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Dr. Yu has also written nearly 30 academic articles in some renown Chinese journals such as *Tribune of Political Science and Law*, *Law Science*, and *Taiwan Civil and Commercial Law*, e.g., "Challenge on the Independent Liability of Legal Persons", *China Law Science* (No. 1, 2001), and "Constructing a New Model of Multiple Corporate Governance Organs in China", *Peking University Law Journal* (No. 1, 2008).

Because of his academic achievements in both substantive and procedural laws, company law, the judicial system, as well as his contribution to China's legal theory research and legislative and judicial development, Dr. Yu has been appointed as a part-time professor and researcher at such renown Chinese law schools and

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Translators' Preface

Company law is closely related with the modern market economy, which is an important factor for an investor to enter the market. Any formation and development of the market economy cannot be achieved without the market players in a country. While the company is the most fundamental, important and regulated market player, corporate law is a branch of law governing corporate establishment, governance and dissolution and balancing the rights and interests among the stakeholders, which constitutes the most fundamental and essential part of the legal system on the market economy in a country.

In China, along with the development of market economy, the legislature made four amendments to the *Company Law of the People's Republic of China* ("Company Law") in order to meet the practical demands for business transactions, to encourage active investment of various market players, and thus to secure healthy development of market economy. Meanwhile, we may notice that the number of disputes over company law has been increasing with market transactions and the parties' stronger awareness of protection of rights in China. Moreover, the practice requires the guidance from the authority on how to apply the *Company Law* and other relevant laws and regulations. Thus, several interpretations on the application of the *Company Law* were promulgated by the Supreme People's Court of China as a result.

It can be said that China is moving toward establishing a modern corporate law system in line with both its own national practice and international practice. But in the process of exploring a legal system compatible with the current social development model, China does not only draw on the legislative achievements of civil law system, but also absorbs the theoretical research of common law countries. Under the tradition of civil law system, the case in China does not constitute the legal source of private law, so the effective rulings and judgments do not have the binding force of *stare decisis* on the subsequent cases. However, through the identification and research of these cases, we can observe how the specific legal provisions are applied and understood by judges in China's judicial practice.

This book is divided into two parts, combining both theory and practice. The first part is an overview of China's company law system, mostly focusing on the historical evolution process of Chinese company law, from which readers can understand the business organisation

Chapter 1

Overview of China's Company Law

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I. Historical Development of China's Company Law*

From the commercial operation practice of corporate models worldwide and the history of corporate legislation, we can clearly see that the development of China's corporate system has been delayed for a long time, and has now mostly drawn on the achievements of the Western corporate system. For China, "company" is actually an exotic term. This does not mean, however, that China lacks early exploration and practice of commercial operation models. In fact, any country is bound to develop its own commercial operation system and corresponding organisational modes along with its social and economic development to a certain extent. Accordingly, it is necessary to understand China's early commercial operation modes and to appreciate the historical development of its company law system.

A. Business Organisation and Operation Model in Ancient China

Under the traditional economic model, what corresponded with the small-scale farming economy and family property right in China was the imperial-centred state property ownership, just as the saying goes, "All land belongs to the King". Even the handicraft industry based on the small-scale farming economy was mainly controlled by the government. The urban handicraft industry, which survived from the extrusion of the small-scale farming economy and the government-controlled handicraft industry, opened new channels for the development of limited commodity economy in the feudal society. When it comes to the Ming Dynasty (1368–1644) and Qing Dynasty (1616–1911), China's commodity economy was unprecedentedly dynamic, and reached a new height of prosperity. Thus, some Chinese scholars point out: "After the middle period of the Ming Dynasty, the developed commercial cities and the well-built business routes promoted the emergence of merchant class. In the Ming and Qing dynasties, a great number of original commercial capitalists appeared in such provinces as Shanxi, Shaanxi, Shandong, Jiangsu, Zhejiang, Anhui, Fujian, and Guangdong".¹ It was the rise of the original commercial capitalists that brought the original business organisation or the enterprise form to maturity. The main business models in the Ming and Qing dynasties, which will be discussed in the

* This section is translated by Dr. Xin Fu with the translating and proofreading assistance from Yuting Jiang, postgraduate candidate (Year 2017) from Northwest University of Political Science and Law, Xian.

1 Chen Mingguang [陈明光], *Ancient Chinese Private Banking History* [钱庄史], (1997) Shanghai [上海]: Shanghai Wenyi Press [上海文艺出版社], at p. 24.

following section, were not inferior to the commercial organisations in the Middle Ages of Europe.

1. Commercial Guilds

Regarding the origin of China's commercial guilds, "some business organisations had existed in the Spring-Autumn and Warring States Period (770BC–221 BC). The Tang Dynasty (618–907) and Song Dynasty (960–1279) provided clear records of commercial guild activities, and from then on, the guild system was constantly perfected during the Yuan Dynasty (1271–1368), Ming Dynasty and Qing Dynasty".² We can have a glimpse of the origin of Chinese commercial guilds in the following excerpt: "The Chinese commercial guilds originated from the folk custom of *jieshe* (forming association). The term *she* (association) was a kind of autonomous folk organisation, which was formed based on public will and the core of god worship. Along with the business development, governments in the Han Dynasty (202 BC–220 AD) and Tang Dynasty developed a *fangshi* (residence and market) system which strictly separated the residential area from the commercial area. The industrial and commercial shops were lined up in fixed areas according to commodity categories, known as *hang* (line[s]). There were altogether 230 *hang* (lines) in the Tang Dynasty and 360 *hang* (lines) in the Song Dynasty respectively. During the flourishing period of the Tang Dynasty, a kind of organisation named *Sheyi* (association capital) or *She* (association) also appeared in the residential and commercial areas, which was characterised with the harmonious relationship, education, and economically assistance for each other, and had been popular in the seventh year (748) of Emperor Xuanzong's ruling (742–756) in the Tang Dynasty. This kind of autonomous associations organised by businessmen of the same trade is the original commercial guilds".³ From the description of these two paragraphs, we can clearly see the long history of Chinese commercial guilds. However, it was actually not until the Ming and Qing dynasties after the middle period of the 14th Century that the commercial guilds started to play an important role in social and economic life with the formation of the original commercial capital to a certain scale.

2 Xiao Guoliang [萧国亮], *Imperial Power and Chinese Social Economy* [皇权与中国社会经济], (1991) Beijing [北京]: Xinhua Press [新华出版社], at p. 38.

3 Li Xizeng (ed.) [李希曾], *Historical Records and Research of Shanxi Merchants* [晋商史料与研究], (1996) Taiyuan [太原]: Shanxi People's Press [山西人民出版社], at p. 352.

In the Ming and Qing dynasties, merchants from Anhui Province and Shanxi Province were best known for their business wisdom and wealth. Take the Shanxi merchants for example. The Shanxi commercial guilds were well established in the Ming Dynasty in the middle of the 16th Century. In terms of the specific name for the commercial guilds, people used the terms "*hangbang*", "*she*", "*gongguan*", "*gongsuo*" and "*gonghui*" due to regional distinctions and changes in dynasties. Moreover, the types of commercial guilds can be divided into two main categories: "The first type was that some guilds were formed and named according to the native place because, when the merchants were far from home and family, it was necessary to care for and protect each other, and to become united to resist others' bullying, thereby doing the commercial activities smoothly. The second type was formed according to the occupation. Some of the guilds were named with the founders of the craft, such as *Mawangshe*, *Lubanshe*, *Jinlongshe*; others were named after the profession, e.g., *jinyishe*, *chengyishe* and *shengpishe*; some just called themselves by auspicious names like *baofengshe* and *deshengshe*; and some were focused on the solidarity and brotherhood, e.g., *yiheshe*, *gongxinshe* and *jiyishe*".⁴ The commercial guilds had two main functions: (i) handling business operations such as business negotiation, revision of guild regulations, organisation of the trade, and settlement of the disputes among the persons from the same trade or business, or the persons from the same place; and (ii) offering affective communication. That is, people from the same trade or business or from the same place offered sacrifices to professional gods, united and interacted, and safeguarded common interests. The funding source of commercial guilds was collected in the form of membership fee, annual fee, or certain proportion of the members' business profits. If the guilds' funding were unable to cover the expenses, they may also raise funds by means of the members' resolution.

Although the commercial guilds in the Ming and Qing dynasties came into being about two centuries later than their European counterparts—urban guild—which had flourished since the 12th Century, the two types of guilds had no substantive differences in formation, organisational functions, or costs management. In particular, the members in the commercial guilds were both independent and responsible for their own profits and losses, who were encouraged to compete with external opponents and strive for monopoly. It is also worth mentioning that both European and Chinese commercial guilds performed government administrative

4 *Ibid*, at p. 354.

functions in their industrial management. They both had absolute control over business management, and thus became the ruling tool of imperial power in commercial activities and daily life. However, after the development for four centuries, the European guilds had been generally evolved into chartered guild organisations in the 16th Century, and the chartered regulated company was the result of such evolution. The chartered guild organisations or chartered regulated companies were generally given the qualification of independent legal persons because their establishment was based on the royal or parliamentary charter. In terms of the duty form, the European companies retained the guild tradition, i.e., the members managed themselves in their own way, and undertook their respective responsibilities. The chartered regulated companies as legal persons enjoyed the monopoly of a particular trade and business within certain regions by law in a more intensive and legal manner, and bore unlimited joint liability. The members paid not only the fees required for maintaining the organisation's normal operation, but also shared part of the funds insufficient for running the business. The development of chartered regulated companies created conditions for further evolution into chartered joint stock companies, and the combination of chartered joint stock companies and shareholders' limited liability promoted the formation of modern companies limited by shares.

The prosperous commercial guild organisations in the Ming and Qing dynasties failed to evolve themselves into business entities with legal personality as the chartered guild organisation in Europe. Although the formation of commercial guilds in China may also rely on the tacit recognition of feudal regimes, they were essentially always formed voluntarily and developed autonomously. Thus, the commercial guilds at that time were not able to contribute to the formation of modern companies in China after the development for more than five centuries. Perhaps this is the most important difference between Chinese and European guilds.

2. For-profit Partnership and Business Associate System

There are the two models of business operation— for-profit partnership and manager system— used by Shanxi businessmen since the Ming Dynasty. Due to their status in Chinese business circles, Shanxi businessmen were highly representative for the popular business model at that time.

The for-profit partnership was recorded in the *Memorial to the Emperor for Opening up Wasteland in Yansui* by Pang Shangpeng in the Ming Dynasty: "At times, Shanxi transportation businessmen came to town and provided huge capital for local merchants to establish the for-profit partnership. They signed private contracts in which the investor could earn profits and the operator also receive benefits. It is a mutual cooperation between capital and labour".⁵ Obviously, this for-profit partnership indicated the labour-capital business mode that the Shanxi businessmen contracted with local businessmen. Those merchants who had or did not have the capital, and who were or were not competent, would work together in mutual cooperation, which was certainly better than the operation on one's own. The competitiveness of Shanxi businessmen was thus enhanced in China at the time.

The business associate system originated from the writings of Shen Sixiao in the Ming Dynasty: "[Shanxi merchants'] business partners are called *huoji* (business associate). One person invests the capital and the other person jointly manages the business. Although they do not swear, nobody would seek for personal selfish interests. If the elder generation borrows an amount of money with compound interest and has not paid off the debt for several decades, their descendants who knew the duty would work diligently for the creditor to make the restitution. Others with enormous wealth certainly desire to hire these industrious men as business associates because they would not disavow their duties under any circumstances. The associates thus could eventually obtain great benefits though they may lose some interest at first. In this way, both the rich and the poor can benefit. The wealthy do not store all their property at home; they entrust it to business associates. Therefore, one's considerable wealth can be evaluated simply by counting the number of business associates. A wealthy man cannot be impoverished instantly, but a destitute person may become sufficient very soon".⁶ Accordingly, in the business associate system, the master (the investor) chooses morally honest men as business associates and provides capital for them, and the latter shall perform their duties to the master faithfully. If the elder generation fails to return the capital and due profits to the

5 Zhang Zhengming [张正明], *The Rise and Fall History of Shanxi Commerce* [晋商兴衰史], (1995) 太原 [Taiyuan]: Shanxi Guji Press [山西古籍出版社], at p. 45, cited from Pang Shangpeng, "Cleaning up Yanfu Suotian Commentary" [清理延绥屯田疏] (Vol. 359), in Chen Zilong (ed.), *Collections of Reports and Articles on Governors and Military Issues* [明经世文编].

6 *Ibid*, at p. 46, cited from Shen Sixiao, *Record of the Jin Dynasty* [晋录] (Publisher's info unknown).

master, their children or even grandchildren shall continue to work assiduously to make the full restitution.

Comparatively speaking, both the for-profit partnership and business associate system are joint labour-capital operation modes, but the business associate system requires the investor to choose a trustworthy person from the kin family or from the native place to manage the business, while the for-profit partnership is based on a contract with non-local merchants. The business associate system is based on the faith instead of the contract alone, and this is the reason that it applies only to the kin family members or people from the same place. In the era when regional cultures were fairly developed, the faith in a kin family and native place was well known in China. The standards of faith became the ethical basis for local people's behaviour, and only a morally trustworthy man was qualified to join in the business associate system. Because the business associate system is a joint business mode in which the master is able to continuously cooperate with local associates on the basis of trust, it can be passed down from generation to generation, and the scale of the business associate system can be increased unlimitedly. The master's wealth can be easily measured by the number of persons in the business associate system. The scale of for-profit partnership obviously cannot rival that of the business associate system. In terms of legal nature, it is agreed by many Chinese scholars that both the for-profit partnership and the business associate system can be attributed to the partnership business in forms. But essentially, the business associate system may create a long-term debit and credit relationship maintained by creditworthiness in which all parties would have common interests. The associates and their descendants are required to fulfil their obligations to repay the principal and due profits, while the master has the right to forever collect repayment from business associates and their descendants. The business associate system, in the sense of modern legal concept, can be understood as a partnership in name but in fact a legal relationship of loan, so some people call it the "loan system". As for the for-profit partnership, it is difficult to define and further understand what kind of legal nature such a partnership belongs to due to the lack of more specific data.

3. The Share System

Shanxi merchants, based on the for-profit partnership and business associate system in the Ming Dynasty, established a distinctive new form of labour-capital organisation. Both regular businesses and the

rights during the liquidation, the residual creditors' rights of the company realised by the shareholders will still be part of the remaining corporate assets and shall be redistributed according to the nature of such assets. The internal redistribution shall be carried out based on the principles like the proportional capital contribution, unless it is otherwise prescribed. That is, after the cancellation of a company, the proportion of capital contribution among the shareholders is still handled according to the situation when the company existed, and the relationship between the shareholders will continue after the cancellation.

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Chapter 2

Disputes over the Establishment of a Company and Its Personality Right

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1. Judicial Measurement on the Property Ownership of Affiliated Enterprises at the Transitional Stage of China's Market Economy*

—*Deng Dehong v. The Communist Youth League of China Zhoukou Committee on Tort Dispute*

Case Index: The Supreme People's Court (2003) Min-Er-Ti-Zi [2003] No. 26 (Judgment of 1 April 2005); Henan Provincial Higher People's Court (2000) Yu-Fa-Shen-Jian-Jing-Zi [2000] No. 377 (Judgment of 22 December 2000); Henan Provincial Higher People's Court (1998) Yu-Jing-Er-Zhong-Zi [1998] No. 452 (Judgment of 5 October 1998); and Zhoukou Intermediate People's Court of Henan Province (1995) Zhou-Jing-Chu-Zi [1995] No. 405 (Judgment of 17 October 1995)

I. BASIC FACTS

In September 1994, the Communist Youth League of China Zhoukou Committee (hereinafter referred to as "Youth League Zhoukou Committee") in the capacity of Plaintiff sued Deng Dehong for tort and requested the Court to order Deng to return the land use right and property ownership of the Zhoukou Hualong Entertainment Centre and to compensate its economic loss caused by Deng's tort.

After the trial, the Court found that the Youth League Zhoukou Committee, without receiving any approval documents or applying for the corporate registration, applied for carving three seals to the Zhoukou Public Security Office on 19 March 1993, one for the Zhoukou Swimming Entertainment Centre (hereinafter referred to as "Swimming Centre"), one for the Zhoukou Hualong Entertainment Centre (hereinafter referred to as "Hualong Centre"), and one for the special financial seal of the Hualong Centre. On 23 March 1993, the Zhoukou Gardening Management Department (hereinafter referred to as "Gardening Department") applied to the Zhoukou Planning Commission to establish a swimming centre. On the next day, the Commission approved the application for establishing a "Zhoukou Entertainment Centre" with the nature of collective ownership, which

* This case is translated by Professor Junwei Fu with the translating and proofreading assistance from Zhuo Wang, postgraduate candidate (Year 2016) from Xian International Studies University, Xian.

shall implement the system of independent accounting, assume the responsibility for its own profits and losses, and should be affiliated to the Gardening Department. On 26 March 1993, the Youth League Zhoukou Committee issued a letter of appointment to Zhang Ruiyun¹ and appointed her as the person in charge of the preparatory group of the Hualong Centre (also known as the Zhoukou Youth Palace). The Gardening Department as Party A and Deng Dehong (used to be the driver of the CPC Zhoukou Municipal Committee) as Party B signed the *Contract for Joint Construction of the Zhoukou Swimming Pool and Entertainment Centre* on 30 March 1993. The contract stipulated that Party A should provide over 3,744 square metres of land in the People's Park for Party B to build a swimming pool and entertainment centre; Party B shall pay RMB 21,000 annually as the management fees to Party A; and the contract duration shall be 40 years. In April 1993, the Gardening Department as Party A and Zhang as Party B jointly signed the *Contract for Joint Construction of Hualong Entertainment Centre in Zhoukou*, which was basically the same as the aforementioned contract in content. The printed date of signing the contract was also the same as the aforementioned contract. Zhang paid RMB 21,000 for the annual management fees successively to the Gardening Department in her own name in June 1994 and March 1995 respectively, and RMB 3,000 in compensation for tree damages in July 1994.

The foundation stone laying ceremony for establishing the Swimming Centre was held in the People's Park as agreed in the above contracts in April 1993. Deng Dehong attended the ceremony and delivered a speech in the capacity of general manager of the Centre. During the ceremony, the local municipal leaders gave speeches and fully praised the spirit and social significance of Deng's self-financing for building the swimming centre. Since then, Deng presided over the preparation of related events in the capacity of the legal representative of both the Swimming Centre and the Hualong Centre and on behalf of the two Centres.

In April, May and July 1993, with the help of Zhang Qiusheng (Zhang Ruiyun's husband), the Deputy Secretary of the Youth League Zhoukou Committee, Deng Dehong in the capacity of the legal representative of and on behalf of the Swimming Centre borrowed RMB 300,000, RMB 600,000 and RMB 300,000 respectively from the China Construction Bank Zhoukou Branch (hereinafter referred to as "CCB Zhoukou Branch"). Later, he obtained the

¹ Zhang Ruiyun is the wife of Zhang Qiusheng, the Deputy Secretary of the Youth League Zhoukou Committee — Translator's note.

loans successively from the relevant financial institutions in the capacity of the legal representative of and on behalf of the Hualong Centre. In total, Deng secured RMB 1,800,000 in the name of the two Centres, but only returned RMB 100,000 when the loans were due. In addition, Deng signed the *Construction Project Contract* and ballroom decoration contract with third parties, and purchased construction steel, recruited staff members, and published advertisements on the Zhoukou TV Station and Education TV Station on behalf of and in the name of the Hualong Centre.

In December 1993, Deng Dehong applied to the CPC Zhoukou Municipal Directly Affiliated Committee (hereinafter referred to as "Zhoukou Party Committee"), requesting that the Swimming Centre be affiliated to the Party Committee. In January 1994, the Party Committee issued a document and decided to set up the Zhoukou Rainbow Entertainment Centre (hereinafter referred to as "Rainbow Centre"). The Zhoukou Administration for Industry and Commerce officially issued a business license of corporate legal person to the Rainbow Centre in April 1994. The registration materials specify that the Rainbow Centre is located in the West Section of Qiyi Road (inside the People's Park); the legal representative is Deng Dehong; the economic nature of the enterprise is collective ownership; and the registered capital is RMB 680,000, in which the Party Committee invested RMB 400,000 and the staff raised RMB 280,000. Thereafter, the Rainbow Centre successfully obtained the planning permit for construction project issued by the Zhoukou Committee of Municipal and Rural Construction and the certificate of house ownership issued by the Zhoukou Real Estate Administration Bureau for the main and wing buildings and the swimming pool, which were located in the People's Park and to be built in the name of the Swimming Centre and the Hualong Centre. The Rainbow Centre also successfully obtained a tax registration certificate, a business license for particular industry, a cultural business license, and hygiene license. In addition, Deng successively secured seven loans from the relevant financial institutions in the name of the Rainbow Centre from May 1994 to January 1995, totalling RMB 1,800,000. The construction project of the Rainbow Centre was completed in June 1995.

During the litigation process, neither the Gardening Department nor the Zhoukou Party Committee claimed any rights and interests arising from the Swimming Centre, the Hualong Centre or the Rainbow Centre. The Youth League Zhoukou Committee also admitted that it did not invest capital in the Centres involved in this case.

According to the evaluation of the Intermediary Department of the CCB Henan Branch entrusted by the Court of first instance, the total project construction costs was RMB 2,461,797.90, including the main and wing buildings, the swimming pool, the motor-pumped well, central air conditioning facilities, bath boiler and its facilities, other water and electricity equipment built in the name of the Hualong Centre, the Swimming Pool Centre and the Rainbow Centre.

It was also found that, after the judgment of second instance came into effect, the property of the Rainbow Centre was transferred to the Youth League Zhoukou Committee by the law enforcement of the Court of second instance on 11 May 1999. After that, the Youth League Zhoukou Committee as Party A, Zhang Ruiyun as Party B and Zhang Qiusheng as Party C signed an agreement to settle the remaining detachment problems of the Hualong Centre, in which the Youth League Zhoukou Committee agreed to gratuitously transfer the property of the Hualong Centre to Zhang Ruiyun, but she was required to pay for the Centre's debt at the amount of nearly RMB 2,500,000. After the agreement was signed, Zhang Ruiyun took over all the business premises of the Rainbow Centre and registered a new company which is still in operation.

II. RULING AND REASONING

The Zhoukou Intermediate People's Court of Henan Province held that, the Hualong Centre (also known as the Swimming Centre) was initiated and constructed by the Youth League Zhoukou Committee. Although the Centre was not registered at the Administration for Industry and Commerce, it actually had the business premises and its own independent property, and engaged in the civil activities in its own name. Deng Dehong occupied the business premises and properties of Hualong Centre and conducted profitable business activities, which were tortious acts. Since the Swimming Centre (also known as the Hualong Centre) has not been registered at the Administration for Industry and Commerce, Deng occupied its business premises and properties. Therefore, Deng was ordered to immediately cease the tortious acts, return the business premises and properties which originally belonged to the Youth League Zhoukou Committee, and assume the main liability for this dispute. Meanwhile, the Youth League Zhoukou Committee had not timely applied for the registration at the Administration for Industry and Commerce after it decided to set up the Swimming Centre, but carved the official seals directly, and started the project construction without the approval of the Urban Construction Department, and also failed to hire the

personnel in accordance with the regulations. Accordingly, the Youth League Zhoukou Committee shall also assume certain liability. Hence, the Court made the judgment that Deng Dehong should return the business premises and properties of the Hualong Centre—including the main and wing buildings, the swimming pool, the motor-pumped well, as well as the central air conditioning facilities, bath boiler and its facilities, other water and electricity equipment invested and built by Deng Dehong—to the Youth League Zhoukou Committee, which were initiated and constructed by the Committee. The Court also made the judgment on other related matters.

Deng Dehong was dissatisfied with the judgment and filed an appeal, but the Henan Provincial Higher People's Court in the trial of second instance upheld the judgment of first instance. Deng was still dissatisfied with the judgment and applied to the Supreme People's Court for retrial. The Supreme People's Court referred the case to the Henan Provincial Higher People's Court for the review, and the latter held a retrial.

After the retrial, the Henan Provincial Higher People's Court held that, Zhang Qiusheng initiated and contracted the project in the capacity of the Deputy Secretary of the Youth League Zhoukou Committee, so the Committee shall be recognised as the founder. Moreover, the Committee issued the report requesting to carve the official seals for the above two Centres in order to apply for the loans from the bank. Meanwhile, it also sent an appointment letter to Zhang Ruiyun. Deng Dehong signed a land use agreement with the Gardening Department in his own name without the signature or official of the competent authority on 30 March 1993. At the end of April 1993, Zhang Ruiyun represented the Youth League Zhoukou Committee and signed a land use agreement with the Gardening Department. On 12 April 1993, the construction project was started to implement the agreement signed by Zhang Ruiyun with the Gardening Department which became effective after the signature or seal of the competent authority. The loans, which were used for the two Centres, were coordinated by Zhang Qiusheng. However, because the two Centres had not been registered in the Administration for Industry and Commerce, they did not have any civil rights, so the Youth League Zhoukou Committee shall be responsible for any legal consequences. If the loans cannot be repaid when they were due, the bank shall seek recourse from the Committee. According to the principle of consistency between right and obligation, the resulting rights of the property shall be enjoyed by the Youth League Zhoukou Committee, who shall be responsible for repaying the relevant debts. Except for the loans obtained originally in the name of the two Centres, the remaining debts shall be paid

by the Committee to Deng Dehong. The occupied land is for public use, so it should not be subject to personal use and management. The grounds for Deng's appeal cannot be established, so the original judgment is not improper. After the deliberation of the adjudication committee, the Henan Provincial Higher People's Court decided to uphold the judgment of second instance it had made. Deng was dissatisfied with the judgment, and applied to the Supreme People's Court for another retrial.

The Supreme People's Court in the retrial held that there was no factual or legal basis for the Youth League Zhoukou Committee to sue Deng Dehong for returning the land use right and property rights of the Hualong Centre. The Swimming Centre and the Hualong Centre were one but the same enterprise to be established. Although the two Centres were not legally registered, and the Committee applied for the official seals and appointed Zhang Ruiyun as the head to prepare for project construction, a lot of facts showed that the preparatory construction activities implemented in the name of the two Centres did not represent the Youth League Zhoukou Committee. In this case, Zhang Ruiyun signed the contract with the Gardening Department in her own name, held the position of financial accountant for the two Centres, and paid the management fees to the Gardening Department in her own name, while the name of the legal representative for each loan contract was Deng Dehong. All those facts showed that the Youth League Zhoukou Committee's assertion that Zhang Ruiyun was the person in charge of the project preparation work and on behalf of the Committee for the Hualong Centre was not in line with the facts. Moreover, the Zhoukou Party Committee as the competent department issued the approval document, formally registered the Rainbow Centre and inherited the rights and obligations in the name of the Rainbow Centre from the Swimming Centre and the Hualong Centre to be constructed. The Party Committee also applied for the property rights of the buildings to be constructed in the name of the Rainbow Centre and obtained the corporate property rights of the Rainbow Centre, while Deng Dehong was just the legal representative of the Rainbow Centre. There was no evidence to prove that the Youth League Zhoukou Committee invested in the enterprises established or to be established, and the Swimming Centre and the Hualong Centre as the enterprises to be established did not acquire any right to land use in their names. The Youth League Zhoukou Committee argued that Zhang Ruiyun signed the contract with the Gardening Department and paid the management fees before and after the litigation of this case on the premise that she had not factually taken over the land use right, which failed to support its claim that Deng Dehong shall return

Chapter 4
**Disputes over Shareholders’
Rights and Interests**

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11. Legal Mode of Identifying a Shareholder's Qualification*

—*Fang Jianhua v. Hangzhou New Yada Commercial and Trading Co., Ltd. on the Dispute over Confirmation of the Shareholders' Qualification*

Case Index: Zhejiang Provincial Higher People's Court (2009) Zhe-Min-Zai-Zi [2009] No. 73 (Judgment of 15 September 2009); Hangzhou Intermediate People's Court of Zhejiang Province (2007) Hang-Min-Er-Zhong-Zi [2007] No. 770 (Judgment of 27 September 2007); and Gongshu District People's Court of Hangzhou (2006) Gong-Min-Er-Chu-Zi [2006] No. 589 (Judgment of 26 March 2007)

I. BASIC FACTS

In September 2006, Fang Jianhua brought a case to the Court against the Hangzhou New Yada Commercial and Trading Limited Liability Company (hereinafter referred to as "New Yada Company") on the grounds that "although he was registered as the shareholder of the New Yada Company at the industrial and commercial registration department, he did not subjectively have the true intent of becoming a shareholder, nor was there the fact of objectively making any capital contribution, participating in the company's operation and management, or enjoying the dividends". Thus he requested the Court to rule his disqualification as a shareholder of the New Yada Company.

After the trial, the Court found that the New Yada Company was established in April 2003, with the registered capital of RMB 2,000,000. The industrial and commercial registration materials recorded that the Company was established and funded by four natural persons Guo Xiaoquan, Zhang Tiehua, Shang Xinjuan and Fang Jianhua, and the proportions of their capital contribution were 26%, 25%, 25% and 24% respectively. When the New Yada Company was established, its *Articles of Association* was formulated in accordance with law and was signed by the aforementioned four shareholders who were recorded in the register of shareholders.

* This case is translated by Professor Qinglin Ma with the translating and proofreading assistance from Yihong Bai, postgraduate candidate (Year 2017) from Northwest University of Political Science and Law, Xian.

In early 2006, Luo Zhengsen, Guo Xiaoquan's husband, was sentenced by the Court for embezzlement. The criminal judgment stated that Luo misappropriated the New Yada Company's registered capital of RMB 2,000,000 by taking advantage of his position in the Zhejiang Jinbao Pawnshop Co., Ltd. After the registered capital of the New Yada Company was verified and the registration was completed, the public funds were returned. During the criminal investigation, Zhang Tiehua stated to the procuratorial organ that the New Yada Company was actually established by Shang Xinjuan, Zhang Tiehua and Luo Zhengsen. Since Luo was a public official, he registered in the name of his wife Guo Xiaoquan and controlled the shares held by Fang. The specific proportion of each shareholder's equity and the Company's *Articles of Association* were negotiated and agreed by Luo, Zhang, Shang and Fang. The formalities of business registration were handled by Zhang, and the formalities of capital verification were handled by Fang respectively. But Fang actually did not hold any shares or enjoy the company's dividends. Moreover, Shang Xinjuan reported to the procuratorial organ the information on specific dividends sharing among Luo, Shang, and Zhang. In addition, Luo Zhengsen also stated to the procuratorial organ that Guo and Fang were only nominal shareholders instead of true shareholders of the company.

During the business operation, the New Yada Company had a debtor-creditor relationship with the Hangzhou Gaodegao Commercial and Trading Co., Ltd. (hereinafter referred to as "Gaodegao Company"). According to the Court's judgment, the New Yada Company should repay the arrears of RMB 500,000 to the Gaodegao Company. During the enforcement of the judgment, the Gaodegao Company applied to the Court to add Guo Xiaoquan, Zhang Tiehua, Shang Xiaojuan and Fang Jianhua as the debtors because of the New Yada Company's illegal withdrawal of capital contribution, and the Court approved the application on 7 July 2006 after the public hearing.

II. RULING AND REASONING

The Gongshu District People's Court of Hangzhou held in the trial of first instance that Fang Jianhua provided his identity card, signed the Company's *Articles of Association*, and handled the company's capital verification in the process of establishing the New Yada Company, all of which fully proved that he was aware of his identity as being a shareholder, and also made his expression of intent. As a corporate organisation, a company is a collection of various legal relationships, involving various stakeholders with complex legal relationships.

Viewing from the principle of maintaining commercial subjects, it is necessary to maintain relative stability of various legal relationships. If the qualification of one shareholder is cancelled, the corresponding legal relationship would be absent and no one could undertake the share of contribution and the contribution responsibility attached. Under the *Company Law of People's Republic of China* (hereinafter referred to as "Company Law"), there are three ways for shareholders to withdraw from the corporation: equity transfer, corporate repurchase, and capital reduction procedures. Judicial decisions on disqualification of shareholders should also comply with the above-mentioned provisions. Fang could not disqualify himself from being the company's shareholder on the basis of the criminal judgment. He had to change the shareholder registration record through the procedures stipulated in the Company Law to relieve himself of the shareholder's qualification. Accordingly, the Court made the judgment to dismiss his claim. Fang Jianhua was dissatisfied with the judgment and filed an appeal.

The Hangzhou Intermediate People's Court held in the trial of second instance that the New Yada Company's industrial and commercial registration materials, the *Articles of Association*, and register of shareholders recorded Fang Jianhua as a shareholder. In the process of establishing the Company, Fang voluntarily provided his identity card, signed the Company's *Articles of Association* and dealt with the company's capital verification, which fully proved his real intent of becoming a shareholder. The actual capital contribution was only the basis for a shareholder's rights, and no actual contribution could only prove that the shareholder was a shareholder of defective investment, which could not deny the shareholder's qualification. Accordingly, the Court dismissed the appeal and maintained the original judgment. Fang Jianhua was still dissatisfied with the judgment and complained to the Zhejiang Provincial People's Procuratorate.

The Zhejiang Provincial People's Procuratorate held in the protest that such rights as signing *Articles of Association*, fulfilling the obligation of capital contribution, enjoying the rights to assets benefit and major decision-making, and selecting managers belonged to the substantive characteristics of shareholders of limited liability companies. The acts of being registered as a shareholder in the industrial and commercial registration materials, receiving the capital contribution certificate and being recorded in the register of shareholders belonged to the formal characteristics of shareholders. When there are conflicts between the substantive and formal characteristics, the Court shall, in combination with the nature of legal relations in the dispute, select a reasonable criterion to determine the qualification of shareholders. That is, if

the dispute occurred in the internal relationship, the substantive characteristics shall prevail, i.e., whether there was the expression of true intent of becoming a shareholder, or whether the party actually enjoyed the shareholder's rights. However, if there is a dispute with a third party outside the company, the formal characteristics shall prevail based on the idea of safeguarding transactions and protecting the interests of a *bona fide* third person, especially when making the identification on the basis of the registered information at the industrial and commercial authorities.

This case involved the internal legal relationship between shareholders and the company, so it should be judged with the priority of substantive characteristics. According to the records of the New Yada Company's *Articles of Association*, the register of shareholders and the industrial and commercial registration materials, although Fang Jianhua was formally a shareholder of the New Yada Company, he neither actually invested, nor enjoyed dividends sharing or actually participated in the company's business operations and management activities. Therefore, he did not meet the substantive conditions of being a shareholder. More importantly, Fang himself did not express the intent of becoming a shareholder of the New Yada Company and did not reach a consensus on the respective shares with other shareholders. He provided his identity card, signed the *Articles of Association* and handled the Company's capital verification formalities in the process of establishing the Company, who was simply offering convenience for the establishment of the company. On these grounds, it was not proper to identify Fang as a shareholder in terms of the internal relationship of this case.

The Zhejiang Provincial Higher people's Court held in the retrial that during the establishment of the New Yada Company, Fang Jianhua provided his identity card and participated in the Company's capital verification, and did not raise any objection to the fact that his name had been recorded in the register of shareholders and the industrial and commercial registration materials, so he was not unaware of his identity as a shareholder. More importantly, the *Articles of Association*, as one of the core conditions and the most important documents for the establishment of a company, is a normative and long-term arrangement negotiated and formulated by the shareholders on the important affairs of the company. It is a contract between the shareholders. As a rational person, Fang was obviously aware of the nature, connotation and significance of the Company's *Articles of Association*, but he still signed the *Articles of Association* as a shareholder. This was sufficient to determine his real intent and expression of becoming a shareholder, which cannot be regarded

that he was "simply offering convenience for the establishment of the Company". To say the least, even if Fang did not have the real intent of becoming a shareholder, he was recorded as a shareholder in the *Articles of Association*, the register of shareholders and the registration materials; and thus he had the extrinsic and formal shareholder's characteristics, and a third party had good reason to believe that he was a shareholder. If his identity as shareholder was denied on the grounds that he had no real intent, it would cause changes to many already established legal relationships, and the comprehensive review of the transactions between the company and a third party, which was harmful to safeguarding the transactions and the stability of economic order, and was contrary to the principle of public exposure and the *Rechtsschein Theorie* in commercial law. In the creditor-debtor relationship between the New Yada Company and the Gaodegao Company, the latter, as a bona fide creditor, raised the claim against Fang Jianhua in the execution stage of the case based on the trust in the extrinsic characteristics such as the industrial and commercial registration materials and the register of shareholders. The Court cannot support Fang's lawsuit, which was brought only after the third party made the claim that he should be added as a debtor in order to deny the Court's verdict to add him as a party subject to enforcement, thereby to evade the debt arising from the shareholder's identity.

Regarding such facts as whether Fang Jianhua actually contributed the capital, whether he received dividends, or whether he participated in the Company's business management, they lacked the nature of publicity and the extrinsic characteristics to be trusted by a third party who did not have the legal obligation to conduct the investigation. In this case, where the interests of a third party were involved, the above-mentioned facts should not be the basis for identifying Fang's shareholder identity. In sum, the Court did not support Fang Jianhua's request for denying his shareholder identity, and it can be resolved through other means if he had other relations with the other shareholders of the New Yada Company and Luo Zhengsen. Accordingly, the Court maintained the original judgment.

III. COMMENTARY

The case is one of the few lawsuits involving reverse confirmation of shareholders in China. The so-called reverse confirmation, which is relative to obverse confirmation, refers to the lawsuit of denying the shareholder's qualification. In general, people are more likely to claim their identity and qualification as a shareholder of a company

and may appeal to the court for the equity of a company. But it is not impossible in judicial practice that a person requests for disqualifying himself/herself as a shareholder of a company in order to avoid the liability that shareholders may be faced with. In this case, the Courts of first and second instances as well as the retrial Court unanimously confirmed that Fang Jianhua was a shareholder of the New Yada Company and dismissed his claim that he was not a shareholder of the Company.

The main basis for such judgments are the records of Fang Jianhua's shareholder identity in the New Yada Company's industrial and commercial registration materials, *Articles of Association* and register of shareholders. Despite the evidence that Fang had not actually contributed the capital, or was just a temporary nominal shareholder, and given the fact that the New Yada Company cannot repay the debt to the Gaodegao Company, and that the shareholders of the New Yada Company may bear the joint and several liabilities for making up the contribution to the false capital contribution, Fang should not be allowed to avoid the liability as a shareholder under these circumstances, which was in line with the concept of the formalism or *Rechtsschein Theorie* of external transactions.

This case involves the basic mode and concept of shareholders' qualification or the lawsuit involving equity confirmation, which also involves various problems such as confirming the differentiation of shareholder's internal and external qualifications and the principle of obverse and reverse processing.

A. Basic Modes of Confirming a Shareholder's Qualification

The legal mode of confirming a shareholder's qualification is intended to explore the form, method or standard used by the Court for confirming the shareholder's qualification. In terms of the interested parties, it refers to the channel or path the parties can take to prove or deny their shareholder's qualification. The confirmation of shareholder's qualification is very practical work in judicial practice. Although there are few direct legal provisions in various countries in this respect, it is not difficult to determine the shareholders on the basis of indirect regulations of the relevant systems and general principles of the company law. In fact, any party who can prove that (s)he (it) owns the company's equity is a shareholder, so the actual forms of proving or identifying the shareholder's qualification may vary. Overall, the major modes of identifying the shareholder's qualification are as follows:

Chapter 5

Disputes over Equity Transfer

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19. Evaluation on the Impact of Nominal Replacement on the Effect of Equity Transfer Agreement*

—*Ding Yufang v. Zhou Jinyao on the Dispute over Equity Transfer*

Case Index: Changzhou Intermediate People's Court of Jiangsu Province [2006] Chang-Min-Er-Zai-Zhong-Zi No. 1 (Judgment of 6 September 2006)

I. BASIC FACTS

Ding Yufang filed a lawsuit in Court requesting to recognise the validity of the equity transfer agreement that she signed with Zhou Jinyao, to order Zhou to continue to perform the contract and transfer the equity to her in accordance with the agreement, and that Zhou handle the relevant formalities for the industrial and commercial registration change.

After the trial, the Court found that in July 1999, Zhou Jinyao, Chen Dingrui, and the Asset Management Operating Company on Huaide Road, Zhonglou District of Changzhou City, Jiangsu Province (hereinafter referred to as "Huaide Company") contributed RMB 250,000, RMB 247,500, and RMB 2,500 respectively to set up the Longcheng Communication Equipment Sales Centre Co., Ltd. of Changzhou City (hereinafter referred to as "Longcheng Company"). Since then, the Longcheng Company experienced several equity transfers: (i) in March 2002, Chen transferred all his equity to Wang Jiye. This transfer was confirmed by the resolution of the shareholders' meeting, the amendment to the Company's *Articles of Association*, and the equity transfer agreement, but these documents have not been registered with the industrial and commercial authorities; (ii) in December 2002, the Huaide Company transferred its shares to Zhou. The resolution of shareholders' meeting was signed and sealed by Zhou in the name of Chen; and the Company's *Articles of Association* were put on record at the Changzhou Administration for Industry and Commerce Xinbei Branch; (iii) in September 2003, Zhou transferred his equity to Ding Yufang and signed an equity transfer agreement, and Wang also signed this agreement for approval; and

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(iv) in October 2003, Wang transferred the equity to Zhou and signed an equity transfer agreement.

Because of the dispute over the third equity transfer, Ding Yufang brought the case against Zhou Jinyao and the Longcheng Company to the Court. It was agreed in the equity transfer agreement signed by Ding and Zhou that Zhou would transfer 50.5% of the Longcheng Company's equity and the capital share of the Longcheng Market set up by the Company (including the registered shares) to Ding; Ding should deliver the compensation funds at the amount of RMB 100,000 to Zhou in two instalments; Zhou was responsible for handling the Company's equity transfer and change of license procedures; and before Ding took over the company, Zhou would bear all the former company's claims and debts, and after the take-over, Ding would be responsible for all the corporate affairs. Plaintiff Ding paid RMB 50,000 on that day and paid off the rest funds very soon. Soon after, Zhou did not handle the Company's formalities of registration change, which caused the dispute of this case.

II. RULING AND REASONING

The Court of first instance held that the equity transfer agreement signed by Ding Yufang and Zhou Jinyao was their real expression of intent in form and content, and met the legal requirements for equity transfer. Therefore, the Court ruled that the agreement was lawful and valid, and Zhou shall continue to fulfil the agreement signed with Ding and handle the formalities of industrial and commercial registration changes together with the Longcheng Company within 30 days since this judgment came into effect. Zhou Jinyao was dissatisfied with the judgment and filed an appeal.

The Court of second instance held that although the Longcheng Company made a resolution on equity transfer between Chen Dingrui and Wang Jiye at the shareholders' meeting of and amended the relevant contents of the Company's *Articles of Association* on 10 March 2002, the parties did not fulfil the duties of equity transfer. Without actual performance, there would be no legal consequences of the equity transfer. Moreover, the resolution and the amendment to the Company's *Articles of Association* made at the shareholders' meeting were not put on record at the industrial and commercial authorities, and consequently, the effect of the proposed equity transfer was suspended for a long time objectively. Only after having accepted the equity transfer from the Longcheng Company in accordance with the equity transfer contract with the transferor Chen Dingrui,

and having handled the industrial and commercial registration formalities, could Wang Jiyi eventually obtain the shares and claim his shareholders' rights and obligations to confront with other third parties as a shareholder. As a result, when Zhou signed the equity transfer agreement with Ding, Wang's status as a shareholder of the Longcheng Company had not been established, while Chen had not lost his shareholder's qualification. Hence Wang's signature on the equity transfer agreement as a shareholder of the Longcheng Company cannot be regarded as the consent of other shareholders of the Company, which shall not be supported by law. Accordingly, the Court ruled that the equity transfer agreement signed by Zhou and Ding had no legal effect and thereby should be considered invalid. Ding Yufang was dissatisfied with the judgment and filed a petition. After the review, the Changzhou Intermediate People's Court of Jiangsu Province ruled that the case shall be retried.

The retrial Court held that the effect of equity transfer agreement should be judged in accordance with its own rules. Under the *Contract Law of the People's Republic of China* (hereinafter referred to as "Contract Law"), when signing an equity transfer agreement, the parties shall express their true intent and do not violate any laws and regulations, and the shares to be transferred shall be consented to by more than a half of the shareholders and shall not infringe upon other shareholders' pre-emptive subscription right, and the equity transfer can be valid only in this way. In this case, the shareholders of the Longcheng Company were Zhou Jinyao, the Huaide Company and Chen Dingrui. The equity transfer agreement signed by Chen and Wang was the expression of true intent by the parties, which did not violate the mandatory provisions of laws and administrative regulations, and was also confirmed by the resolution of the shareholders' meeting and the amendment to the Company's *Articles of Association*. Therefore, the equity transfer agreement was valid and Wang was an actual shareholder of the Longcheng Company. The equity transfer agreement signed by Zhou and Ding also was the expression of real intent by the parties. Although it was not confirmed by the resolution of the shareholders' meeting, Wang expressed his consent, and the agreement was also valid. Accordingly, the Court ruled to revoke the judgment of second instance and to maintain the judgment of first instance.

III. COMMENTARY

The review on the effect of equity transfer agreement is a quite complex legal issue, which often becomes a difficult point in handling such

lawsuits. For judges, it requires great courage, wisdom and many challenging decisions when dealing with various equity transfer disputes fairly through reviewing the effect correctly, particularly as the *Company Law of the People's Republic of China* (hereinafter referred to as "Company Law") lacks express provisions, or the relevant provisions are not clear and even unreasonable. In this case, although the details are simple and the amount in dispute is not large, it considerably reflects the inconsistency of judicial practice in dealing with similar issues. The phenomenon of conflicting judgments in this case indicates that people should pay attention to the following questions: What are the basic principles for reviewing the effect of equity transfer agreement? What impact does the registration of business changes have on the effect of equity transfer agreement? Is it possible that the equity transfer agreement is invalidated simply because of failing to handle the formalities of industrial and commercial registration change?

A. Basic Principles of Reviewing the Effect of Equity Transfer Agreement

The effect of an equity transfer agreement should generally be reviewed by the agreement itself, that is, it should first be reviewed in accordance with the Contract Law. This is the basic step to review the effect of equity transfer agreement. Equity transfer is a change in share ownership based on the parties' expression of true intent. It corresponds to the shift of share ownership that occurs only on the basis of a legal fact (such as the decease or bankruptcy of a shareholder). Because the equity transfer must be based on the expression of intent by the transferor and the transferee, it is essentially a contractual act that must be specified in the form of an agreement. As one of the various types of agreements, the equity transfer agreement has no substantive difference with other types of agreements in the review of effect. In other words, the basic legal principles for reviewing the validity of contracts in various countries should be applied equally to the effect review of equity transfer agreements. For example, whether the capacity for rights and capacity for action of the parties to an agreement are deficient, whether their expression of intent is true, and whether the form of the agreement is legal are all the basic elements of reviewing the effect of equity transfer agreement. The parties may also request a change or revocation if there is any major misunderstanding or obviously unfair equity transfer. If the conditions for terminating an equity transfer agreement occur, the rights-holder will naturally enjoy the right to terminate it.

Under the current legal system in China, the Contract Law is first used as the legal basis for reviewing the effect of equity transfer agreement, which is the basic foundation that should be grasped in reviewing the effect of such agreements. Undoubtedly, for the review of the effect of equity transfer agreement, the relevant stipulations of the Company Law or even the specific provisions of the company's *Articles of Association* should be considered in addition to the general principles of the Contract Law. It is likely that a valid equity transfer agreement that has been reviewed under the Contract Law could be invalid under the further review based on the Company Law or the company's *Articles of Association*. This case and the several other cases in this book will provide more specific interpretations of the basic principles and concept of equity transfer agreement.

B. General Legal Relationship between Nominal Replacement and the Effect of Equity Transfer Agreement

Nominal replacement usually refers to a legal act that a company changes the qualification of shareholders on the register of shareholders. Combined with the corporate system in China and for the convenience of research, nominal replacement could be further understood in a broader sense, that is, the registration of shareholder changes at the company's registration department (the administrative departments for industry and commerce in China) will also be included in the connotation of nominal replacement. In this way, the nominal replacement of equity in China actually includes two levels and aspects: "internal replacement" and "external replacement" or "internal registration" and "external registration". Under the current corporate law system in China, Article 32 of the Company Law (2013) stipulates that, the equity transfer of limited liability companies requires not only the internal nominal replacement within the company, but also the corresponding external nominal replacement at the administrative departments for industry and commerce. As for companies limited by shares, the transfer of registered shares only requires necessary internal nominal replacement within the company. Based on such legal provisions, nominal replacement is often considered as a factor in reviewing the effect of equity transfer agreements in the long-term judicial practice. However, this actually blurs the legal relationship between the effect of equity transfer agreement and that of nominal replacement. They are actually legal issues at different levels and stages. According to the general principles of the Company Law, when dealing with their relationship, the following basic principles should be adhered to:

1. Nominal Replacement only Belongs to the Legal Requirement of Confronting the Company

Although the company law in China provides the above-mentioned regulations for nominal replacement, it does not clearly define the legal nature of such replacement, or make explicit provisions on the legal effect caused by nominal replacement. To summarise the foreign practice, nominal replacement first of all refers to the internal replacement, which generally does not require the external replacement. Meanwhile, the nominal replacement is generally only a legal requirement for confronting the company. Such a requirement means that nominal replacement is the precondition for the transferee to claim the shareholder's rights to the company. Those who have not made the nominal replacement cannot confront the company in the capacity of a shareholder. This legal attribute indicates that such replacement is only a system that deals with the legal relationship between shareholders and the company, and it has no substantive influence on the effect of equity transfer agreement. If the equity transfer agreement itself is only to establish the creditor's rights, the nominal replacement may be similar to disposing of property right. There are substantive differences between these two concepts. From another perspective, nominal replacement is the legal act of the parties in fulfilling an equity transfer agreement after entering the agreement. It is obvious that the act of claiming the creditor's right and the act of disposing of property right, or the effect and fulfilment of the agreement are legal issues at different levels and stages. An originally valid agreement would certainly not become invalid merely because of the parties' performance failure. Likewise, an originally invalid agreement would obviously not become valid simply because it has been fulfilled by the parties. Therefore, for the parties to an agreement, a valid equity transfer agreement is still effective without nominal replacement. Similarly, an invalid equity transfer agreement that has undergone nominal replacement cannot be recognised and supported by law if there is fraud or damage to the interests of others on the grounds of nominal replacement.

2. Parties to a Valid Equity Transfer Agreement Shall Have the Right to Request Nominal Replacement

Although the legal provisions that nominal replacement shall not be used against the company can prevent the transferee from exercising the shareholders' right as a shareholder, it does not mean that the parties to a valid equity transfer agreement cannot enjoy the legal rights to request the counterpart or even the company to make the nominal replacement. For example, the *Companies Ordinance*