# A Brief Analysis Of The Validity Determination Of Nominee Share Holding

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## Abstract

**As one of the tools to achieve the separation of capital ownership and capital control in modern commercial transactions, nominee holding is often widely used in commercial practice. The legal nature, ownership and disposition of nominee shareholdings on behalf of shareholders have always been an urgent problem to be solved in theory and practice. It involves not only the contract law, but also the company law, the relationship between the nominal shareholder and the dormant shareholder, as well as the relationship between the dormant shareholder and other shareholders, the company and creditors. In recent years, with the development of economy and society, China's determination of the validity of nominee shareholding has also changed. Starting from several cases of disputes over nominee shareholding agreement issued by the Supreme Court of China, this paper briefly discusses and introduces the effectiveness of nominee shareholding in different fields, and briefly puts forward relevant risk aversion measures in the process of signing nominee shareholding agreement.**

## Keywords

**Nominee shareholding; Nominee shareholding agreement; Company Law.**

## 1. Introduction

Nominee shareholding, also known as entrusted shareholding, anonymous investment or investment under a false name, is a kind of share or share disposal method in which the actual investor agrees with others and performs shareholders' rights and obligations on behalf of the actual investor in the name of others.

Generally speaking, nominee shareholding involves three legal relationships. The first is the legal relationship between dormant shareholders and nominal shareholders. This level only involves both share holders, and the contract law is applicable. The dormant shareholders are the parties to the contract and enjoy rights and obligations according to the contract. The core is the actual investment and the investment income. Second, the legal relationship between anonymous shareholders and other shareholders of the company and the company, referred to as the internal relationship of the company. This level only involves the issue of the qualification of shareholders, which is mainly applicable to the company law. When the anonymous shareholder does not show his name, he is only associated with the company or other shareholders through the nominal shareholder, and he belongs to the person outside the corporate governance structure from the appearance; The explicit registration is not only subject to the approval of the company or the consent of other shareholders, but also subject to the special provisions of the relevant companies in the Company Law or the restrictions of the company's articles of association; After being named, the anonymous shareholders become shareholders of the company, and their rights and obligations are completely consistent with those of the shareholders of the company. Third, the relationship between dormant shareholders, nominal shareholders and external creditors of the company, referred to as external relationship. This level is mainly based on the debt law relationship between external creditors and companies or shareholders, which is interwoven with the former two legal relationships, and needs to be applied to both Contract Law and Company Law.[1]

As for the legal relationship of the first layer, because it only involves nominal shareholders and dormant shareholders, it can generally be handled according to the contract of both parties, and the

dispute is not big. However, for the remaining two layers of legal relations, because they also involve other shareholders, companies or the relationship with external creditors of the company, they are relatively complex, so there has been a great controversy over the effectiveness of share disposal in the holding of share for a long time.[2] Article 52 of the Contract Law stipulates five situations in which an agreement is invalid, that is, one party concludes a contract by fraud or coercion; Harm national interests; Malicious collusion damages the interests of the state, the collective or the third party; Covering up illegal purposes in a legal form; Harm the public interest; Violation of mandatory provisions of laws and administrative regulations. However, when it comes to the trial practice of share holding disputes, the situation is more complicated. Because the legal nature, ownership and disposition effect of holding share can not be uniformly stipulated, the judicial judgment of holding share disputes can not form a consistent judgment logic.[3]

## 2. Structure

### 2.1 Analysis On The Effectiveness Of Share Holdings By Listed Companies and Insurance companies

In July 2018, the Supreme People's Court of China announced the ruling (2017) No.2454 of the Supreme People's Republic of China on Yang Jinguo's and Lin Jinkun's share transfer dispute. According to the Supreme Court, the validity of the contract for holding shares of listed companies should be comprehensively determined according to the relevant laws and regulations on the supervision of listed companies and the Contract Law of the People's Republic of China. According to the *Interim Measures on Administration of Initial Public Offering and Listing on Growth Enterprise Board ,Securities Law of the People's Republic of China* and other relevant regulations, it is not allowed to hide the real shareholders in the IPO process of listed companies, that is, the shares of listed companies may not be held in anonymity. Secondly, if the true shareholders of listed companies are not clear, the relevant specific regulatory measures such as information disclosure requirements, related party transaction review, and avoidance of senior executives will inevitably fail, which will inevitably damage the legitimate rights and interests of the majority of non-specific investors, thus damaging the basic trading order and security of the capital market, financial security and social stability, and ultimately social public interests. Therefore, the contract for holding shares of listed companies violates Article 52, Item 4 of *Contract Law of the People's Republic of China* and should be invalid.[4]

This ruling also sounded the alarm for the relevant subjects in the capital market. Under the background of strengthening the supervision in the field of financial securities, the validity determination of the share holding contract of listed companies in judicial practice may also be changed due to this precedent. This case can also be regarded as a sign that the judicial organs strictly administer justice to the capital market, which indicates the beginning of a series of cooperative supervision and judicature between judicial organs and supervisory departments in the capital market in the future.

### 2.2 Analysis On The Effectiveness Of Share Holdings By Insurance Company

In the case of business trust dispute between Fujian Weijie Investment Co., Ltd. and Fuzhou Tiance Industrial Co., Ltd. in March 2018, Weijie Company and Tiance Company signed the Trust Shareholding Agreement, and Tiance Company entrusted Weijie Company to hold 400 million shares of Junkang Life Insurance Company in dispute. Later, the company requested to become dummy shareholder, but Weijie Company disagreed with its request for some reasons, so both sides choose to settle the dispute through litigation. The Higher People's Court of Fujian Province ruled that the proxy shareholding relationship between the two parties was legal and valid, and ordered Weijie Company to handle the transfer procedures of disputed shares for Tiance Company. The Supreme People's Court of the second instance ruled that the Trust Shareholding Agreement signed by both parties violated the prohibitive provisions of *the Measures for the Administration of share of Insurance Companies of China Insurance Regulatory Commission*, and damaged the public interests, so it should be deemed invalid according to law.Specifically, although the Measures for the

Administration of share Rights of Insurance Companies belongs to departmental regulations in terms of the effectiveness of legal norms, the China Insurance Regulatory Commission was formulated in accordance with Article 134 of the Insurance Law of the People's Republic of China.From this, it can be seen that the provisions of the management measures prohibiting the holding of share in insurance companies are consistent with the legislative purpose of the Insurance Law of the People's Republic of China; Secondly, this method does not conflict with the provisions of higher-level relevant laws and administrative regulations, and does not conflict with other norms with the same level of effectiveness. At the same time, its formulation and release do not violate legal procedures, so it has substantial legitimacy and legitimacy. Thirdly, from the harmful consequences of holding insurance company share, allowing anonymous holding of insurance company share will make real insurance company investors free from the supervision of relevant state functional departments, which will inevitably increase the operating risks of insurance companies and hinder the healthy and orderly development of the insurance industry. Therefore, the Supreme Court held that the Trust Shareholding Agreement was invalid.

In recent years, the judgment tendency of the Supreme Court has also changed with regard to the determination of the validity of insurance company's share holding. In 2015, during the retrial of contract disputes between Bozhi Capital Fund Co., Ltd., Hongyuan Holding Group Co., Ltd. and Shanghai Xinhong Investment Management Co., Ltd., the Supreme Court confirmed the validity of the holding behavior of share from both internal and external relations, while in this case, it directly confirmed that the holding behavior of insurance companies was invalid. This change is also closely related to the strong supervision situation of the insurance industry in recent years. In view of the chaos of illegal holding and excessive shareholding in the insurance industry, the current effective Measures for the Administration of share of Insurance Companies not only explicitly stipulates that it is forbidden to hold share of insurance companies, but also further stipulates that investors with records of holding share of insurance companies may not become shareholders of insurance companies. Under this trend, the validity of insurance company's share holding behavior is often regarded as invalid in judicial practice.

### 2.3 Analysis On The Effectiveness Of Share Holdings By Bank

With the development of China's banking industry's opening to the outside world, the recognition of the validity of bank share holding agreements has also changed accordingly. As the *Administrative Rules Governing the Equity Investment in Chinese Financial Institutions by Overseas Financial Institution* was abolished on August 23, 2018, if an overseas financial institution entrusts a mainland enterprise to hold the share of a Chinese-funded financial institution, in principle, it will not be deemed invalid for violating the regulations. However, the Measures for share Custody of Commercial Banks issued by China Banking Regulatory Commission on July 23, 2019 emphasizes strengthening the share management of commercial banks, improving the transparency of share information of commercial banks, and doing a good job in penetrating supervision of share of commercial banks. In case of violation of this measure or other relevant provisions of China's financial management system, there is still the risk of being deemed invalid, so specific analysis should be made in combination with specific events. At the same time, we should pay attention to the corresponding changes in China's financial regulatory policies and regulations when analyzing the validity of the holding agreement in the financial field.

### 2.4 Analysis Of The General Problems Of Nominee Shareholding

*Provisions (3) of the Supreme People's Court on Several Issues Concerning the Application of the Company Law of the People's Republic of China* stipulates that the actual investor and the nominal investor of a limited liability company enter into a contract, which stipulates that the actual investor will contribute and enjoy investment rights, and the nominal investor is the nominal shareholder. If there is a dispute between the actual investor and the nominal shareholder over the validity of the contract, the people's court shall determine that the contract is valid if there is no circumstance stipulated in Article 52 of the Contract Law. If there is a dispute between the actual investor and the

nominal shareholder as mentioned in the preceding paragraph over the ownership of investment rights and interests, and the actual investor claims rights from the nominal shareholder on the grounds that he has actually fulfilled his capital contribution obligations, the people's court shall support it.If the nominal shareholder denies the rights of the actual investor on the grounds that it is recorded in the register of shareholders and registered by the company registration authority, the people's court will not support it. If the actual investor requests the company to change shareholders, issue a capital contribution certificate, record it in the register of shareholders, record it in the articles of association and register with the company registration authority without the consent of more than half of the other shareholders of the company, the people's court will not support it. This regulation divides the legal relationship into contract law and company law. At the contract level, if there are no five situations stipulated in Article 52 of the Contract Law, the principle of party autonomy should be respected, that is, the contract is valid on behalf of the contract. At the same time, according to the principle of fairness in contract law, investors should also enjoy the income, and the shareholders who actually contribute can also claim to enjoy the investment income. However, at the level of company law, because limited liability companies have the characteristics of personality, if new members join as shareholders, they should also refer to the internal equity transfer process of limited companies and obtain the consent of more than half of other shareholders. Although this provision only stipulates the determination of the validity of proxy holding by limited companies, since the legal principle of proxy holding in limited companies is the same as that in limited liability companies, and the limited companies are also limited liability companies in essence, the determination of proxy holding in limited companies should also refer to this article.[5]

In addition, the legal status of the act of holding shares does not mean that the act of holding shares is of course effective. Article 24 of *the III Judicial Interpretation of Chinese Company law* does not directly recognize the legal effect of the act of holding shares, but requires that the act of holding shares be determined according to Article 52 (5) of *Contract Law of the People's Republic of China*. This is also because the act of holding shares is still a contractual act in nature, and the act of holding shares belongs to an intentional act rather than a statutory act. Therefore, it is not based on the law, but on the mutual consent of both parties. That is to say, the generation of the act of holding shares on behalf of the owner needs the actual investor and the nominal investor to conclude the contract of holding shares on behalf of the owner. Only when the actual investor and the nominal investor of equity conclude the corresponding contract of holding shares by proxy can the relationship between the two parties be formed. Since the act of holding shares on behalf of itself is a kind of contract act, the judgment of the effectiveness of this act should also comply with the relevant provisions of the Contract Law on the determination of contract effectiveness. Therefore, in addition to the situations described in the above cases, in practice, there are some cases where the act of holding shares is deemed invalid because of violation of Article 52 of Contract Law, and most of these cases cover up the illegal acts behind it through the act of holding shares. For example, civil servants violate the *Civil Service Law of the People's Republic of China* and other relevant laws and regulations, and conduct business in the form of equity holdings; In another case, if the briber bribed an official with equity, the official appointed a specific related person to hold shares for him in order to avoid risks. The above-mentioned nominee shareholding behaviors are obviously invalid as stipulated in Article 52 of the Contract Law, such as violating the mandatory provisions of laws and regulations, maliciously colluding to harm the interests of the state, the collective or the third party, and harming the public interests, so they should be deemed invalid.

## 3. The Risk Prevention And Control Of The Company's Nominee Shareholding

The behavior of holding shares is often a double-edged sword. In order to avoid potential risks as much as possible, actual investors should carefully choose the object of holding shares, ensure the legitimacy of both parties, and avoid special personnel such as government officials and leading cadres of state-owned enterprises; We should also ensure the legality of the contents of the equity holding agreement, and avoid the invalidation of the equity holding agreement due to violation of

Article 52 of the Contract Law. In particular, we should assess the risks of the holding behavior through existing judicial precedents, and try to avoid involving special fields such as banking, insurance and listed companies. While under the general trend of cooperation between financial and commercial trials and financial supervision, it is easy to identify the holding behavior in these fields as invalid. In addition, the rights and obligations of both parties should be clearly stipulated in the agreement, and the rules for the exercise of shareholders' rights and powers in equity should be stipulated separately as far as possible, such as the exercise and restriction of voting rights, the way of transferring equity income, and the unconditional cooperation of equity transfer, so as to reduce the rights disputes that may arise in the future. It is also best to stipulate the high liability for breach of contract in the equity holding agreement and notarize it to limit the nominal investor to a certain extent, so as to minimize the possibility of infringing on the interests of the actual investor. After the signing of the proxy shareholding agreement, the actual investor should keep as many records as possible of paying the capital contribution to the nominal investor to prove that he actually fulfilled his capital contribution obligations.

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