

# China's Supreme Court creates scope for financing between companies

December 10, 2014

Finance-related activities are strictly regulated in China. As a general rule, loans between companies that do not have a licence to engage in financial services are considered invalid. This includes intra-group loans. But the People's Supreme Court of China recently ruled that loans between two Chinese companies are permitted if they are short-term and used for operational purposes. In addition, extending loans should not be the lender's main business activity. This new ruling will give Chinese companies more options in financing their operations.

So far, Chinese courts had based decisions to declare financing arrangements between companies without licences invalid on two main legal sources. First, in accordance with the General Rules for Loans issued by People's Bank of China in 1996, "no financing business involving lending or borrowing, or lending and borrowing in a disguised form, may be conducted among companies without mandatory license". Second, pursuant to an approval reply issued by the People's Supreme Court in 1996, "loan agreements between companies violate relevant financial regulations and therefore are invalid".

The Supreme Court's recent judgment involved an RMB 80 million loan agreement between lender Zhengzhou Jia De Property Services Limited and borrower Zhengzhou Guang Xia Real Estate Limited. The loan agreement had a term of two years and an interest and surcharge rate of 21‰ per month. Shareholders of the borrower provided a guarantee to the lender assuming joint and several liability. The borrower and its shareholders failed to repay the loan when it matured, and the lender initiated court proceedings.

The main subject of dispute in these proceedings was whether the loan agreement was valid. In deviation from previous judgments, the Supreme Court surprisingly ruled in favour of the lender and deemed the loan agreement valid. According to the Supreme Court, a loan provided by a Chinese company that is not licensed to provide financial services does not violate China's financial laws and regulations and should therefore not be deemed invalid if:

- the loan is short term
- the regular business of the company is not financing
- the purpose of the loan is to provide funds for production or business operational uses.

Before this ruling, the Supreme Court would be concerned that a company providing loans without a licence could affect the State's financial administration. But the Supreme Court now seems to have changed its mind. The judgment is, however, specific to this

case. It therefore continues to be important to carefully plan financing between companies in China.

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