

Interpretation and Application of the “Equal Conditions” for Shareholder’s Preemptive Right in Limited Liability Companies

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Abstract. The “equal conditions” clauses in the Company Law not only guarantee the transfer of shareholders’ right to freely dispose of property and the economic benefits obtained therefrom without substantial damage, but balance the interests among a company’s shareholders. As for the standards and specific content of “equal conditions” and how to identify them, however, there is still a lack of reliable legal basis. Therefore, this article, extracting the interpretation and application principles of the “equal conditions” clauses from judicial practice, aims to solve these problems.

Keywords: preemptive right, content of equal conditions, notice of equal conditions, special procedures.

1. Introduction

Shareholder’s preemptive right means that when a shareholder of a limited liability company transfers its shareholdings, the other shareholders have the preemptive right on condition that the transferor and a third-party reach agreement on relevant terms of the transfer. Article 71 of Company Law stipulates: “The shareholders of a limited liability company may transfer all or part of their equity interests among them. Where a shareholder transfers its equity interests to a person other than a shareholder, it shall obtain the consent of more than half of the other shareholders. The shareholder shall notify the other shareholders in writing of the transfer of equity interests and seek their consent. Where the other shareholders do not reply within 30 days of receipt of the written notice, they shall be deemed to consent to the transfer. If more than half of the other shareholders do not consent to the transfer, the dissenting shareholders shall purchase the equity interests to be transferred. If they do not purchase the equity interests, they shall be deemed to consent to the transfer. Provided all conditions are equal, the other shareholders shall have the priority purchase right for the equity interests the transfer of which has been approved by the shareholders. If two or more shareholders exercise the priority purchase right, they shall determine their respective purchase ratio upon consultation. If consultation fails, they shall exercise the priority purchase right in proportion to their respective ratio of capital contribution at the time of the transfer.” It thus can be seen that the exercise of the preemptive right is based on other shareholders’ agreement on the transfer. In other words, the preemptive right can be exercised only by obtaining the agreement of more than half of the company’s shareholders, which distinguishes China’s “preemptive right” system from other countries’ (such as France and Japan). Unlike China, other countries’ “preemptive right” is the built-in rule of the “agreement rule”, which is applicable only if other shareholders or companies do not agree to the transfer. In addition, according to Decision of the Supreme People’s Court on Issues Relating to Application of Company Law of the People’s Republic of China IV (hereinafter referred to as Interpretation IV), when exercising the pre-emptive right, a shareholder needs to prove that the transferor and the third party have reached a consensus on the equity transfer, and seek other shareholders’ consent through written documents of specific transfer terms or reasonable notification ways.

The substantive core of the shareholder’s preemptive right lies in the “equal conditions”. In the “Shareholder’s Preemptive Right” section, the Interpretation IV includes seven clauses stipulating its practical application. However, the provisions pertaining to “equal conditions” are only mentioned in Article 18 which stipulates that other shareholders can exercise the preemptive right only by meeting the “equal conditions” of the share transfer agreement reached between the transferor and the third party. As for the standards and specific contents of “equal conditions” and the way to identify them

in practice, however, there is currently no reliable basis for legislation. Moreover, scholars have different opinions on this issue. Based on existing theoretical controversies, this paper attempts to extract the interpretation and application principles of the “equivalent conditions” clauses from judicial practice, thus providing possible solutions to the above questions.

2. Views on the Interpretation of the “Equal Conditions” Clauses

2.1 Content Listed in the “Equal Conditions” Clauses

Although Article 17 of Interpretation IV lists the content of “equal conditions”, involving factors such as price, number of shares, method of payment, and time limit, these provisions are too general and hard thus to identify in practice, which is not as expected by the practice community. The academic community also has different opinions on the content of “equivalent conditions”.

2.1.1 Equity Transfer Price

Although scholars are divided on specific content of the “equal conditions”, they all recognize the price of equity transfer as the core. However, they have different views on judging the degree of price equity based on “equal conditions” and price terms.

Some scholars [1] believe that the “same price” is unreasonable. The third party might buy the equity at a higher price because it judges whether to purchase the equity according to the current business conditions disclosed by a company and determines the price without adequate understanding of the company in question. Compared with internal shareholders who know more about the company’s operating conditions and its equity value, the third party will bear unnecessary loss if buying shares at the same price. There is another case where a preferential price is given for special reasons. For example, a third party is willing to exchange a term that is more attractive to the transferee for lowered share price. In this case, if other shareholders obtain the equity through the preemptive right, the transferor will not only bear loss in the equity value, but also lose other relevant benefits that could have been obtained.

Some scholars [2] believe that the same price as that negotiated by the transferor and the third party doesn’t necessarily meet the “equal conditions”. The factors behind the price should also be taken into account, which can be evaluated in terms of money. Economic interests can be directly converted into monetary terms. As for non-economic benefits that are difficult, the currency conversion should be made if the special reason can be converted. If the conversion is impossible, however, the “equal conditions” exist only when other shareholders have the same special reason.

Other scholars have different views on whether non-economic benefits that can’t be converted into monetary terms belong to “equal conditions” [3]. They believe that such non-economic factors can be directly excluded in practice. However, the “equal conditions” standard is met when other conditions are the same, the reasons for which mainly include two aspects. First, the shareholder’s preemptive right involves the interests of three parties and the change of shareholders affects the internal structure and daily operations of the entire company. At the same time, this right is to protect the company’s closedness and thus cannot be excluded when a shareholder transfers its shares at low prices because of special reasons. Second, the shareholder’s decision to transfer the shares indicates that the identity of the company’s shareholders is no longer necessary for it. Since low transfer price can be accepted, the transferor suffers no loss when other shareholders exercise the preemptive right to acquire the shares transferred at the same price.

2.1.2 Quantity of Shares

In some cases, the shareholders having the preemptive right will purchase part of the shares transferred under the “equal conditions”. Then, can this be considered that other shareholders exercise the preemptive right under the “equal conditions”? There exist two main viewpoints on this question in the theoretical community, namely being “affirmative” or “negative”.

Scholars who support “affirmative view” believe that there are no clear legal provisions in China that prohibit the exercise of the preemptive right on part of the equity transferred, and the equity itself

is divisible. The legislative purpose of the shareholder's preemptive right is to protect the integrity of the limited liability company. If other shareholders can achieve the majority ownership by purchasing only part of the shares transferred, there is no need to preferentially purchase all of them. However, if the company's articles of association have specific provisions for exercising the preemptive right, they should be the standard. [4]

Scholars who support the "negative view" believe that although the shareholder's preemptive right is aimed to maintain the integrity of a limited liability company, it is also used to balance the interests among the shareholders who have the preemptive right, the transferor, and the third party. Simply taking into account the expected interests of other shareholders will often make the remaining shares difficult to be transferred or transferred at a lower price, thus harming the interests of the transferor. (Pennington, an expert on corporate law in the United States, believes that if the shareholders of the company are not willing to purchase all the shares of the transfer shareholder, the transfer shareholder will not be obliged to sell its shares to other shareholders of the company.) Meanwhile, in addition to obtaining investment interests, the third party often purchase the transferred shares in order to obtain a certain percentage of the company's control. Therefore, the third party's interests will inevitably be affected if other shareholders are allowed to exercise their preemptive rights.

2.1.3 Payment Method

There are generally two payment methods: lump sum payment and payment by instalments. The lump sum payment method does not incur the potential credit risk that caused by the installment method; and it is the most favorable method for the transferor because it can receive the cash obtained from the sold shares at one time. The more periods the installment is divided, the longer the payment time will be, which thus brings greater risk to the transferor and causes more uncertainties. Regarding the payment method and time limit, most scholars believe that other shareholders cannot ask for payment by installment if the third party can pay in a lump sum; if the transferor trusts the third party and accept installment method due to the third party's credit, ability to pay or corresponding guarantee provided, other shareholders should also have the same ability to pay, credit or provide corresponding guarantee as the third party do so as to meet the requirements of "equivalent conditions". [5] Whether the payment method is lump sum payment or payment by installments determines the risks the transferor will bear. Therefore, changing lump sum payment into payment by installments actually causes a substantial modification of the "equal conditions". [6] In the case of making the transfer payment by cash, the "equal conditions" is hard to identify if the third party offers a lump sum payment while the shareholders having the preemptive right ask for payment by installment. [7]

2.1.4 Time Limit

Time limit generally refers to the time of payment, that is, the time for transfer payment negotiated by the transferor and the third party. Some scholars believe that time limit can set be relatively equal. This is because, in general, the contract between the transferor and the third party is established before that between the transferor and the shareholders having the preemptive right. It is thus unfair to other shareholders if the time limit set as starting and due date of the contract between the transferor and the third party. Therefore, the starting time of the payment time limit can be set on the date when other shareholders propose to exercise the preemptive right and meet the same conditions. And the length of the payment period can be fulfilled according to that negotiated by the transferor and the third party. Some scholars believe that the time limit should be set absolutely equal, so that the rights of the transferor can be protected (Ibid.). For example, according to Article 468 of the German Civil Code, when the third party requests an extension in the contract, the shareholders having the preemptive right must provide guarantee in the amount of the deferred payment if they also want a deferred payment.

2.2 "Equal Conditions" Notification

According to Article 71 of the Company Law and Article 17 of the Interpretation IV, a shareholder shall obtain the consent of more than half of the other shareholders when transferring equity interests

to a person other than a shareholder. At the same time, the transfer shareholder has the obligation to notify the other shareholders in writing of the transfer of equity interests; and the other shareholders determine whether to express the consent to the “external transfer of equity” after receiving the notice. According to the Article 19 of the Interpretation IV, however, other shareholders may claim the preemptive right within the prescribed time limit after receiving the notice. In this case, the content of the notice shall be the specific trading conditions for the transfer of the equity to a third party. Therefore, the transfer shareholder actually has two notification obligations. It shall firstly inform other shareholders of its intention to transfer the shares and secondly inform them of the specific transaction terms it has reached with the third party, namely, the “equal conditions” notification.

In general, scholars’ opinions on the judgment of the same conditions can be divided into three categories: absolutely equal view, relatively equal view and compromise view. Absolutely equal view means that the purchaser having the preemptive right should buy the equity under the completely same conditions as other buyers, with all the contract terms being equal. Some scholars believe that the Item 2 of Article 505 of the German Civil Code conforms to the absolute equal view, which stipulates that “the transaction between the obligor and the one who has the preemptive right shall be established in accordance with the same terms as agreed between the obligor and the third party”. The absolutely equal view is aimed to protect the interests of the transferor and the third party.[8] The relatively equal view states that the priority purchaser meets the requirements of the “equal conditions” if they provide substantive conditions that are not more unfavorable to the transferor than those offered by the third party, thereby protecting the shareholders of the transferor. [9] The compromise view, as the name suggests, balances the above two doctrines. It holds that the “equal conditions” are restricted in the price terms and payment terms in the transfer contract that affect the transferor’s interests, not only ensuring the main benefit of transfer price of the transferor, but protecting the interests of other shareholders. [10]

3. Contents of the “Equal Conditions” Clauses

3.1 Equal Conditions based on Contractual Terms (Quantitative)

The equity transfer price, quantity of shares, payment method and time limit mentioned in the second part of this article are not only the enumeration of the same conditions in Interpretation IV, but also the basic items in all the contracts defined and bound by the Contract Law. Meanwhile, these equal conditions can be measured by numbers and thus can be called the equal conditions based on the contractual terms (quantitative). The opinions and disagreements on four main contents from the academic community have been summarized above. In the following part, from the perspective of judicial practice, this article summarizes the court’s discretion on relevant cases involved the equal conditions.

3.1.1. Equity Transfer Price

In judicial practice, equity transfer price has undoubtedly taken an extremely dominant position in the “equal conditions” clause. According to the written judgement of the first trial of “Equity Transfer Dispute between Xing and Xiao” (No.2213 Civil Judgement of the First Trial from the Court of the High-tech Zone (2013).), for example, “the equal conditions” include many factors with the equity transfer price being the most important. However, as for strict adherence to the “same price”, the judicial trial practice has given a relatively consistent answer despite the fact that the academic community is divided on this issue. For example, in the case of “Equity Transfer Dispute between Wang, Lu and Hu”(No. 2788 Civil Judgement of the Second Trial from the High Court (2012).), the court pointed out that when a shareholder exercised the preemptive right, the “equal conditions” were not simply equivalent to the transfer price of the equity transfer contract, but should also include the economic trade and benefits promised between the parties. In the second trial of “Equity Transfer Infringement Dispute between an Investment Limited Company and Wang”, the court held that although China’s Company Law clearly stipulated that “shareholders must exercise the preemptive right on the premise of ‘equal conditions’ and the determination of ‘equal conditions’ is generally

also the transfer price agreed between the parties to the equity transfer in practice, transfer price shall not be simply equated with the ‘equal condition’”. For instance, the parties may determine a relatively favorable price due to factors such as business relationship or interests, or decide on an abnormally high price to discourage other shareholders from exercising the preemptive right. These factors thus deserve comprehensive consideration when the “equal conditions” are determined. In the case of the “Equity Transfer Dispute between Kangqiao Company and Shen”(No.3249 Civil Appeal to the High People’s Court of Zhejiang Province (2016).), Zhejiang High People’s Court held that when there were no significant operation changes during the two equity transfer periods, there existed an intention to circumvent the provisions of the shareholder’s preemptive right stipulated by Company Law in the act of transferring few shares at an abnormally high price to let the transferee get the shareholder qualification and then transferring most of shares. In other words, Shen did not truthfully inform the other shareholders of the real transaction price. The price on the agreement was thus not “equal” and other shareholders could not assess whether to exercise the preemptive right based on it.

It can be seen that the court does not strictly follow the “same price” when judging the equity transfer price conforming to the “same conditions” clause. On the one hand, when the preferential price is given between the parties based on special business or economic factors, the special factors should also be taken into account so as to balance the interests of other shareholders and transferor. The special factor involved should be converted into a specific price if it belongs to economic interests (such as capital contribution and debt commitment). When the special factor cannot be measured by currency, other shareholders should also be required to provide the “equal conditions”. On the other hand, if the equity transfer price is fair, the court will also make comprehensive judgment and support other shareholders’ request to revoke the unfair share transfer contract that infringes their preemptive right.

3.1.2. Quantity Number of Shares

The quantity of shares is also one of the important parts of the “equal conditions” clause. Contrary to the academic community’s divided opinions on whether other shareholders can exercise the preemptive right on part of the shares transferred, China’s judicial practice without exception denies this operation. For example, in the first trial of the “Dispute between Chen, Zhou and Yang and a Company” (No. 16172 Civil Judgement from the Guangdong People’s Court (2017).), the court held that the defendant’s transfer of his all 66.7% equity of the company didn’t belong to split transfer. The plaintiff filed a lawsuit only requesting the transfer of one share held by the defendant, whose trading terms of the petition were obviously not “equal conditions”. In the case of “Equity Transfer Dispute between Suzhou Construction Housing Development Co., Ltd. and Nanjing Keshun Investment & Management Co., Ltd.”(No. 10249 Civil Judgement of the Final Trial from the Jiangsu People’s Court (2017).), Suzhou Construction Housing Development Co., Ltd. intended to transfer all 82.1% of the shares it held in Xinghe Company and sent “Letter of Inquiry on Preemptive Right of Share Transfer” to Keshun Company. After receiving the letter, Keshun Company replied that it intended to purchase 32.12% of the shares transferred. The courts of the two trials both held that the Keshun’s acquisition of only 32.12% of the shares was not in conformity with the “equal conditions” clause stipulated in the provisions of Article 48 of Interpretation IV. Instead it changed the quantity of shares transferred by Suzhou Construction Housing Development Co., Ltd.

From the perspective of the transferor, the partial exercise of the preemptive right by other shareholders is very likely to result in difficulties in selling the remaining equity, thus failing to achieve the purpose of the transaction. In addition, while the “equal conditions” cannot be split as an overall agreement, does it mean that other conditions can be split if the quantity of shares can be split? This is obviously unreasonable. Therefore, if other shareholders exercise the preemptive right, they must acquire all the shares to be sold. Otherwise, even if the other conditions are the same, the overall conditions cannot be considered the equal and thus the “equal conditions” clauses cannot be met.

3.1.3. Payment Method and Time Limit

The payment method and time limit are also important contents of the same conditions. There are numerous examples of the “equal conditions notice” being recognized by the court as invalid due to

the lack of specific payment method and time limit conditions. The payment method and time limit are related to cash flow and other factors, thus affecting the quality of the conditions as well as the judgment of having same conditions.

Ji (Party A) and Liu (Party B) agreed to transfer the equity of Yuanli Company held by Ji to Liu, with the transfer price being 3.5 million yuan in lump sum and the penalty for defaults being 20% of the total value of the shares transferred. Before the two parties made the agreement, Ji sent a letter to Sun Wei “shareholder of Yuanli Company and the third party in the first trial) informing him that an external entity intended to purchase the shares Ji held in the company at a price of 9 million yuan. Sun believed that the equity transfer specified in the letter and the agreement signed between Ji and Liu mentioned above were two different agreements. Later, Ji and Sun signed an “Equity Transfer Agreement” in which Ji transferred 30% of his shares to Sun and agreed that the equity transfer price was RMB. 3.6 million paid in three installments if he could provide cement business to Sun. Liu believed that Ji’s subsequent transfer of equity to Sun was a breach of contract since he signed a contract with Ji first, so he filed a law suit requesting that Ji continue to perform the equity transfer agreement and pay a penalty of 700,000 yuan.(No. 00042 Civil Judgement of form the High People’s Court of Jiangsu Province (2015).)

The case was tried by courts of three levels, whose core issue of dispute was whether Ji breached the contract signed with Liu. In other words, whether the equity transfer agreement between Ji and Liu have fulfilled the prerequisite of transfer and whether it was valid. In this case, it was necessary to demonstrate whether Sun’s acquisition of Ji’s shares was the exercise of his preemptive right or an ordinary equity transfer. If it was the former, it belonged to the legal prerequisite for equity transfer—the procedure of performing the obligation to send the shareholders the equity transfer notice and the “same conditions” notice. If it was the latter, however, it breached the contract for “selling one’s shares to many buyers”. The court of the first trial and the court of the second trial were divided on this issue. The court of the first trial held that the difference between the equity transfer price disclosed by Ji to Sun and that in the agreement with Liu was significant and thus it could not be regarded that Ji had fulfilled the obligation of informing other shareholders of the equity transfer. Therefore, the equity transfer agreement was invalid because it did not meet the precondition for equity transfer. The court of the second trial held that whether other shareholders’ claim on the preemptive right was blocked or not didn’t affect the validity of the equity transfer contract, while Sun’s exercise of the preemptive right caused the equity transfer agreement between Liu and Ji to be unable to be performed. Although the two courts were divided on the judgment of this issue, they both ignored the importance of “payment method and time limit” as “equal conditions”. The retrial court made improvement in this aspect.

The retrial court held that the agreement between Ji and Liu stipulated that Liu should pay 3.5 million yuan for acquiring Ji’s shares in one lump sum while and the agreement between Ji and Sun stipulated that Sun should pay 3 million yuan in installments. Although the agreement between Ji and Sun also stipulated that the transfer price was 3.6 million yuan if Ji chose Sun’s cement business to offset the total amount. Considering the interest and other factors, although the transfer price was paid by installments in three years, the term was still more unfavorable than that of 3.6 million paid in one lump sum. It was evident that Sun’s offer was lower than Liu’s and thus Sun didn’t meet the “equal conditions”. Therefore, Ji breached the contract with Liu by transferring shares to Sun when Sun was not eligible for the preemptive right.

In this case, although Sun’s conditional transfer price (3.6 million yuan) was higher than Liu’s, the retrial court explicitly considered the impact of the installment payment and the lump sum payment on the “equal conditions” clauses. Therefore, it can be seen that the content of the equal conditions needs comprehensive judgment and a simple calculation of a certain indicator or a few indicators is by no means justified because the payment method and time limit are just as important as the quantitative factors. When the payment method is installment payment, the judgment of whether the prices are equal should be made based on the comparison between the lump sum amount and the current value of installment amount.

3.2 Equal Conditions based on Subordinate Payment Terms (Non-quantitative)

Although Article 18 of the Interpretation IV only enumerates the above four factors, it does not mean that the equal conditions include no other factors, such as the liability of the external investor for the breach of contract, the commitment to improve performance, assistance in resource integration, technical support, strategic planning, business reorganization, assistance in IPOs and other various written or verbal guarantees, etc. It is out of these guarantees that the controlling shareholders of limited liability companies with the aim of expand and strengthen their companies are often willing to sell a part of the equity to the external strategic investors at a price lower than the market price. Moreover, all guarantees except for the liability for breach of contract are difficult to be measured in currency.

As mentioned earlier in this article, the understanding of price should also involve the factors behind the formation of the price, which should then be converted into monetary terms. For those factors that cannot be measured, other shareholders should also have this special reason to be regarded as meeting the “equal conditions” clause. If other shareholders claim the preemptive right in court by relying only on the quantifiable terms of the equity transfer contract and ignoring the commitments made by third-party investors to the company, the request is very unlikely to be supported by the court.

However, since these factors are unable to be measured, it is difficult to discover and prove beyond the contract the arrangement of interests between the transferor and the transferee of the shares, and it is thus difficult to judge whether such factors are equal or not. The court often requires the holders of the preemptive right provide the same resources as third party and then makes a judgment that is very unfavorable to the priority purchaser.

In this regard, the author suggests that the holder of the preemptive right may require the transferor to stipulate in the equity transfer agreement with the third party a “performance bond” item targeted at the resource provider other than the equity transfer price. This makes the identification of the “equal conditions” more transparent and more operable, while at the same time maximizing the interests of the transferor and the company.

3.3 Third Party Transferee Information

In general, the transfer price and the number of shares in the “equal conditions” clause are the most basic, most important and most intuitive basis for claiming the preemptive. Therefore, there is less controversy on these two factors in judicial practice. However, there are divided views on whether or not to disclose the external equity transfer contract and the information of the transferee of the equity in the identification of the equal conditions.

The Pumping Company had a total of 9 shareholders, including shareholders Ding, Li, and Feng (hereinafter referred to as “Ding and the other two”), shareholder Qu, and shareholders Chen, Ou, Wang, Ma and Lu (hereinafter referred to as “Chen and the other four”). The company convened a shareholders’ meeting and decided to transfer all the shares held by all shareholders to a third party at a price of 1/3. In the resolution of the shareholders’ meeting, Qu stated that he decided to preferentially acquire the other shareholders’ equity. On the same day, Qu and “Chen and the other four” made an agreement in which Qu would acquire the entire equity of “Chen and the other four” at a price of 1/3 and pay them in installments.

“Ding and the other two” fulfilled the notification obligation by sending Qu the equity transfer contracts they respectively signed with the outsiders Cao and Fu. In reply, Qu claimed the preemptive right to buy the shares of “Ding and the other two” at the price decided on the shareholders’ meeting and the payment terms he made with “Chen and the other four”. Qu was rejected by “Ding and the other two”, so he appealed to the court to confirm his preemptive right to purchase the shares of “Ding and the other two”(No. 31Civil Judgement of the Preemptive Right Dispute between Qu and “Ding and the Other Two” from the Supreme Court (2012).).

The case was tried by people’s court of three levels and the focus of the dispute in the trial lied in whether the transfer price of being 1/3 recorded in the resolution of the shareholders’ meeting belonged to the “equal conditions” clause. In other words, whether the “equal conditions” were met

or not when the payment method, the time limit and information of the third party of the equity transfer were not disclosed.

The first trial held that the “equal conditions” included not only the transfer price, but also other terms that were favorable to the transferor, such as the time limit and the breach clause. Since the shareholders’ resolution of Pumping Company’s did not specify the third-party information and liability for breach of contract, the “equal conditions” cannot be considered to have been met. Therefore, Qu could not exercise the preemptive right.

The second trial concluded that the price of the equity transfer decided in the resolution of the shareholders’ meeting of the company was consistent with the price agreed between Qu and “Chen and the other four. In addition, the agreement on specific time limit and the liability for breach of contract was basically the same, so Qu had exercised the preemptive right in the shareholders’ meeting.

The Supreme People’s Procuratorate filed a protest against the second trial. Among the reasons for the protest, the Supreme Procuratorate proposed that the conditions for Qu exercising the preemptive right on the equity of “Ding and the other two” were not determined. Moreover, the equity transfer conditions determined by the shareholders’ meeting only involved the equity transfer price; but specific information of transferee and other factors concerning the equity transfer were not clearly defined. Therefore, conditions for the transfer of the shares of “Ding and the other two” could not be considered to have been determined at the shareholders meeting.

After the trial the Supreme People’s Procuratorate stated that the prerequisite of exercising the shareholder’s preemptive right was that the transferor and a third party rather than the other shareholders had reached an equity transfer agreement which included the amount of the payment, the time limit, and the payment method and all other factors requiring consideration. In this case, the transferees were not present, and their identity and the specific transfer contract were not disclosed until the resolution of the shareholders’ meeting was signed in the end. In other words, the prerequisite of exercising the preemptive right was not met because the external transferees were not determined. Therefore, the judgement of the second trial was revoked and the judgement of the first trial was sustained.

From the judgement of this case and the case of “Equity Transfer Dispute between Zheng and Yang”(No. 10505 Civil Judgement of the Sichuan People’s Court (2018).), it is known that to guarantee the preemptive right of other shareholders judicial practice usually requires the equal conditions to include not only quantitative factors, but also the information of the transferee and the transfer contract with the transferee.

Although some scholars believe that disclosing the information of a third party is unnecessary and the “equal conditions” should be considered to be met by only disclosing the price term in the prior contract. [11] Since the lack of full consideration in the resolution of the shareholders’ meeting was the key reason for which the court of the first trial and the Supreme Court judged the “equal conditions” to be invalid in this case, it is evident that the judicial practice considers specific information of the third party as one of the contents of the “equal conditions” for exercising the preemptive right.

Therefore, the author believes that the third-party information also belongs to content of the “equal conditions”. First, the offer must be sent to a specific party, which is, in most cases, only an offer invitation if there are no specific parties. When the equity transferor and the specific buyer initiate an offer with each other, the two parties enter the negotiation of business clauses once one of the parties accepts the offer. Second, where there exists asymmetric information in the business clauses between the equity transferor, the third-party buyer, and other shareholders, other shareholders will be in a relatively unfavorable position. Therefore, similar to the qualification conditions in property rights transactions, the transferee sometimes needs to have special qualifications to be considered as meeting “equal conditions”. The information of the third party is more helpful to other shareholders to comprehensively determine whether it is necessary to claim the preemptive right.

4. Notification of “Equal Conditions”

4.1 Distinctions between “Equity Transfer” Notification and “Equal Conditions” Notification

Although the transferor is the obligator of both the “equity transfer” notification and the “equal conditions” notification, these two notification obligations belong to different stages in the whole process of equity transfer. According to the provisions of the Company Law and Interpretation IV, the “equal conditions” notification is different from the “equity transfer” notification. Even though they may be combined in practice, the two procedures are different in terms of both academic theories and legal provisions.

The “equity transfer” notification is made in the “consent procedure” of the equity transfer. According to Article 71 of the Company Law, when a shareholder transfers its equity interests to a person other than a shareholder, it shall obtain the consent of more than half of the other shareholders. The shareholder shall notify the other shareholders in writing of the transfer of equity interests and seek their consent. The notification here refers to the “equity transfer” notification, the content of which conveys the transfer intention. Where the other shareholders do not reply within 30 days of receipt of the written notice, they shall be deemed to consent to the transfer. This is the process of issuing “equity transfer” notification and getting feedback. In essence, it is the process of making internal decisions on equity transfer issues, thus belonging to the “consent procedure” for equity transfer.

The “equal conditions” notification is made in the “priority purchase procedure” of the equity transfer. According to Article 19 of Interpretation IV, other shareholders may claim the preemptive right within the prescribed time limit after receiving the notification. The notification issued by the transferor here is the “equal conditions” notification, the content of which shall be the specific trading conditions for the equity transfer, so that other shareholders may comprehensively judge whether to claim the priority purchase right. This is the process of sending and receiving “equal conditions” notification, which should belong to “priority purchase procedure” for equity transfer.

The “equity transfer” notification may be issued prior to the “equal conditions” notification, or the “equity transfer” notification may include the “equal conditions” (on the condition that the equity transferor and the third-party buyer have reached agreement on the main transaction terms of the equity transfer). In other words, the internal decision-making of equity transfer and other shareholders’ choice of claiming the preemptive rights can be carried out simultaneously.

4.2 Disclosure of “Equal Conditions”

As mentioned above, the consent procedure and the priority purchase procedure are often combined in practice, so the disclosure of the equal conditions and the disclosure of the equity transfer are also combined. The impact of information disclosure method and disclosure time on the judicial judgment of the equal conditions is discussed as follows.

4.2.1 The Impact of Disclosure Methods on the Identification of Equal Conditions

The disclosure methods of the equal conditions include the path of information transmission (involving the transferor, other shareholders, external equity transferees, the company, etc.), the choice of transmission media (mail, fax, instant messaging tools, paper, etc.), and the way of notification (announcement notice, letter delivery, verbal notification, etc.). In judicial practice, the method of notification exerts a greater impact on the judicial determination of the equal conditions.

On December 15, 2010, Fuguang Lianxing Company and Ma agreed that Ma would acquire the equity of Yuelong Company held by Fuguang Lianxing Company with 4 million yuan. On December 20 of the same year, Fuguang Lianxing Company and Ma announced the equity transfer on Yongzhou Daily on January 14, 2011. On May 19, 2012, Guo, another shareholder of Yuelong Company, received the Equity Transfer Notification issued by Fuguang Lianxing Company, which informed Guo that Ma intended to acquire 40% of the shares held by Fuguang Lianxing Company for 4 million yuan. Guo replied to Fuguang Lianxing Company on the following day, clearly expressing his disagreement with the equity transfer to Ma and his willingness to acquire the equity interests at the

same price. Subsequently, Guo bought 40% equity of Yuelong Company on June 8, 2012, and then transferred it to other parties. Ma filed a lawsuit requesting the invalidation of the “Equity Transfer Contract” signed between Yuelong Company and Guo (No. 1593 Civil Judgement of the “Dispute between Ma, Guo, and Fuguang Lianxing Company” from the Supreme Court (2015).). The first trial, second trial, and re-trial of the case all determined that Ma’s method of notifying the equity transfer was not in compliance with the written notification required by the Company Law. Therefore, Ma shall not assume that Guo had waived the preemptive right on the ground that the equity transfer notification had been announced.

The question raised in this case was whether the disclosure method of making announcement through public media was a statutory or justifiable one that disclosed “equal conditions”. The Interpretation IV stipulates that the transferor shall seek other shareholders’ consent by notifying them in written document or other reasonable means that can confirm the receipt of the equity transfer notification. In this case, the court determined that the disclosure of equity transfer made by transferor and the third-party transferee in the public media did not conform to the disclosure of equal conditions stipulated by Interpretation IV. This judicial application is in line with the legislative purpose of the preemptive right to protect the integrity of a limited company. Considering the fact that the method of announcement in this case did not guarantee the receipt of the notification by other shareholders, it was thus neither a legal nor a reasonable method of disclosing “equal conditions”.

4.2.2. The Impact of Disclosure Time on the Identification of Equal Conditions

In the case of “Contractual Invalidation Dispute between Ma and Guo and Guangdong Fuguang Lianxing Co., while Ma and Fuguang Lianxing Company signed the contract on December 15, 2010, Guo received the Equity Transfer Notification issued by Fuguang Lianxing Company on May 19, 2012, 1 year later. Due to the failure to submit evidence to prove that Guo had been informed of the equity transfer agreement in written document, that the time when Guo has received the notification and that Guo had clearly waived the preemptive right, Ma could not claim that Guo shall no longer exercise the preemptive right on the ground that Guo had not done so for more than a year.

In this case, the first notification was made on December 20, 2010, only 5 days after the date of the signing of the equity transfer agreement between the company and Ma. Since the method of notification did not meet the requirements of the Company Law, however, it could not be judged that Guo had waived the preemptive right according to this notification. Although the second notification was made more than one year after the date of the signing of the equity transfer agreement between the company and Ma, the court determined that it was in the valid period for fulfilling the notification obligation because its formality conformed to the Company Law. Therefore, although the current Law does not clearly stipulate the time limit for the shareholders who sell the equity to fulfill the notification obligation, it can be seen from judicial practice that the disclosing time does not affect the judicial determination of equal conditions as long as the content of the equal conditions notification and the disclosing method are in line with the law.

4.3 Determination of “Equal Conditions”

The determination of “equal conditions” is operable only when the transferor and a third part have reached an agreement on equity transfer and more than half of the shareholders consent to it. Therefore, as the name implies, the “same conditions” are a result of the comparison made in the following three ways.

4.3.1 Determining Equal Conditions based on the Terms of the Contract Signed First

Whether the “equal conditions” are exactly the same as the content of the contract signed first determines that there are two cases of being “absolute equal” and “relatively equal”.

There is a being “absolutely equal” view in both theoretical community and judicial practice, which means that all the conditions in the transfer agreement concluded between the transferor and the third party are “equal conditions”. The advantage of the view is that the determination of the equal conditions is justified and easy to be accepted by the court. However, there are some drawbacks as well. First, it may bring the transferor liability for breach of contract when he or she is unable to fulfill

the transfer contract. Second, although it seems to support the shareholder's preemptive right, other shareholders are actually excluded from the priority purchase right in most cases, especially when other shareholders are individuals with medium wealth but the third party is a corporate entity with broad financing channels, which is mainly reflected in the equal purchase price and quantity. For example, the other shareholders have to give up acquisition only because the third person can obtain the loan from the bank to pay the equity transfer. In addition, other non-economic benefits may be met by only a specific third person. Therefore, it is unfair on other shareholders if the equal conditions are determined in full accordance with the prior contract.

Those who agree with being "relatively equal" believe that the equal conditions are met as long as the purchase terms proposed by other shareholders are not worse than those of prior contract. For example, if the transfer price is RMB 124,340,000 at an annual interest rate of 10, the equal conditions are met when the third party chooses to pay in one lump sum and other shareholders choose to pay 50 million yuan at the end of each year for three years. This is because the present value of the two payment methods is actually equal, even if time limit is different. The advantage of this method is that the confirmation of the equal conditions is more flexible. However, its disadvantage lies in that some unquantifiable factors are difficult to be measured with a uniform benchmark, thus leading to greater discretion in the judges' determination of equal conditions.

4.3.2 The Price Inquiry Procedure before the Signing of the Equity Transfer Agreement

One price inquiry method is that the shareholders estimate and discuss the enterprise value internally and then reach a valuation interval based on their own understanding of the enterprise and the expectation of its future development. Then the equity transferor looks for a third party. Finally, other shareholders choose whether to claim the preemptive right based on the third-party bid and their own valuation of the company.

Another method of price inquiry is that the transferor notifies the other shareholders of its quotation in advance. If other shareholders are unwilling to purchase and a third party offers an equal price or a greater one in the transfer contract, the other shareholders may no longer claim priority purchase right. If the quotation is lowered due to the lack of buys, the transferor shall notify other shareholders again to determine whether they are willing to buy the shares. This process is stopped until the price is accepted by a third party. The advantage of this method is that the process of constant price inquiry and comparison is carried out with the equal condition's notification, so there will be fewer disputes on the equity transfer procedure among shareholders. However, its disadvantage lies in that the equity transferor raises the quotation in order to maximize personal interests, which infringes on the preemptive right of other shareholders.

4.3.3 Price Determination Procedure that Occurs Simultaneously with the Equity Transfer

The equity transferor may entrust an auction company to publicly auction the equity to be transferred. That is, the court notifies the other shareholders of the company to come to the auction site, who, however, do not directly participate in the bidding. After the highest bid emerges, the auctioneer asks other shareholders whether they are willing to purchase the shares at the price provided by the highest bidder. If other shareholders are not willing to buy, the auctioned equity will be acquired by the highest bidder. If they are willing to buy, then the auctioneer asks if there are any other third-party buyers who are willing to increase the bid. The shareholders will be asked whether to buy after the price increase. This process is repeated until the one of them quits and the auction is completed. Once the shareholders express willingness to buy at the bidder's offer, the bidder shall not bargain again.

The advantage of this method is that the other shareholders of the company exercise the preemptive right after the highest bid emerges and the auctioneer seals the deal, thus not only complying with the auction rules but exercising the preemptive right under the same conditions. It greatly improves the efficiency of equity transfer. The disadvantage lies in that there is a risk that the equity transferor and the bidders may collude to raise the transaction price.

All of the methods mentioned above have their own advantages and disadvantages. Combined with judicial practice, the author suggests that transferor sign a framework agreement with the third-

party buyer after fulfilling the obligation of notifying the equity transfer to other shareholders. The price, quantity, payment method and time limit involved in this framework agreement serve as the basis for the transfer's obligation to notify the equal conditions. Meanwhile, the framework agreement should include the following two clauses: the framework agreement will be invalid if the other shareholders claim the preemptive right; the framework agreement will be further negotiated to form an official contract if no shareholders claim the preemptive right, which can not only help avoid the risk of transferor's breach of contract, but also improve the efficiency of equity transfer. Moreover, the notification of equal conditions received by other shareholders is relative comprehensive, which help them made a reasonable judgement.

5. Application of “Equal Conditions” in Special Procedures

Since the identification of equal conditions in special procedures such as auctions and property rights transactions shall conform to the Auction Law, the Property Law, and other legal rules pertaining to property transactions, ambiguity and disputes may emerge because one appeal simultaneously applies to different legal provisions.

5.1 Auction

Article 72 of the Company Law affirms the exercise of the preemptive right by other shareholders in special procedures such as auctions. Compared with ordinary procedures, the auction procedure causes the following disputes when applying the identification of equal conditions: whether other shareholders must attend the auction in person and participate in it so as to be regarded as having the equal conditions as other bidders; and whether the equal conditions follow the preferential principle of same time and equal price. Article 14 of the Provisions of the Supreme Court on Auction and Sale of Properties in Civil Enforcement Proceedings by People's Courts stipulates “A people's court shall, within five days prior to an auction, notify, in writing or by any other appropriate means of which a confirmation of receipt is available, the parties concerned and the known owners of right of secured property, preemptive right, or any other preferential right to be present at the auction date. Any owner of preemptive right who fails to be present upon the notice shall be deemed to have waived its preemptive right.”

As for the question of whether the right holder must be present at the auction, although the literal meaning of the above provisions is “failing to be present upon the notice shall be deemed to have waived its preemptive right”, they, in fact, mean that “lack of intention to claim the preemptive right when having received the notice is considered to waive the right”. From the perspective of commercial transactions, these transactions must not only follow the efficiency orientation, but protect the interests of the transaction entities. Moreover, as for shareholders who have the preemptive right do not attend the auction, their absence unnecessarily affects the efficiency of the transaction as long as they are notified of whether they accept the final price emerged within a certain period of time. However, if the right holder neither expresses the intention to apply for the preemptive right within the prescribed time limit nor attends the auction to wait for the auction result, it should naturally be regarded to have waived the preemptive right and no longer have equal conditions as others.

On the question of whether the exerciser must participate in the auction, some scholars believe that after the auction is over, the buyer of the highest bid is entitled to sign the equity transfer contract. It is argued that other shareholders' exercise of the preemptive right changes the auction procedure and the price formation mechanism, which is a violation of Article 51 of Auction Law which stipulates that: “the auction shall be completed after the auctioneer confirm the highest bid price by dropping the hammer or other means of announcement”. [12] Based on this provision, the exerciser must participate in the auction. However, the current law does not mandate that priority purchasers must participate in the auction. If the exerciser is required to do so and to keep bidding after the highest bid emerges, it is bound to be unfair to both the preemptive right holders and other bidders because it affects not only the advantage of the preemptive right of the shareholders but the fairness

of the auction process, thus conflicting with the provisions of the Auction Law. The trial of “Bidding Dispute between Xu and Tuoyuan Company” confirmed this concept.

Both Tuoyuan Company and Sanquan Government are shareholders of Dahe Power Station. Tuoyuan Company notified the Sanquan Government that it intended to dispose of its equity of Dahe Power Station through auction, and announced the “Bidding Instruction” on November 25, 2011. Sanquan government sent a letter to Tuoyuan Company stating that its entrusted Xiang to participate in the bidding as an agent and requesting the preservation of its preemptive right. Tuoyuan Company replied that “Under equal conditions, if the Sanquan Government would participate in the bidding, the winner would be bidder with the highest price according to the price priority principle; if the Sanquan government would not participate in the bidding, the preliminary winner would be determined according to the price priority principle. And then it would solicit the Sanquan Government’s preferential purchase intention at the preliminary highest price. The Sanquan Government would be ultimate winner of the auction if it agreed to purchase the equity at this price. Otherwise, the preliminary winner would be the ultimate winner.”

Although Xiang, the entrusted agent of Sanquan Government, attended the auction he did not participate in the bidding. The highest bid, 3.2 million yuan, was made by Xu. On the same day, the Sanquan Government stated in writing that it was willing to purchase the shares of Tuoyuan Company held in Dahe Power Plant at the bid of 3.2 million yuan. The two parties subsequently signed an equity transfer contract.

Xu believed that the Sanquan Government’s failure to participate in the actual bidding in accordance with the principle of “equal priority, same time and equal price” should be regarded that it had waived the preemptive right under the equal conditions. Therefore, he appealed to the court requesting the defendant Tuoyuan Company to fulfill its obligation for the bid contract and sign the “Equity Transfer Contract” with the plaintiff Xu himself.

The court held that the equal conditions of the preemptive right only referred to equal conditions of acquiring shares, rather than the principle of “equal priority, same time and equal price” claimed by the plaintiff. In other words, as a preemptive right holder, the Sanquan Government did not have to participate in the auction as a bidder like the plaintiff Xu. Therefore, the Sanquan Government’s failure to participate in the actual bidding did not result in its loss of the preemptive right.

It can be seen from the above judicial case that, in the auction procedure, other shareholders shall clearly state whether they will exercise the preemptive right within the statutory time (within 20 days from the date of receiving the notice); when other shareholders reserve the right but do not participate in the bidding, the equal conditions of exercising the preemptive right should be the highest bid. The auctioneer shall ask other shareholders whether they are willing to buy the equity at the highest price before dropping the hammer. If the shareholders are unwilling to buy, they will then be deemed to have waived the preemptive right.

5.2 Property Transactions

Article 28 of the Interpretation IV stipulates that the transfer of state-owned equity in a property rights trading place established in line with the law, to which the “written notification” and “equal conditions” provisions stipulated in Article 71 of the Company Law are applicable, shall be made in accordance with the exchange rules formulated by Assets and Equity Exchange.

The public bidding of the property trading institutions of state-owned equity (such as the Shanghai United Assets and Equity Exchanger, hereinafter referred to as the “UAE”) is aimed to maximize the value of state-owned assets and prevent its loss by extensively soliciting buyer. Therefore, the transfer of state-owned shares needs to follow stricter and special trading rules. First, the pricing principle of transferring the state-owned shares is “the price should be set in line with the law, recognized by the institutions that perform as buyers, and then reviewed and approved by the people’s government at the same level; and the lowest transfer price should be reasonably determined”.(Article 54 of the Enterprise State-owned Assets Law) Second, unlike the equal conditions of the general equity transfer, the property trading rules of the state-owned shares set the qualification and trading conditions of the

transferee. When the preemptive right is applied in the transfer of state-owned equity, these two conditions shall be covered into the “equal conditions”.

In the transfer of state-owned shares, the prospect transferee shall satisfy certain qualifications and trading conditions. Article 9 of the Operation Rules for the Transfer of State-owned Property Rights of Enterprises stipulates that “The transferor shall disclose in the ‘property transfer announcement’ the basic information of the transfer object, trading terms, qualifications of transferees, relevant information that has a significant impact on property transactions, the choice of bidding methods, the setting of trading margins. Article 12 stipulates that “The transferor may reasonably set the qualifications of transferee according to the actual situation of the target enterprise. Qualifications of the transferee may include the entity qualification, management ability, asset size, etc. The transferor can also require the transferee to provide written or specific explanation on the criteria for determining its qualifications as the transferee and disclose the explanation in the transfer announcement when the property trading institution deems it necessary.”

According to the above provisions, domestic property exchanges have set the following special and specific trading terms. First, the intended transferee is required to pay a certain transaction margin. For example, UAE formulates the Property Rights Trading Margin Operation Rules of UAE, and China Beijing Equity Exchange published the Trading Margin Operation Rules for the Transfer of State-owned Property of China Beijing Equity Exchange. In addition, when applying for the formal disclose of property transfer, the transferor can set the transaction margin clauses, including the time when the deposit is paid, the specific amount, the payment method, guarantees and disposal methods, etc. In the event of violations, the same amount of margin is required to bear the liability for damages. Second, the settlement method and payment time limit of the transaction must meet the requirements of the Exchange. For instance, UAE Settlement Rules for Transfer of State-owned Property stipulates that “The transaction funds shall be settled in a unified manner. In principle, the funds shall not be collected by a third party rather than the UAE. When the payment method of the property transaction contract is paid by installments, the settlement shall not be less than that of the down payment and the down payment shall not be less than 30% of the total amount. Moreover, the settlement payment shall be made within 5 working days from the date when the Property Transaction Contract takes effect. The remaining amount shall be guaranteed legally and effectively by a third party that is recognized by the transferor. Interest on the deferred payment should be set according to the loan rate of the People’s Bank of China of the time and the payment period shall not exceed one year. Third, if there is only one eligible transferee during the information disclosure period, the transaction price shall be determined through negotiation and shall not be less than the lowest transfer price previously set. If there are two or more eligible transferees during the information disclosure period, the winning bidder shall be determined by multiple bidding. In addition to the special rules on trading conditions set by the Exchanges, the placement of the employees of the target enterprise and the disposal of the original creditor’s rights and debts are often disclosed in the public announcement as the trading terms.

Then, must the equal conditions for other shareholders to exercise the preemptive right fully satisfy the above qualifications and trading terms? Some scholars believe that the transferee qualifications are transparent and open to all potential transferee entities including other shareholders who have the preemptive right. Therefore, they are also subject to all the terms. The terms of acquiring the equity is the substantive standard that judges whether other shareholders have met the equal conditions or not. [13] However, some other scholars argue that harsh trading terms should not be included in the equal conditions because they violate the original intention and purpose of the public bidding. [14]

The author believes that the equal conditions for exercising the preemptive right in the transfer of state-owned equity should not rigidly include the special “transaction terms” set by the Exchanges for the following reasons. First, the Exchanges, which are government approved property trading institutions, are not entitled to set terms for the preemptive right holder to enter the transaction. Second, as long as the right holder claims the preemptive right according to the procedures of the Interpretation IV during the prescribed time, they are not subject to the trading terms such as trading margin and transaction price set by the Exchanges. However, the payment time limit in the equal conditions shall be basically the same as that required by the Exchanges. The equal conditions are

considered to be met if the payment is made within five working days from the effective date of the contract when the payment method is one lump sum; in the case of payment by installments, the equal conditions are met when the down payment is made within five working days from the effective date of the contract and the rest is paid within one year.

What “qualifications” should be included in the equal conditions is not absolute. The reason why the transferor sets the qualifications is to ensure better development of the transfer object by setting a certain threshold for the transferee’s entity qualification, management ability and asset size based on the basic conditions of the target enterprise. Therefore, the industry category, financial status, ability to pay, commercial credit, influence, scale, and region of the intended transferee may be included in the equal conditions, while the nature of the enterprise and factors that are irrelevant to the future development of the object enterprise shall not be included in the equal conditions to restrict other shareholders.

This article tries to specify the “equal conditions” in property transactions with the case of “Equity Transfer Dispute between Zhongjing Company and Power Company”.

The shareholders’ meeting of the New Energy Company made a resolution to agree that the Power Company would transfer its shareholding in the New Energy Company through a property trading institution, and that the existing shareholder Zhongjing Company had the preemptive right under the same conditions. Subsequently, the Exchange announced the listing of the equity transfer. The trading terms in the announcement was that “potential transferees must pay the deposit of 14 million yuan to the designated account of the Exchange within 3 working days after its transfer qualification was confirmed. Otherwise, it would be deemed to automatically waive the transfer qualification”. The qualification was that “the potential transferee must be a state-owned enterprise, a state-owned legal entity or a statutory institution that is under legal and normal operation.” Zhongjing Company believed that the special “transferee qualification” set by the Power Company in the announcement of equity transfer excluded Zhongjing Company from the bidders, which seriously infringed its preemptive right. Therefore, Zhongjing Company appealed to the court requesting the confirmation of its preemptive right under the equal conditions. It also required that the Power Company to make a new announcement at the Exchange giving Zhongjing Company a bidding period of no less than 20 working days and a three-month time limit for the equity transfer payment.

After the court mediated this dispute, Power Company and the Exchange agreed to accept the registration of Zhongjing Company as a transferee and Zhongjing Company paid a deposit of 14 million yuan after registration.

The court held that Zhongjing Company had the preemptive right as a shareholder of the New Energy Company. Since the Power Company limited the qualification of the transferees to state-owned enterprises, legal entities or statutory bodies, Zhongjing Company had reasonable grounds to believe that its preemptive right was infringed. Therefore, Power Company and the Exchange were obliged to clarify this issue and give Zhongjing Company reasonable time limit to participate in bidding. However, Zhongjing Company could only enjoy the preemptive right under the equal conditions in the bidding, and did not enjoy the preferential rights in the time limit of the equity transfer payment. Therefore, Zhongjing Company had no legal ground to claim for extended payment time limit.

It can be seen from the above case that the “qualifications” of the potential transferees of the state-owned equity released by the property trading institution shall not include the nature of the enterprise and other contents that evidently violate fair competition. Meanwhile, the “trading terms” shall be set by taking into account the choice of entering the trading, reasonable preparation time, payment time limit and other transactional items in which the preemptive right holder do not have priority over other bidders.

5.3 Transfer of State-owned Assets

The provisions on equity transfer do not apply to free transfer of state-owned assets.

Huineng Company and Jiuquan Huineng Company are both state-owned sole proprietorship companies. The shareholders’ meeting of Xinhui Company made a resolution on September 4, 2014

to agree that Huineng Company could transfer its the capital contribution of 396 million yuan in Xinhui Company to Jiuquan Huineng Company. Article 21 of the Articles of Association of Xinhui Company stipulates that the company may directly produce the resolutions of the shareholders' meeting and submit them to each shareholder for signature when the chairman thinks necessary; and the above resolutions become effective when the number of voting shareholders approving these resolutions reaches the proportion specified in the Articles of Association. In this case, the resolution to transfer equity was only signed by Xinhui Company and Huineng Company; but another shareholder Xinmao Company did not sign it. Xinmao Company then appealed to the court to claim its preemptive right. (No. 205 Civil Judgement from the Supreme Court (2017).)

The Supreme People's Court held that the number of voting shareholders that approved this resolution in this case had reached the proportion prescribed by the Xinhui Company's articles of association. Therefore, although Xinmao Company did not sign the resolution, the validity of the resolution of the shareholders' meeting could not be negated. Not notifying the shareholders meeting and the equity transfer in advance could only prove that the procedures for the shareholders' meeting of Xinhui Company were flawed; but they could not prove that the equity transfer procedure between Huineng Company and Jiuquan Huineng Company was illegal. Item 3 of Article 14 of the Articles of Association of Xinhui Company stipulates that shareholders shall not transfer their equity for free, which does not apply to the free transfer of state-owned assets though. On September 1, 2014, Gansu Electric Power Group held a joint meeting of the party and government to decide that Huineng would transfer the equity it held in Xinhui Company to Jiuquan Huineng Company. In fact, Huineng Company and Jiuquan Huineng Company did not negotiate the transfer price, because this transaction was actually the transfer of state-owned assets decided by Gansu Electric Power Group. Therefore, the equity transfer should not be subject to the relative provisions on equity transfer and thus Xinmao Company had no preemptive right on this transfer.

6. Conclusion

Due to the closedness and human integrity of limited liability companies, the combination of funds between shareholders is realized through a kind of trustworthy relationship. However, when a shareholder transfers its equity to a third party, the trustworthy relationship will be broken. Therefore, the Company Law entitles the shareholders to exercise the priority purchase right under the "equal conditions" with the aim to protect the human integrity of limited liability companies. The clauses of the equal conditions shall include the content and the notification procedures of equal conditions.

As for the content of the equal conditions, on the one hand, they shall include the price, quantity, payment method and time limit of the equity transfer, third party information, and other transaction considerations subordinate to the payment conditions. It should also be noted that the payment method, time limit and other transaction considerations should be comprehensively considered provided that the conditions offered by the shareholders do not harm the transferor's interests when compared with those offered by the third-party buyer. On the other hand, special procedure conditions (such as qualification and transaction terms) involved in auctions and property rights transactions shall not be in conflict with the current law on the preemptive right, and simply mechanical application of rules should be avoided in judicial practice. As for the notification procedures, they are the "equity transfer" notification and the "equal conditions" notification. Among them, the former notification is the "consent procedure" of the equity transfer while the latter belongs to the "priority purchase procedure". The two procedures are deemed as different in terms of both academic theories and legal regulations; but in practice they are often combined without causing procedural errors.

Due to the diversity of economic behaviors, the content of the equal conditions cannot be fully enumerated in the law and thus there have emerged various disputes over the application of the preemptive right in existing legal provisions, which then inevitably consume a lot of social resources. In judicial practice, the preemptive right rule is more similar to a pricing mechanism. In other words, other shareholders' purchase of equity should be priced according to the price and conditions reached between the transferor and the third party, which restricts the free and equal transfer of the equity of

a limited liability company to a certain extent. In addition, the exercise of the shareholder's preemptive right in special procedures such as judicial auctions often conflict with the legal provisions of relevant special procedures, which inevitably gives judges more discretion and greatly tests the fairness of law enforcement. Therefore, it is recommended that the judicial interpretation of determining the equal conditions of the preemptive right be made separately, and that the applicable standards for the equal conditions of the preemptive right in different procedures be specified. It is also advised that the limited liability companies be given enough freedom in self-governance. In other words, only the statutory content of the limited liability companies' articles of association should be added into the Company Law which in turn stipulates that the consent procedure and the priority purchase procedure for the preemptive right shall be specified in companies' articles of association so as to reduce unnecessary disputes over equity transfer in the future.

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