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Research on the Nature and Effectiveness of Equity Holding

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Abstract: As a kind of business practice, equity holding has positive significance in activating capital market and promoting financing. With the continuous development of market economy, equity holding has been more and more widely used in the field of commercial affairs, but at present, the relevant laws in our country are too general, and the legal nature and effect of equity holding are unclear. In practice, it is difficult to solve the legal disputes caused by equity holding in a timely and effective manner. More and more commercial entities circumvent laws and regulations by taking advantage of legal loopholes in equity holding, resulting in market chaos and damage to the interests of bona fide counterparts. The purpose of this paper is to analyze the legal nature of the equity holding and the effect of the equity holding agreement, and give suggestions to improve it, in order to provide useful ideas for solving the problem of equity holding in judicial practice.

1. Overview of equity holding

1.1. The concept of equity holding

At present, there is no clear definition of the relevant concept of equity enproxy in law. In theory, equity enproxy usually refers to an equity investment method in which the two parties agree by signing an agreement or other means that the nominal shareholder holds and manages its equity on behalf of the actual investor, and the actual investor pays the corresponding remuneration to the nominal shareholder.[1] Under this arrangement, the establishment of equity holding usually includes the following elements: (1) the actual investor. (2) Nominal shareholders. (3) Equity holding agreement.

1.2. The causes of equity holding

Because equity holding violates the requirements of the principle of commercial externalism, the issue of equity holding has been controversial since its emergence. In practice, the causes of equity holding can be divided into two categories: evasive causes and non-evasive causes. The reason of circumvention mainly refers to the equity holding generated by actual investors in order to avoid the legal restrictions on their identity. The non-circumvention reasons are mainly to protect the privacy of the investor to the greatest extent or to choose the nominal shareholder to hold the equity on behalf

of the investor based on the reasons of personal financial arrangement, and to entrust professional institutions or individuals to carry out commercial operation to achieve profit.

1.3. Characteristics of equity holding

As a commercial practice, equity holding has been widely used in the commercial field in recent years because it can improve the operation level and management efficiency of companies by introducing professional management teams or investors. At the same time, equity holding can also be used as a carrier of equity incentive mechanism to encourage the management and employees of the company to better participate in the operation and development of the enterprise. As a new type of investment, it has the following characteristics: First, the subject of equity holding has the separability. In entrustment of shares, the agreement of entrustment of shares makes the nominal shareholder enjoy the equity in appearance, but the actual shareholder's equity obtained by the equity should belong to the actual investor or the actual beneficiary designated by him. Secondly, the way of equity holding has certain concealment. The reason for the emergence of the new investment method of equity holding is generally that the actual investor based on circumvention of regulations or investment needs, so that their information is not open to the public. Third, equity holding will generally agree on a compensation mechanism. Equity entrusting is usually paid, and the two parties generally agree on the remuneration of nominal shareholders in the equity entrusting agreement. This reward mechanism is helpful to motivate nominal shareholders to perform their duties.

2. Research on the nature of equity holding

The existing law does not clearly define the nature of equity holding, and there are many disputes on this issue in theory, which also leads to the different judgment of the same case because the court does not have a unified standard in the trial of equity holding related cases. About the nature of equity holding, there are two main viewpoints in the academic world: agency theory and trust theory.

2.1. Agency statement

According to the agency theory, equity holding is essentially entrusted holding, and the equity holding agreement signed by both parties is an entrustment contract, which establishes an principal-agent relationship between both parties. In this kind of equity disposal method, the reason why the nominal shareholder enjoys the equity in appearance is that the actual investor entrusts the nominal shareholder with the equity by signing a contract or agreement. His criticism of the agency theory is mainly based on the following two points: First, the subjects involved in the two are different, the agency usually involves two subjects, namely the principal and the trustee; The equity holding can occur in both parties or involve many parties. Secondly, in the entrusted agency, the termination of the entrusted agency can be because the principal cancels the entrustment or the agent resigns the entrustment.[2] However, in the process of share entrustment, the parties can not terminate the share entrustment by canceling the share entrustment agreement. To sum up, many scholars believe that due to the intervention of special rules of company law, it is not convincing to explain the relationship of equity holding by agency relationship.

2.2. Trust theory

The theory of trust holds that the nature of equity holding should be the legal relationship of trust. A trust is a legal entity or arrangement in which the trustee hands over property, assets or interests to a third party, the trustee or the executive of the trust, for management, protection and distribution in

order to meet pre-established purposes and conditions. The flexibility of the trust structure makes it a key component of many financial plans and estate planning options. The trust theory holds that the nominal shareholder is the trustee, the actual investor is the trustor and the beneficiary, the actual investor trusts his equity to the nominal shareholder out of trust, and the purpose of the nominal shareholder holding equity should be to ensure the maximization of the interests of the beneficiary. Because the existing law has not clearly defined the nature of share entrustment, in judicial practice, some courts also define the act of share entrustment as a legal relationship of trust when judging cases. However, many scholars do not agree with this view. They think, in equity entrustment, the nominal shareholders often exercise the shareholders' rights according to the will of the actual investor, which is inconsistent with the independence of the trust property, so the equity entrustment should not be identified as the legal relationship of trust.

2.3. The author's opinion

In view of the trust theory, the author thinks that the main difference between the equity holding relationship and the trust relationship is that the obligation of the trust trustee is usually stricter than that of the nominal shareholder. First of all, the creation of trust is based on the trust of the trustee, so the trust requires the trustee to handle the affairs in person; However, the exercise of the rights of the nominal shareholders is usually based on the instructions of the actual investor or the actual investor directly participates in the exercise. Secondly, the establishment of a trust requires that its purpose must be legal; However, the establishment of entrusting shares is often to avoid laws and regulations, which is a non-legal state, and its establishment does not require that the purpose of entrusting shares must be legal. Finally, a written contract or agreement should be concluded for the establishment of the trust; However, in the case of lack of written entrustment agreement, the court will not naturally determine that the entrustment relationship is not established, but conduct a comprehensive review from all aspects according to the relevant evidence materials and statements of the parties in the case. To sum up, the author thinks that it is inappropriate to identify the equity holding as the legal relationship of trust.

In view of the principal-agent theory, most viewpoints in practice, including the author, believe that the equity holding agreement belongs to the principal-agent contract. First of all, when the nominal shareholders exercise the rights and obligations of shareholders, they usually follow the instructions of the nominal shareholders and have the external characteristics of accepting the entrusting and dealing with the affairs of others, which is consistent with the definition of entrusting contract in the Civil Code. Secondly, the nominal shareholders also have the obligation to report the exercise of their shareholder rights to the actual investor in a timely manner, and the dividends obtained by the nominal shareholders during the shareholding period should be paid to the actual investor, etc., all of which are in line with the relevant provisions of the Civil Code on entrusted contracts. The author believes that in the scope of the entrusting contract, the behavior of the nominal shareholder in order to fulfill the equity holding agreement belongs to the agency behavior in nature, but because the external agency of the nominal shareholder is carried out in his own name, it should belong to the indirect agency legal relationship in civil law. Considering that the behavior of equity holding occurs in the commercial field, and limited liability companies are often founded on the basis of personal compatibility, the acquisition and change of shareholder identity requires the consent of more than half of other shareholders. If the legal provisions of the entrusting contract are fully applied when dealing with the legal relationship of equity entrusting, the contractual arrangement between the actual investor and the nominal shareholder will become fragile, which will easily damage the interests of the actual investor and other shareholders of the company after the termination of the contract, and then impact the equity entrusting contract system.[3] Therefore, the author thinks that

although the relevant legal provisions of entrustment contract can be applied, the application of unilateral arbitrary rescission right of the actual investor or the nominal shareholder should be limited.

3. Analysis of the effectiveness of the equity holding agreement

From the level of legal effect, legislators have not given a clear action guidance to investors in market economic activities for this special form of investment. Domestic laws and regulations on the construction of equity holding were basically vacant before. It was not until the release of the Company Law Interpretation (III) that the relevant issues of equity holding of limited liability companies were regulated for the first time. Based on the reasons mentioned above, the author will discuss the validity of the equity holding agreement respectively.

3.1. The effect of equity holding based on non-circumvention reasons

China's relevant laws and administrative regulations do not directly make effective mandatory provisions on the equity holding agreement, so the act of equity holding itself is not the reason to deny the validity of the contract. In practice, there is no dispute that the validity of equity enrolement based on non-circumvention reasons is usually determined according to the provisions of Article 24 of Judicial Interpretation of Company Law (III). For this type of equity holding agreement, both the theoretical and practical circles tend to respect the autonomy of will between the parties and pay attention to the freedom of contract, that is, as long as it meets the conditions of the establishment and effectiveness of civil juristic acts in Article 143 of the Civil Code, it is legal and effective.

3.2. The validity of an entrustment agreement based on circumvention reasons

In view of the validity determination of equity entrusting agreements based on evasive reasons, from the current judicial precedents, the validity determination of equity entrusting agreements signed in order to evade laws, regulations and rules is stricter in practice. It is generally believed that the mandatory provisions of laws and regulations are divided into two types: effective mandatory provisions and management mandatory provisions, and the violation of the effective mandatory provisions of civil legal acts is one of the reasons leading to the statutory invalidity of legal acts.[4] However, because the existing law does not clearly distinguish between the two, it leads to the phenomenon of different judgments in the same case in practice. In this regard, the author believes that the distinction between the two should be divided into two steps, first of all, we should look at whether the laws and regulations make it clear that the violation of the provision is invalid, if it is clear that the violation of the provision is invalid, you can directly identify the provision as an effective mandatory provision, without going to the next step.[5] If it is not clear in the provisions of the law, the second step is to see whether the normative purpose of the law is only for the needs of administrative management, if it is for the convenience of administrative management, it should be a mandatory regulation of management. Otherwise, it belongs to the effective compulsory provisions.

3.3. The validity of an entrustment agreement that violates public order and good customs

There is no clear definition of public order and good customs in the existing legal provisions of our country. Because there is no official unified concept, there are some disputes about the specific connotation and extension scope of public order and good customs in academic circles and judicial practice, and judges have discretion in the application of specific cases. It is not uncommon for judicial decisions that violate the principle of public order and good customs to lead to the invalidation of the equity holding agreement, most of which occur in the validity determination of the equity

holding agreement of listed companies. Most judgments of Chinese courts carry out the spirit stipulated in the 31st of the "Nine People's Records", and take public order and good customs as reinforcement clauses for violating mandatory provisions of laws on the grounds that violations of departmental rules and regulatory measures destroy market order or national financial security. The author believes that the court should carefully consider many factors to make a comprehensive judgment when determining the invalidity of the equity holding agreement on the grounds that it violates the principle of public order and good customs.

4. Normative Suggestions on equity holding behavior

Through the above theoretical and practical analysis of equity holding disputes, it is found that with the development of economy and the rule of law, more and more people choose equity holding as an investment method to participate in commercial activities, thus giving rise to various forms of equity holding disputes. Many provisions of the current Company Law and other relevant laws and judicial interpretations are still blank or incomplete. At the same time, judicial practice cannot be unified and disputes cannot be fully resolved due to the ambiguity of legal provisions in the application of law. Therefore, the author thinks that we should strengthen the risk prevention, perfect laws and regulations, and unify the judicial judgment to explore the perfect path of our country's equity holding system.

4.1. Strengthen the risk prevention of equity holding

Due to the hidden characteristics of share entrusting and the lack of relevant laws and regulations, both parties who reach an agreement on share entrusting and form a legal relationship of share entrusting should strengthen their awareness of risk prevention, and engage in pre-risk prevention to reduce the occurrence of disputes that are difficult to solve afterwards, so as to better protect the legitimate rights and interests of all parties. In order to protect the legitimate rights and interests of the actual investors and nominal shareholders, the two parties should sign a written agreement as far as possible when reaching an agreement on equity holding. The written equity holding agreement can help the parties effectively prevent risks, and also has great significance for reducing disputes and clarifying the rights and obligations of the parties. When a dispute enters a lawsuit, it can also improve the efficiency of judicial trial to a certain extent, and thus better protect the legitimate interests of both parties.

4.2. Improve the relevant laws and regulations on equity entrustment

In this year's revised draft of the "Company Law" (third review draft), mainly related to strengthening shareholders' responsibility for investment and strengthening the protection of shareholders' right to know, there are still no direct provisions on equity enproxy. Therefore, we should improve the laws and regulations of equity holding as soon as possible and make a unified definition standard, and try to adopt a formal theory to identify the qualification of shareholders and equity ownership. This is not only conducive to the implementation of the spirit of commercial externalism, while properly respecting the true expression of the parties in the agent relationship, but also conducive to maintaining the stability of the equity publicity system of China's Company Law, so as to improve transaction efficiency and protect transaction security. In addition, it should also be clear that the actual investor can not obtain the shareholder qualification without the naming process, which is conducive to urging investors to choose equity enproxy carefully, so as to curb the abnormal phenomenon of excessive equity enproxy.[6] The author believes that at present, when the phenomenon of equity enproxy is becoming more and more common, the state should speed up the

formulation of laws and regulations to clarify the legality or illegality of the behavior of equity enproxy of listed companies, unify the judicial judgment standards, and suggest that the behavior of equity enproxy of listed companies should be strictly restricted under the framework of financial supervision, but it is not a complete ban that damages the freedom of investment, but should be based on restrictive provisions.

4.3. Unify the thinking of judicial adjudication

Existing laws only provide a general definition of the validity of the equity holding agreement in the Interpretation of the Company Law (III), that is, to determine the validity of civil legal acts and the invalidity of contracts in accordance with the Civil Code. In addition, the laws and regulations do not make other specific arrangements, let alone further provisions on the legal consequences of the invalidation of the holding agreement and subsequent matters such as how to allocate and handle the investment rights and interests. In order to avoid the occurrence of different judicial decisions, it is suggested that the court unify the criteria for determining the validity of equity holding agreements, and nullified the equity holding agreements that disrupt market order and damage public interests in violation of departmental rules and industry norms, so as to maintain a good and orderly commercial market environment. In view of the legal consequences of the invalidation of the agent-holding agreement, it is suggested that the nominal shareholders continue to hold the equity of the company and assume the obligations of the company's shareholders under the principle of commercial factionism, and the nominal shareholders should compensate the actual investors for the capital and benefits received by the actual investors.[7] Secondly, we should unify the criteria of shareholder qualification and equity ownership as soon as possible. The identification of shareholder qualification and equity ownership involves multiple legal relations, and there are often major interest disputes between the subjects. Combined with the previous analysis, the author believes that the principle of commercial facialism should be adhered to to identify the shareholder qualification and ownership in the legal relationship of equity holding, while the internal disputes involving the parties to the entrusting agreement should be handled in accordance with the relevant provisions of the Civil Code, and the identification criteria of the shareholder qualification and ownership should be unified, which is conducive to better standardizing the behavior of equity holding and resolving legal disputes over equity holding.

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