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Research on Issues Related to Equity Holding by Proxy and the Exclusion of Non-Equity Transaction Creditors from Compulsory Execution

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Abstract. The causes of equity proxy relationships are complex, concealed and diverse, leading to endless theoretical and judicial disputes. The revised Company Law of the People's Republic of China (2024) has taken effect, but does not directly regulate equity proxy relationships, leaving the question of whether actual investors in equity proxy relationships can exclude non-equity transaction creditors from compulsory enforcement still unanswered. Focusing on this issue, this study adopts a literature review method to systematically sort out the relevant theories, precedents and legislative texts. The study finds that the essence of the enforcement procedure lies in achieving substantive justice, and it is not a transactional context. Therefore, the commercial appearance doctrine should not be extended to apply to enforcement proceedings, and actual investors should have the right to exclude enforcement based on their substantive rights. A system of "shareholder contribution notes" should be established in the national enterprise credit information publicity system to balance and protect the interests of shareholders, companies and creditors.

Keywords: Equity holding by proxy, Nominal shareholder, Actual investor, Commercial appearance, Non-equity transaction type

1. Introduction

With the vigorous development of China's market economy, business activities are thriving. As of the end of November 2024, there were 189 million registered business entities in China, among which 60.867 million were enterprises, representing year-on-year growth of 3.1% and 5.4% respectively [1]. Against this backdrop, equity proxy relationships have emerged on a large scale, characterized by complex causes and diverse types. Legal issues arising from shareholding by proxy have increased and the debates have intensified. The discussion and debate on whether commercial appearance can be applied to the enforcement stage in the case of equity holding by proxy, whether the scope of third parties in Article 25 of the Interpretation (III) of the Company Law can be expanded from equity transaction creditors to non-equity transaction creditors, and whether actual investors can exclude non-equity transaction creditors from compulsory enforcement are based on the first two. The Company Law (2024) and its related judicial interpretations have not addressed this question, resulting in a persistent lack of consensus on relevant issues. Based on the previous

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legislative and judicial status quo, this paper takes the issue of enforcement by actual investors and non-equity transaction creditors as the research topic, using the literature research method (including analysis of doctrines, precedents, and legislative texts) to conduct in-depth analysis of the above disputes. The purpose is to balance the protection of the interests among shareholders, companies, and creditors; promote the stable development of commercial activities; and put forward relevant suggestions.

2. Overview of equity holding by proxy

Equity holding by proxy refers to a form of equity ownership where, for various reasons, the actual investor of equity is separated from the entity of the equity registration authority [2]. The characteristics are as follows: 1. Complexity of causes: Actual investors often actively choose or passively accept nominal shareholders for equity holding based on one or more reasons, including legitimate purposes such as financing and borrowing, as well as illegal purposes such as evading market access regulations [3]. 2. Strong concealment: The actual investor (the nominee shareholder), due to its extremely strong concealment, can even remain invisible from the establishment, operation, and dissolution of the company after reaching an agreement with nominal shareholders. 3. Diversity of types: Different types of equity proxy holding and corresponding legal consequences arise from differences in causes and the initiative of the actual investor.

Based on the causes of equity holding and the division of the effect of different civil legal acts in China's civil law, equity holding acts can be divided into legal holding acts and illegal holding acts. Legal proxy holding refers to a situation where the actual investor and the nominal shareholder agree on the purpose and conduct of proxy holding in compliance with legal requirements. Illegal proxy holding refers to acts of proxy holding carried out by the actual investor and the nominal shareholder to cover up an illegal purpose with a legal act. Some scholars argue that there is an intermediate type between legal and illegal proxy holding, whose legality depends on specific circumstances [4]. However, this study argues that such acts will eventually be classified as legal and illegal, and therefore do not require separate classification.

According to the initiative of the actual investor in equity holding, it can be divided into active equity holding (the form of equity holding formed by the actual investor's active agreement with the nominal shareholder) and passive equity holding (the form in which the appearance of the equity belongs to the nominal shareholder due to objective reasons without prior agreement).

Equity and shareholder status are interdependent and indivisible. In essence, the internal logic of equity is embodied in two layers of meaning: one is shareholder status, that is, the legal status obtained after contributing capital; the other is shareholder rights, such as the right to vote, the right to dividends, and so on [5]. The determination of shareholder status mainly involves two aspects: the formal requirement for determining shareholder status is the procedural matter of the original or subsequent acquisition of equity, and the substantive requirement is the legal relationship on which the equity is acquired. The basic legal relationship (substantive requirement) is established first, and then the procedural requirements of the company law for obtaining the equity qualification (formal requirement) can be transformed into complete and flawless equity and shareholder qualification [6]. The essence of equity holding by proxy is the failure to unify the formal and substantive requirements of equity qualification, which leads to the separation of the appearance of shareholder qualification from shareholder rights, and thus raises judicial practice issues such as the determination of the shareholder qualification of hidden shareholders, the unauthorized disposal of equity by nominal shareholders, and whether equity holding by proxy can exclude the compulsory execution by nominal shareholders' non-equity transaction creditors. Among these, the question of

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whether actual investors can exclude enforcement by non-equity transaction creditors is the most controversial in both academic and judicial practice, with no unified judgment standards to date.

3. The absence of regulations on equity holding by proxy, theoretical differences and the resulting judicial adjudication issues

The latest revised Company Law does not directly regulate the legal relationship of equity holding by proxy. Regarding the relevant judicial interpretation of the Company Law, Article 24 of the "Provisions of the Supreme People's Court on Several Issues Concerning the Application of the Company Law of the People's Republic of China (III)" (hereinafter referred to as the "Company Law Interpretation (III)") regulates the validity of shareholding agreements, the ownership of investment interests between actual investors and nominal shareholders, and the procedures for actual investors to obtain the appearance of shareholder rights from a civil law perspective. Article 25, referring to the provisions of the Property Law on the application of good faith acquisition to the disposal of equity by a nominal shareholder, still fails to fully resolve judicially adjudicated issues arising from proxy holding of equity, especially whether the actual investor can exclude the application for compulsory enforcement by the nominal shareholder's non-equity transaction creditors.

According to Article 25 of the Interpretation (III) of the Company Law, creditors of nominal shareholders can be classified into equity transaction type and non-equity transaction type [7]. The former claims arising from the disposal of equity shall be subject to the rule of good faith acquisition; The latter lacks clear regulations, leading to the dilemma of "double repayment of one item". The root cause of this judicial dilemma lies in the fact that although Chinese civil and commercial laws follow the model of the civil law system, they adopt a cautious attitude toward the commercial appearance doctrine and only regulate it from a civil law perspective, resulting in ambiguous legal attributes of equity holding by proxy and inconsistent judicial standards.

Currently, debates focus on two points:

1. Can the commercial appearance doctrine be applied to the execution stage?

There are affirmative and non-affirmative views on the question. The affirmative view holds that the appearance doctrine determines the effect of a legal act by the standard of appearance of rights. As long as a third party has a reasonable reliance interest based on trust in appearance facts, such reliance interest should be given priority protection by law, and the commercial appearance doctrine, by its extensiveness, should be applied to the enforcement stage [8,9]. The negative view holds that it is essentially an interest measurement principle rather than a specific adjudication rule, and its scope of application must be strictly limited. If mechanically applied in enforcement procedures in non-transactional areas, it essentially replaces "substantive justice" for the purpose of seeking true rights with "formal justice" at the cost of substantive fairness [10]. This aligns with China's current legislative stance, as the Supreme People's Court holds that commercial appearance is merely an exceptional rule in the private law domain and should only apply to specific circumstances [11].

2. Can the scope of third parties as regulated in Article 25 of the Interpretation (III) of the Company Law be expanded from equity transaction creditors to non-equity transaction creditors?

There are also affirmative and non-affirmative views on this issue. The affirmative view, citing the natural interpretation of "weightlifting to show lightness" in criminal law, holds that the interests of non-equity transaction creditors, who cannot conduct due diligence on the equity involved in the case, should be better protected than those of equity transaction creditors who have the opportunity to conduct strict and detailed investigations. The negative view holds that the bond debt relationship between the applicant and the respondent is based on trust in the respondent's overall property.

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When conducting transactions with the nominal shareholder, the creditor should have considered the potential risk of equity proxy holding, making the creditor subjectively at fault [12]. It is notable that outside the framework of the discussion on this issue, some scholars have taken a different approach and proposed the "trust theory" interpretation path. The theory contends that the equity proxy relationship conforms to the legal structure of the trustee holding property rights for the benefit of a beneficiary and can be interpreted as an intended trust relationship. The actual investor shall, in accordance with the provisions of the trust law, exclude non-equity transaction creditors from enforcement [13].

Some scholars screened judicial documents from January 1, 2018, to May 1, 2024, excluded irrelevant samples, collected 184 relevant cases, and conducted a preliminary review of judicial viewpoints, as shown in Table 1.

Table 1. Analysis of judgment cases in a lawsuit against an objection to execution by an anonymous shareholder [9]

Judgment results	Number of cases/article	Proportion /%	Referee's reasons
Support the applicant for enforcement	146	79.35	Reliance on interest protection; relativity of equity holding by proxy; a balance of risk and benefit; judicial policy orientation
Support the actual investors	38	20.65	Appearance does not apply to execution procedures; the applicant for enforcement is not a good-faith counterparty; in violation of the principle of fairness and justice;

After reviewing these judgments, the scholars found the court's views on whether an actual investor can exclude enforcement. Although the proportion of judgments supporting the applicant for enforcement is higher, the specific grounds for the judgments vary, which is consistent with China's relevant judicial policies.

4. Suggestions for resolving the judicial dilemma caused by equity holding by proxy

4.1. The application of the commercial appearance doctrine should be restricted

China's civil and commercial judicial policy has clearly defined the application of the doctrine of appearance: Under current legal rules, the doctrine of appearance is an exceptional provision set for the protection of transaction security and is generally applicable to transactions based on reasonable reliance on the appearance of rights or expressions of intent. The relationship between the actual right holders and the nominal right holder should focus on the substantive ownership of the property rather than merely on the publicized appearance. In summary, judicial practice must accurately grasp the boundaries of the commercial appearance doctrine to avoid overgeneralization and abuse [14]. This indicates that China only retains the commercial appearance doctrine in the transaction scenario, which is an exception to the protection of the reliance interest of the third party when it is difficult for the third party to know the true state of rights. However, no transaction relationship exists between creditors and actual investors in enforcement proceedings. Blindly expanding the commercial appearance doctrine to the enforcement stage contradicts the original design intent of the relevant system.

4.2. Objections to enforcement proceedings highlight the value of substantive justice

The legislative value of the system of objection to execution lies in protecting the legitimate property of a third party from being disposed of as the property of the person subject to enforcement. This means that trials of objection to execution adhere to substantive examination

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rather than formal examination. If the commercial appearance doctrine is mechanically extended to enforcement procedure and the ownership of rights is determined merely by appearance, then even if the actual investor provides sufficient evidence to prove that he has rights over the property subject to enforcement, the enforcement cannot be excluded, resulting in the creditor obtaining additional benefits that should not have been obtained. This would lead to the failure of the substantive review function of the objection to enforcement action, contradicting the legislative intent and value of the system.

4.3. Improving rules to balance the interests of all parties from the source—the mechanism for specifying shareholders' contributions

Based on the above conclusions, the study argues that in the enforcement process, enforcement proceedings should adhere to the principle of substantive justice. Therefore, the commercial appearance doctrine does not apply to the enforcement stage, and actual investors have the right to exclude the enforcement application of non-equity transaction creditors in respect of their true rights. Additionally, the scope of "third parties" under Article 25 of the Interpretation (III) of the Company Law should not be extended to such creditors. However, while protecting the interests of actual investors, the reasonable reliance interests of nominal shareholder creditors should also be considered. Right holders often rely on the appearance of business registration to assess the debtor's ability to repay debts. Equity, as an important component of property, may mislead creditors in their judgment through the proxy holding relationship. Even if the creditors have flaws in their duty of care, they still suffer from information disadvantage. To balance the interests of both parties, this study proposes establishing a "shareholder contribution indication" mechanism in the national enterprise credit information publicity system. Specifically, companies should indicate whether their registered shareholders are consistent with actual contributors, without revealing the information of the actual contributors. This mechanism can provide risk warnings for creditors, reduce transaction costs, and urge actual investors to fulfill the obligation of moderate disclosure to reduce enforcement disputes at the source.

5. Conclusion

Based on the aforementioned study, this paper concludes that no transaction occurs in the enforcement procedure, and its legislative purpose is to highlight substantive justice. Therefore, the commercial appearance doctrine cannot be extended to the enforcement stage, and actual investors have the right to exclude enforcement by nominal shareholder debtors in respect of their true rights. To address the information vulnerability of the nominal shareholder debtors and balance the interests of all parties, this study suggests establishing a "shareholder contribution note" mechanism to the national enterprise credit information publicity system in conjunction with the public disclosure of company-related information. This mechanism provides certain protection for nominal shareholders' creditors when they examine debtors' assets. This study has certain limitations and currently only discusses the legal relationship between the actual investor and the non-equity transaction creditor of the nominal shareholder in equity holding by proxy. In practice, the legal relationship of equity ownership between the actual investor and the nominal shareholder also remains controversial. Therefore, future research should explore this issue in greater depth to construct a more complete and clear legal rule system for equity holding by proxy.

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