

Legal Analysis of Issues Related to Business Trust Disputes under the Ninth Civil Minutes

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Abstract: On November 8, 2019, the Supreme People's Court released the Minutes of the National Courts' Civil and Commercial Trial Work Conference, which not only has reached the consensus on some difficult legal issues in the current civil and commercial trials, but also has extended some problems. This paper analyses the business trust dispute and focuses on the following five questions: whether the investment with repurchase constitutes of the assignment security; whether the dispute on the contract-based asset management business of the non-trust company belongs to the business trust dispute; whether the real existence of the investment target is the precondition of the investment with repurchase; the legal basis of the invalidity of rigid payment clauses; and the reason of the amendment from “entrusted and wealth management” to “entrusted and due”.

1. Introduction

On November 8, 2019, the Supreme People's Court (hereinafter referred to as the “Supreme Court”) released the *Minutes of the National Courts' Civil and Commercial Trial Work Conference* (hereinafter referred to as the “*Ninth Civil Minutes*”), which is practice-oriented, rich in content and has reached consensus on some difficult legal issues in the current civil and commercial trials. However, there are also some problems in *Ninth Civil Minutes*. Especially, the relevant provisions in Chapter 7 of *Ninth Civil Minutes* leave some space for further discussion while unifying the standards for the trail of the business trust dispute.

Since it is not a long time till now from the publish of *Ninth Civil Minutes* and the discussion on *Ninth Civil Minutes* is still not quite much, this paper focuses on five issues involved in the business trust dispute, and discusses them by the methods of normative analysis, value analysis, logical analysis and so on, in order to further clarify the value orientation of the Supreme Court on the basis of the provisions of the *Ninth Civil Minutes* and provide some reference for other legal practitioners.

2. Analysis on whether the investment with repurchase constitutes of the assignment security

The investment with repurchase is a kind of common business mode of financing trust. Its structure of deal is roughly as follows: the trust company initiates and establishes a trust; then the trust uses the raised funds to purchase shares, accounts receivable, real estate and other specific assets or the rights to income from such specific assets owned by the financier; and the financier or a third party designated by it makes repurchase of such specific assets or the rights to income from such specific assets with the principle of the cost of initial assets transfer assets plus a premium price after a certain period of time, and provides other corresponding credit enhancement measures [1].

Article 71 of *Ninth Civil Minutes* explains the general situation of assignment security. And Article 89, Paragraph 2 of *Ninth Civil Minutes* further clarifies that the form that the “debts are secured by the shares” obtained through acquiring or increasing capital belongs to assignment security. Then, after the publish of *Ninth Civil Minutes*, does it mean that the mode of investment with repurchase which is commonly used by the trust company (on behalf of trust project, the same below) will be considered as assignment security? If such mode is deemed as the assignment security,

it means that the trust company cannot hold the underlying assets such as shares as the owner of such assets. Following that, does the trust company still enjoy the rights such as voting rights?

2.1 How to understand the provision that “debts are secured by the shares” in article 89, paragraph 2 of ninth civil minutes?

The author tends to consider that the word, “secured”, in this provision does not refer to the sense of the security in *Security Law*, since the sense of the security in *Security Law* will no longer be applicable after that the trust company obtains the shares through the way of acquiring or increasing the capital. Therefore, the notion of “secured” here refers to the “credit enhancement measure”. That means that holding of the shares by the trust company is sufficient to constitute the credit enhancement measure for the creditor's rights such as the right of claim for the payment of the repurchase price, and constitute that “that debts are secured by the shares”.

2.2 Investment with repurchase constitutes the assignment security

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After the implementation of *Ninth Civil Minutes*, investment with repurchase is identified as a kind of assignment security. The consequence of that is that what the trust company can enjoy is not the ownership of shares, accounts receivable or other debt financing vehicles, but only the priority right of compensation by auction, sale or discount of such vehicles.

On the logical path in the terms of the assignment security identified in *Ninth Civil Minutes*:

1) For the investment with repurchase in which the vehicle is shares, Article 89, Paragraph 2 in *Ninth Civil Minutes* should be applied; for the ones which refers to the repurchase of the shares by the target company itself, Article 5, which is about the stipulation of decrease of capital, in *Ninth Civil Minutes* should be applied in the meanwhile to implement the principle of capital maintenance and the principle of protecting the legal rights and interests of creditors;

2) For the investment with repurchase in which the vehicle is account receivable or other assets other than shares, Article 71 in *Ninth Civil Minutes* shall be directly applied.

2.3 Recognition of cash flow returned on shares, accounts receivable and other debt financing vehicles

Under the premise of assignment security, for the cash flow returned on the debt financing vehicle itself, the author consider that it should be in the extent of the property realization under the priority, if it is share dividends, the repayment of accounts receivable or other fund that enters into the special account of trust property. And such cash flow can deduct the same amount of the repurchase price in order to pay off the debt in advance.

2.4 Identification of the identity rights such as voting rights

Although the recognition of the assignment security in *Ninth Civil Minutes* does not support that the trust company can enjoy ownership of the shares, the author tends to consider that the identity rights as the shareholder during the period that the trust company owns the shares should not be denied. And the author tends to consider that, the directors nominated by the trust company as the shareholder and elected by the shareholders’ meeting to represent the interests of the trust company, and the exercise of the veto or other voting right by the trust company as the shareholder, should be recognized and respected. The reasons are as follows.

1) Firstly, the exercise of identity rights under shares is itself an indispensable kind to enhance the credit for the creditor's rights. In practice, it is in favor of the supervision on the target company and the project spending or collecting funds, that the trust company designates the directors, executive officers, chief financial officer and other staffs to the target company through legal

procedures. And besides the stipulation in the contracts, the identity of the trust company as the shareholder and the rights exercised through the board of directors are also the important source of the rights to exercise such designation.

2) Secondly, the shares held by the trust company usually will be registered with the company registration authority, and such registration has public credibility. It is necessary for the registered shareholders to exercise the identity rights in the normal operation of the target company, both internally and externally. For example, when the trust company holds 100% shares of the target company, if denies the validity of voting right of the trust company as the shareholder, there will be no more valid shareholder of the target company and the target company will fall into the situation of inability to operate normally.

3) Thirdly, the exercise of identity rights under equity does not infringe the interests of the share transferor. The essence that the duly ownership of the subject matter by the secured party shall be denied in the assignment security, is to reflect the principle of fairness and the principle of compensation for equal value, and to prevent the creditor's right holder or the secured party from making excessive profits by taking the advantage of the unequal status [3]. However, the exercise of the identity rights by the trust company is generally in a defensive nature. In such situation, the trust company does not fully take over the target company but exercises the identity rights under the nature of supervision and prevention. And such exercise of the identity rights does not infringe the interests of the transferor.

3. Analysis on whether the dispute on the contract-based asset management business of the non-trust company belongs to the business trust dispute

In the definition of business trust dispute, on the one hand, the Supreme Court limits the operating subjects involved in such dispute to the trust companies; on the other hand, it also stipulates that the disputes between the parties shall be complied with *Trust Law* and other relevant regulations, if the asset management business practiced by other financial institutions constitutes the trust relationship. Then, whether the dispute on the contract-based asset management business of the non-trust company belongs to the business trust dispute? Does the relevant rules of business trust dispute in *Ninth Civil Minutes* shall be applied in the trial of such business trust dispute? The author makes the following interpretation on the Supreme Court's logical arrangement about the definition of the business trust dispute.

Firstly, the Supreme Court does not have the right to recognize business trust activities.

According to the *Notice of the General Office of the State Council on Related Issues since the Trust law of the People's Republic of China Comes into Force* (Guo Ban Fa [2001] No.101), “without the approval by PBC or CSRC, neither legal persons nor natural persons may engage in for-profit trust practices in any form or in any name”. Therefore, the business trust has the nature of the franchise. And the power to recognize business trust activities shall belong to the particular regulatory authorities, but not the Supreme Court.

Secondly, the recognizing of the trust relationship by the particular regulatory authority is approved.

Trust Law and *Securities Investment Fund Law* provides that the trust and the contract-based securities investment funds belong to trust legal relationship. In addition, after the publication of *Guiding Opinions on Regulating Asset Management Business of Financial Institutions* (hereinafter referred to as the “*New Regulation on Asset Management*”), the relevant regulations enacted by China Banking and Insurance Regulatory Commission and China Securities Regulatory Commission according to the *New Regulation on Asset Management* all provides some stipulations about whether the asset management business belongs to trust legal relationship in some different extent. Such stipulations are arranged as in table 1:

Table 1 Source of the Recognizing on Asset Management Business

Serial Number	The Type of the Asset Management Business	Source
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Serial Number	The Type of the Asset Management Business	Source
1	Trust	<i>Trust Law</i>
2	Securities Investment Fund	Article 2 of <i>Securities Investment Fund Law</i> provides that: “for matters not stipulated by this Law, the provisions of the <i>Trust Law of the People's Republic of China</i> , the <i>Securities Law of the People's Republic of China</i> and other related laws and administrative regulations shall apply.”
3	Wealth Management of Bank	In the answers to the reporters’ questions on <i>Administrative Measures on Wealth Management Subsidiaries of Commercial Banks</i> , the person in charge of relevant department of China Banking and Insurance Regulatory Commission referred that, the wealth management products issued by commercial banks or subsidiaries of commercial banks shall be established according to the trust legal relationship.
4	Private Offering Asset Management Business of Securities and Futures Business Organization	In the answers to the reporters’ questions on <i>Administrative Measures on Private Offering Asset Management Business of Securities and Futures Business Organizations</i> , the person in charge of relevant department of China Securities Regulatory Commission referred that, <i>Administrative Measures on Private Offering Asset Management Business of Securities and Futures Business Organizations</i> and <i>Administrative Provisions on the Operation of Private Asset Management Plans by Securities and Futures Business Institutions</i> legally provide that all kinds of private asset management products are all established according to the trust legal relationship.

Thirdly, if the contract-based asset management dispute belongs to trust legal relationship, *Trust Law* shall be applied in the trial of such dispute. And the cause of action on such trial shall be “trust dispute”.

The author considers that the “other relevant provisions” in Article 88, Paragraph 2 in *Ninth Civil Minutes* are other relevant provisions compared to the *Trust Law*. Thus, such “other relevant provisions” also includes the provisions about business trust disputes in *Ninth Civil Minutes*. However, for the management of the causes of action, such dispute does not belong to the business trust dispute. Business trust dispute belong to the third-level cause of action under trust dispute. In accordance with the *Notice of the Supreme People's Court on the Promulgation of the revised Regulations on Causes of Action for Civil Cases* (Fa [2011] No. 42), if there is no provision for one kind of dispute in certain n-level cause of action, then the n-1-level cause of action shall be applied in such dispute. Therefore, the author considers that, the second-level cause of action, “trust dispute” shall be applied during the trial, if the contract-based asset management dispute belongs to trust legal relationship; the cause of action, “disputes over contracts for wealth management entrusted by financial institutions” or “civil disputes relating to companies, securities, insurance, negotiable instruments, etc.” shall be applied during the trial, if the contract-based asset management dispute does not belong to trust legal relationship.

4. Analysis on whether the real existence of the investment target is the precondition of the investment with repurchase

Before the publication of *Ninth Civil Minutes*, it is not accordant on whether the real financing vehicle target has to exist and has to be delivered or transferred to the trust company in the investment with repurchase in practical. It, for example, will constitute a dilemma that “without the skin, the hair will not stand”, if the financiers assigns the rights to income from the specific assets to the trust company without obtaining the certificate of title (such as certificate of land, certificate of real estate and etc.) and the financier makes repurchase of such rights to income from the specific assets with the principle of the cost of initial assets transfer assets pluses a premium price after a

certain arranged period of time, since the financier has not obtained the ownership of the specific assets when the financier assigns the specific assets to the trust company. Therefore, such structure of deal has some certain compliance risk.

In such background, Article 89, Paragraph 1 of *Ninth Civil Minutes* clears up the fog of the investment with repurchase, affirms the nature of its creditor's rights and unifies the understanding in the perspective of justice: "... the people's court shall, according to the law, support the claims filed by the trust company that the transferor or the third party designated by it is subject to liability as agreed, regardless of whether the subject matter transferred by the transferor actually exists, is actually delivered, or is registered, as long as the contract is not subject to a statutory cause of nullity."

Significance can be found in commonplace. Such regulations also show that in the face of numerous and complicated financing activities, *Ninth Civil Minutes* adopts a pragmatic attitude of substance over form. It puts aside the tangle on the debt financing vehicle targets and returns to the simple substantial justice of "the borrowed has to be repaid".

However, compared with the investment with repurchase, the requirement for the financing vehicle target in the investment with option of repurchase is not relaxed. For the investment with option of repurchase, the structure of deal is roughly as follows: the transferor or a third party designated by it has the right to choose whether to repurchase the asset or the right to income from the specific asset, or not, after a certain period of time; and the trust company has the right to dispose the trust property by itself, if the transferor or the third party designated by it does not choose to repurchase the asset or the right to income from the specific asset. Although the two types of business above-mentioned have a similar nature, in essence, the investment with option of repurchase does not belong to the creditor's-rights-type financing. Since the transferor or the third party does not bear the obligation of repurchase, the investment with option of repurchase belongs to the equity investment of the trust company [2]. Therefore, such mode does not belong to the situation in Article 89, Paragraph 1 of *Ninth Civil Minutes*, and Article 89, Paragraph 1 of *Ninth Civil Minutes* shall not be applied in such mode.

The author considers that, the contract of transfer between the trust and the counterparty of the trust in the deal may be determined to be invalid in the investment with option of repurchase, if the court cannot confirm whether the parties have agreed on the target of transfer, since that not only does not conform with the stipulations in Article 134 of *General Rules of the Civil Law* that "civil juristic acts can be based on the expression of intention of both parties or all parties", but also does not conform with the stipulations in Article 30 of *Contract Law* that "the contents of the acceptance must be identical to the contents of the offer", according to Article 1 of *Interpretation of the Supreme People's Court on Several Issues Concerning Application of the "Contract Law of the People's Republic of China"* (2) (Fa Shi [2009] No. 5) that "if the relevant parties are in dispute arising from the formation of a contract, the People's Courts shall in general find the formation valid where the names of the relevant parties, the subject matter and the quantity concerned can be ascertained, except where it is otherwise provided under other provisions of the law or agreed between the relevant parties".

According to Article 3 of *Interpretations of the Supreme People's Court on Issues relating to the Application of Law in Hearing Cases Involving Disputes over Contracts of Sales*, "where one party concerned asserts that the contract is invalid, citing that the seller does not have ownership or right of disposal of the subject matter at the time of conclusion of contract, the People's Court shall not support the assertion; where the ownership of the subject matter cannot be transferred because the seller does not have ownership or right of disposal, the buyer requests that the seller bears the default liability or requests for rescission of contract and asserts for compensation of damages, the People's Court shall support the assertion", if, when signing the contract of transfer, the transferor does not have the ownership or the right of disposing of the subject matter of transfer, or the subject matter of transfer is referred to precisely by both the parties when it does not exist in reality though. In other words, the contract of transfer between the trust company and the counterparty of the trust in the deal is concluded and valid, unless there are other conditions which may lead the contract to be not

concluded, invalid or revocable. If the transferor fails to transfer the subject matter to the trust company then, the trust company can request for the transferor to bear the default liability according to the contract of transfer.

5. Analysis on the legal basis of the invalidity of rigid payment clauses

Article 92 of *Ninth Civil Minutes* provides that “if a trust company, commercial bank, or any other financial institution as trustee of asset management products and a beneficiary enter into a contract containing clauses guaranteeing interest on the principal, guaranteeing protection of the principal against losses, and other minimum guarantee or rigid payment clauses, the people's court shall determine the clauses to be invalid”. However, *Ninth Civil Minutes* does not provide the legal basis of the invalidity of rigid payment clauses in the level of law or administrative regulation. Although *Administrative Measures on Trust Companies*, *Administrative Measures on Assembled Funds Trust Schemes of Trust Companies* and *New Regulation on Asset Management* all provides that the trust products issued by the trust companies shall not offer minimum guarantee or rigid payment, the validity level of such documents is generally low. In the author's opinion, the legal basis should be found in the principle clauses in laws and the stipulations in *Administrative Measures on Trust Companies*, *Administrative Measures on Assembled Funds Trust Schemes of Trust Companies* and *New Regulation on Asset Management* should be subsumed in the stipulations in laws or administrative regulations.

Article 153 of *General Rules of the Civil Law* provides that “the civil juristic acts that violate public order and social customs are invalid”. Article 52 of *Contract Law* provides that “in any one of the following situations, a contract shall be without effect: ... (4) There is detriment to social and public interests”. It will cause the systemic risk of the entire financial industry and might disturb the order of the financial industry and public moral of the entire society, that the existence of the minimum guarantee or rigid payment for the trust interests of the investors offered by the trust companies and other financial institutions as the trustee of asset management products. That is the essential reason of the invalidity of rigid payment clauses.

For example, in the contract dispute of Shanghai Li-Ao high and new technology investment co., LTD., v. a trust company ((2004) H. Y. Z. M. S. (S.) C. Z No. 97), the Shanghai First Intermediate People's Court said that the clause, which stipulated that the defendant should pay the fixed trust interests to the plaintiff in the Supplemental Agreement of Capital Trust Contract between both the parties, belonged to the minimum-guarantee clause and was invalid since it violated the principle of equity which the trust relationship shall comply with.

6. Analysis on the amendment from “entrusted and wealth management” to “entrusted and due”

Ninth Civil Minutes summarizes the active asset management process of the trustee as “entrusted and due”. However, such statement in the draft for comments of *Ninth Civil Minutes* is “entrusted and wealth management”. Such amendment is tiny, but quite meaningful. It not only is more precise in logic, but also reflects the core responsibilities of the trustee.

Wealth management is the core feature of asset management business. In the answers to the reporters' questions on the *New Regulation on Asset Management*, the relevant person in charge of People's Bank of China pointed out that asset management business is a kind of financial service that “entrusted and wealth management”. However, the asset management business cannot cover all the business trust business. For example, the essence of the service trust in the business trust does not belong to the asset management business to a large extent. According to the statement in the *Notice of Trust Department about Further Regulating of the Supervision on Trust during the Transition Period of Asset Management Business*, family trust and true property-right trust do not comply with the *New Regulation on Asset Management*. And such types of trust business are exactly belonged in the service trust. Therefore, taking “entrusted and due” as the characteristics of the business trust can reflect the duties of the trustee more comprehensively.

7. Conclusion

According to the relevant provisions in *Ninth Civil Minutes*, this paper selects and discusses the following issues related to business trust disputes.

1) As for the issue of investment with repurchase, the author considers that it might constitute the assignment security.

2) As for the dispute on the contract-based asset management business of the non-trust company, the author considers that it does not belong to business trust disputes, but should be recognized separately: the ones which belong to the trust legal relationship could be deemed as trust disputes, otherwise, they should belong to other causes of action.

3) For the investment with repurchase, it is not based on the real existence of the investment subject. However, for the investment with the right of option of repurchase, such issue is another matter.

4) The legal basis for the invalid of rigid payment clauses in *Ninth Civil Minutes* should be the principle clauses in *General Rules of the Civil Law* and *Contract Law*.

5) As for the amendment from “entrusted and wealth management” to “entrusted and due” in *Ninth Civil Minutes*, it is a more comprehensive summary of the characteristics of business trust.

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