

# Dissection of the Nature of Equity with Hohfeld's Analyses Theory on Rights

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**ABSTRACT.** *The nature of equity has been controversial. It has been formed such relatively influential theories as ownership, claim, membership right, shareholder status' right, and independent civil right, etc. In order to reveal scientifically the nature of equity, it has been prominently used not only legal logic reasoning method but also Hohfeld's analyses theory on rights. It has been revealed layer after layer that equity is not bundle of rights, and cannot be also classified to a claim or real right. Equity is a new civil property right with the unique structure.*

**KEYWORDS:** *nature of equity, Hohfeld's analyses theory on rights, property right*

## 1. Introduction

Article 4 of the Company law of China stipulates: "the shareholders of a company shall enjoy the rights of asset income, participation in major decisions and selection of managers." Shareholders' right, or simply "equity" for short, is right that shareholders enjoy for holding the company's shares. The "shares" here refer to the shares in a broad sense, including both the capital contribution of shareholders of a limited company and the shares purchased by shareholders of a joint-stock company. The nature of equity has been debated since its creation."In the course of the research on the nature of equity in the legal circle of our country, it has been formed such relatively influential theories as ownership, claim, membership right, shareholder status, and independent civil right, etc. "[1]In fact, "the theory can be adopted, but it cannot be applied everywhere. Instead, its scope is limited." [2]Therefore, this paper not only uses the usual legal logic reasoning method, but also focuses on using the right structure analysis method to reveal the nature of equity in a scientific, objective and comprehensive way, in order to eliminate confusion. "The right structure analysis method" here refers to Hohfeld's analyses theory on rights, who is an American famous analytical jurist. Hohfeld defined the right (broad sense) into four concepts, such as "right (narrow sense) or

claim", "privilege", "power" and "immunity". At the same time, the corresponding concept of "duty" is also analyzed as Jural correlatives with the above four concepts, namely "duty", "no-right", "liability" and "disability".[3] The two groups of concepts form four one-to-one correspondences.

## **2.Primary orientation of the nature of equity: a unitary right**

Some scholars believe that: "as a new and independent form of rights, equity is manifested as a comprehensive right...Equity is a combination of property rights, claims and personal rights. In other words, equity is an organic combination of property rights and personal rights."[5]Some scholars believe that "shareholder right is not a single right, but a bundle of rights composed of property rights and non-property rights."[6]Some scholars also believe that "equity is the right to obtain economic benefits from the company and participate in the company's operation and management based on the identity and status of its shareholders."[7]That is commonly referred to as "shareholder status theory".Other scholars believe that "equity is the right enjoyed by shareholders based on their membership in for-profit organizations. It is a kind of membership right, including property right and management participation right."[1]That is commonly known as "membership rights doctrine". These scholars all believe that equity is "bundle of rights", that is, a collection of multiple rights.

On the other hand, some scholars think that: "the purpose rights (property rights) and means rights (the rights to participate in public affairs) of equity just to describe the image of the specific content, these rights don't essentially refers to the independent rights, and belong to the specific powers and functions of equity, as the property rights power having four items: holds the power, the right of use, the usufruct and the disposition right. It is because of the powers and functions of these so-called rights, that the equity become a single right rather than a collection of rights."[8]In a word, equity is a unitary right. This paper agrees with the latter opinion, mainly for the following reasons:

### **2.1 Profit-seeking nature of shareholders**

"The ultimate purpose of shareholders to set up a company is to obtain the maximum economic benefits in a way that minimizes risks. The drive to maximize profits enables them to exchange investment property ownership for equity."[9]That is, the ultimate purpose of shareholders to invest and acquire equity is to pursue profit, which is the essential attribute of shareholders. In other words, the asset income right in equity is the key right, the ultimate goal of shareholders' investment and the goal right; Other rights, such as the right to participate in major decision-making and the right to choose managers, are auxiliary or instrumental rights for the realization of asset income right."It is fair to say that shareholders set up companies for profit, not just to acquire the identity of a shareholder."[10]The "right" here is not so much "right" as "power", because listing it as "right" alone has no meaning for shareholders. "The capital nature of a company determines that

natural persons or legal persons can exchange equity as long as they make capital contribution. That is, they can enjoy the right of identity only if they enjoy the property right." [11] Shareholders often only pay attention to the realization of their basic and decisive asset income rights, especially the shareholders of the dispersed listed companies. Therefore, it can be said that asset usufruct and other powers have a clear primary and secondary status. The profit-seeking nature of shareholders determines that other powers serve asset usufruct, while other powers have strong dependence on asset usufruct.

## ***2.2 Analogies of intellectual property right***

"In the theory of intellectual property rights, there is a view that they include personal rights, and there are such legislative examples in practice, but they are essentially property rights." [12] This is the consensus of intellectual property law and even civil law circles on the nature of intellectual property. Similar to equity, intellectual property scholars do not emphasize that intellectual property, such as patent and copyright, is "bundle of rights", but understand it as one right, thus establishing it as an independent property right parallel with traditional real right and creditor's right. If corporate law scholars insist that equity is a mixture of "multiple" rights, with both personal rights and property rights, and the priority is not clear, then it is easy to cover the deep nature of equity, which will inevitably make people confused about the nature of equity as a "bundle of rights". Therefore, in order to uncover the "veil" of equity and reveal the deep nature of equity, it can be inferred from the analogy method based on experience of intellectual property essence theory that equity should be a unitary right. In this way, the claim is untenable that equity is "bundle of rights" such as "shareholder status said", "membership rights said" .

## **3. Intermediate orientation of the nature of equity: a civil property right**

On the basis of determining the primary position of equity as a single right, it is easier to distinguish and analyze the property attribution of equity, mainly from the following two aspects.

### ***3.1 Basic attribution: equity is a civil right***

Civil rights refer to the rights enjoyed by natural persons, legal persons or other organizations as equal subjects, which are synonymous with "private rights" and opposite to "public rights" or "administrative rights". "No matter what the direct motives of investors are, their final purpose is to seek the greatest economic benefits. The company is just a tool to get married for the benefit of shareholders. The company undoubtedly takes the economic interests of shareholders as the ultimate concern." [8] With the purpose of maximizing profits, shareholders invest capital to acquire shares of the company and enjoy equity rights. Shareholders and company, shareholders and shareholders are the civil legal relationship between equal subjects.

At the same time, the company's shares held by a shareholder, are also the shareholder's private property, not related to national political interests and social public interests. For the exercise of equity without executive intervention, equity is the private right, and right of non-public ownership. In addition, "equity, as a private right, is also reflected in the fact that it is a right based on civil law, company law, securities law and other private law norms, which should follow the basic principle of autonomy of will." [1] Therefore, equity is a civil right, which further determines the basic attribution of equity.

### ***3.2 Specific attribution: equity is a property right***

Article 2 of Chinese Civil Code stipulates: "the civil law adjusts the personal relationship and property relationship between natural persons, legal persons and non-legal persons." Specifically, "from the perspective of the rights system, property rights and personal rights become the basic limits of the civil rights system." [13] Property rights mainly embody people's material interests, and personal right mainly embodies the spiritual interests of the right. The typical difference between two rights is whether there is property, that is, whether its value can be calculated in money, and whether its interests can be transferred and inherited according to law. From this point of view, the carrier of equity is the amount of capital contribution or shares, and it can be used to calculate the value of money and be transferred and inherited. So equity should belong to the property right. In addition, shareholders exchange their own capital for shares, so shares is a variation of the original property, which essence is property. "The shares are the objects of equity as pointed out by a kind of right, and equity is the object of rights. The relationship between 'shares' and 'equity' is similar to 'content' and 'real right'." [14] The equity formed on the basis of the share property should also be the property right. At the same time, "a company has a strong capital nature, and the status of shareholders is completely determined by the shares or capital contribution of shareholders. It is the property right nature of the equity from the perspective of the form of rights." [11] In order to obtain the return on assets, shareholders care about the daily management of the company, and even actively exercise their rights to participate in major decisions and choose managers, which of course reflects certain attribute of identity right. However, the profit-seeking nature of shareholders determines that the exercise of these means of rights is to achieve the goal of asset income, so equity is a property right. To sum up, equity is not only a civil right, but also a civil property right.

### **4. Advanced orientation of the nature of equity: a new property right**

"Property rights mainly include two categories, namely real rights and claims." [15] Is equity a real right or claim? There is no hurry to answer this question. In fact, "the system of civil rights is open and developed, and there are certain types of rights in the past, present and future that cannot be simply classified into the system of civil rights centered on real rights and claims since the Roman law. Equity

belongs to such right." [16] In this part, Hohfeld's analyses theory on rights is introduced to analyze the right structure of equity, and the structures of real right and claim are compared to confirm the specific nature of equity.

#### ***4.1 Structure of equity based on Hohfeld's analyses theory on rights***

i. Right or claim -- obligation: the shareholder has the right to claim that the company pays the dividends of the shares, and the company has the duty to pay dividends according to law or articles of association. From the perspective of the meta-form of the right, equity reflects the relativity characteristic and is a kind of claim.

ii. Privilege -- no-right: the shareholder has the privilege to participate in the management of the company's affairs and enjoy the benefits of the assets in accordance with their shares. Any person, especially the company or any other shareholder, has no-right to demand that the shareholder can't have the privilege to participate in the affairs of the company or to enjoy the right to benefit from the assets. In the meta-form of the right, equity embodies exclusivity and is a kind of privilege.

iii. Power -- liability: in addition to guaranteeing the preemptive right of other shareholders of the limited liability companies, shareholders have the power to dispose of their shares. Every other person, especially the company or other shareholders, has the liability to bear the legal relationship arising from shareholders' disposition. In the meta-form of the right, equity reflects a certain worldliness and is a kind of power.

iv. Immunity -- disability: anyone including the company or other shareholders has no disability to dispose of the shareholders' shares, and the others' disposition has no legal effect on the shareholders. The shareholders have immunity against the disposition of others. In the meta-form of the right, equity reflects antagonism and is a kind of immunity.

#### ***4.2 Structure comparison of equity and claim***

A claim is the simplest form of property right, expressed in Hohfeld's terminologies, as (narrow sense) right or claim, where Party A has the right to claim payment from party B. From the structure comparison of equity and claim, the meta-form i of equity fully reflects the characteristic of claim. In fact, the property right in the equity, such as the right of assets income, is the claim of shareholders to the company. But to the meta-form ii, iii and iv of equity, claim really cannot cover. In other words, the meta-form i of equity has the characteristic of claim, but claim cannot cover the other three form. Thus equity is not a claim. In this way, from the perspective of Hohfeld's analyses theory on rights, it is untenable that equity is a "claim".

### ***4.3 Structure comparison of equity and real right (ownership)***

Real right, especially ownership, is known as "the most complete property right", expressed in Hohfeld's terms, namely "right (narrow sense)", "privilege", "power" and "immunity". Firstly, the owner has the right (narrow sense) to require any one not to encroach upon his property and not to interfere with his arbitrary conduct toward it. Secondly, he has the privilege to do anything to his property. Thirdly, he has the power to dispose of it. Fourthly, he has the immunity against the disposition of others. Others, in turn, have the duties not to encroach upon or impede the owner's arbitrary ACTS with respect to the property. They have no-right to demand that the owner refrain from any arbitrary act on his property. They have the liability to bear the legal relationship arising from the disposition behavior of the owner. And they have no disability to dispose of the property of the owner.

From the structure comparison of equity and real right (ownership), the meta-form ii, iii and iv of equity is very similar to that of ownership, but the meta-form i of equity is different from that of ownership. And the meta-form i of ownership reflects the possessor's domination, worldliness and exclusiveness of the property, namely, the absolute one-to-many relationship between the possessor and others. Strictly speaking, the meta-form i of equity is a typical right of claim. The shareholders need the counter party (the company) to actively act to realize their rights. However, the meta-form i of ownership is a typical right of control, in which the owner doesn't need any counterpart's active actions. On the contrary, ownership can be realized as long as the counterpart's passive inaction. Therefore, there is no substitution between the claim and the right (narrow sense). In this way, from the perspective of Hohfeld's theory, it is untenable that equity is an "ownership".

## **5. Conclusion**

To sum up, equity structure about  $1/4$  reflects the characteristic of claim, and about  $3/4$  reflects characteristic of real right (ownership). Both have not reached 1, the "equity is neither real right, nor claim. We can't reveal the nature of equity in traditional civil law of real right and claim. Equity is another property right essentially tied with ownership and claim." [17] However, only from the perspective of mathematics, since " $1/4 < 3/4$ ", equity structure is more similar to that of real right than claim. In a word, in order to further clarify the boundary between equity, real right and claim, it is better to make it clear that equity is a new civil property right with the unique structure. The nature of equity is a special property right with certain attributes of personal right. Thus, the theory of "independent civil rights" on the nature of equity is established by analyzing equity structure with Hohfeld's theory.

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