

Comparative Analysis on the Legal System of Shareholding Between China and Foreign Countries

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Abstract: There is a gap in the domestic legal system regarding the regulation of shareholding in lieu of ownership. Compared with the earlier common law and civil law countries, it is not perfect. In practice, problems arising from shareholding are frequent, and the imperfection of the law has led to many different judgments in the same case. By combing through the current situation of shareholding in China, it is found that the most prominent issues in practice are the determination of the validity of shareholding agreements and the criteria for determining the eligibility of shareholders. This article compares the current systems in common law countries and civil law countries, and concludes that the incorporation of the trust model into the regulation of shareholding, combined with the commercial appearance doctrine to protect bona fide third parties is more in line with the domestic situation, and has certain feasibility.

Keywords: shareholding by proxy, extra-territorial legal system, shareholder recognition, nominee shareholders

1. Introduction

With the further development of China's socialist market economy, more and more people are realizing the importance of investment as a way to create wealth, and among the many investors, some have chosen to sign agreements with others to make capital contributions in the capacity of a nominee shareholder. However, the nature of anonymous shareholders has also led to a variety of disputes arising in the course of actual business activities, which has led to numerous lawsuits in judicial practice regarding the issue of nominee shareholding. Regrettably, the current legal system in China does not regulate the act of "proxy shareholding", and there is still a large gap in the relevant laws and regulations, which has led to a large number of lawsuits concerning proxy shareholding in judicial practice. This has led to a large number of "different judgments in the same case" in judicial practice.

In contrast, the legal systems of the shareholding systems in Europe, the United States, Japan and other countries have started earlier and have matured to date. This article will use empirical analysis to illustrate the prominence of the problems related to shareholding in China's current judicial practice, explore the feasibility of transplanting the shareholding systems of the two major legal systems by means of literature research and comparative analysis, and draw on the legislative principles and ideas of foreign countries in order to provide reference for the construction of China's shareholding system.

2. Deficiencies and Shortcomings of the Existing Domestic Legal Regime for Shareholdings in Lieu of Shares

Shareholding, as a practically widespread practice in commercial activities, is not clearly defined in our current legal system. The concept of "nominee shareholding" means that the actual contributor, for his or her own or other special reasons, chooses to enter into a nominee shareholding agreement with another person, who acts on his or her behalf in respect of the rights and obligations of the shareholder. The person who enters into the agreement with the beneficial owner is generally referred to as the nominee shareholder, whose name appears in the business register or register of shareholders, while the actual contributor is referred to as the nominee shareholder and cannot be found in the business register or register of shareholders. Due to the existence of such characteristics of nominee shareholders, the current legal system in China does not provide a perfect regulation of them, which has given rise to many problems in judicial practice.

2.1. The Validity of a Shareholding Agreement

A shareholding agreement is generally considered to be a contract formed by agreement between the parties, but not all shareholding agreements will be considered valid in judicial practice. The validity of a shareholding agreement is determined by whether the agreement is invalid as a civil action under the law. In reality, the nature of a shareholding agreement may vary depending on the actual circumstances. The most complex of these agreements is the "circumventing shareholding agreement". A "circumvention agreement" refers to an agreement with another person to avoid the legal requirements and risks associated with a shareholding agreement. Through the analysis of the above case law, it is easy to see that the judge's judgment is mainly based on whether the act of proxy holding has disturbed the socialist market economic order and whether it has violated public order and morality. Although Article 31 of the Summary of the Work of the National Courts in Civil and Commercial Matters has clarified this issue, i.e. it has been left to the people's courts to consider whether it is contrary to public order and morality in the light of the specific circumstances, this provision has also led to excessive discretionary power of judges, which makes it difficult to make uniform decisions in judicial practice, and this problem is also the main reason for the emergence of "different judgments in the same case [1]. It is worth noting that in 2011, the Supreme People's Court issued Interpretation (III) of the Company Law, which for the first time regulated the holding of shares in lieu of shares [2]. The legitimacy of shareholding is also evident. However, the China Securities Regulatory Commission (CSRC) has also stipulated that the shareholding of a stock issuer should be open and clear, which means that listed companies are expressly prohibited from having shareholdings [3]. The conflict between departmental regulations and judicial interpretations further demonstrates that there is still much room for improvement in China's current laws and regulations to regulate proxy shareholdings.

2.2. The Issue of Determining the Qualification of a Nominee Shareholder

The hidden shareholders will not be found from the register of shareholders as well as the industrial and commercial register because of the special nature of their identity. As an actual contributor to the company, the qualification and protection of the rights and interests of the hidden shareholders become problematic. Although the Company Law Interpretation (III) issued by the Supreme People's Court in 2011 covers to a certain extent shareholding and hidden shareholders, it does not give a precise method to determine the qualification of shareholders, and judges lack uniform standards when deciding relevant cases, making it difficult to protect the rights and interests of actual contributors [2]. In judicial practice, the most frequent problem is that the exercise of shareholders' rights by conspicuous shareholders on the basis of commercial appearanceism has touched the

interests of actual contributors, which has led to a few disputes. In his paper, Wang Shunhua listed the possible problems: is the relationship between the two a loan or an implicit investment relationship or some other legal relationship? How is the distribution of interests between the two balanced and who should bear the responsibility when liability is required? [4] It can be seen that the confirmation of the qualification of the hidden shareholder is not only related to the interests of both the hidden shareholder and the apparent shareholder, but also to the future development of the company and even the protection of the rights and interests of external creditors.

At present, the domestic academic community has three views on the identification of shareholders' qualification: formal, substantive and compromise. Some scholars believe that the formal theory should be adopted to identify the shareholders' qualification in shareholding, and when dealing with internal disputes between parties to shareholding, it is sufficient to deal with them in accordance with the relevant provisions of contract law [5].

3. A Review of Overseas Legal Regimes on Shareholding

3.1. Common Law Countries

A trust is a trust in which the owner of property is given possession of the property to another person, in this case the trustee, who takes possession of the property and has the right to use and dispose of it, but the parties agree to give the profits wealth to a specific person to achieve a specific purpose. The trust legal system has been developed in common law countries, and these countries also generally use their mature trust system to regulate the holding of equity, treating the holding of equity as a trust relationship, so as to protect the legitimate rights and interests of the parties. This article takes a few major common law countries as examples.

Firstly, in the United States, under US law, shareholders are divided into registered shareholders and beneficial shareholders, both of whom are required to register and both of whom have the status of shareholders, but the rights of shareholders are mainly exercised by the registered shareholders, i.e. the trustees, while the beneficial shareholders enjoy only some of the rights, such as the proceeds from equity and the right to bring shareholder representative actions. According to domestic scholar Zhao Dan, the US company law does not contain strict provisions on the proxy system, and the provisions on voting trusts, although also transferring shares to a trust, are essentially voting trusts, which are somewhat different from the proxy system in China, but still have considerable significance [6]. In practice, the US law does not impose too many regulations on shareholdings in lieu of shares. Listed companies may carry out shareholdings in lieu of shares provided that they have fulfilled their disclosure obligations, but only if the beneficiary shareholders benefit from the disclosure obligations of the company's share holders and disclose the actual beneficiaries. In general, the United States regulates the relationship of proxy shareholding based on the trust system, which on the one hand affirms the shareholder status and rights enjoyed by the nominal shareholders, and on the other hand makes the actual contributors also enjoy certain rights through a strict disclosure system and procedures, such as filing shareholder representative actions and urging the trustee to fulfill its obligations, in order to protect their interests.

Turning to the UK, the law in the UK provides that shareholder status is determined by the register of shareholders of the company, thereby recognizing the legal status of nominee shareholders. Trusts of share rights are also permitted, but must be registered with the company and do not recognize the status of a nominee shareholder. However, this does not mean that the actual contributor is unable to defend his or her legitimate rights and interests once the trust has been made. In judicial practice, the shareholding agreement is generally regarded as a trust agreement, and the actual contributor can defend his or her interests by filing a lawsuit, or use it to require the trustee to fulfil his or her obligations. In order to prevent the shareholding relationship from affecting the normal operation of

the whole company, UK company law also provides that the company's right to manage the shares will not be affected by any trust relationship, which effectively prevents the company from being involved in shareholding disputes between the beneficial owner and the trustee.

Similar to the United Kingdom and the United States, Australia requires that the legal shareholders are those listed on the register of shareholders and that the liability and obligations of shareholders are borne by the nominee shareholders. Even if the actual contributors are named on the register, only the nominal shareholders are recognized as legal shareholders in order to ensure the stability of the company. At the same time, however, Australian law allows for the existence of equity trusts and there is specific trust law governing the relationship between beneficiaries and trustees.

In summary, most common law countries recognize only the registered shareholders as legal shareholders in order to ensure the long-term development of the company, thus ensuring the stability of the company's management and operation. Disputes between beneficiaries and trustees are dealt with by establishing a separate trust relationship, whereby beneficiaries can assert their rights and interests against the trustees under the trust system, while avoiding too much contact with the company. In this model, the rights of the shareholders of the company are separated from the beneficiaries and investors who lack experience in corporate governance are not involved in the decision making of the company, which improves the efficiency of corporate governance and facilitates the flow of funds.

3.2. Civil Law Countries

Germany, a representative of civil law countries, for example, generally follows a strict appearance doctrine when dealing with the issue of shareholdings in lieu of shares. In other words, the determination of shareholder qualification is generally based on public notice and registration. In addition, Dan Zhao mentioned that Germany requires not only internal registration of the company's shareholders, but also registration by the external commercial register of the company [6]. Under the dual registration system management, there is no way for the hidden shareholders in shareholding to obtain shareholder status. Section 15 of the German Commercial Code (HGB) specifies that a nominee agreement with a nominee shareholder is binding only between the two parties, which is an indication of the enhanced protection of the interests of third parties in transactions under German company law [7]. From this perspective, it will be difficult for the beneficial owner to legally seek an interest in the identity of the company, but the property rights of the beneficial owner are preserved.

It has been mentioned in the literature that although Germany does not legislate to recognize the qualification of an implicit shareholder, in practice it is recognized that whoever is the owner of the contributed property has the right to act as a beneficiary and to have direct management rights over the property to which they have contributed [8].

In Japan, the academic community generally distinguishes between the internal legal relationship of a company and the external legal relationship of a company. In the case of relationships within the company, i.e. between the actual contributor and the nominal shareholder, the intention of both parties to the nominee agreement must be respected and the validity of the agreement recognized, and the issue resolved within the framework of the principle of autonomy. In the case of the relationship between the company and third parties, the commercial appearance doctrine is followed and the rights of shareholders are exercised by the conspicuous shareholder in accordance with the name registered in the register of shareholders. The Japanese company law does not directly reject shareholding, but there are relevant punitive provisions against mismanagement of the company. This approach has the effect of maintaining the stability of the company's operation to a certain extent, but does not actually solve the problems that may arise in the process of shareholding.

On balance, civil law countries generally follow a strict commercial appearance doctrine in dealing with issues between the company and third parties by the exercise of shareholders' rights by the visible

shareholders on the register, which facilitates the day-to-day management of the company and directly negates the identity power of the actual contributors in the company. However, such an approach has the potential to undermine the rights and interests of the actual contributors and discourage investment.

4. Analysis of Overseas Shareholding Systems by Reference

The relevant legal systems in foreign countries have an early start and are more mature in development. With full consideration of China's national conditions and economic development, learning from overseas legal systems dealing with shareholding can effectively help China improve relevant laws and regulations, regulate the act of shareholding, reduce the risks that may arise in business activities and promote the healthy development of China's society and economy.

In China's judicial practice, the validity of the shareholding agreement is the focus of much controversy. Taking into account the extra-territorial system, the nature of the shareholding agreement should first be determined, with reference to the common law system, based on the high similarity of the behaviour and motives of the parties to the shareholding agreement and the parties to the trust relationship, it is more appropriate to consider the shareholding agreement as a trust relationship. In a trust system, the actual contributors can safeguard their legal rights through their rights of supervision and termination, and avoid being caught in a passive situation due to the exercise of the rights of the conspicuous shareholders to dispose of their shares, effectively balancing the interests between the actual contributors and the conspicuous shareholders. In addition, China's domestic legislation already has trust-related legislation, and it is clearly more practical to regulate the relationship of shareholding on a corresponding basis. Some domestic scholars have also argued for the high similarity between the trust model and the shareholding model, both of which not only require the original property owner to proceed on the basis of trust in the other party, but both have a clear transfer of property and a very similar subsequent management disposition [9]. Combined with commercial appearance doctrine, a trust-based shareholding relationship can effectively prevent business conduct between the company and bona fide third parties from being interfered with by intra-company shareholding disputes, contributing to the long-term development of the company and the domestic economy.

As regards the criteria for determining the qualification of shareholders, it is recommended that the industrial and commercial register and the register of shareholders of a company be taken as the main basis, taking into account the principle of "commercial appearanceism" of the civil law system. Firstly, this approach is similar to our legislation in areas such as real estate registration, which helps to standardize and unify the spirit of the legislation. Secondly, legislation that is similar to existing legislation is also more accessible to the public. In combination with the trust system, the "commercial appearance doctrine" protects the rights and interests of bona fide third parties, while the "fiduciary relationship" regulates the relationship between the actual contributor and the apparent shareholder within the company, giving the actual contributor certain rights against the exercise of the apparent shareholder's right to dispose of the shares. It has been argued that, in principle, an incognito shareholder should not be protected against the creditors of a nominal shareholder, but when the creditors of a nominal shareholder do not have a reliance interest worth protecting, the incognito shareholder should be protected in preference to the nominal shareholder [10]. By regulating the holding of shares, the interests of all parties can be balanced, the potential risks reduced and the stable and healthy development of the social economy promoted.

5. Conclusion

The emergence of the phenomenon of shareholding is an inevitable product of the development of the market economy. Both for the market and for investors, shareholding can play a positive incentive role, stimulate market dynamics and promote the market economy towards prosperity. However, the emergence of new phenomena means that we must have new ways to adjust them and prevent various legal problems and legal risks from arising. In this paper, through a comparative analysis of the different responses adopted by common law and civil law countries in dealing with the act of proxy holding, it is found that, on the basis of the existing trust system in China, the act of proxy holding is incorporated into the "trust relationship", combined with the "commercial appearance" principle in civil law countries to protect third parties. In addition, it is found that, based on the existing trust system in China, the trusts are incorporated into the "trust relationship", and the rights and interests of third parties are protected by the principle of "commercial appearance" in civil law countries. However, the research on the legal aspects of shareholding in this paper is only at the theoretical level and lacks data support. In the future, we can further explore the strategies to deal with the issue of shareholding on the basis of summarizing the cases in judicial practice, so as to help regulate the act of shareholding and make it truly play a positive role in stimulating the development of the market.

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