

Interpretation Path of Equity Transfer Guarantee Effect from the Perspective of Company Law

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Abstract: In China, the judicial practice has confirmed the effect of the transfer of share rights guarantee, but it is often classified into the standard framework of general transfer of movable property guarantee and lacks the special system consideration in the company law of share rights. Therefore, the commercial purpose of the transfer of share rights guarantee and the market rules it follows can provide an interpretation path in the view of Company law for the affirmation of the validity of the transfer of share rights guarantee. The characteristics of equity transfer guarantee, such as compound power, formal appearance, and common value, should be incorporated into the legal framework. In terms of internal effectiveness, the scope of the rights of the parties should be determined based on the shareholder qualification system of the Company Law. In terms of external effectiveness, it should follow the normative and theoretical purposes of the Company Law, and determine the rights and obligations of each party according to the specific situation.

Keywords: Company Law, Equity transfer guarantee, Transaction structure, Internal and external effectiveness

1. Introduction

An equity transfer guarantee is a guarantee means of right transfer transformation designed by the commercial subject for financing. Its transaction structure is that the debtor and creditor sign an equity transfer agreement and equity repurchase agreement, the debtor will transfer the equity to the creditor, and it is agreed that after the debt is paid off, the creditor will transfer the equity back to the debtor. If the debtor fails to perform or not fully perform, The creditor may liquidate the transferable equity and receive the compensation first. This transaction structure makes the equity independent of other assets of the debtor, reduces the risk of debt non-performance, and has the function of enhancing credit.[1] This guarantee mode is the commercial subject's flexible use of equity and creditor's rights as financing tools so that the secured creditors appear to be a combination of equity and debt in appearance, which affects the judgment of rights and obligations between the parties.[2] However, in judicial practice, the cases of equity transfer guarantee are summarized in the system of general transfer guarantee, which does not highlight the corporate law attribute of equity. In the field of company law, equity transfer guarantee involves many systems such as shareholder qualification recognition, commercial registration, and publicity, and is associated with other interest subjects in different scenarios such as execution objections and bankruptcy proceedings, and there are diversified

and complex legal relationships. Therefore, it is necessary to pay attention to the corporate law attribute of equity transfer guarantee, re-examine the rights and interests structure of the parties to the equity transfer guarantee, and explore the interpretation path of the effectiveness of equity transfer guarantee that is integrated into the corporate law attribute.

2. The Legal Structure of Equity Rights

2.1. Compound Power Structure

Article 4, paragraph 2, of the Company Law, stipulates that "Shareholders of a company shall enjoy the rights to profit from assets of the company, participate in major decisions and choose managers in accordance with the law." In addition to the transfer, donation, or inheritance of equity, shareholders can indirectly control the company through participation in shareholders' meetings, voting, and other ways. At the same time, based on the trust relationship within the company, shareholders should be limited by the preemptive rights of other shareholders in the company when transferring equity. From the perspective of the content of rights, equity is a kind of compound right, which combines the property right to obtain profits and the managerial authority to participate in corporate governance. Shareholders can design the corresponding ownership structure according to different interest needs.[3] In the case of the Supreme People's Court Bulletin, the court supports that under the premise of not infringing the actual shareholders' right of operation and management, the two parties can agree on management rights such as the right to know or the right to supervise to protect the value of the equity transferred as a guarantee to the maximum extent.[4] This indicates that the managerial right of equity can be transferred through voluntary autonomy, which recognizes the possibility of the secured creditor exercising the managerial right of equity to participate in corporate governance. This kind of autonomy design reached by the parties based on risk management and control should be considered valid on the premise that it does not violate relevant mandatory regulations and public interests.

2.2. Formal Appearance Structure

The company registration items stipulated in Article 32 of the Company Law include "the name or name of the shareholder of the limited liability company and the initiator of the joint stock limited company", and article 34 stipulates that "if the company registration items are changed, the change registration shall be handled according to law; Without registration or alteration of the registered items, the company shall not oppose the bona fide counterpart." The commercial registration and publicity system established by the Company Law requires the shareholders of a company to register and publicize the formal appearance of the equity. In the guarantee of equity transfer, the guarantor usually attributes the equity to the secured creditor in the form and appearance by some procedures, such as changing the industrial and commercial registration, so as to achieve the effect that the secured creditor restricts the guarantor to the property disposition of the equity. However, in commercial practice, the shareholders who operate and manage the company are often the guarantors, and the actual shareholders recognized by judicial practice are also guarantors. This kind of "penetrating" judgment thinking causes a conflict between the formal appearance structure of equity and the intrinsic design of the transfer guarantee. If we ignore the form and appearance structure of equity just to pursue the fairness and justice of the case of equity transfer guarantee, it will shake the trust foundation of the commercial registration and publicity system of the company law.

2.3. Common Structure of Value

Firstly, assign the equity value of the security to be common to the secured creditor and the guarantor. Both the secured creditor and the guarantor want to maintain or raise the share price for the purpose of securing the claim and the guarantor for the purpose of making a profit. Based on the information asymmetry, the executives of the company may carry out opportunistic behaviors to obtain personal benefits, and may have a negative impact on the equity value. Therefore, it is necessary to supervise the behavior of corporate executives. If the secured creditor is given the right to know, the right to supervise, and other managerial powers, the common interests of the secured creditor and the guarantor can be guaranteed at the same time.

Secondly, the equity value of the security transferred is made common to the secured rights and other shareholders of the company. As the actual shareholders of the company, the guarantors and other shareholders of the company enjoy the return on the assets when the company is profitable and may be inclined to make high-risk and high-return decisions. The purpose of "nominal owner" is to ensure the realization of creditor's rights, so the secured creditor will be inclined to low-risk and high-security decisions. Therefore, the two have different decision-making concepts, which makes it difficult to jointly make the company's operating decisions of interest reconciliation.[5] If the secured creditor is given the management right to participate in the company's operation decision, even if the interests of the guarantor are not taken into account, the interests of other shareholders of the company may be damaged.

Thirdly, the equity value of the security transferred is made common to the secured right and to the creditors of the company. To fulfill the creditor's right, both the secured creditor and the company's creditors at least want to maintain the value of the equity and not conflict with the interests of the guarantor. However, what needs to be paid attention to is the order in which money is paid back between the secured rights holder and the creditors of the company. In the event of insolvency, if the secured creditor is deemed to be a shareholder, it will be paid back after all ordinary creditors, and the secured creditor will have to bear a significant risk of insolvency of the subject company. For example, in the famous "New China Trust case", the court held that the creditor had the status of shareholder after the transfer of equity rights, and could not be preferentially paid as a creditor.[6] As a result, the holder of the secured right needs to pay more costs to examine the operating conditions of the subject company when accepting the guarantee. However, if the creditor status of the secured creditor is recognized, it may improperly encourage the subject company to sign a backdated contract with the creditor to make up for the fictitious equity transfer and guarantee the transfer of the bankruptcy risk.

2.4. The Influence of the Legal Structure of Equity Rights on Equity Transfer Guarantees

In addition to following the legal structure of equity transfer guarantee, it is necessary to take the particularity of equity into account and make corresponding amendments to the identification path of its validity.[7] From the problems of the legal structure of the compound power, formal appearance, and common value of equity in equity transfer guarantee, the previous validity interpretation path pays insufficient attention to the special legal structure of equity, only applies the civil law norms by analogy, and lacks the consideration of applying the commercial norms. Article 34 of the Company Law, "Without registration or alteration of registration, the company shall not oppose the bona fide counterpart", establishes the validity rule of registration antagonism. Therefore, it is necessary to integrate into commercial norms and identify the effectiveness of equity transfer guarantee from the dual perspectives of both inside and outside the company.

3. Internal Effectiveness: the Shareholder Qualification of the Secured Creditor and the Scope of Exercising Its Rights

3.1. Identification of the Shareholder Qualification of the Secured Creditor

A company is an organization formed on the basis of trust between shareholders, and trust protection should be the core of internal effectiveness determination. Article 86 of the Company Law stipulates that "in the case of equity transfer, the transferee may claim to the company to exercise the rights of shareholders from the time it is recorded in the register of shareholders". This indicates that the qualification of shareholders in a limited liability company should be determined by the shareholders' register. In the equity transfer guarantee, the secured right is to protect its nominal shareholder status. In addition to the industrial and commercial registration, it is often required to change the shareholder register to be registered as the secured creditor by the guarantor. Shareholder register is an important basis for determining the qualification of shareholders in the company. If the shareholder identity of the secured creditor recorded in the shareholder register is denied, the internal recognition effect of the shareholder register will be affected, and it will lead to the loss of certainty in the internal legal relationship. Therefore, the secured right should be presumed to be the shareholder in the company to show respect for the effectiveness of the shareholder identity recorded in the shareholder register. However, the shareholder qualification essentially comes from the shareholder's contribution to the company, and the secured creditor in the equity transfer guarantee has not fulfilled the obligation of investment, so the guarantor of the actual contribution can overturn effect of presumption of the shareholder register by showing the contract to prove the equity transfer guarantee relationship between the guarantor and the secured creditor.

3.2. The Scope of Shareholders' Rights of the Secured Creditor

Within the company, the secured creditor can claim the shareholders' rights to the company according to the identity of the shareholders recorded in the register of shareholders, but it needs to be limited to a certain range, otherwise, there will be a conflict of interest between the secured creditor, the company and other shareholders.

Firstly, the shareholder rights of the security holder should be limited to the scope of the purpose of the security. The reason why the secured creditor nominally accepts the subject equity is for the realization of the secured claim, so the scope of the shareholder rights of the secured creditor should be limited to this scope, and should not exceed the boundary of the realization of the purpose of the secured claim. For example, there is a conflict between the interests of the secured creditor and the interests of corporate information protection when the secured creditor exercises the right to know.[8] Article 57 of the Company Law stipulates that shareholders have the right to inspect and copy the shareholders' register, shareholders' meeting minutes, financial and accounting reports, and other internal documents. Only for accounting books and accounting vouchers, does the company have the right to refuse to inspect them for improper purposes. If the secured creditor violates the legitimate interests of the company by stealing the internal document information of the shareholders' meeting and financial accounting report, the company's information protection interests will lack the legal basis for protection. Therefore, in the guarantee of equity transfer, the secured creditor should be limited to exercise only part of the rights directly related to the realization of the purpose of the guarantee and should bear the corresponding burden of proof, otherwise, the company has the right to refuse to provide the secured creditor's right to inspect and copy the shareholders' register, shareholders' meeting minutes, financial accounting reports and other internal documents.

Secondly, the shareholder's rights of the secured creditor should be limited to the scope of personal protection. As an organization, a company is formed internally on the basis of mutual trust and

cooperation between shareholders. The secured creditor in the equity transfer guarantee usually agrees in the agreement to acquire the control right of the internal operation and management of the subject company based on economic advantages, which damages the human basis of the internal governance of the company and should be regulated. For example, in the "Chengdu Anson Tiffany Education Technology Co., LTD., Yang Jianhua Company license return dispute", the secured creditor requested the return of the company seal, license and removal of the legal representative, which is directly involved in the company's internal operation and management, beyond the basic scope of the purpose of the guarantee, so the court rejected the secured creditor's claim.[9] In order to protect the personal basis of the company, in principle, the shareholder rights of the secured creditor should be limited to the supervisory rights such as the right to know the purpose of the guarantee, and the substantive management rights such as the exercise of voting rights of the secured creditor should be denied unless there is a clear agreement between the parties.

Thirdly, the shareholder rights of the security holder should be limited to the scope of the fiduciary duty of the shareholder. Fiduciary duties are those in which the beneficiary exercises trust and reliance on the fiduciary to act in the best interests of the former with the utmost sincerity, integrity, and loyalty. At the same time, the fiduciary is obliged to act unselfishly for the benefit of the beneficiary and is obliged to use his advantage over the beneficiary fairly and without prejudice to the latter.[10] The fiduciary duty of shareholders was originally only aimed at the controlling shareholder of a company, but with the diversified development of the company law, the choice of the object of fiduciary duty of the controlling shareholder of a company is no longer limited to the company but extends to other shareholders of the company, and even to creditors or relevant interest subjects. In practice, the guarantor often transfers the guarantee with a high proportion of the equity, and the secured creditor very easily obtains the actual control of the company in name, which has the risk of great damage to the rights and interests of the company and other shareholders, especially in the case where the parties agree that the secured creditor enjoys the actual management rights. At this time, the liability that the secured creditor only bears to the other party in the civil law cannot cover its damage to the rights and interests of the company and other shareholders, so it is necessary to construct the liability burden in the company law based on the identity of the shareholder of the secured creditor. Article 21 of the Company Law stipulates that the shareholders of a company shall not abuse the rights of shareholders to damage the interests of the company or other shareholders, otherwise, they shall bear the liability for compensation. In addition, the income generated by the breach of fiduciary duty by the secured creditor may be transferred to the Company by analogy with the provisions of the right of attribution for Board of directors, Board of supervisors, and senior management in Article 186 of the Company Law.

3.3. Realization of the Secured Right of the Secured Creditor

It is generally believed that in the security of equity transfer, the prohibition of liquid pledges should be moderated appropriately, and the balance of payment between the parties should be achieved by imposing mandatory liquidation obligations on the secured creditor.[11] There are two types of compulsory liquidation obligations: debt-in-kind liquidation and disposition. When the debt is not paid off at maturity, the former secured right holder can reach a valuation agreement with the guarantor and directly acquire the ownership of the subject matter, while the latter secured right holder must auction or sell the subject matter to be paid off. In the guarantee of equity transfer, if the parties do not clearly agree on the liquidation method, what kind of presumption should be made is a matter of debate. Some scholars advocate debt-in-kind liquidation, because it avoids complicated auction or price change procedures, and has great advantages in efficiency. Some scholars support dispositional liquidation because it determines the market value of equity and is more equitable in payment.[12] Based on the respect for the autonomy of the commercial subject, debt-in-kind liquidation can be

presumed to be applicable on the premise that both parties agree. If one party does not agree, dispositional liquidation should be applied. In this way, the advantages of debt-in-kind liquidation and dispositional liquidation are given consideration. In addition, with respect to the point at which the secured right acquires the equity, if the equity price is higher than the secured claim, it should be determined as the time when the secured creditor returns the excess; If the equity price is equal to or lower than the secured claim, it should be determined as the time when the parties reached an agreement on price or when the price was auctioned or started the liquidation.[13]

4. External Effect: the Effect of the Conduct and the Assumption of Obligations of the Secured Creditor and the Guarantor

4.1. The Effect of the Transfer of Equity by the Secured Creditor to the Third Party

If a nominal shareholder is considered to have the status of a shareholder, he has the right to transfer the shares to the third party. However, since then, the external counterpart can obtain the equity directly through the equity transfer regardless of bona fide or not, which provides an unregulated space for the malicious collusion between the secured creditor and the external counterpart to damage the rights and interests of the guarantor. However, as previously analyzed, although the secured creditor often enjoys the formal appearance of industrial and commercial registration in the equity transfer guarantee, the scope of its shareholders' rights is limited to the scope of the purpose of the guarantee, the protection of personal integrity and the fiduciary duty of the shareholder, while the external equity transfer is obviously outside the scope and should be regulated. However, if the external party is bona fide, and he or she does not know that there is the possibility of a transfer arrangement of the underlying equity to the secured transaction, his or her trust interest based on the appearance of commercial publicity should be protected and the equity transfer should be deemed effective. Therefore, Article 25 of the Third Interpretation of the Company Law stipulates that the bona fide acquisition system applies to the disposal of equity by nominal shareholders. If the disposal causes losses to the actual investor, the actual investor may request the shareholder to bear the liability for compensation. For example, in the case of the contract dispute between Hu Xiaowu and Xiang Yumeng and Xinjiang Diwang Industrial Group Priority Company, the court held that the disputed equity involved the rights and interests of external parties of the company, and rejected the request of the guarantor to confirm the shareholder's qualification and handle the registration of equity change.[14]

4.2. The Liability of the Secured Creditor to the Creditors of the Company for the Defect of Investment

As to whether the secured creditor should bear the liability of defective investment of the guarantor, there have been various opinions in the academic circle. Some scholars believe that the nominal shareholder has the appearance of a commercial business due to registration and has the responsibility to make up the capital contribution to protect the trust interests of the external counterpart.[15] Some scholars hold that how to deal with this issue depends on the informed situation of the company and its creditors. If the company is aware of the facts of the equity transfer guarantee and agrees that the secured creditor does not bear the responsibility of capital contribution, the secured creditor does not have to bear the responsibility. The creditors of the company, have a relationship of trust based on the appearance of the registration publicity and have the right to ask the secured creditor to assume supplementary liability for the company's debts to the limit of the amount of principal and interest not contributed.[16] Which way to solve this problem depends on how to apply the doctrine of commercial appearance. Commercial exteriorism is a legislative principle and theory that determines the effect meaning according to the appearance of a merchant's behavior. It is used to adjust

commercial transaction activities, reduce transaction costs, and ensure transaction security. In principle, its scope of application should be limited to the scope of the transaction, and it cannot be applied in non-transaction occasions such as the right conflict between the right holder and the non-transaction counterpart.[17] In the case that the equity transaction is direct to the external counterpart, the external counterpart can create a trust relationship based on the registered appearance, so the secured creditor uses its ownership appearance to dispose of the equity and register the equity without authorization, and the external counterpart can obtain the equity in accordance with the bona fide acquisition system to protect the trust interests of the external counterpart. However, as the company is a legal person with an independent personality and property, other creditors are parties to company, which is a separate entity, and there is no trust relationship to the nominal shareholder despite the registration of shareholders. The company assumes external liabilities independently with independent property, and there is no necessary connection between the shareholder debt and the company debt. Therefore, the liability of guarantors for defective investment should be pursued internally by the company. Therefore, the appearance doctrine must be carefully applied in non-transaction occasions, otherwise, it may impose an excessive obligation burden on the appearance right holder, which is unfair. Jiu Min Ji points out that commercial externalism is essentially a provision for exceptional cases, that is, it is only applicable when the external counterpart conducts commercial transactions based on the expression of will and trust in the appearance of rights, with the fundamental purpose of maintaining transaction security. Article 69 of "Guarantee Interpretation" exempts nominal shareholders from the liability of making up capital contributions, which also reflects the view of adopting a restrictive interpretation of commercial externalism. Therefore, for the conflict of interest between the secured creditor and the creditors of the company, the liability of the secured creditor to bear the defective investment of the guarantor has been exempted.

4.3. The Bankruptcy Liquidation Right of the Secured Creditor

Between the secured creditor and the guarantor, the subject equity is indisputably the guarantor's liability property. By holding that the guarantor is insolvent, the secured creditor has the priority to be paid after the bankruptcy.[18] However, there are two liquidation methods at this time: the first is that when the value of the subject equity to the bankrupt consortium is higher, the manager is more likely to pay off the debt and terminate the transfer of the secured right; The second is that when the subject equity has no impact on the interests of the bankrupt consortium, the manager may allow the secured creditor to choose to vesting or disposing of the subject equity to liquidate the debt. In the bankruptcy of the subject company, since there is no direct legal relationship between the secured creditor and the subject company, the property of the subject company should first be used to repay the debts of the company. However, the bankruptcy of the subject company will cause serious damage to the equity value of the subject company, so the secured creditor has the right to ask the guarantor to provide another security value for the lack of guarantee. If the guarantor cannot provide it, The secured creditor shall have the right to require the guarantor to pay off the debts in advance.

5. Conclusion

As a transaction structure spontaneously designed by commercial subjects in market practice, equity transfer guarantee has a conflict between the effectiveness system of the Civil Code and the special system of the Company Law, which has caused a lot of confusion in judicial practice. On the issue of determining the validity of equity transfer guarantee, judges should consider more special commercial registration system of the Company Law, rather than simply analogy the standard application treatment of the general movables transfer guarantee. The legal structure of an equity transfer guarantee should not just focus on the relationship between ownership and secured rights, but should

focus on the special structure of equity, and discuss the normative interpretation path of equity transfer guarantee according to the common characteristics of the compound power, formal appearance and common value. Based on the registration antagonism of the commercial registration system of the Company Law, the validity determination of the equity transfer guarantee should be discussed separately inside and outside the company. Within the company, the rights and obligations of both parties should be balanced based on respecting the system of shareholder qualification in the Company Law. When it comes to the outside of the company, the rights and obligations of the parties should also be distributed under the premise of following the norms and theoretical purposes of the Company Law.

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