

# A Study on the System of the Appraisal Right of Dissenting Shareholders for Share Repurchase in China

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**Abstract**—The dissenting shareholder repurchase system is an effective way to safeguard the interests of shareholders, and it is necessary to fully understand the concept and characteristics. However, the protection of dissenting shareholders' right to repurchase shares is weak in China, and there are many problems in legislation, and many disputes in judiciary either. In order to protect the interests of minority shareholders, and to promote the maximization of social fairness and efficiency value, it is of great practical significance to improve the system of the appraisal right of dissenting shareholders for share repurchase in China.

**Index Terms**—Dissenting shareholders, appraisal right, corporation law, share repurchase.

## I. INTRODUCTION

The shareholders meeting resolution is adopted by the Principle of Capital Majority Representation, which means the shareholders shall exercise their voting rights on the basis of their respective percentage of the capital contributions. The shareholders who own a large number of shares enjoy more rights in the voting process of the shareholders meeting, and their benefits can generally be fully protected. However, the minority shareholders who enjoy small proportion of voting rights in the shareholders meeting are unable to make decisions about the company. Thus, their interests are more easily overlooked. Special attention and protection should be given by law either, in order to correct the imbalance between the interests of shareholders effectively. The system of the appraisal right of dissenting shareholders for share repurchase is a corrective mechanism. Its essence is to give the shareholders who are opposed to the resolution of shareholders meeting the right to require the company to recover their shares at a reasonable and fair price. Based on this, the seventy-fifth article of China's new corporation law confirmed the right of dissenting shareholders to repurchase shares for the first time. However, it should be noted that, although this system has been made, it still needs to be improved gradually from the perspective of protecting the interests of minority shareholders.

## II. AN OVERVIEW OF THE APPRAISAL RIGHT

### A. The Concept and Origin of the Right

The right to repurchase shares of dissenters originated from

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the United States. The model business corporation act and the corporation law of each state have clearly defined the right to repurchase shares of dissenting shareholders. In accordance with the relevant provisions of the corporation law of the United States, the dissenting shareholders may have the right to request the dissenters in the following five cases [1],

- 1) Technical company merger.
- 2) Stock exchange plan.
- 3) The sale or exchange of company property in abnormal commercial activities.
- 4) Amendment of articles of Association.
- 5) Articles of association, company management rules or board resolutions.

The appraisal right of dissenters for share repurchase is a right which allows the minority shareholders who hold different opinions on the resolution to request the company to buy their shares at a fair price, and exit the company [2]. Its meaning is usually divided into broad sense and narrow sense [3]. The concept of narrow sense refers only to the right to repurchase shares of dissenting shareholders in joint stock companies. The concept of the broad sense also includes the right of the dissenting shareholders in limited liability company to repurchase shares. The new corporation law basically adheres to the broad sense, and recognizes the shareholders of limited liability company and limited company have the right to request the company to repurchase their shares in the form of legislation.

### B. The Nature of the Right

The Chinese scholars generally believe that the appraisal right of dissenters for share repurchase belongs to the right of formation in nature. As presented by professor Ye Lin, the seventy-fifth article of China's new corporation law have adopted the statement that "the shareholder may request the company to purchase its equity at a reasonable price". However, when it comes to its nature, we should proceed from the characteristics of continuing legal relations and determine its nature as the essence of the right of formation rather than adhere to the law rigidly [4]. The shareholders and the company do not sign a contract, but there is a continuing legal relationship between them. In this continuing legal relationship, the shareholders should be able to terminate the relationship with the company when there is a major cause. In order to protect the interests of dissenting shareholders, restrict and even eliminate unreasonable confrontation, legislators should set the equity claim for acquisition as the right of formation, so as to achieve the purpose of dissenting shareholders to withdraw from the company and obtain fair compensation.

### III. THE LEGISLATIVE STATUS OF THE APPRAISAL RIGHT IN CHINA

The seventy-fifth article of China's new corporation law provides that in one of the following circumstances, the shareholders who vote against the resolution of shareholders meeting may request the company to acquire their equity at a reasonable price:

- 1) The company meets the conditions for the distribution of profit, and has been profitable but not distributed profits to shareholders for five consecutive years.
- 2) Company merger, division, transfer of principal property.
- 3) Pursuant to the provisions of the company's articles of association, the term of operation of the company expires or one of the other events which are grounds for dissolution occurs, the shareholders meeting adopted a resolution to amend the articles of association to keep the company alive. Within sixty days from the date of the adoption of the resolution of the shareholders' meeting, the shareholders and the company can't reach an agreement on the acquisition of shares, the shareholder may bring a lawsuit to the people's court within ninety days from the date of the resolution adopted by the shareholders' meeting

In addition, the 143<sup>rd</sup> article of the new corporation law provides that the company shall not acquire shares of the company itself. However, shareholders may require the company to acquire their shares for their disagreement about the merger and the resolution of split. In the case of the acquisition, the acquired shares shall be transferred or cancelled within 6 months.

The provisions of China's dissenting shareholders' appraisal right are a big progress in Chinese corporation law legislation. It plays an important role in perfecting the system of protecting the interests of minority shareholders and balancing the two sides of the capital majority rule.

However, through the analysis of its legal provisions, we can also find the following deficiencies:

#### *A. Too Narrow Scope of Application*

For the appraisal rights of dissenting shareholders for share repurchase in limited liability company, the corporation law only stipulates three kinds of circumstances. In the first case, the shareholders have the right to repurchase shares only if the company has been profitable for five consecutive years and has not distributed the dividend. This condition is too harsh, and not conducive to the protection of the rights and interests of dissenting shareholders. In the third case, the variation in the company's articles of association provides only one condition, and no amendment to any other articles that may cause significant changes in the company's structure.

For limited company, China's corporation law stipulates that only in the case of mergers and acquisitions, the dissenting shareholders could enjoy the right to repurchase shares. However, in the case of a joint stock company, in addition to the merger and reorganization, the controlling shareholders still have a lot of interests which is against the interests of minority shareholders, such as the sale of major assets, changes in the scope of the company's business, amendment in the articles of association, etc.

As can be seen above, the corporation law of our country

has a great limitation on share repurchase of the dissenting shareholders, which is not conducive to the comprehensive protection of the interests of minority shareholders.

#### *B. Deficiency and Lack of Exercise Procedures*

In China, only the seventy-fifth article of corporation law provides for the procedures for the exercise of the right to repurchase shares, that is, within sixty days from the date of the resolution of the meeting, the shareholders and the company may reach an equity acquisition agreement, if no agreement was reached, the shareholders may bring a lawsuit to a people's court within ninety days from the date the resolution was adopted by the shareholders' meeting. This provision is too simple, not specified for many other relevant legal systems, and not conducive to protecting the interests of minority shareholders.

The exercise of the right to repurchase shares of Limited by Share Ltd lacks reasonable procedures. China's new corporation law only provides the scope of application of the right to repurchase shares of the stock company, and does not provide for the exercise of the procedures. Besides, the relevant provisions of whether the right is applicable to limited company exist questions.

For the disposal of shares repurchased, the limited liability company has no rules about it. However, Limited by Share Ltd stipulates that it should be transferred or canceled within six months. There are questions about whether limited liability company can apply the share repurchase provisions of Limited by Share Ltd.

As can be seen, the provisions of the procedures for the exercise of the appraisal right of dissenters are too simple in China. And it lacks specific procedural rules.

#### *C. The Legislative Provisions Are Too Abstract and Lack of Maneuverability*

The corporation law of our country is not clear about the scope of the shareholders of the implementation of dissenting shareholder repurchase system.

The standard of "main property" is not specified. For different companies, the main property has different meanings. However, the corporation law does not provide a general applicable standard [5]. Such a simple abstract is not conducive to practical operation, and it is difficult to protect the interests of minority shareholders.

As can be seen, the legislative provisions of the right to repurchase shares of dissenting shareholders are too simple, too abstract, and lack of operability.

### IV. THE PRESENT SITUATION OF THE JUDICIAL DISPUTE

By the Chinese referee instrument network, the author has found six results by using "dissenting shareholder repurchase" as the key word. Based on three judgments of them, this paper focus on the disputes and analyzes the disputes in the repurchase of dissenting shareholders.

#### *A. Whether the Transferred Property Is the Main Property of the Company*

In the disputing case that Xi'an Sanyuanda Haitian antenna Co. requested Shenzhen Jinxin high-tech Limited by Share

Ltd to acquire the shares, the two sides have a dispute on whether the property transferred by the company is main property.

Factors in determining whether the transferred property is a major factor in the company's property include as follows:

- 1) Whether the transfer of property is core assets of the company.
- 2) The proportion of the company's assets.
- 3) Whether the act of transferring property affects the purpose of the establishment of the company and the existence of the company, and whether it affects the normal operation of the company.

Therefore, under the circumstances that the legislation does not specify the scope of the main property, and based on the above considerations, the court considered that the plaintiff's claim that the laboratory is the main property of the defendant is insufficient and difficult to recognize.

#### *B. Whether the Right to Repurchase Shares Has Been Lost*

In the disputing case of the plaintiff Yang Jianxin sued the defendant Nantong iron and steel Economic Development Co., Ltd to requested the company to acquire its equity, the two sides have difference on whether the defendant has distributed to the plaintiff for 5 consecutive years, whether the transferred property is the main property of the company, and whether the plaintiff's right to repurchase shares has been lost.

"Equity shareholders and the company have not reached a purchase agreement" is the premise of shareholders' litigation, including shareholders shall request the acquisition of equity to the company. But the corporation law does not make specific provisions on whether it must be made in a written formal way or not. Nantong iron and steel Economic Development Co., Ltd fails to fulfill the obligation of disclosure, and makes strict demands on the form of the repurchase, which is obviously unfair to minority shareholders and not conducive to the protection of minority shareholders' rights and interests.

Therefore, the court finds the reason that Yang Jianxin has lost his right is invalid and court inadmissible.

#### *C. Whether the Articles of Association of the Company on Repurchase of Shares are Invalid Due to Violation of the Corporation Law.*

In the disputing case of the plaintiff Deng Zhongsheng sued the defendant Zhuzhou Architectural Design Institute Co., Ltd and Xie Hui for Equity transfer, the two sides are in dispute over whether the articles of association of the company on repurchase of shares are invalid for the reason that it violates the provisions of the corporation law.

Article seventy-fifth of the corporation law is about the provisions on the right to repurchase shares of dissenting shareholders in limited liability companies. If one of the three statutory requirements was satisfied, the company is obligated to repurchase the shares of dissenting shareholders. However, the provisions does not specify that the company can only repurchase the shares of dissenting shareholders and not for other shareholders of the company. The law does not have any prohibitive provisions on the purchase of shares of limited liability companies.

Therefore, the court rejected the reason presented by

prosecutor, that is, in addition to the repurchase rights given by the seventy-fifth article of the company's law, the limited liability company is not allowed to repurchase shares.

### V. THOUGHTS ON PERFECTING THE SYSTEM

In view of the problems mentioned above and the problems existing in the legislation of the dissenting shareholders' share repurchase in China, the following suggestions are put forward to improve the system of share repurchase of the dissenting shareholders' in China.

#### *A. Whether the Transferred Property is the Main Property of the Company*

The corporation law in our country has a lot of restrictions on the use scope of dissenting shareholder repurchase in Limited liability company and Limited by Share Ltd, which is not conducive to the comprehensive protection of the interests of small shareholders. Thus, the company can expand the situations of repurchasing shares of dissenting shareholders to better protect the interest of minority shareholders.

Besides, the corporation law may give the company the freedom to set up the dissenting shareholder's right of share repurchase in the articles of association and the management system. Under the premise of not violating the prohibitive provisions of the law, this kind of freedom should be reasonable and legal.

#### *B. Perfect Exercise Procedure*

The corporation law in our country only stipulates that if the shareholder and the company fail to reach an agreement on equity acquisition within 60 days from the date of the meeting, the shareholder may bring a lawsuit to a people's court within 90 days from the date of the meeting. However, the legislation does not mention whether the obligation of the company to inform the shareholders is needed or whether any notice of objection of the shareholders is needed before voting against. In order to protect the procedural justice of the dissenting shareholders' share repurchase system, lessons should be learnt from foreign legislation to formulate the relevant procedures for the exercise of the right to repurchase shares.

Firstly, the company shall write to the shareholders to inform that they have the right to dissent, for example, stated that the shareholders enjoy the right in the meeting notice. Secondly, the shareholders who have received the notice of the meeting and have any objection to the meeting shall submit a written objection to the company in a timely manner. Thirdly, after the adoption of the resolution of the shareholders' meeting, the dissenting shareholders may request the company to repurchase shares.

#### *C. Clarify the Scope of Dissenting Shareholders*

Due to the complexity of the identity of the shareholders, the dispute is often relatively large in determining the qualifications of the dissenting shareholders who enjoy the rights to repurchase shares. The corporation law of our country has no clear stipulation on the scope of the shareholders who have the appraisal right of dissenting shareholders for share repurchase. As mentioned before, the

legislation shall make it clear on whether the shareholders who have the right to vote, the shareholders of derivative acquisition, and defective contributed shareholder are the subjects of rights.

*D. Specific Provisions to Determine the Price of Share Repurchase*

The corporation law of our country only explains the method of determining the repurchase price through consultation or court, but there is not a clear and definite provision on how to determine a reasonable price. Therefore, the method of judicial pricing should be clear. There are two kinds of ideas, namely, if the company is a listed company, you can refer to the market price to determine the stock price. Or you can calculate the actual value per share according to the amount of the net assets of the company. Since the company knows its own property well and the shareholders are in a state of information disadvantage, the company shall take the responsibility to prove the price is reasonable.

*E. Clarify the Invalid Cases of the Dissenting Shareholders' Right to Repurchase Shares*

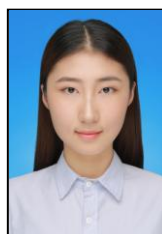
China's current legislation does not clearly stipulate the cases of failure of dissent shareholders' right to repurchase shares, which results in a lot of judicial disputes. Therefore, the legislation should clarify the invalid cases of the dissenting shareholders' right to repurchase shares, and make clear the time limit for the shareholders to exercise the right of repurchase, so as not to cause unnecessary litigation.

## VI. CONCLUSION

In fact, some problems still remain to be solved in the seventy-fifth article of China's new corporation law. The provisions of the repurchase rights for dissenting shareholders are too principle and fuzzy, which makes this system difficult to operate in practice. In order to make full use of the appraisal rights of dissenting shareholders in the protection of interests, China should learn from foreign advanced experience in legislation, and design a system suitable for our country.

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