Study on Internal Recovery Mechanism of Mixed Joint Guarantee

Nan Zeng
School of Law, Civil and Commercial Law, Macau University of Science and Technology

Abstract: To protect creditors’ rights and interests and share the risk of the debtors’ impossibility of performance, creditors usually request both personal security and real security in the same debt, which is called mixed joint guarantee. And the recovery of mixed joint guarantee falls into two categories, external and internal. With the provision of six legal documents, namely the Guarantee Law, the Judicial Interpretation on the Guarantee Law, the Property Law, Minutes of the National Courts’ Civil and Commercial Trial Work Conference (The Minutes), the Civil Code and the Judicial Interpretation on the Guarantee System of the Civil Code, external recovery has been largely solved. If the debtor fails to perform the debt due, the creditor has the right to choose either personal security or real security to realize the claim. However, internal recovery remains highly controversial. When the agreement is unclear, whether the guarantors can recover compensation from each other has always been stipulated differently in the law. Accordingly, some similar cases have been treated dissimilarly, and two opposite views have also emerged in the academic field. Facing this problem, the latest Judicial Interpretation of the Guarantee Law as the core basis, and supports the implementation of an internal recovery mechanism, to achieve the unity of theory and application in practice, lay a good foundation for the rule of law for the business environment, stimulate the market vitality and exert the rule of law as a guardian of economic development.

Keywords: Mixed joint guarantee, Internal recovery.

1. Presentation of the Problem

According to the analysis of the cases retrieved from “China Judgements Online”, “PKULAW” and other legal search websites, it is easy to find that courts around the country have different tendencies and reasons in deciding the internal recovery of mixed joint guarantee.

Courts that hold that guarantors can recover compensation from each other have two reasons for their decisions. First, based on the core principles of fairness and good faith, it is more in line with the fairness and justice in civil law that guarantors can recover from each other. Second, with the Judicial Interpretation of the Guarantee Law as the core basis, it is not improper to apply the Judicial Interpretation of the Security Law where the Property Law is silent on this issue but the Judicial Interpretation of the Guarantee Law has provisions on it.

Other courts that consider that guarantors cannot recover from each other also have two reasons. First, mutual recovery between guarantors has no legal and logical basis and cannot be supported. Second, the law only states the right to recover from the debtor and does not support mutual recovery between guarantors. From the above analysis, it can be seen that there is not yet a unitive tendency in judicial practice on the issue of internal recovery of mixed joint guarantee.

The reason why there is no a unitive judgment tendency in judicial practice is largely due to the changes in the legal provisions. There are six legal documents that have provisions of this issue, in chronological order, namely the 1995 Guarantee Law, the 2001 Judicial Interpretation on the Guarantee Law, the 2007 Property Law, the 2019 Minutes of the National Courts’ Civil and Commercial Trial Work Conference, the 2021 Civil Code, and the 2021 Judicial Interpretation on the Guarantee System of the Civil Code.

Then, can a guarantor who has assumed responsibility for a guarantee recover from a guarantor who has not assumed responsibility for the guarantee? Article 28 of the Guarantee Law does not provide for this. Article 38(1) of the Judicial Interpretation on the Guarantee Law gives recovery of the corresponding share from other guarantors. Article 176 of the Property Law does not provide for this. Article 56 of the Minutes provides for non-recovery from other guarantors. Article 392 of the Civil Code does not provide for this. Article 13 of the Judicial Interpretation on the Guarantee System of the Civil Code provides for recovery from other guarantors in the case of joint and several guarantees.

In academic fields, there are views for and against the issue of internal recovery of mixed joint guarantee. Among them, the supporting view is the “affirmative theory” represented by Liming Wang, and the negative view is the “negative theory” represented by Jianyuan Cui.

The reasons for the affirmative theory can be divided into four points. First, affirming recovery is in line with the concept of fairness and justice and fits the public’s simple feelings towards the law. If the right of recovery among co-guarantors is denied, it means that the creditor has an absolute say on who bears the liability of the guarantee, which depends entirely on the creditor’s choice of guarantors. However, it is inevitably unfair, for some guarantors will not bear any responsibility, while others will bear excessive responsibility. In the end, those who bear excessive responsibility pay the whole, while others pay nothing. Second, affirming recovery helps to spread the risk, thus encouraging guarantees, and is also more conducive to financing and securing the realization of claims. The affirmative recovery approach is equivalent to creating an insurance policy for the guarantor that alleviates the guarantor’s concerns about providing the guarantee beforehand and shares in the guarantor’s liability for the guarantee after the fact. Third, the denial of recovery may...
trigger an ethical crisis. Ethical crisis refers to a creditor colluding with a guarantor in bad faith to harm the interests of other guarantors. For example, a guarantor who provided real security colludes with the creditor maliciously and asked the creditor to directly request another guarantor to assume all the guarantee responsibilities, leading the guarantor to the brink of bankruptcy without incurring any liability of his own. Fourth, affirming the right to recovery is consistent with general international legislative practice. The difficulties in system design should not be used as an excuse to sacrifice the fairness and justice that the law should uphold.

The reasons for the negative theory can also be divided into four points. First, if the recovery is affirmed, there is a risk of imposing joint and several liabilities on the guarantor, which violates the autonomy of will. When creating security for a debt, if the guarantor of property or the guarantor of credit does not enter into a joint guarantee or even know that there are other guarantors in the debt, each guarantor shall have independent legal status. Second, from the perspective of systematic interpretation, the Guarantee Law and Judicial Interpretation of Guarantee Law are old laws as compared with the Property Law. According to the principle of “the new law is superior to the old law”, the Property Law should be applied to this issue. Moreover, as the Civil Code fully inherits the expression of the Property Law, it is impossible to conclude that the right of recovery is affirmative. Third, if recovery is affirmed, the share of recovery is difficult to calculate, and the recovery system is difficult to design and lacks a practical formula. After guarantors recover from each other, they still end up recovering from the debtor, adding to the cost of the recovery procedure. What is more, once the debtor’s funds recover and some of the guarantees are paid off, the original share between the guarantors will change, resulting in uneven shares, which will easily lead to secondary litigation. Fourth, denying the right of recovery can force the guarantor to increase his duty of care when establishing the guarantee and examining the debtor’s financial status and credit, hence reducing the cost of recovery.

In summary, the issue of internal recovery of mixed joint guarantee has different tendencies and perspectives in judicial practice, legal regulations, and academic theories, which is precisely the problem that makes this issue difficult to truly solve.

2. The Jurisprudential Basis for Affirming Mutual Recovery between Guarantors

There has been a long-standing discussion in Chinese jurisprudence about the right of recovery between mixed co-guarantors, with the majority of proponents. As for the jurisprudential basis of the affirmative view, there are roughly four doctrines elaborated by the academia, namely, the true meaning doctrine, the vicarious discharge doctrine, the unjust enrichment doctrine, and the joint and several debt doctrines.

The core logic of the true meaning doctrine is to affirm the existence of internal recovery by inferring the true meaning of the guarantor. When the guarantor knows that there are other guarantors besides himself who also guarantee the debt, his true meaning will probably turn into that all guarantors should share the amount of the debt and be jointly liable for the guarantee, rather than only one person. As a jurisprudential basis for affirming internal recovery, the true meaning of doctrine has been challenged by most scholars. Firstly, the guarantor’s intention at the time of signing the guarantee contract should be explored, rather than the subsequent change of mind. The intention is fixed from the time the guarantor enters into the guarantee contract with the creditor, and no matter how the guarantor’s state of mind changes afterward, it should not affect the original agreement with the creditor. Secondly, the autonomy of the will is the spirit of private law handed down from ancient Rome. After all, the true meaning is a presumption of the guarantor’s true meaning, not an expression of the guarantor’s true meaning. After knowing that there are other guarantors, it is acceptable for the guarantor to hope that the other guarantors will be liable so that he or she will be “spared”. Therefore, the theory of true meaning cannot be used as the legal basis for affirming the internal recovery of mixed joint guarantee.

The core logic of the vicarious discharge doctrine is to make the guarantor who has assumed responsibility for the guarantee subrogated to the rights of the creditor and thus entitled to recover from other guarantors who have not assumed responsibility for the guarantee. It is based mainly on Article 523 of the Civil Code, which emphasizes that “third parties unrelated to the legal relationship” pay off the debt, while the guarantor in the context of a mixed joint guarantee assumes the role of the debtor rather than the third party under the guarantee contract. Therefore, the vicarious discharge theory does not apply to the situation of internal recovery of the mixed joint guarantee.

The core logic of the unjust enrichment doctrine is to allow a guarantor who has undertaken liability to recover from other guarantors who have not assumed the guarantee responsibility based on unjust enrichment. However, if the existence of internal recovery is denied, then the creditor has the right to choose any guarantor to take the responsibility, and there will be no unjust enrichment. On the contrary, if the existence of internal recovery is affirmed, the guarantor who has assumed the responsibility for the guarantee can make up for its own losses by recovery, then there is no such thing as unjust enrichment. Therefore, in both cases, unjust enrichment cannot be the jurisprudential basis for internal recovery.

The core logic of the joint and several debt doctrines is that each guarantor is liable to the creditor based on the guarantee contract, one guarantor assumes full responsibility for the guarantee, and the rest of the guarantors are immediately released from liability. Any guarantor can recover from the debtor after assuming responsibility, and the creditor can only receive an amount not exceeding the amount guaranteed with the debt. The guarantors are of the same rank and have the same right to payment, which is in accordance with Article 518 of the Civil Code.

3. Suggestions for Improving the internal Recovery of Mixed Joint Guarantee

Article 13 of the Judicial Interpretation of the Security Regime of the Civil Code, which came into effect in 2021, initially establishes an internal recovery system for mixed joint guarantee, i.e., the right of recovery between guarantors.
is generally viewed negatively and is affirmed only in exceptional cases. Specifically, first, the right of recovery between guarantors is generally not supported. Second, unless otherwise agreed by the parties, i.e., if the guarantors agree on mutual recovery and their shares, they will do so according to the agreement and has no need for legal intervention. Third, where joint guarantee or recovery is agreed but no recovery share is not, the share that is not recoverable from the debtor should be shared proportionately among the guarantors. Fourth, although there is no agreement on joint and several joint guarantee or mutual recovery, the same guarantee contract is signed, sealed and fingerprinted. The law also presumes such cases as joint and several co-guarantee between guarantors who can recover from each other.

There are three inadequacies in the above provisions. First, in cases where joint guarantee or recovery is agreed but recovery share is not, the amount that each guarantor can not recover from the debtor shall be shared proportionately. But how should it be shared “proportionally” is not elaborated in the judicial interpretation? Second, the judicial interpretation only states in a general way that guarantors who sign the same guarantee contract are considered to be jointly and severally liable. Is this provision unfair? Does it need to take into account involuntary situations such as fraud, coercion, and situations of signing, stamping, and fingerprinting at different times? Third, to avoid burdensome litigation, should the right of recovery be limited to one time in the case of joint and several co-guarantees? The reason why the negative theory is against the right of recovery is that it is likely to cause secondary litigation and increase the burden of court trials. For example, after complementing the share division, once the debtor’s funds are returned and the individual guarantors are paid off, the already balanced relationship within the guarantors will be broken again, resulting in a situation of circular recovery between the guarantors.

For the first question, how can the pro rata share of the amount among the guarantors be specified in more detail? I think we should refine it in two ways. First, how can “proportional” be understood? It is somewhat controversial whether the amount of contribution should be calculated in proportion to the sum of the maximum risk to be taken by each guarantor and the maximum risk to be shared by all guarantors together, or in proportion to the respective expected liability when the creditor holds the guarantor liable. The comparison of the two options shows that the first option is an objective maximum risk ratio, reflecting the risky and somewhat equitable nature of the security contract. The second option is based on the creditor’s subjective choice, which is somewhat arbitrary and speculative. Second, how can the term “different guarantees” be understood? The existence of both personal security and real security in a mixed joint guarantee should be taken into account, as the market value of the collateral changes with the change of supply and demand in the market. If the liability of the physical insurer is greater than the market value of the collateral, it is suspected to be too harsh on the physical insurer, whose liability is limited by the value of the collateral. Therefore, considering the two points above, in the case of joint and several co-guarantees or mutual recovery is agreed upon, but the share of recovery is not, the amount that each guarantor cannot recover from the debtor should, firstly, be calculated in the ratio of the maximum risk that each guarantor needs to bear to the maximum risk that all guarantors need to bear together so that each guarantor can share. Secondly, paying particular attention to changes in the market value of the collateral, the share of a guarantor of property is limited to the market value of the collateral, even if the share required for the first step of the proportional calculation exceeds the market value of the collateral. Thirdly, the share of the first proration that exceeds the market value of the collateral should be calculated as the ratio of the maximum risk to be taken by all guarantors other than the guarantor of property to the maximum risk to be borne by all guarantors collectively. For example, K owes a debt of $15. A provides a maximum guarantee of $5, B provides a maximum guarantee of $4, C provides a maximum guarantee of $3 and D provides a physical guarantee of $3. K has only repaid $3 to the creditor, leaving $12 outstanding. At this point, A is liable for $12 × [5 ÷ (5 + 4 + 3 + 3)] = $4, B is liable for $12 × [4 ÷ (5 + 4 + 3 + 3)] = $3.2, C is liable for $12 × [3 ÷ (5 + 4 + 3 + 3)] = $2.4, and D is liable for $12 × [3 ÷ (5 + 4 + 3 + 3)] = $2.4. If the market value of Ding’s collateral decreases at this time and only has a value of $2. Then D is liable for $2 yuan, A is liable for 4 + [(2.4 - 2) × [5 ÷ (5 + 4 + 3 + 3)]] = $4 + $1/6, B is liable for 3.2 + [((2.4 - 2) × [4 ÷ (5 + 4 + 3 + 3)]) = $3.2 + $2/15, C needs to bear 2.4 + [(2.4 - 2) × [3 ÷ (5 + 4 + 3 + 3)]] = $2.4 + $1/10 of guarantee liability.

As to the second question, how to view the existence of fraud, duress, and other involuntary situations in the same security contract and the situation of separate signatures, seals, and fingerprints at different times? From my perspective, for starters, if there is involuntary fraud, coercion, malicious collusion, etc. in the guarantee contract, it will be dealt with in accordance with the provisions of the Civil Code on the validity of civil legal acts. Second, if there is a situation that the guarantor signed, stamped or fingerprinted at different times, the true intention of the guarantor should be investigated. Whether the guarantor who signed before the guarantor knew about the guarantor who signed after the guarantor, and whether he or she had the intention of joint and several joint guarantees should be known.

As to the third question, should the right of recovery among guarantors be limited to one time? In my opinion, the principle of one-time exhaustion of the right of recovery should be stipulated. When a guarantor claims the corresponding share from individual guarantors based on the right of recovery, the lawsuit can only be filed once and cannot be filed repeatedly because the right of recovery is not realized. The reason why the negationists oppose the right of recovery is that the affirmative right of recovery is likely to cause secondary litigation and increase the burden of the court to receive cases. Therefore, even if recovery is affirmed, the guarantor’s right to recover against other guarantors should be limited to once. Otherwise, once the debtor’s share has been shared, the balance between the guarantors will be broken again once the debtor’s funds are returned and the individual guarantors are paid off, and a circular recovery situation between the guarantors will occur.

On the technical side of the legislation, the sharing of liability between co-guarantors is a complex calculation problem that has deterred both the Legislative Affairs Commission of the Standing Committee of the National People’s Congress and the Supreme People’s Court. With the gradual development of
the economy, the situations of mixed joint guarantee will only become more and more complicated, and the situations involving internal recovery will also get complicated, in which the problem of share calculation is even more difficult. In this regard, I believe that the situation of internal recovery can be typologically divided and the calculation of each type of share can be demonstrated by a model mechanism so that courts around the nation can be familiar with and imitate the operation.

In judicial enforcement, the existence of the internal recovery relationship of mixed joint guarantee is affirmed, which can effectively prevent the phenomenon of malicious collusion between creditors and guarantors to the detriment of other guarantors. But at the same time, there will be a situation of malicious collusion between enforcement judges and guarantors. The guarantor and the enforcement judge collude in bad faith to deliberately delay their execution and slow down the progress of other guarantors’ recovery in order to obtain time benefits and transfer their personal property, which eventually leads to unsuccessful execution. In this regard, the enforcement rules of the courts should be strictly standardized and standardized, the supervision and reporting channels should be increased, and the penalties should be increased.

In terms of institutional safeguards, through the retrieval of the above cases, it can be found that in practice, most of the mixed co-guarantee internal recovery disputes exist in financial loan disputes, and the subjects involved are usually small guarantee companies or financial institutions and other organizations. Therefore, financial institutions can be required to add standard clauses such as “right of recovery between guarantors” when entering into a guaranteed contract in the form of company management regulations to establish the right of recovery in an agreed form, so as to ensure the fairness of the future sharing of debts and the liability of disputes.

4. Conclusion

With the initial establishment of the internal recovery mechanism in mixed joint guarantee in the Judicial Interpretation of the Guarantee System of the Civil Code, the legislative, judicial, and academic controversies on this issue in China should come to an end. On the basis of affirming the existence of internal recovery of mixed joint guarantee, we should perfect the areas where the current legal provisions are not detailed enough, and complement them with other measures to assist in implementation, so that this mechanism can play the role of stimulating market vitality and promoting economic development.

References

[22] He Jian. Out of the “fair” misunderstanding of the internal recovery of joint guarantors: the interpretation