A Comparative Study on the Application of Shareholder Loss of Equity System

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Abstract. Entering the "14th Five-Year Plan" period, China has introduced the shareholder loss of equity system into the "Company Law," aiming to strengthen shareholders' capital contribution responsibilities and safeguard the authenticity of company capital. However, due to the abstract nature of the legal provisions and the lack of judicial interpretations, academic debates are ongoing and consensus is elusive, leading to doubts about the applicability of the system and insufficient activation efforts. To address this dilemma, this paper first elucidates the system from three aspects: applicable conditions, operational procedures, and legal consequences. It focuses on comparing and analyzing the shareholder loss of equity system with the directors' call for capital contributions the shareholder expulsion system, and the accelerated maturity system, clarifying the applicable scenarios and functional differences of each system. Based on the aforementioned analysis, the paper proposes three major recommendations: to introduce the shareholder loss of equity system in judicial interpretations to define its status; to add provisions in the judicial interpretation to delineate the scope of the system's application from both positive and negative perspectives; and to optimize the operational procedures of the system through measures such as the related director's recusal system. The aim is too perfect and activate the shareholder loss of equity system, unleash its full potential, and promote the sustained and healthy development of the socialist market economy.

Keywords: Shareholder Loss of Equity System; Directors' Call for Capital Contributions; Shareholder Expulsion; Acceleration of Maturity; Corporate Governance.

1. Introduction

With the advent of the 14th Five-Year Plan period, against the backdrop of rapid economic development and the increasingly sophisticated social credit system, the shareholder loss of equity system has emerged. The introduction of this system is not only a concrete expression of China's efforts to deepen corporate law theory by drawing on international best practices and addressing the needs of judicial practice but also a proactive response to issues such as inadequate capital contributions by shareholders and the resulting harm to companies and creditors. This system aims to strengthen shareholder capital contribution responsibilities through legal means, protect the legitimate rights and interests of minority shareholders and creditors, improve corporate governance structures, and contribute to the establishment of a robust social credit system through corporate legal frameworks. It seeks to ensure the security of market transactions and promote the sustained and healthy development of the socialist market economy.

However, since the implementation of the new Company Law, the shareholder loss of equity system has encountered significant challenges in terms of practical application and operation due to the brevity of the legal provisions and the lack of comprehensive judicial interpretations. This has led to difficulties in applying the system, with scholars and judicial practitioners debating several aspects without reaching a consensus. Furthermore, a review of publicly available data reveals a scarcity of judicial cases related to the shareholder loss of equity system. As of September 14, 2024, searches conducted by the author using keywords such as "shareholder loss of equity system" and "Article 52 of the Company Law of the People's Republic of China (Revised 2023)" on platforms like China Judgments Online, Wolters Kluwer Legal Information Database, and Alpha Legal System returned no relevant cases. A few platforms indicated no data, while most provided search results with minimal or even irrelevant connections. Even in cases where judgment documents containing the keyword "shareholder loss of equity" were retrieved, the judgments predated the implementation of the new

Company Law, where “shareholder loss of equity” was more accurately understood as “shareholder expulsion.”

This reveals that the shareholder loss of equity system is in a precarious state of being recognized in name but not effectively implemented, making the activation of this system an urgent issue. Against this backdrop, this article first provides a theoretical and systematic interpretation of the shareholder loss of equity system based on legal provisions, aiming to achieve a clearer definition. It then compares and contrasts this system with other related mechanisms under the company capital regime to clarify its independent status and prevent confusion or reluctance in its application. Finally, the article addresses the more evident issues currently facing the system and offers feasible recommendations to improve and optimize the shareholder loss of equity system, ensuring it can better fulfill its intended role.

2. Systematic Interpretation of the Shareholders' Loss of Equity System

As a newly established system, the shareholder loss of equity mechanism is defined in legal terms; however, its abstract nature makes it difficult for companies and directors to accurately identify appropriate circumstances for its application. Relying solely on the statutory provisions has proven insufficient to motivate market participants to actively use the system, rendering it largely ineffective in practice. Therefore, it is essential to systematically clarify and interpret the shareholder loss of equity system, specifying the conditions for its application and the procedures for its implementation, while also analyzing its legal impact on various parties. This section will address these three dimensions, aiming to provide a clear and practical guide to enhance the confidence and readiness of companies and shareholders in applying this system.

2.1 Applicable Conditions: Whether Non-monetary Contributions and Their Deficiency Compensation Can Apply to This System

According to Articles 51 and 52 of the Company Law, shareholder loss of equity refers to a system where a shareholder who fails to fulfill their capital contribution obligations on time, even after being urged by the company to do so, may lose the equity corresponding to the unpaid portion of their capital contribution. This decision is made by the company and communicated to the shareholder. Many scholars argue that the shareholder loss of equity system is closely linked to the company capital regime, reinforcing post-implementation regulatory measures to ensure the authenticity of company capital while safeguarding transaction security [1].

To uphold the goal of preserving the capital integrity of a company, the Company Law specifies that the prerequisite for applying the shareholder loss of equity system is the failure of a shareholder to make full and timely contributions as stipulated in the company’s articles of association. This emphasizes situations where only partial contributions are made within the designated timeframe, rather than a complete failure to contribute. Beyond clarifying contribution circumstances, it is also necessary to discuss the forms of contributions. Scholarly debate primarily centers on two issues: whether non-monetary contributions can be subject to the shareholder loss of equity system, and whether the system applies when the actual value of non-monetary assets contributed is significantly lower than the subscribed capital amount [2]—particularly the latter point.

Non-monetary contributions should indeed be covered by the shareholder loss of equity system. As discussed earlier, the legal provisions emphasize the requirements of making contributions “on time” and “in full,” and there is no justification for excluding non-monetary contributions from this understanding. Besides monetary contributions, shareholders may provide non-monetary assets, such as intellectual property rights or land use rights. Cases where the actual value of non-monetary assets is significantly lower than the subscribed contribution amount fall under the category of contribution shortfalls and should similarly be subject to the shareholder loss of equity system.

Admittedly, this conclusion might appear somewhat simplistic, but it can be further substantiated from another perspective. Article 50 of the Company Law makes it clear that “failure to make full

and timely contributions" and "the actual value of non-monetary assets contributed being significantly lower than the subscribed amount" are parallel situations, both constituting breaches of contribution obligations [3].

Based on the reciprocal relationship between capital contributions and the acquisition of equity, the relationship between shareholders and the company is essentially a contractual one under civil law [4].

When the actual value of non-monetary contributions is lower than the subscribed contribution amount, it indicates that the shareholder has failed to fulfill their contribution obligations to the company as agreed, constituting a breach of contract. As a result, the company is naturally entitled to unilaterally terminate the contract, thereby causing the shareholder to lose the equity corresponding to the unpaid portion of the contribution. Furthermore, from the broader perspective of maintaining the capital integrity of the company, if the actual value of non-monetary contributions is lower than the subscribed amount, the authenticity of the company's capital cannot be ensured [5]. This undermines the goal of maintaining a stable and substantial capital base for the company, which contradicts the fundamental purpose of the shareholder loss of equity system. Therefore, this system should be allowed to regulate such situations.

In conclusion, the shareholder loss of equity system applies when a shareholder fails to make full and timely contributions as required by the company's articles of association. This includes both monetary and non-monetary contributions, and the application should also be extended to situations where "the actual value of non-monetary assets contributed by the shareholder is significantly lower than the subscribed contribution amount." Additionally, the provisions in the Company Law regarding the payment of capital contributions or share payments upon the establishment of limited liability companies and joint-stock companies are also applicable to the shareholder loss of equity system.

2.2 Operational Procedures: Entity Selection and Basic Process

Articles 51 and 52 of the Company Law ultimately clarify the specific procedures for the operation of the shareholder loss of equity system. These procedures include the board of directors verifying contributions, issuing contribution demands, making loss of equity resolutions, and sending loss of equity notices. Among these, there are considerations for the selection of the collection subject, rights, powers, and obligations, as well as reflections on the doctrine of notice issuance, all of which are worth discussing.

2.2.1 The Board of Directors as the Best Entity for Verification and Collection of Shareholders' Contributions

The Company Law designates the board of directors as the sole entity responsible for verifying shareholder contributions and issuing contribution demands. It also clearly states that the demand for contributions is an obligation of the board, seemingly the optimal choice considering both parties' interests. From a theoretical perspective, the fiduciary duties of directors provide a framework for their role in overseeing and demanding contributions. The so-called duty of loyalty requires directors to avoid conflicts of interest between their personal interests and those of the company, and strictly prohibits the use of their position for personal gain. The duty of care requires directors to act in a manner that maximizes the company's legitimate interests and to exercise reasonable attention in fulfilling their managerial duties. In general, when directors issue demands for contributions from shareholders who have failed to contribute on time and in full, there is no conflict of interest between the directors' personal interests and those of the company. Therefore, the duty of the board to demand contributions can be considered a specific manifestation of the directors' duty of care [6].

The duty of loyalty serves as a constraint on directors, requiring them to fulfill the contribution demand obligation with the goal of maximizing the company's interests, thus laying an important foundation for the smooth execution of the demand process. This is the "ought to be" perspective. From the standpoint of the board's responsibilities and capabilities, the board, as the company's

decision-making body elected by the shareholders' meeting, executes the company's business internally and is most familiar with the company’s operational status and financial needs. It also represents the company externally and possesses professional business judgment [7], making it the most suitable "intermediary" to carry out the verification and contribution demand duties. This is the "is" perspective.

Other aspects related to the directors' call for capital contributions will be discussed in the subsequent section addressing the relationship between shareholder loss of equity and directors' call for capital contributions.

2.2.2 The Board of Directors Issues Notices based on Resolutions, Which is a Key Process to Achieve the Effect of Loss of Equity.

Faced with shareholders who have received a written demand for contribution but still fail to make up the contribution by the expiration of the grace period, the company will consider the next steps through a board resolution. It can be said that the board resolution is a prerequisite for declaring shareholder loss of equity and plays an important role in the operation of the entire system by bridging the previous steps and determining the shareholder's fate. Although verifying and demanding contributions is the board's duty, issuing a loss of equity notice to the shareholder is the board's power, granting it some discretion. In this decision, the board has the authority to make a comprehensive judgment based on factors such as the shareholder's situation and the company’s operational needs, using its business judgment. This includes determining whether issuing a loss of equity notice is necessary, whether doing so is beneficial or harmful to the company, or whether there are other alternatives superior to shareholder loss of equity.

Additionally, regarding the effectiveness of the loss of equity notice, the Company Law adopts the principle that a notice becomes effective when it is issued. I believe this approach is reasonable and justified. If a shareholder, after receiving a written demand, still fails to make up the contribution within a reasonable grace period, it is not excessive to consider this a fundamental breach of contract. On the one hand, the company has the right to unilaterally terminate the contract, resulting in the shareholder losing the equity corresponding to the unpaid portion. On the other hand, the long-term lack of capital in the company will seriously affect the efficiency of the company’s operations and management, which goes against the governance principle of "efficiency first, with fairness taken into account." Therefore, it is necessary to resolve this awkward situation promptly. Hence, adopting the principle of effectiveness upon issuance for loss of equity notices is a just and appropriate measure.

2.3 Legal Consequences: The Impact of Shareholders' Loss of Equity on Relevant Entities

Once the loss of equity notice is issued, the shareholder loses their rights. The loss of equity of a shareholder affects not only the disqualified shareholder but also the company, other shareholders, and creditors. It is crucial to reach a consensus on what rights these parties have, what responsibilities they must bear, and what obligations they must fulfill moving forward. Currently, academic discussions mainly focus on the relationship between the disqualified shareholder and the other shareholders, with some attention given to the impact on creditors and the company. Since the impact on creditors is external and typically pertains to the responsibilities between the disqualified shareholder and the company, this article will not address it separately. Instead, the focus will be on examining the effects on the disqualified shareholder, the company, and the other shareholders.

2.3.1 The Impact on Disenfranchised Shareholders

First, the impact on shareholder rights. The "rights" lost by a disqualified shareholder include both property rights, such as the right to profit distribution and the right of first refusal for new shares, as well as identity-related rights, such as voting rights and the right to information. Based on the reciprocal relationship, it is easy to understand the loss of property rights, but there is a possibility of separating this from identity-related rights. In the situation stipulated in Article 52, Paragraph 2 of the Company Law, if the identity-related rights of a disqualified shareholder are not revoked, the

other shareholders, after fulfilling this part of the capital contribution obligation, should obtain corresponding identity-related rights, which does not align with the facts. Thus, the shareholder loss of equity system deprives both the property and identity-related rights attached to the shares. However, considering the inseparability of the right to information, even after loss of equity, the law should still retain and recognize the shareholder's right to be informed about the loss of equity [8]. If this right is harmed, the shareholder can, according to the last paragraph of Article 52 of the Company Law, file an objection to loss of equity, or directly file a lawsuit regarding the right to information under Article 7 of the "Supreme People's Court's Interpretation on Several Issues Concerning the Application of the Company Law of the People's Republic of China (Amended in 2020)."

In addition to the loss of rights, the responsibilities borne by shareholders who forfeit their rights have also drawn considerable attention. Shareholder loss of equity involves a proportional loss of rights, meaning the shareholder only forfeits the equity corresponding to the unpaid capital contribution, rather than losing their shareholder status entirely. After loss of equity, does the shareholder still need to bear responsibility to creditors for the unpaid capital associated with the forfeited equity? In my view, this responsibility should not be waived until the statutory capital reduction procedures are completed or until other shareholders or third parties fulfill the corresponding capital contribution [9].

The loss of equity by a shareholder does not retroactively negate their status as a shareholder, nor does it imply that the shareholder's debt obligations to the company are extinguished. This remaining liability could serve as a mechanism to penalize the shareholder's breach of trust, preventing future cases where shareholders might deliberately trigger loss of equity to evade their capital contribution obligations. To some extent, this approach embodies the principle of commercial law's Rechtsscheinlehre, protecting the trust interests of creditors. Similarly, although a shareholder loses the right to make supplementary capital contributions after loss of equity, this merely externalizes the fact of unpaid contributions. If the company suffers damage due to the unpaid capital, the shareholder remains responsible and must provide compensation [10]. If the forfeiting shareholder is a founding shareholder, he is also jointly and severally liable under Article 50 of the Company Law for any shortfall in contributions owed by other shareholders.

2.3.2 The Impact on the Company and Other Shareholders Within the Company

After the shareholders' loss of equity, a series of ripple effects can impact the company's overall structure and operational strategy. The forfeited equity, no longer actively circulating, is officially taken over by the company and classified as treasury shares for specialized management and disposal. The company may choose to either transfer these shares or cancel them through a capital reduction. Both options carry a degree of uncertainty, requiring the company to carefully weigh the pros and cons based on its current circumstances and future plans before making a decision.

Regarding treasury shares that are not transferred or canceled within six months, the Company Law imposes a mandatory capital contribution requirement on the company's "other shareholders." It is crucial to clearly define the point in time when "other shareholders" are identified. In academic discussions, there are three main views: the due date of the forfeiting shareholder's capital contribution, the date the loss of equity notice is issued, and six months after the loss of equity notice is issued, when the company has failed to transfer or cancel the forfeited shares within this period [11].

This paper leans toward supporting the first view, which identifies the due date of the forfeiting shareholder's capital contribution as the point when "other shareholders" are established. First, the initiation of the entire loss of equity process begins on the date the shareholder's capital obligation becomes due. Second, the role of "other shareholders" is to ensure the sufficiency of the company's capital, and this obligation arises precisely when the forfeiting shareholder's contribution obligation becomes due. Third, this mandatory capital contribution responsibility is a financial legal obligation that "other shareholders" assume based on their trust in the status of the forfeiting shareholder. The moment this "trust crisis" begins is self-evident. Comparing the three possible time points, adopting

the second or third view could expose the company to the risk of some investors maliciously transferring their shares to uninformed third parties or exiting the company to protect their interests, thereby causing additional losses to the company. To prevent a chain reaction that could affect the company's operational efficiency and reputation, setting the identification point of "other shareholders" at the due date of the forfeiting shareholder's contribution is the safest approach.

3. Comparative Analysis of the Shareholders' Loss of Equity System with Other Systems

The comparative analysis method involves comparing two or more subjects to reveal their similarities and differences, thereby gaining a deeper understanding of the essential characteristics of the subjects being studied. By systematically comparing the similarities and differences between various systems, this method helps us gain a more comprehensive understanding and evaluation of these systems. After exploring the legal implications of the shareholder loss of equity system, this article shifts its focus to a comparison with related systems. As a novel mechanism, the shareholder loss of equity system faces the challenge of properly aligning with existing frameworks to ensure that different company capital systems fulfill their respective roles and work together effectively. By employing comparative analysis, this study contrasts the shareholder loss of equity system with the directors' call for capital contributions, shareholder expulsion, and accelerated capital contribution systems. This approach not only introduces innovative elements to the discussion but also clarifies the application contexts and functional differences of each system, guiding investors, corporate management, and judges in their precise use of these mechanisms, thereby avoiding confusion or circumvention application of the shareholder loss of equity system.

3.1 The Shareholder Loss of Equity System and The Directors' Call for Capital Contributions System

The call for capital contributions is part of a director's duty of diligence, aimed at maintaining adequate company capital. When a director requests that shareholders fulfill their capital contributions, they are both fulfilling their internal responsibilities as a director and representing the company in asserting its contractual rights under the capital contribution agreement [12].

In China, both the directors' call for capital contributions and the shareholder loss of equity system are crucial mechanisms for maintaining the financial health of companies. However, existing research often only briefly mentions the differences between the two, leading to misunderstandings that the director's call for contributions is merely a subsidiary part of the shareholder loss of equity process. To clarify this misconception, this article seeks to provide an equal and detailed comparative analysis of the two systems, demonstrating their respective independence while revealing their intrinsic connections. This analysis offers initial theoretical support for the evolution of corporate governance toward a "board-centric" model and lays a foundation for the development of a uniquely Chinese corporate governance system tailored to address local challenges, leverage local resources, and reflect domestic realities [13].

The preconditions for activating the two systems differ. As discussed in the second part of this article, the shareholder loss of equity system applies only when a shareholder fails to make capital contributions by the deadline stipulated in the company's articles of association. Since the director's call for capital contributions involves the director acting on behalf of the company to assert the company's rights against shareholders, the directors' call for capital contributions arises only if the company has the right to demand payment from the shareholder [14]. Based on the principles of contract law and Articles 51, 52, and 54 of the Company Law, it is clear that the directors' call for capital contributions arises under conditions such as the "expiration of the shareholder's contribution deadline" and "the company's inability to pay its debts." Furthermore, given the flexible nature of a company's operations—where goals, financial status, and needs are subject to change—it may also

be appropriate for directors to undertake the duty to call for contributions based on the company's objective needs to better align with these demands and safeguard the overall interests of the company.

The directors' call for capital contributions is a prerequisite for the consequence of shareholder loss of equity, but it does not necessarily lead to shareholder loss of equity. The directors' call for capital contributions is a coherent and integrated obligation fulfillment, divided into three stages: verification and discovery of the reasons for the demand, making the decision to demand payment, and taking measures to demand payment [15].

The Company Law explicitly stipulates in Articles 51 and 52 that before the result of proportional loss of equity of shareholders occurs, it is mandatory to go through four stages: director's verification, written demand for payment, decision-making, and issuance of notice. None of these can be omitted. It can be inferred that the directors' call for capital contributions is a necessary condition for shareholder loss of equity, and each stage of the directors' call for capital contributions has been integrated into the operational procedure of shareholder loss of equity. However, the system of directors' call for capital contributions also has a certain degree of independence. Initiating the procedure for shareholder loss of equity is only one of the means after the directors' call for capital contributions, not the only choice. If we consider the work of verifying shareholders' contributions as a ray, "company establishment" is the starting point of this ray. In its endless extension, there may appear a point in time called "reason for demand," followed by several points in time such as "decision to demand payment," "measures for demand payment," and "proportional loss of equity of shareholders."

However, each of these points in time has its own particularities. First, in terms of type, demand for payment can be specifically divided into loss of equity demand and general non-loss of equity demand. Loss of equity demand is a demand made by the director with the purpose of issuing a notice of loss of equity to the shareholder in the future, which must specify a grace period of no less than 60 days, while other general demands mainly serve to inform and remind shareholders of their contributions. Only a written loss of equity demand can communicate and pave the way for subsequent loss of equity work; if a general demand is issued, shareholder loss of equity cannot occur. Secondly, in terms of demand payment measures, the board of directors also has different options. "In terms of capital contribution, based on the quid pro quo relationship between shareholders' contributions and the acquisition of equity, the essence of the relationship between shareholders and the company is a contractual relationship under civil law." As argued earlier, a shareholder's failure to pay after being demanded is a fundamental breach of contract. The company, as the other party in the contractual relationship, has the right to choose the way to protect its interests: demanding the breaching party to continue performance, which can be a non-loss of equity written demand, or restricting the shareholder's rights, or filing a lawsuit and applying for compulsory enforcement by the court when the shareholder clearly refuses to contribute; or unilaterally terminating the capital contribution contract on the grounds of fundamental breach, which is shareholder loss of equity. The board of directors only needs to make decisions based on their business judgment ability combined with the severity of the situation and the subjective and objective conditions of the shareholders. This also corroborates "if the grace period expires and the shareholder still fails to fulfill the capital contribution obligation, the company can issue a notice of loss of equity to the shareholder after a resolution of the board of directors," reflecting the flexibility and autonomy of corporate governance.

In summary, directors' call for capital contributions system is a necessary but not sufficient condition for the operation of the shareholder loss of equity system. It is a fundamental institution under the company's capital system, with a broader scope of application than the shareholder loss of equity system. It has certain connections with the shareholder loss of equity system in its operational links, but it is not a subsidiary system that exists by depending on the shareholder loss of equity system, nor is it included within the shareholder loss of equity system. It emphasizes the daily fulfillment of obligations, and there is no need to be overly cautious when applying this system. On the other hand, the shareholder loss of equity system has its independence and is a prominent and specialized capital contribution regulation system. It regulates specific shareholders within a limited

scope and serves as a legal remedy for companies to protect their overall interests, focusing on constraint, punishment, and relief. Therefore, the use of the shareholder loss of equity system must be well-considered and maintained with a rigorous attitude at all times.

Additionally, these two respectively provide validation for the "board-centric" corporate governance model from both positive and negative viewpoints. The essence of corporate governance lies in the rational distribution of company power and ensuring the effective implementation of responsibilities [16]. Company law needs to choose between a shareholder meeting-centric or a board of directors-centric corporate governance model. "Board centrism" emphasizes centralized decision-making by the board of directors, focusing on strategy, decision-making, and risk control [17].

Designating the board of directors as the sole entity for demanding payment directly promotes the further expansion of the board's authority, while the shareholder loss of equity system indirectly recognizes board centrism from the perspective of residual rights. According to the theory of incomplete contracts, given the bounded rationality of human beings, company law and articles of association cannot stipulate all power distributions in detail, and the remaining power space is the residual rights [18].

The shareholder loss of equity system, as a new provision in the field of shareholder qualification, clearly stipulates that the board of directors makes decisions on shareholder loss of equity and is granted the right to execute them. This represents a concession by shareholders and the shareholders' meeting on residual rights, demonstrating the value choice of corporate governance moving towards board centrism.

3.2 The Shareholder Loss of Equity System and Shareholder Expulsion System

In terms of applicable conditions, procedures, and legal consequences, the shareholder expulsion system is most similar to and closely related to the shareholder loss of equity system. Before the formal establishment of the shareholder loss of equity system, Article 17 of the "Provisions of the Supreme People's Court on Several Issues Concerning the Application of the Company Law of the People's Republic of China (III)" (hereinafter referred to as "Company Law Interpretation III") had already made provisions for the shareholder expulsion system. For most people's initial impressions, the legal consequences of the two systems seem to be consistent, and many cannot understand why the loss of equity system was born, or consider the shareholder loss of equity system to be a sub-system under the shareholder expulsion system. Many scholars and practitioners have started to compare the two systems and summarize the differences between them - first and foremost, the fundamental reasons for the emergence of the systems are different, with loss of equity aimed at maintaining the capital nature of the company, while expulsion starts from the perspective of personal unity; secondly, the prerequisites for their application are different, that is, there is a clear distinction between "failing to fully perform the capital contribution obligation" and "completely failing to perform the capital contribution obligation and fleeing all contributions"; moreover, the legal consequences are essentially different, one being proportional loss of equity and the other being the complete deprivation of shareholder status. In addition, there are still many differences in the application procedures of the two systems, which will not be elaborated upon here [19].

In summary, the shareholder loss of equity system and the shareholder expulsion system are two parallel systems, both adhering to the overall goal of promoting the stable operation of the company, improving the company's operational efficiency, and safeguarding the legitimate interests of the company. However, the former actively emphasizes the obligation to contribute capital, while the latter passively punishes shareholders by excluding them from the company's operations, and there is no situation where one includes or absorbs the other.

This article compares and analyzes these two systems, aiming to discuss whether the "withdrawal of capital contributions" by shareholders who violate their capital contribution obligations can apply to the shareholder loss of equity system. It is clear that if a shareholder withdraws all their capital contributions and fails to pay or return the contributions after being urged by the company within a reasonable period, the shareholder expulsion system shall apply. However, under the same conditions,

the legal provisions do not provide a clear answer on how to handle the situation where a shareholder withdraws part of their contributions. Due to the similarities between the loss of equity system and the expulsion system to some extent, some scholars believe that the shareholder loss of equity system can be applied to solve this issue. This article disagrees with this viewpoint, and it is inappropriate to regulate the withdrawal of part of the capital contributions with the loss of equity system.

From an internal company perspective, the withdrawal of capital by shareholders is covert. Once it occurs, the trust interests among shareholders within the company are severely damaged. This can very likely lead to internal conflicts and disputes due to a crisis of trust, thereby exacerbating the company's operational difficulties. Looking externally, the withdrawal of capital poses risks to creditors, and the internal distrust extends to the company's overall image and credibility. If litigation arises, it will consume the company's operational costs. If the company has a significant influence in the market, there is also a potential to trigger unfair competition or financial risks. Additionally, the harmfulness and severity of capital withdrawal are reflected in the legal responsibilities borne by shareholders. Apart from civil liabilities, shareholders may also bear administrative responsibilities stipulated by the Company Law and criminal liabilities under Article 159 of the Criminal Law of the People's Republic of China. The importance our country's law places on capital withdrawal cannot be underestimated. Most importantly, in terms of subjective motivation, the vast majority of shareholders who withdraw capital do so with malicious intent. Those who deliberately harm the company's interests for their own private gains should be severely punished.

The loss of equity of shareholders is designed to actively encourage shareholders to pay their contributions in a positive manner; punishing shareholders has never been the main purpose of this system. Moreover, from the legal provisions, it is evident that the legal responsibilities borne by disqualified shareholders are relatively light and mainly civil in nature. If the loss of equity system were truly applied to regulate shareholders who withdraw part of their capital, it would be difficult to truly serve as a deterrent or warning. It could also backfire, leading to a bad situation where other shareholders are not convinced, the offending shareholder continues to create trouble, and some shareholders begin to follow suit. Therefore, this article believes that the withdrawal of all capital by shareholders must apply the shareholder deregistration system. The situation of withdrawing part of the capital is not suitable for handling with the shareholder loss of equity system, and the best path to solve this issue still awaits exploration.

3.3 The Shareholder Loss of Equity System and Accelerated Contribution Payment System for Shareholders

Shareholder capital acceleration is a legal system that requires shareholders to fulfill their capital contribution obligations in advance under specific conditions. The shareholder capital acceleration system and the shareholder loss of equity system are both important capital regulation systems within company law. The former emerged in response to the need for "flexible handling of shareholder contributions when the company faces financial difficulties or bankruptcy risks," focusing on balancing the term interests of shareholders with the legitimate rights and interests of creditors. The latter was established against the backdrop of the five-year capital contribution requirement, focusing on constraining and regulating shareholders who fail to pay their contributions on time by declaring shareholder loss of equity to maintain the stability of the company's capital. The two systems have clear differences in applicable scenarios, operational procedures, legal consequences, and impacts, which need no further explanation.

However, the universal interconnectivity of things has led scholars to boldly connect and hypothesize about the two systems: under the circumstances of accelerated maturity, if shareholders fail to fulfill their capital contribution obligations, can the company apply the shareholder loss of equity system to this part of the capital?[20] It is known that the condition for applying the shareholder loss of equity system is "shareholders failing to pay their contributions in full and on time." Therefore, the core of this issue lies in whether, after the company uses the acceleration system, the shareholders'

failure to contribute is considered "failure to contribute upon maturity" or "failure to contribute before maturity"?

The paper supports the former viewpoint and believes that it is appropriate to combine legal interpretation with the balancing of interests to argue for this perspective. In accordance with Article 54 of the Company Law, this article suggests that "advancement of capital contributions" should be legally interpreted as "acceleration of the maturity of capital contribution obligations": "Acceleration of maturity" means that the shareholders' contribution period is advanced, transforming from not yet due to due, and no longer follows the original term stipulated in the company's articles of association, but instead requires shareholders to immediately fulfill their capital commitment based on the company's current financial situation and debt repayment needs. At this point, a shareholder's failure to fulfill their capital contribution obligation under the accelerated maturity scenario is considered as "shareholders failing to pay their contributions in full upon maturity." Analyzing from the perspective of interest protection, if shareholders ignore the company's use of the acceleration system and continue not to pay their contributions, it will undoubtedly have a severe impact on the company's survival, reputation, operational efficiency, and the legitimate rights and interests of creditors. Faced with such a stalemate, why not consider breaking down the barriers between shareholder loss of equity and accelerated maturity, and use the shareholder loss of equity system to make changes to this dilemma?

4. Strategies for Improving the Shareholders' Loss of Equity System

To understand a system, one should first clarify its position and function within the legal system, and then accurately define its scope of application. This is a prerequisite for the efficient use of the system and can reduce misuse, abuse, and neglect. However, even with a clear scope, the application of a system may still face challenges due to the diverse needs of various stakeholders. Often, the emphasis on one party's needs leads to the neglect of another's, resulting in the obstruction of the system's operation and the difficulty in achieving its intended purpose.

Based on the analysis of company law theory and the recognition of the low actual application rate of the shareholder loss of equity system, the author attempts to propose insights from three angles: clarifying the system's position, defining the scope of application, and optimizing operational procedures to avoid risks. The aim is to activate the shareholder loss of equity system, enhance its application value, promote its role in modern corporate governance, and advance the standardized development of corporate governance structures.

4.1 Clarify the Status of the Shareholders' Loss of Equity System

The author suggests amendments and supplements to the Interpretation III of the Company Law—adding a new paragraph 3 to Article 17 (Shareholder Loss of Equity System) to briefly explain the relationship between the loss of equity and expulsion systems, and adding a new article after Article 17 to preliminarily introduce the shareholder loss of equity system, distinguishing it from the directors' call for capital contributions: "... (Article 17, Paragraph 3) The purpose of this article is to maintain the personal unity of the company, which is fundamentally different from the systems established in Articles 51 and 52 of the Company Law, and should be carefully distinguished when applied." "(Added Article 18, Paragraph 1) If a shareholder fails to fulfill their capital contribution obligations on time and in full, and still refuses to perform after the company's demand for payment, the company has the right to pass a resolution to deprive them of the corresponding equity for the part of the capital they have not contributed. This is the ultimate goal of maintaining the capital nature and overall interests of the company. (Paragraph 2) The board of directors is the sole entity responsible for demanding shareholder contributions and may choose to fulfill their obligations in the manner specified in the preceding paragraph or have the right to legally request the court to order the shareholder to continue contributing and to bear responsibility." This article focuses on the

confirmation of applicable scenarios for the loss of equity system and the accelerated maturity system, and the modification plan for their connection will be detailed later, without further elaboration here.

Macroscopically, the shareholder loss of equity system, starting from the maintenance of the company's capital nature, regulates shareholder contributions and is a legal remedy to protect the overall interests of the company. It is connected to the directors' call for capital contributions system, the shareholder expulsion system, and the accelerated maturity system for shareholder contributions, but also has clear differences and maintains independence. In view of the current provisions of Article 17 of Interpretation III of the Company Law on the shareholder expulsion system, the connection between the shareholder loss of equity system and the other three systems can be carried out in the same vein within Interpretation III of the Company Law. Clarifying the function and positioning of the shareholder loss of equity system paves the way for the subsequent clear definition of the scope of the system, improving the efficiency of its application.

4.2 Define the Scope of Application of the Shareholders' Loss of Equity System

Following the aforementioned amendment proposal, the author suggests adding an interpretation in Interpretation III of the Company Law to define the scope of application of the loss of equity system - "(Added Article 19, Paragraph 1) After the establishment of the company, if a shareholder's contribution falls under any of the following circumstances, and the company deals with it in accordance with Article 18 of this interpretation, the People's Court shall support it:

(1) For cash contributions, if they are not paid in full and on time;

(2) For non-cash contributions, if they are not paid in full and on time or if the actual value of the contributed property is significantly lower than the subscribed amount;

(3) If shareholders refuse to contribute under the accelerated maturity scenario;

(4) In other circumstances where shareholders fail to pay their contributions in full on the dates stipulated by the company's articles of association during the actual operation of the company.

This provision applies to the contributions of both common and class shareholders.

(Added Article 19, Paragraph 2) If a shareholder completely fails to fulfill their contribution obligations or withdraws all or part of their contributions, the provisions of Article 18 of this interpretation shall not apply.

(Added Article 19, Paragraph 3) The system involved in this article may be excluded by agreement between the shareholder and the company based on objective circumstances, except where it harms the reasonable interests of other shareholders or the long-term interests of the company."

Precisely defining the scope of a system is the core of enhancing its effectiveness and can activate the system in multiple dimensions. First, it can effectively prevent the misuse of the system; second, it allows the company's management to anticipate triggering conditions, comply with regulations, and improve governance efficiency; third, it warns shareholders to actively fulfill their capital contribution obligations; and fourth, it provides lawyers and judges with a solid legal basis, reducing interpretive differences and boosting their confidence in studying the shareholder loss of equity system.

The development of the market economy inevitably leads to the diversification of share types and the heterogeneity of shareholders. The core of class shares lies in the expansion or restriction of rights for specific classes of shareholders compared to ordinary shareholders [21]. The introduction of new regulations of classes of shares formally regulates the relationship among shareholders, but in essence, it opens up effective avenues for corporate financing and broadens the scope of corporate capital system autonomy [22]. Both common shares and preferred shares are forms that constitute and maintain the company's capital, closely related to the company's capital system, and should all be subject to the constraints of the loss of equity system.

Additionally, it is necessary to include the issue of party autonomy within the scope of discussions on applicable scenarios. For instance, if a company is in financial distress and the only shareholder capable of contributing capital demands that the loss of equity system be excluded by agreement in order to agree to contribute, how should the company respond? Civil law advocates for freedom of

contract and active autonomy, while commercial law allows for private law to interfere in public matters, granting relative freedom in pursuit of a higher level of organizational will freedom [23], emphasizing risk distribution and balance of interests, and not absolute fairness in the protection of private rights [24].

This paper believes that in such extreme circumstances, company law should recognize the consensus between the company and its shareholders aimed at protecting the overall interests of the company at the moment, while also paying attention to the legitimate rights and interests of other shareholders and the long-term interests of the company. If serious and irreparable damage is caused, the agreement between the two parties should be revoked.

4.3 Optimize the Operational Procedures of the Shareholders' Loss of Equity System

The misuse or neglect of the shareholder loss of equity system can harm the rights and interests of other shareholders and creditors. To control this risk and maintain the stability and healthy development of the company, optimizing the operational procedures is crucial. It is the key to activating the system and also the cornerstone for its smooth and efficient use in the future.

4.3.1 Establish a System for Related Directors to Abstain, Confirming the Resolution Passing Ratio as 1/2

This article recognizes the board of directors as the entity responsible for demanding shareholder contributions and making loss of equity resolutions, but it cannot avoid these two questions: What should be done if a director or their appointee fails to contribute on time? Should the passing ratio of the board resolution be a majority or more than two-thirds? The author believes that Article 185 of the Company Law should be amended to include a related director recusal system for voting on capital contributions, namely "(Article 185, Paragraph 2) When convening a board resolution as stipulated in Article 52 of this Law, the provisions on recusal from the preceding paragraph shall apply." Furthermore, Article 52 of the Company Law should establish the passing ratio for board resolutions as a majority, that is, "(Article 52, Paragraph 3) The passing ratio for the board resolutions mentioned in Paragraph 1 shall be determined in accordance with Articles 73 or 124 of this Law, and directors who should recuse themselves according to Article 185 shall not be counted in the base number for the vote."

The current Company Law does not require directors of non-listed companies to abstain from voting in shareholder loss of equity resolutions, which may lead to controlling shareholders using their positions as directors or controlling other directors to thwart the implementation of the loss of equity system. In contrast, minority shareholders do not have this "protective umbrella," making them more susceptible to loss of equity [25].

If this continues, the shareholders' loss of equity system is very likely to become a tool for major shareholders to maintain their own selfish desires and harm the legitimate rights and interests of small and medium shareholders, which is unfair. Therefore, this paper suggests the establishment of an abstention system for related directors in the vote on loss of equity, clearly stipulating that directors who fail to pay their contributions on time and in full, their representatives, and other directors who have a close relationship with the said director should abstain during the loss of equity resolution. If the abstention results in a board of directors with less than three people, the resolution should be handled by the shareholders' meeting, and shareholders who fail to pay their contributions on time should also abstain. In addition, this paper proposes that during the implementation of the loss of equity system, the company temporarily forms a loss of equity supervision committee composed of some small and medium shareholder directors, responsible for reviewing the timeliness and compliance of the directors' verification and written collection notices, supervising the proper implementation of the abstention system during the resolution period, actively investigating other illegal or obviously unfair actions in the operation of the loss of equity system, and accepting reports from other shareholders.

The determination of the resolution passing ratio can be directly derived from the legal provisions. The Company Law only applies the "absolute majority" principle to the matters stipulated in Articles 153, 162, and 163, and the recusal system may reduce the total number of voters, which should be taken into consideration. Therefore, a relative majority passing is the optimal choice, and it should be clarified that the passing ratio for shareholder loss of equity resolutions is a majority, excluding the directors who recuse themselves in the calculation.

Having determined the content of the rules, where should we establish them? Shareholders become parties to the articles of association by agreeing to subscribe for shares, and the company is established in accordance with the articles of association; both are subject to the constraints of the articles. The company's articles of association, as a normative contract established among shareholders, are an important basis for resolving internal disputes between shareholders and between shareholders and the company [26]. However, both recusal and voting ratios are restrictions on the powers of directors, and these responsibilities are primarily statutory and cannot be arbitrarily adjusted through the company's articles of association [27]. That is, from the perspective of necessity, they are "obligations" rather than "options," and it is appropriate to establish them through legal norms rather than as a product of the autonomy of will between shareholders and the company.

4.3.2 Establish Registration Standards for Shareholder Loss of Equity.

The company's board of directors must not only issue a loss of equity notice to the disqualified shareholders but also inform the creditors, which can be done in the form of commercial registration. After the loss of equity notice is sent to the shareholders, the company should also apply to the registration authority for a "pre" registration of loss of equity, with the purpose of informing the creditors and providing them with a certain buffer period. Once the matter of the loss of shareholders' rights is officially confirmed, the company then proceeds to submit an application for change registration to the relevant registration authority. The change registration for loss of equity should be more rigorous, and in addition to the provisions of Article 35 of the Company Law, more detailed proof materials should be submitted, such as necessary documents and audit standards to confirm the loss of shares, internal decision-making documents of the company, and the capital reduction procedures and other operational guidelines followed when executing the reduction of capital and cancellation of corresponding equity [28].

Civil and commercial registrations are both legal acts with public faith and opposability, but they differ from each other. Civil registration confirms the status of rights and protects the interests of the subjects, with registration authorities and procedures varying depending on the object, commonly seen in the field of property rights; commercial registration targets the establishment, change, and termination of commercial subjects, regulates market access and exit, ensures transaction security, and is managed by specialized agencies with strict procedures. This revision of the Company Law has achieved innovation in many areas, especially in company registration and information disclosure—adding a special chapter on "Company Registration," optimizing processes, and enhancing the standardization and transparency of the registration system: Article 32 centrally stipulates the registration matters, Article 34 comprehensively clarifies the legal effects, and Article 40 incorporates the regulations on information disclosure...[29] At present, the scope of business of commercial registration authorities has covered four major areas: registration services for company establishment, change, and cancellation, information disclosure and inquiry services, monitoring and management of registration changes, and policy guidance.

Before the completion of equity transfer or capital reduction, the company has no right to recover the contributions from the shareholder who has lost their rights [30]. Given that the equity is still registered in their name, the company needs to provide protection to creditors. Loss of equity is a decision made within the company; if seeking the opinion of creditors is made a prerequisite procedure, it would instead obstruct the initiation of the system. Ensuring the right to be informed through registration can to some extent alleviate the relationship between the company and creditors,

giving creditors some time to consider strategies to protect their own interests, thus avoiding a crisis of trust that could lead to mutual harm.

5. Conclusion

The shareholders' loss of equity system is an indispensable part of the corporate capital system, and its effective implementation is of great significance for promoting the healthy development of companies and maintaining market order. This paper systematically organizes the shareholders' loss of equity system, distinguishes it from three other systems, and proposes relevant suggestions for potential defects in the system design, striving to contribute to the activation of the shareholders' loss of equity system. As legal practice deepens and theoretical research continues to advance, the shareholders' loss of equity system will undoubtedly be applied more widely and developed more perfectly. It is hoped that the many discussions surrounding this system will receive clear answers in the future. May the "Company Law" keep pace with the times, become increasingly refined, and contribute to the flourishing development of our country's legal system.

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