When does a share buyer become shareholder in a Chinese company when buying its shares?

Description

To many, it may seem a simple and even stupid question. But it is not.

I In the Case of Domestic Company

In a country with the tradition of statute laws, when a statute law fails to offer a clear answer to a certain legal issue, it can be a problem in practice.

With respect to the captioned question, China Company Law does not provide clearly for when a buyer of the equity interests (shares) in a company (for purpose of this pose, I refer to limited liability company only) is effectively considered as a real shareholder of the company. Many may say the buyer should be regarded as the shareholder of the company at the time of execution and effectiveness of the equity or share transfer agreement or contract or at the time of the pay-up of the price in the transaction document or at the time of being registered as shareholder with company registry, namely, the industry and commerce bureau. However none of the answers is correct.

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From a procedural point of view, a typical share transfer in the case of domestic companies encompasses the following steps: (a) the seller and buyer executes the share transfer agreement, (b) internal changes, for instance, cancelling old shareholder's contribution certificate (*chu zi zheng ming shu*) and issuing new one to the new shareholder, amending shareholder register and revising articles of association, and (c) apply to company registry to register the change of shareholder.

The shareholdership refers in essence to the relationship between the shareholder and its invested company. When the shareholdership is established, it means that the shareholder can now exercise its shareholder right against the company. The execution of share or equity transfer contract is just between the seller and buyer, so at the time of execution of share transfer contract, the company may not be aware of the deal at all and won't and actually cannot take the buyer as shareholder. On the other hand, China Company Law has made one point clear that registration of shareholder information with company registry shall be for the purpose of constructive notice. In other words, where the parties fails to register shareholder change with company registry, bona fide third party can still enter into valid transaction with the old shareholder registered at company registry. This indirectly means that the creation of shareholdership is not legally predicated on the registration of shareholder information (as it serves the purpose of constructive notice only).

It would be more logic and reasonable to say that the shareholdership is set up upon acknowledgement and affirmation by the company of the share transfer deal, which can be well embodied by the issuance of contribution certificate and/or the amendment of shareholder register by the company. The company whose equity interests are being transfer shall have the obligation to do the same according to Article 73 of China Company Law.

However, in practice, many limited liability companies don't issue contribution certificate or maintain the

shareholder register at all. So without them, what can be said to signify or manifest the establishment of shareholdership? In my opinion, anything that can prove the knowledge by the company of the share transfer deal can suffice for purpose of setting up the shareholdership. It would be safer for the buyer to get the company informed of the deal by serving a written notice of the deal on the legal representative of the company.

II In the Case of Foreign-invested Company

Unlike in the case of domestic company, it is indeed much clearer in the case of the foreign invested companies.

First of all, according to relevant foreign investments laws, the contract for transfer of share or equity interests in a foreign invested company (either a joint venture or wholly foreign-owned company) shall have to be first approved by foreign investment department of the government in order to be valid.

On the other hand, in practice, the submission for approval of the share transfer contract in respect of the foreign-invested company is conducted by the company itself so there is in no way the possibility of the company denying the knowledge of the deal. So once the share transfer contract is duly approved by the government, the buyer can be said to be the shareholder of the foreign-invested company.

The problem with respect to share transfer in foreign invested company is in most cases related to delay or refusal of application for approval of the deal contract. However this is another issue to be addressed in future posts.

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