, 2 QB, at [503].

and 49 (both of which are agency rules) where the transaction is put through by the LR. That a separate apparent authority provision is enacted for the LR suggests that the LR is treated differently under the PRC legal framework.

A question that the abovementioned limitation of the minority approach raises is the possibility of resolving issues raised through alternative means. An answer, it is suggested, may be found through an examination of the ways in which similar issues are resolved in Japan and Taiwan, where, as mentioned, the corporate authority-delegation mechanism is similar to the LR system.

A. The corporate authority-delegation mechanism in Japan and Taiwan

Under the corporate representative regimes of both Japan and Taiwan, if the company has more than one director, each director represents the company individually unless the company has provided otherwise. If the company does decide otherwise, it may appoint more than one representative director ('RD').[134] A consequence of appointing RDs, is that no representative powers are vested in other directors.[135] Under China's LR regime, as mentioned, the company must designate *one* of its senior officers as its LR.[136]

An extra, and significant, feature of the RD systems in Japan and Taiwan is that a rather plenary representative power is granted to the RD by law. Article 349(4) of Japan's Companies Act provides that the RDs 'have authority to do any and all judicial and non-judicial acts in connection with the operations of the Stock Company.' The combined effect of Articles 57, 58, and 108.4 of Taiwan's Companies Act is, *inter alia*, that RDs of a limited company 'shall have power to conduct all affairs pertaining to the business of the company.' In contrast, no equivalent power is conferred onto the LR of a Chinese company.

Notwithstanding the general delegation of powers to the RDs under the Japanese and Taiwanese company law/civil law systems, the issues can still arise. This is because, *inter alia*, the law or the company's constitution may still preclude the RDs' from exercising the company's powers in relation to certain matters. Under Japan's Companies Act, for example, certain powers vested in the board of directors, such as those of disposing of, or accepting, important assets, as well as borrowing in a significant amount are not delegable.[137] Under Taiwan's Company Act, the powers of, *inter alia*, transferring the whole of any essential part of the company's business or assets are exclusively vested in the general meeting.[138] Also, the scope of an RD's power's may be defined under the company's constitution.[139]

B. How is the similar issue resolved in Japan and Taiwan?

In Japan and Taiwan, where one or more directors are designated as the company's RDs, the issue raised may be resolved through one of the three avenues. These are (i) an analogous application of the provisions on 'concealment of intention' (心里保留), (ii) the good faith and abuse of power principles,[140] and (iii) an analogous application of the rules on 'unauthorized agency.'

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[134] Companies Act 2005, arts. 349(1) (2) (Japan); Civil Code, Article 27 (Taiwan).
[135] KOJI OMI, *supra* note 100.
[136] *See supra* text accompanying note 31; Company Law, Article 13 (China).
[137] Companies Act, Article 363(4) (Japan).
[138] Company Law, s. 185 (Taiwan).
[139] For example, *see below* text accompanying note 149.
[140] MINPŌ [Civ. C.] Article 1 (2) (Japan); Civil Code Article 148 (Taiwan); GPCC arts. 7, 132 (China).

1. Concealment of intention

This is a concept relating to 'manifestation of intention' (意思表示) provided in the Civil Codes of Japan. Article 93 of Japan's Civil Code provides that:

> The validity of the manifestation of intention shall not be impaired even if the person who makes the manifestation knows that it does not reflect his/her true intention; provided, however, that, in cases the other party knew, or could have known, the true intention of the person who makes the manifestation, such manifestation of intention shall be void.

In the context of an 'abuse of rights/power' by the RD, the intention concealed is that of the company. The intention manifested is, as a matter of fact, that of the RD. Where the RD acts without authority, the intention that the RD manifested is not that of the company. According to Article 93, the intention manifested is taken to be that of the company, unless the third party knew or 'could have known' the true intention of the RD, in which case the manifestation of intention is void. In other words, if the third party 'knew or could have known' that the intention that the RD has manifested (to commit the company as a surety) is not that of the company, the RD's manifestation of the intention is void. Consequently, the civil juristic act undertaken by the RD in the name of the company (e.g., entering the contract in the name of the company) does not take legal effect. There are cases in Japan where disputes arising from an unauthorised transaction were resolved through an application of Article 93.[141]

2. The good faith principle

The Civil Codes of civil law jurisdictions typically provide for the general principles on the duty to act in good faith and the prohibition against an abuse of rights.[142] There is a view among critics in Japan that a contract made by the RD in the name of the company in abuse of her power is *prima facie* valid. However, if the third party knew (or 'could have known') about the RD's abuse of her 'representative power', that person is unable to insist on the validity of the contract. This is because doing so (with knowledge) would contravene the good faith principle.[143]

3. Unauthorized Agency (the agency approach)

As mentioned, there are cases in Taiwan to say that provisions on unauthorized agency may be applied analogously where the a director has acted without authority.[144] In (1974) Tai Shang Zi No 2014, the court held that if a director had entered into a transaction in the name of the company without authority, the dispute should be resolved through an analogous application of the provisions on unauthorized agency. The company would thus be liable if it had ratified the transaction. However, the company would not be liable if it has refused to ratify the contract, in which case the third party may have recourse against the purporting RD.[145]

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[141] Minshu, Vol 17, No 8, p. 909; Minshu, Vol 23, No 4, p. 737.
[142] MINPŌ [Civ. C.] Article 1(2) (Japan); Civil Code arts. 148.2 and 148.1 (Taiwan).
[143] KOJI OMI, *supra* note 100, at 127.
[144] *See supra* text accompanying note 40.
[145] Civil Code Article 110 (Taiwan), WANG, *supra* note 40, at 310. Note that Article 16 of Taiwan's Companies Act prohibits the company from acting as a security provider unless other Laws or the company's constitution provide otherwise. In other words, under this default rule, the company does not have the capacity to act as surety.

C. The options for PRC courts

1. Concealment of intention

The concealment of intention avenue, regardless of its merit, is unavailable to the PRC courts. The PRC civil law framework does not provide for a disputant's rights in the case of the other party's 'concealment of intention.'[146] Even if it did, this rule would still be unlikely to be of assistance. Article 93 of Japan's Civil Code applies *where a person conceals her own intention*. It follows that, where the 'person' is a company, the provision applies only where the intention that the RD conceals is that of the company. This may be the case where the RD acts within power, in which case her act (and intention) may arguably be treated as that of the company.

The RD, however, may act without authority. As mentioned, the RD's powers may be limited by laws[147] or the company's constitution. A common example of an internal restriction of the RDs' powers is that a disposition of the company's real property must be approved by the board of directors.[148] This example illustrates that, as a general rule, the RDs do not have the authority to do the above-mentioned act. Where the RD acts without authority, her intention cannot be treated as the resolve of the company. Where this is the case, it is impossible to treat the RD and the company as the same person.

In any event, cases decided through an application of Article 93[149] need to be understood in light of Article 349(4) of Japan's Companies Act of 2005. This provision, it will be remembered, confers a rather plenary authority on the RD to perform the company's acts. It may be that Article 349(4) is the legal basis for treating the act of RD as that of the company.

Under the PRC legal framework, it would be difficult to invoke an Article 93-like provision, if it existed. The main reason is the lack of a provision, under the PRC company law or civil law framework, which is equivalent to Article 349(4) of Japan's Companies Act. In any case, Article 16 precludes the LR from exercising the power to commit the company as surety.[150]

2. The good faith principle

The good faith approach proposed by Japanese critics is unlikely to be of assistance for Chinese judges. The difficulty of the abovementioned approach is that it involves the concept of the abuse of power. Under the Japanese approach, it will be recalled, when the RD abuses her power, the transaction is valid, unless the third party has acted in bad faith, etcetera. The difficulty of this approach is that it treats an unauthorized action of the RD as an abuse of power.

There is, however, a difference between the want of authority and the abuse of authority.[151] If this difference is recognized in Japanese law, it may be hard to resolve the issue

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Under Japan's legal framework, it would seem, the agency approach would only be relevant where the RD has acted *in excess of her power*. In this situation the RD is considered to have *abused her power*, in which case Civil Code Article 110 (Japan) is applicable by analogy. KOJI OMI, *supra* note 100, at 126-7.

[146] However, this concept is discussed in academic treatises. *See* LIXIN YANG, General Regulation of Civil Law (MINFA ZONGZE) 242 (2nd ed. Law Press China 2017).

[147] For example, the board may not delegate its powers with regard to (i) the disposition of and acceptance of transfer of important assets, (ii) borrowing in a significant amount, and (iii) the establishment, changes or abolition of significant corporate structures such as branch offices. Companies Act 2005, Article 362(4) (Japan).

[148] Companies Act 2005, Article 362(4)(i) (significant assets) (Japan); KOJI OMI, *supra* note 100, at 124 (real assets).

[149] *See supra* text accompanying note 142.

[150] SPC decision (2017) Zuigao Fa Min Zai No. 209, *see supra* text accompanying note 25.

[151] Macmillan Inc v. Bishopgate Investment Trust Plc (No 3) (1995) 1 WLR 978, 984 (Eng).

raised through the Japanese good faith approach. The RD cannot abuse a power if she does not have the power. In the Chinese context, there is a further reason why this approach is inapplicable. That is that, given the effect of Article 16, committing the company as surety is not with the LR's power.

It should be noted, however, that the good faith principle, when applied differently, can be of assistance in determining whether a third party has acted in good faith. The court, for example, may refuse to hold the alleged surety liable on the basis that the third party did not act in good faith when she entered into the transaction fraudulently or with actual knowledge that the middle person acted without authority.[152]

3. Unauthorized agency (the agency approach)

As mentioned, this avenue was successfully explored in a number of cases under review where the transaction was made by a *purporting agent*.[153] The HPCs, however, appear to be reluctant to apply Article 48 where the middleman was *the LR*. This may be because the HPCs were not sure about the applicability of Article 48 in such a situation.[154] This is understandable. The civil codes of Japan and Taiwan do not provide for the apparent authority of RDs. An analogous application of agency rules where the transaction is entered into by the RD/director without authority in the legal contexts in Japan and Taiwan is logical.

The PRC Contract Law, in contrast, does provide for the apparent authority of the LR (Article 50).[155] Article 50 was perhaps enacted with the assumption that the LR was authorized to undertake all civil juristic acts of the company.[156] This presumption, for the reasons discussed,[157] is baseless.

If it is possible for the LR to act without authority, it should be possible to follow the practice in Taiwan and resolve the case through an analogous application of the rules on agency without authority. There is no reason why the LR cannot be regarded as an unauthorized agent when she acts without authority.[158] Also, as Judge Zhou Lun Jun of the SPC observed, extra judicially, the proposition that agency rules are applicable by analogy where the purporting corporate representative is the LR has become the prevailing view (通说).[159]

4. Summation

Neither the concealment of intention nor the Japanese version of the good faith avenues is available to PRC courts. The main reason for this is the lack of an express statutory power

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[152] *See supra* text accompanying note 72.
[153] *See supra* text accompanying note 107.
[154] This is confirmed by two judges of the G province HPC, whom the author interviewed on 25 April 2019 and 29 April 2019.
[155] In the Taiwan case of (1979) Tai Shang Zi No. 2012, the court ruled that the apparent authority provision in Taiwan's Civil Code (Article 169) had no application to a statutory agent (法定代理) and a legal person's (legal) representative (代表). Japan's Companies Act does contain a rule on apparent authority of RDs, but this rule applies only where the purporting RD, given the title of president, vice president or other title regarded as having authority to represent the company, is not a RD. Companies Act Article 354 (Japan).
[156] Article 50 does not cover the situation where the LR acts without authority.
[157] *See supra* text accompanying note 151.
[158] Wang-Ruu Tseng, *Gongsi Neibu Yisi Xingcheng Zhi Qianque huo Xiaci dui Gongsi Waibu Xingwei Xiaoli Zhi Yingxiang: Jianlun Dongshi (zhang) yu Jingliren Zhi Daibiaoquan yu Daili Quan (The Effect of the Lack or Defects of the Formation of the Company's Intention on External Acts of the Company: also on the Representative Power of the Directors/the Board Chairperson and the Manager)*, 47(2) NTU LAW JOURNAL 707, 737 (2018).
[159] Lunjun Zhou, *Gongsi Duiwai Tigong Danbao de Hetong Xiaoli Panduan Guize (Rule for Determining the Validity of Contracts where the Company Provides Security to Others)*, 2015 SHANDONG DAXUE FALV PINGLUN (SHANDONG UNIVERSITY LAW REVIEW) 166, 176.

on the part of the LR to act in the name of the company generally and for the purposes of security contracts specifically. The unauthorized agency avenue, in contrast, is available. Where an unauthorized transaction is entered into by the LR, the lack of a provision on unauthorized LR should not constitute an obstacle. The decision may be made by applying rules on unauthorized agency by analogy. Also, the good faith principle may be of assistance, at least where the creditor has entered into the security contract fraudulently or with knowledge as to the lack of regularity of the transaction.

VIII. CONCLUSION

According to Liu and Li, judges of the Tianjin HPC, PRC judges do not always make their decisions according to the book. Chinese judges Liu and Li point out, when adjudicating, they typically form a view on the desirable decision outcome before looking for rules to justify their decisions.[160] The findings of the case review conducted for this project are consistent with this account of fact. Whereas HPCs allocated the risks for unauthorized contracts to the alleged surety in most of the cases, the avenues through which judges have reached their decisions vary greatly. There is, however, a resolve at the top of the echelon, as evidenced in the SPC's decision to launch the 'guiding case' system,[161] to ensure that similar cases are decided similarly. This resolve calls for an end of the chaotic state of the ways by which Article 16 cases are decided. And, the best means to achieve this is to establish a norm according to which generically similar cases are to be decided. This paper has considered the desirable shape of this norm through an analysis, conducted from a consequentialist point of view, of a large sample of HPCs' decisions. The analysis concludes that the issue raised should be resolved through the minority, i.e., the agency approach. For the reasons stated, there is no doctrinal barrier to resolve the issue through an application of the rules on unauthorized agency and apparent authority.

The issue raised is one of company law. The solutions, however, hinge on a sensible application of civil law rules. As some of the existing civil law rules (such as the provisions on the LR and those on that person's apparent authority) do not necessarily facilitate a ready solution of the issue raised, further research, as well as legislative and judicial innovation, on the reform and application of these rules are necessary.

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[160] Jia Liu and Jie Li, *Daolu Tongxiang Lifa? – Yi Gaolou Bao Wu Guize Xie Ru Lifa we Yangben de Fenxi (Avenues Leading to Legislation? – An analysis based on the enactment of the rules on (the tort of) throwing objects from a high-rise building), in* SIFA TIZHI GAIGE YU MINSHANG SHI FALU SHIYONG WENTI YANJIU: QUANGUO FAYUAN DI 26 JIE XUESHU TAOLUNHUI HUOJIANG LUNWEN JI (A STUDY OF THE JUDICIAL SYSTEM REFORM AND THE APPLICATION OF CIVIL AND COMMERCIAL LAWS: A COLLECTION OF AWARD-WINNING ESSAYS IN THE TWENTY-SIXTH NATIONWIDE COURTS' ACADEMIC CONFERENCE) 1100, 1101 (Rong He ed., People's Court Press 2015).

[161] Björn Ahl, *Rethinking Judicial Professionalism: The New Guiding Cases Mechanism of the Supreme People's* Court, 217 THE CHINA QUARTERLY 121 (2014); Susan Finder, *China's Evolving Case Law System in Practice*, 9 TSINGHUA CHINA L. REV. 245 (2017).