Gains and Losses in the Introduction of the Authorized Capital System a Commentary on the Relevant Provisions of China's 2023 Company Law

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Abstract: The authorized capital system introduced in the 2023 Company Law of China is, in essence, modeled after the German "permitted capital system." Its distinctive feature lies in the requirement that the company's articles of association specify the number of issued shares, which, when multiplied by a legally prescribed ratio, determines the authorized capital limit. Each issuance of shares increases the number of issued shares, thereby necessitating amendments to the articles of association. Special provisions must be established to exempt such amendments from requiring shareholders' resolutions. The statutory choice between the authorized capital system and the statutory capital system reflects a combination of autonomy and compulsion. However, limited liability companies (LLCs), characterized by the separation of ownership and management, may have a legitimate need to improve financing efficiency by delegating authority to the board of directors. Transitioning to a fully optional mode could better serve this purpose.
Keywords: Authorized Capital System, Improper Issuance, Ex-Ante Control, Return Of Decision-Making Power

1. INTRODUCTION

The introduction of the authorized capital system aligns with the fundamental principles and direction consistently upheld in the successive amendments to China's Company Law. It reflects the global trend in corporate law development, which emphasizes the relaxation of government regulation to stimulate the initiative and autonomy of market participants. However, during over three years of legislative deliberation, extensive discussions were conducted on several key issues: the methods and models for introducing the authorized capital system; the relationship between the authorized capital system, the statutory capital system, and the subscription-based system; whether the authorization under the authorized capital system should derive from the articles of association or the shareholders' meeting; and how to control excessive delegation of authority to the board of directors. Ultimately, the 2023 Company Law provided direct responses to these issues, partially resolving the legislative controversies. This demonstrates that introducing the authorized capital system during the amendment of the Company Law was not a fragmented conceptual change but a comprehensive and transformative restructuring of the rules governing capital formation. This constitutes the appropriateness of introducing the authorized capital system in the 2023 Company Law. Under the authorized capital system, the board of directors, empowered by the articles of association or the shareholders' meeting, is granted the authority to issue shares. This allows the board to make effective decisions within a short timeframe, seizing fleeting commercial opportunities. By providing companies with a high degree of autonomy and operational flexibility, the system maximizes the mobility of capital fundraising, significantly improving corporate operational efficiency, particularly financing efficiency. However, balancing efficiency with fairness, especially protecting the interests of existing shareholders, remains a critical challenge for jurisdictions that adopt the authorized capital system. While leveraging this system to enhance corporate efficiency, it is essential to guard against potential drawbacks and safeguard the interests of both the company and its shareholders. At its core, the authorized capital system is defined by "authorization." While it grants the board flexibility in corporate financing, this same delegation of authority creates room for potential abuse of power by the board. Based on the experiences of various jurisdictions, there are three primary approaches to regulating the misuse of the authority to issue new shares by the board of directors under the authorized capital system: Ex-ante control, which involves setting restrictions on the duration and proportion of the authorization granted to the board, thereby controlling the scope of authorization in terms of time and total issuance volume; Return of decision-making power during the process, where, in certain circumstances that may jeopardize the interests of the company or its shareholders, the decision-making authority for share issuance reverts to the shareholders' meeting, preventing the board from making unilateral decisions; Ex-post remedies, where, if the board abuses its authority to issue new shares and causes losses to the company or shareholders, it may be held liable for breaching its duties of loyalty and diligence and required to provide compensation. The 2023 Company Law incorporates provisions addressing all three regulatory approaches. However, it also leaves certain regrets. In particular, the first two approaches (ex-ante control and the return of decision-making power during the process) face issues of over-regulation and under-regulation. Over-regulation undermines the fundamental purpose of introducing the authorized capital system, which is to enhance corporate financing efficiency, while under-regulation amplifies the risk of the board abusing its authority to issue new shares. These deficiencies reflect certain inadequacies in the implementation of the authorized capital system in the 2023 Company Law. In light of this, this article focuses on the gains and losses associated with the introduction of the authorized capital system. Chapter II analyzes the legal issues resolved by the 2023 Company Law in relation to the adoption of the authorized capital system, exploring the institutional designs aimed at improving corporate financing efficiency. This chapter provides suggestions for improvement primarily from an interpretative perspective, while also offering legislative alternatives. Chapter III examines the strengths and weaknesses of the first two regulatory approaches unique to the 2023 Company Law in addressing the board's misuse of share issuance authority. Chapter IV proposes recommendations for further improvement from a legislative perspective. As for ex-post remedies, they should be incorporated into the framework of directors' duties of loyalty and diligence and be subject to detailed regulatory provisions. However, since ex-post remedies are not unique to the authorized capital system, this article will not address them in detail.

2. GAINS IN THE INTRODUCTION OF THE AUTHORIZED CAPITAL SYSTEM

2.1. The Legislative Model Adopted by China’s 2023 *Company Law*

Since the 20th century, there has been a global wave of reform in corporate capital systems, characterized by a shift from the statutory capital system to the authorized capital system and from capital credit to asset credit. During this transformation, four legislative models have emerged: the declared capital system, the full authorized capital system, the permitted capital system, and the hybrid capital system. Based on the provisions of the 2023 *Company Law*, China has not adopted the declared capital system or the full authorized capital system prevalent in common law jurisdictions. Whether China has implemented the permitted capital system, as seen in German corporate law, or the hybrid capital system, as seen in Japanese corporate law, remains a subject of debate. Overall, the two systems are fundamentally similar as both grant the board of directors the authority to issue shares flexibly. However, they differ in how this authority is constrained: the hybrid capital system limits this authority by specifying a total capital amount (total number of shares), whereas the permitted capital system restricts it by multiplying the registered capital (number of issued shares) by a certain ratio and setting a time limit for authorization. Regarding the registered capital and the number of shares in joint-stock companies, the 2023 *Company Law* requires that the articles of association must specify the company's registered capital, the number of issued shares, and the number of shares issued at the time of establishment. Specifically, the registered capital of a joint-stock company is the total share capital of issued shares registered with the company registration authority. Furthermore, the articles of association or the shareholders' meeting may authorize the board of directors to issue no more than 50% of the issued shares within three years. (Armour & Whincop, 2007) Therefore, whether it concerns the mandatory contents of the articles of association, the determination of registered capital, or the specific scope of authorized share issuance, the "number of issued shares" plays a central role. For example, suppose a company has issued 10 million shares, each with a par value of 1 yuan, resulting in a registered capital of 10 million yuan. The maximum number of authorized shares for issuance cannot exceed 5 million shares, as determined by the articles of association or the shareholders' meeting. This suggests that the 2023 *Company Law* adopts a model similar to the permitted capital system rather than the hybrid capital system.

Table 1. Comparison of the Permitted Capital System and the Hybrid Capital System

System	**Permitted Capital System (German Company Law)**	**Hybrid Capital System (Japanese Company Law)**
Authorization Basis	Number of issued shares	Total number of shares
Scope of Authorization	Issued shares × multiplier	Total shares − issued shares
Authorization Time Limit	Yes	No (public companies)
Is an Amendment to the Articles of Incorporation Required for Issuing new Shares?	Required	No (within the total number of shares)/Yes (if exceeding the total number of shares)

The key differences between the permitted capital system and the hybrid capital system can be summarized in two aspects. First, there is a formal difference in the method of calculating the authorized issuance range. Under the hybrid capital system, the articles of association specify the total number of shares, and the authorized issuance range is determined by subtracting the number of issued shares from the total number of shares. In contrast, under the permitted capital system, the articles of association only record the number of issued shares, and the authorized issuance range (de Raet, 2021) is calculated by multiplying the issued shares by a statutory multiplier. To prevent the board from abusing its authority, the hybrid capital system also imposes restrictions on the authorized issuance range. For instance, Japanese corporate law applies a "four-times rule," stipulating that the total number of shares cannot exceed four times the number of issued shares. Thus, the difference in calculation methods is primarily formal. Second, there is a substantive difference regarding whether amendments to the articles of association are required. Under the hybrid capital system, since the total number of shares is recorded in the articles of association, the board can issue new shares within the total number of shares without amending the articles. If the board intends to issue new shares exceeding the total number of shares, however, an amendment to the articles of association must be approved by a resolution of the shareholders' meeting, and the board cannot unilaterally make this decision. Under the permitted capital system, as the number of issued shares is recorded in the articles of association, any issuance of new shares—whether decided by the board or the shareholders' meeting—will increase the number of issued shares and thus require an amendment to the articles. However, if the issuance falls within the authorized range, such an amendment to the articles does not require a resolution of the shareholders' meeting; otherwise, the purpose of authorization would be undermined. Therefore, corporate law must include special provisions to exempt such amendments from needing shareholder approval. In conclusion, the permitted capital system is based on the statutory capital system while incorporating the flexibility of the authorized capital system for financing purposes. Conversely, the Hybrid Capital System is founded on the Complete Authorized Capital System while embracing the creditor protection principles inherent in the Statutory Capital System. From the perspective of financing flexibility, the hybrid capital system is more flexible than the permitted capital system. This may be because China's Company Law has retained the foundation of the statutory capital system, which still applies to limited liability companies, while introducing the permitted capital system exclusively for joint-stock companies. This approach allows joint-stock companies to adopt the permitted capital system to enhance their financing flexibility.

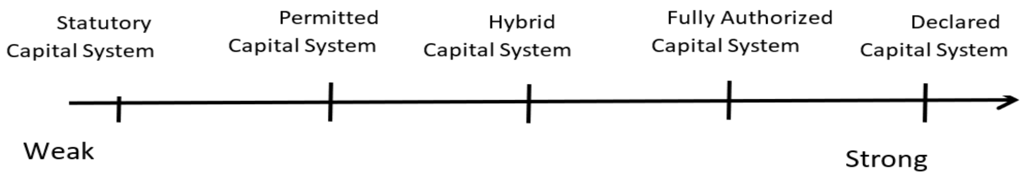

Figure 1. Comparison of Financing Flexibility among Five Capital Systems

2.2. The Relationship Between the Authorized Capital System and the Statutory Capital System

Following the introduction of the authorized capital system in China, addressing its relationship with the existing statutory capital system becomes a key issue. During the revision process of the Company Law, from the first draft to the final promulgation of the 2023 Company Law, the statutory capital system was retained as the foundation, while the authorized capital system was partially introduced. (Ren, 2021) This created a statutory choice model for corporate capital formation, blending mandatory rules with autonomy. This model further implies that the law does not impose rigid restrictions on the types of companies to which the two capital formation systems apply. For instance, joint-stock companies (JSCs) may choose to adopt or refrain from adopting the authorized capital system. However, LLCs are only permitted to adopt the statutory capital system and are not allowed to opt for the authorized capital system. Nonetheless, the current circumstances of corporate types in China suggest otherwise. First, in practice, a considerable number of LLCs have emerged that are large in scale, have a substantial number of shareholders, and exhibit a certain degree of separation between ownership and management. These companies also have a practical need to improve financing efficiency by granting authorization to the board of directors. Furthermore, there are a substantial number of closely held JSCs, which share similar characteristics of closeness and personal connections with closely held LLCs. There is no essential difference between the two. Given that closely held JSCs are allowed to adopt the authorized capital system, there is no sufficient justification for prohibiting LLCs from doing so. Second, allowing LLCs to choose between the statutory capital system and the authorized capital system based on their specific needs, rather than replacing the former with the latter, incurs lower costs in institutional transition. Moreover, implementing the authorized capital system for both JSCs and LLCs in a coordinated manner would not impose significant additional burdens on legislative or judicial practices. From a comparative law perspective, neither common law jurisdictions nor civil law jurisdictions distinguish between closely held and public companies when adopting the authorized capital system. For example, Japan, which follows the hybrid capital system model, permits non-public companies (closely held companies) to authorize the board of directors to issue shares through a resolution of the shareholders' meeting. However, Japan applies different institutional designs regarding the scope and conditions of authorization for non-public companies. The Japanese *Company Law* allows non-public companies to bypass the "four times rule" applicable to public companies, thereby granting broader authorization to reflect greater autonomy. However, the authorization period granted by the shareholders' meeting is limited to a maximum of one year, after which the corporation must reconvene a shareholders' meeting to review and vote on authorization matters. This time limitation aligns with the characteristics of closeness and personal connections in non-public companies. It is evident, therefore, that there is no need for Chinese legislation to restrict the authorized capital system to JSCs alone. Instead, the system could be stipulated for JSCs while also allowing LLCs to adopt or reference its provisions. Although the 2023 Company Law does not explicitly provide that the shareholders' meeting of an LLC can authorize the board of directors to issue new shares, achieving this through legislative reform may not be feasible in the short term. However, from an interpretative perspective, there is room to allow LLCs to reference the authorization provisions applicable to JSCs (Articles 152-153). Accordingly, the shareholders' meeting of an LLC should be permitted to authorize the board of directors in advance to increase the capital contribution ratio within a specific range.

2.3. The Relationship Between the Authorized Capital System and the Subscription-Based Capital Contribution System

After clarifying the relationship between the authorized capital system and the statutory capital system, the next issue to address is whether, under the authorized capital system, the performance of capital contribution obligations should continue to follow the subscription-based system or revert to the paid-in capital system. The subscription-based system corresponds to the paid-in capital system, just as the statutory capital system corresponds to the authorized capital system. Notably, the coexistence of the authorized capital system and the subscription-based system has been a contentious issue during the *Company Law* revision process. Initially, the first, second, and third drafts of the Company Law included the provision: "Founders shall fully pay for the shares they subscribe to." (Hillebrand, 1997) This provision did not impose a time limit for "fully paying," nor did it require founders to fully pay before the company's establishment. As a result, it was interpreted as maintaining the subscription-based system under the statutory capital system, even while adopting the authorized capital system. In practice, some viewpoints have conflated or even equated the authorized capital system and the subscription-based system, as both allow deferred capital contributions. However, these two systems are fundamentally different. From the perspective of capital contribution obligations, the authorized and statutory capital systems pertain to the creation of shareholders' obligations to contribute capital, while the subscription-based and paid-in capital systems concern the performance of those obligations once established (Liu et al., 2018). Although the two systems differ in nature, they exhibit functional overlap to some extent. As mentioned earlier, the primary function of the subscription-based system is to lower the threshold for company establishment and improve capital efficiency. Similarly, under the authorized capital system, the ability to issue shares in tranches achieves the same effect. (Zhao & Valentini, 2022) The key difference lies in the fact that, under the authorized capital system, the board of directors is authorized to issue shares to existing or new shareholders as needed, particularly during multiple rounds of venture capital or private equity financing, without convening a shareholders' meeting. This unique feature of the authorized capital system significantly improves financing efficiency. Since the tranche-based issuance mechanism under the authorized capital system can fully address the issues that the subscription-based system seeks to resolve, the value and necessity of combining these two systems with fundamentally different logics and mechanisms are highly questionable (Dong, 2022). In light of this, Article 98 of the 2023 Company Law introduced targeted adjustments, requiring founders to fully pay for their subscribed shares before the company's establishment. This provision adjusts the capital contribution method for JSCs to the paid-in capital system, clearly establishing a model of "authorized capital system + paid-in capital system" for JSCs. In contrast, LLCs follow a model of "statutory capital system + subscription-based or paid-in capital system." This statutory choice model for capital formation minimizes the costs of selection, avoids institutional redundancy, and achieves a balance of mandatory rules within autonomy. Nevertheless, the mandatory nature of this statutory choice model remains relatively high, posing the risk of institutional rigidity. First, under Article 98 of the 2023 Company Law, if a JSC opts for the statutory capital system, its subscribers must fully pay for their shares upon issuance, with no allowance for installment payments. This compels JSCs to favor the authorized capital system, raising concerns about interference with corporate autonomy. If a JSC opts for the statutory capital system, the Company Law could allow the subscription-based system for capital contributions, thereby more effectively reconciling the coexistence of the statutory and authorized capital systems (Ren, 2021). Second, LLCs are restricted to the statutory capital system, with no option to adopt the authorized capital system. As discussed earlier, this mandatory restriction lacks sufficient justification. This issue could be resolved by allowing LLCs to reference the authorization provisions applicable to JSCs (Articles 152-153). The question then arises: if an LLC opts for the authorized capital system, should it be allowed to adopt the subscription-based system, or must it adhere to the paid-in capital system? For all types of companies, if the statutory capital system is chosen, the subscription-based system may be adopted to lower the threshold for company establishment and improve capital efficiency. However, if the authorized capital system is chosen, the tranche-based issuance mechanism already fulfills the same function. To avoid institutional redundancy, there is no need to adopt the subscription-based system in this context. In summary, the four systems can be applied in combination according to the following table.

Table 2. The Coexistence of the Statutory Capital System, Authorized Capital System, Subscription-Based System, and Paid-In Capital System

Corporate Type	Formation of Shareholders' Capital Contribution Obligations	Performance of Shareholders' Capital Contribution Obligations
LLC	Statutory Capital System	Subscription-Based System or Paid-In Capital System
	Authorized Capital System	Paid-In Capital System
JSC	Statutory Capital System	Subscription-Based System or Paid-In Capital System
	Authorized Capital System	Paid-In Capital System

2.4. Methods of Authorization under the Authorized Capital System

Two key issues remain unresolved regarding the methods of authorization under the authorized capital system: first, whether authorization can only be granted through provisions in the articles of association or whether it can also be granted by a resolution of the shareholders' meeting; second, if authorization through a shareholders' resolution is permissible, whether such a resolution should be an ordinary resolution or a special resolution. First, regarding the method of authorization, from a comparative law perspective, most jurisdictions—whether in common law or civil law systems—adopt the approach of granting authorization through the articles of association. However, some jurisdictions, such as the UK Companies Act 2006, the French Commercial Code, and the Japanese Company Law (specifically for non-public corporations), implement authorization through shareholders' resolutions. Article 152 of the 2023 PRC Company Law adopts a dual-track model that permits authorization through either articles of association or shareholders' resolutions [此处缺一个脚注的翻译，不是重新翻译正文]. Overall, the shareholders' resolution method aligns with the original intent of the authorized capital system to improve financing efficiency, and allowing it provides companies with more flexibility in granting authorization. Naturally, if a company voluntarily chooses to authorize only through provisions in the articles of association, it can impose such a limitation within its articles.

Table 3. Methods of Authorization under the Authorized Capital System in Different Jurisdictions

Legislative Model	**Declared Capital System**	**Fully Authorized Capital System**		**Permitted Capital System**		**Hybrid Capital System**
Jurisdiction	UK	US	South Korea	Germany	France	Japan
Method of Authorization	Articles or Shareholders' Meeting	Articles	Articles	Articles	Shareholders' Meeting	Public Companies: Articles Non-public companies: Shareholders' Meeting
Relevant Laws	Companies Act 2006, Section 32(2)	Delaware General Corporation Law, Section 161; Model Business Corporation Act, Section 6.01(a)	Commercial Code, Article 416	Limited Liability Companies Act, Section 55a; Stock Corporation Act, Section 202	Commercial Code, Article L225-129-1	Company Law, Article 113(3)(1), Article 201(1); Articles 200(1) and (3)

Second, although Article 152 of the 2023 Company Law allows authorization through a shareholders' resolution, it does not specify whether such a resolution should be an ordinary resolution or a special resolution. Based on legislative intent, since a shareholders' resolution for a single share issuance is classified as a special resolution, a resolution by the shareholders' meeting that broadly grants the board of directors the power to issue shares over the next three years would have an even greater impact on the company's registered capital. By analogy, such authorization should, at a minimum, also require a special resolution. From the substantive perspective of the authorization, share issuance directly concerns changes to the company's registered capital, which constitutes a significant matter. Therefore, it should be subject to a special resolution. Furthermore, whether the authorization is granted through provisions in the articles of association or through a shareholders' resolution, it should procedurally take the form of a special resolution. This approach aligns with the principle of consistency in authorization conditions.

3. DEFICIENCIES IN THE INTRODUCTION OF THE AUTHORIZED CAPITAL SYSTEM

3.1. Risk of Board Abuse of Power under the Authorized Capital System

The introduction of the authorized capital system aims to enhance corporate operational efficiency, particularly financing efficiency. However, balancing operational efficiency with fairness, especially protecting the interests of existing shareholders, is a critical issue that must be addressed when adopting the authorized capital system in corporate law. Under the Authorized Capital System, preventing improper issuance by the board of directors, particularly through private placements that may prejudice existing shareholders' interests, is crucial in constructing institutional remedial mechanisms.[此处缺一个脚注的翻译，不是重新翻译正文] In addition to holding directors accountable post hoc for breaches of their fiduciary duty and duty of care, the ex ante imposition of restrictions on the authorization period and scope is a commonly used preventive measure. Improper issuance by the board includes two main scenarios: first, issuance at unfair prices, such as issuing shares at a low price, which directly harms the financial interests of existing shareholders; second, issuance through unfair methods, such as issuing shares to maintain or seize corporate control by diluting or increasing the shareholding ratio of specific shareholders. Although the latter scenario does not involve unfair pricing, the primary purpose of the issuance is not corporate financing but rather improperly maintaining the control of the controlling shareholder or assisting a specific shareholder in seizing control, which constitutes an abuse of power. From the experiences of various countries, two unique mechanisms are employed to regulate the board of directors' abuse of the power to issue new shares under the authorized capital system: (1) Ex ante control, which involves imposing restrictions on the authorization period and the proportion of shares that may be issued when granting authorization to the board, thereby controlling the timing and total volume of share issuance; (2) Reversion of decision-making power, which occurs when specific circumstances arise that may endanger corporate or shareholder interests, requiring the decision-making power for share issuance to revert to the shareholders' meeting, rather than remaining solely with the board of directors. This article will analyze these mechanisms in detail, examine their advantages and disadvantages, and ultimately propose improvements from a legislative perspective.

3.2. Challenges to the Necessity of Ex Ante Control and Deficiencies in Current Provisions

3.2.1 Mandatory Provisions on Ex Ante Control in the 2023 Company Law

Article 152 of the 2023 Company Law stipulates a three-year authorization period and a 50% issuance ratio cap, which is closely related to the legislative shift in the authorized capital system, transitioning from a hybrid capital system to a permitted capital system: (1) Under the hybrid capital system, generalized authorization is granted by specifying the total number of shares in the articles of association, which serves as the upper limit for the board of directors' power to issue new shares. If the board issues new shares within the authorized total, it can resolve to do so independently. However, if the board intends to issue shares exceeding the authorized total, the articles of association must be amended, requiring approval through a shareholders' resolution, as the board cannot decide this unilaterally. In the hybrid capital system, ex ante control generally does not impose an authorization period; as long as the number of issued shares does not exceed the authorized total, there is no need for the shareholders' meeting to reauthorize. Furthermore, the scope of authorization is broader. For example, Japan's "four-fold rule" effectively allows an issuance ratio cap of 300%. The purpose of statutory multiple restrictions is to define the boundaries of authorization and prevent excessive dilution of existing shareholders' ownership (Kraakman, 2017). (2) Under the permitted capital system, the number of issued shares specified in the articles of association serves as the baseline for generalized authorization, with statutory multiples used to calculate the issuance limit. However, the statutory multiples are generally lower. For instance, both German corporate law and the 2023 Company Law set the issuance ratio cap at 50%. Additionally, the permitted capital system imposes restrictions on the authorization period—five years under German corporate law and three years under the 2023 Company Law. Once the authorization period expires, the shareholders' meeting must reconvene to review and approve the authorization.

3.2.2 Deficiencies in Current Provisions on Ex Ante Control

The ex ante control measures under the 2023 Company Law have received both positive and negative evaluations (Ding et al., 2023). This article leans toward the latter view. First, the necessity of setting an authorization period is questionable. The three-year authorization period stipulated in the 2023 Company Law may have been designed to align with the provision that the board's term cannot exceed three years, with the intent of granting each board term a new authorization (Al-Doori et al., 2023) When the board is re-elected, changes in its composition may necessitate renewed authorization via the articles of association or the shareholders' meeting. However, the authorization period is fixed at three years, while the term of the board is "not exceeding three years," and the articles of association can prescribe shorter board terms. This inconsistency may result in situations where the authorization period exceeds the board's term. Second, the combined design of a three-year authorization period and a 50% issuance ratio cap introduces several issues. One major concern is that it undermines the efficiency advantage of the authorized capital system. For example, if the board does not reach the 50% issuance cap within the three-year period, the expiration of the authorization would necessitate reauthorization, leading to wasted authorization. Additionally, if the board reaches the 50% issuance cap in the second year, is it required to wait until the three-year period expires before obtaining reauthorization? Or can the articles of association or the shareholders' meeting immediately grant a new authorization, restarting the three-year clock? The 2023 Company Law neither prohibits changes to the authorization content after authorization is granted nor prevents reauthorization. Even if the 50% cap is reached before the expiration of the authorization period, a new authorization by the articles of association or the shareholders' meeting should be allowed. This aligns with the original intent of the system to enhance corporate financing efficiency, suggesting that the three-year authorization period itself holds limited significance. In summary, ex ante control represents a generalized regulatory approach which, while offering certain indirect preventive effects, may compromise the efficiency advantages of the Authorized Capital System and diminish its institutional value.. To better regulate the board's abuse of the power to issue new shares, reversion of decision-making power during the process is a more commonly used and effective mechanism.

3.3. Importance of Reversion of Decision-Making Power During the Process and Deficiencies in Current Provisions

3.3.1 Deficiencies in Reversion of Decision-Making Power in the 2023 Company Law

Article 152(1) of the 2023 *Company Law* not only provides for ex ante control measures but also introduces reversion of decision-making power during the process. Specifically, when the consideration for share issuance involves non-monetary contributions, the decision must be approved by the shareholders' meeting and can no longer be made solely by the board of directors. This provision appears to be inspired by Section 6.21(f) of the *Model Business Corporation Act* (MBCA) in the United States, which requires shareholder approval for new share issuances when the consideration for the shares is in a form other than cash. However, no similar provisions are found in the company laws of civil law jurisdictions. Indeed, compared to monetary contributions, non-monetary contributions may lead to inaccuracies in valuation, thereby harming the company and shareholder interests. However, whether decision-making power must revert to the shareholders' meeting in such cases remains debatable. First, there is ambiguity regarding what constitutes a non-monetary contribution. For instance, if only a small proportion of shareholders in a new share issuance make non-monetary contributions while the majority contribute cash, would this require a shareholders' resolution? If the scope of application is unclear, it may lead to unnecessary disputes. Second, the effectiveness of a shareholders' resolution is questionable. Non-monetary contributions alone do not necessarily harm the company's interests; the key issue is whether such contributions result in inaccuracies in valuation. However, even with a shareholders' resolution, inaccuracies may not be entirely avoided. Shareholders' ability to assess the value of non-monetary contributions is doubtful. Generally, directors are more familiar with the company's operations and the commercial environment in which it operates. They are better positioned to evaluate whether a non-monetary contribution holds value for the company and whether it can bring benefits. If, merely to prevent improper issuance by the board, the authority for such decisions is withheld from the board without explicitly defining rules for evaluating non-monetary contributions, shareholders may be left unsure of how to assess the actual value of such contributions. In such a model, the preventive significance of requiring a shareholders' resolution is undermined. Third, other remedies are available under company law for inaccuracies in contributions, such as the shareholder's obligation to make up for shortfalls (George, 2023). Thus, the necessity of requiring a shareholders' resolution is also questionable. If inaccuracies in contributions occur, they can be addressed through the legal consequences of such inaccuracies. Conversely, if non-monetary contributions are approved under the proper procedures of a shareholders' resolution, would this exempt contributors from liability for inaccuracies? If so, reverting decision-making power to the shareholders' meeting might actually harm the company's interests.

3.3.2 Regrettable Aspects of Reversion of Decision-Making Power in the First Draft

The first draft of the law initially adopted the legislative model of a hybrid capital system, which did not impose mandatory provisions for ex ante control, leaving restrictions to be determined by the articles of association or the shareholders' meeting and thus reflecting the principle of corporate autonomy (Crawford, 1999) In contrast, the first draft introduced another form of reversion of decision-making power during the process to prevent the board from issuing an excessive number of shares in a single issuance, which could significantly dilute the shareholding ratios of existing shareholders or lead to a transfer of corporate control. It stipulated that a single share issuance could not exceed 20% of the voting rights represented by the issued shares; if it exceeded this threshold, shareholder approval would be required. (CIOCHINĂ-BARBU, 2021) Due to the lack of ex ante control measures such as an issuance ratio cap, this form of reversion of decision-making power was criticized as insufficiently restrictive and prone to circumvention. For example, the board could issue shares in multiple tranches of 19%, thereby avoiding the 20% threshold for reversion of decision-making power. In this way, the board could dilute the shareholding ratios of existing shareholders or alter corporate control through successive decisions without requiring shareholder approval. However, limiting the proportion of shares issued in a single issuance as a mechanism for reversion of decision-making power is a common practice. For instance, Section 6.21(f) of the *Model Business Corporation Act* stipulates that shareholder approval is required for new share issuances when the consideration is non-monetary or when the voting rights represented by the newly issued shares exceed 20% of the voting rights represented by currently outstanding shares. Similarly, Section 251(f) of the *Delaware General Corporation Law* requires shareholder approval for new share issuances exceeding 20%. In U.S. practice, particularly for publicly traded companies, shareholding is often dispersed, and holding 20% of the voting shares is generally presumed to constitute control. In such cases, the board cannot unilaterally determine the identity of the controlling shareholder, and the matter must be resolved by the shareholders, allowing for shareholder-level negotiations. This is likely one of the legislative objectives of U.S. corporate law. Of course, as long as a fixed threshold for single share issuances is established, there will always be a risk of circumvention through successive issuances. The following questions require further discussion: (1) In the context of Chinese practice, is the 20% threshold for the presumed transfer of control appropriate, or should a higher percentage be set? (2) How can more sophisticated institutional designs address the risk of circumvention? (3) Is it necessary to adopt other mechanisms for the reversion of decision-making power? Regrettably, in the subsequent second draft, third draft, and the final version of the 2023 Company Law, the provisions for the reversion of decision-making power merely deleted the restrictions on the single issuance ratio and replaced them with rules regarding non-monetary contributions, without introducing more refined institutional designs.

4. REFINEMENT OF EX ANTE CONTROL AND SOPHISTICATED DESIGN OF REVERSION OF DECISION-MAKING POWER

Given that China has introduced the authorized capital system, to more effectively regulate the abuse of board power (particularly improper issuances), this section, based on the previous analysis, proposes improvements to the ex ante control and reversion of decision-making power mechanisms in the 2023 Company Law. The aim is to uphold the original value of the authorized capital system, enhance corporate financing efficiency, ensure fairness, and protect the interests of the company and its shareholders.

4.1. Recommendations for Improving Ex Ante Control

First, regarding the provision on the authorization period, as discussed earlier, the three-year authorization period set out in Article 152 of the 2023 *Company Law* is of limited significance. From a legislative perspective, one approach is to extend the authorization period, which could partially address the aforementioned issues. However, whether the current three-year period is maintained or replaced with the five-year period adopted by German and UK company laws, (Cahn & Donald, 2010) neither approach fundamentally resolves the two core issues discussed earlier. Another approach is to eliminate the statutory restriction on the authorization period in company law. If a company considers it necessary to set an authorization period, it can stipulate this in its articles of association or through a shareholders' resolution at the time of authorization. Under the current authorized capital system, if ex ante control is to be implemented, the key lies in determining how to set an issuance cap, as this ultimately defines the scope of authorization. Second, regarding the provision on the scope of authorization (issuance cap), the purpose is to impose a total volume control on the board's authority, preventing excessive power from being granted and thereby minimizing the risk of abuse. However, the efficiency gains of the authorized capital system and the risk of power abuse are two sides of the same coin. If the scope of authorization is overly restricted out of fear of power abuse, the potential improvements to financing efficiency will also be limited. If ex ante total volume control is to be implemented, a relatively high issuance cap should be considered. The practical difficulties of corporate financing necessitate empowering the board with greater flexibility in decision-making regarding share issuance. In terms of specific institutional design, similar to China, Germany's *Stock Corporation Act*, which adopts an authorized capital system, sets the issuance cap at 50%, while Japan's *Companies Act*, with its hybrid capital system, allows for an issuance cap of 300%. Under the premise of maintaining the authorized capital system, China could consider a moderate relaxation, such as adjusting the issuance cap to at least 100%. This would mean that "the articles of association or a shareholders' meeting may authorize the board of directors to issue shares not exceeding the number of already issued shares." Moreover, there is no direct correlation between the scope of authorization granted to the board and the likelihood of the board abusing its authority to issue new shares. (Wu, 2024) The key questions are: (a) Under what circumstances is there a risk of improper issuance by the board? (b) What constitutes improper issuance by the board? (c) Whose interests are harmed by various types of improper issuance? Based on these questions, a more sophisticated institutional design can be developed to provide targeted regulatory measures. Naturally, these issues cannot be resolved through ex ante total volume control alone, as such generalized authorization caps can only serve as an indirect preventive measure. The reversion of decision-making power during the process, however, is a temporary remedy for specific circumstances. It allows for targeted institutional design and provides a form of redress by temporarily reverting the authority to issue new shares back to the shareholders' meeting. This approach minimizes the impact of mandatory rules on autonomy of will and financing efficiency.

4.2. Recommendations for Refining the Reversion of Decision-Making Power

To refine the regulatory mechanisms for reversion of decision-making power from a legislative perspective, it is first necessary to address the three key questions raised earlier: identifying the specific scenarios in which the board abuses its authority to issue new shares, clarifying the nature of improper issuances, and determining whose interests are harmed. Since improper issuances by the board can be categorized into two types—issuance at an unfair price and issuance through unfair methods—more sophisticated reversion mechanisms can be designed around these two scenarios.

4.2.1 Reversion of Decision-Making Power in Cases of Low-Priced Issuance

The first issue pertains to issuing shares at an unfair price, also referred to as low-priced issuance. Under the authorized capital system, the legal control of agency costs hinges on whether the issuance price determined by the board of directors (BoD) is fair. When new shares are issued at a price significantly below their fair value, the existing shareholders may not only experience dilution of their shareholding proportions but may also suffer direct economic losses. In contrast, non-monetary contributions do not necessarily result in harm to the company or shareholders, as the key issue lies in whether the contributions are inaccurately valued. Therefore, company law should prioritize evaluating whether the issuance price set by the BoD is excessively low. If the price is significantly below the fair value of the shares, it would no longer be appropriate for the BoD to unilaterally make such a decision. Nonetheless, it is not necessary to completely prohibit low-priced issuances. Instead, the decision-making power should revert to the shareholders' meeting (SM), allowing the original shareholders, whose interests are likely to be adversely affected by the issuance, to decide through an SM resolution whether to bear the resulting losses. As for what constitutes a low-priced issuance, the critical issue lies in determining the fair value of the shares, which can be assessed differently for public companies with a liquid market for their shares and non-public companies lacking such a market. For public companies, since the share market is regulated by securities supervisory authorities, the fairness of the issuance price can be evaluated using market-based benchmarks. For instance, according to Article 56 of the (Easterbrook & Fischel, 1980) Administrative Measures for the Registration of Securities Offerings by Listed Companies (2023), the issuance price of shares offered by a listed company to specific investors must not be lower than 80% of the average stock price over the 20 trading days preceding the pricing date. If the issuance price of new shares for public companies, including listed companies, falls below 80% of the average stock price over the 20 trading days prior to the pricing date, this can be considered significantly below the reasonable price of the shares. Such cases constitute low-priced issuance and should be submitted to the shareholders' meeting (SM) for resolution, rather than being unilaterally decided by the BoD. For non-public companies, it is more challenging to establish objective legal standards for determining fair value in advance. In this regard, Japanese company law has developed a standard for assessing fair pricing through Supreme Court rulings: "The issuance price should be determined based on objective materials using a reasonable calculation method." Nonetheless, China currently lacks clear and practical reference standards for evaluating the fair value of shares in the context of new issuances by non-public companies. A feasible approach would be to recommend that the company's articles of association or an SM resolution specify a minimum price or a method for calculating the minimum price for the issuance of new shares at the time of authorization. (Wymeersch, 2001) If the issuance price falls below this minimum threshold, it would qualify as a low-priced issuance and should be submitted to the SM for resolution.

4.2.2 Reversion of Decision-Making Power in Cases of Control Transfers

Section 251(f) of the *Delaware General Corporation Law* stipulates that the issuance of new shares exceeding 20% of the total voting rights requires the approval of the shareholders' meeting (SM). In U.S. practice, particularly for publicly traded companies, shareholdings are often dispersed. Generally, holding 20% of the voting shares is presumed to constitute a transfer of control under the law. In such circumstances, the BoD can no longer unilaterally decide the identity of the controlling shareholder. Instead, the matter reverts to the SM, where shareholders can engage in negotiations at the shareholder level. In the context of China's practice, is it appropriate to set the legal presumption for control transfer at 20%, or should a higher threshold be adopted? For instance, setting it as "no more than 30% of the total voting rights represented by issued shares." In the context of acquisitions of Chinese listed companies, 30% is the shareholding threshold that triggers a mandatory takeover offer, which is a presumption under the Securities Law, marking 30% as the critical point for the transfer of corporate control. However, regardless of the threshold set, it remains merely a legal presumption. Instead of relying on such a presumption imposed by law, it would be more effective to adopt a more direct regulatory approach, establishing the transfer of corporate control as a scenario requiring the reversion of decision-making power to the shareholders' meeting. The primary purpose of issuing new shares is to raise funds for the target company. If the issuance of new shares results in a change in corporate control, it deviates from the intended function and objective of the system. Therefore, the standard for controlling the boundaries of authorized capital issuance should be whether it leads to a transfer of corporate control, with a shareholders' meeting resolution serving as a safeguard mechanism. (Zheng, 2023) Specifically, when the issuance of new shares will result in a transfer of corporate control, it should require approval by the shareholders' meeting. Considering China's practice, whether the 20% threshold for a legal presumption of control transfer is appropriate or whether a higher threshold should be adopted remains a question. For instance, the threshold could be set at "no more than 30% of the total voting rights represented by issued shares." This is because, under China's Securities Law, a 30% shareholding triggers a mandatory takeover offer, which serves as a legal presumption that 30% represents the critical point for control transfer. However, regardless of the specific threshold, such conditions remain merely legal presumptions. Instead of relying on such presumptions, a more direct regulatory approach could be adopted: defining control transfer as a specific scenario warranting reversion of decision-making power.

4.2.3 Reversion of Decision-Making Power in Cases of Excessive Single Issuance

Section 251(f) of the *Delaware General Corporation Law* also requires shareholder approval for single issuances exceeding 20% of the total voting rights. Beyond regulating control transfers, this provision serves an additional purpose: preventing controlling shareholders from improperly maintaining their control. Maintaining control, like transferring control, is another strategy in the competition for corporate control. Furthermore, excessively diluting existing shareholders' holdings through a large single issuance can significantly harm their interests. As previously discussed, the first draft of China's Company Law once proposed a restriction that a single issuance must not exceed 20% of the total voting rights represented by issued shares. If this threshold is exceeded, the approval of the SM would be required. However, this approach was criticized for its lack of ex ante control mechanisms on issuance caps and for being easily circumvented through multiple smaller issuances. Under the 2023 *Company Law*, which already introduces ex ante control mechanisms, the authorized issuance cap is now limited to no more than 50% of the total issued shares (or 100%, as proposed in this paper). With such total issuance limits in place, ex post control on single issuance proportions can serve its intended function. The purpose of controlling single issuance proportions is to ensure that, in cases of large single issuances, the decision-making power shifts from the BoD to the SM. The SM, through a special majority resolution, can decide whether to allow a substantial increase in a specific shareholder's holdings or whether the original shareholders are willing to accept significant dilution of their shares. As for the threshold for a single issuance, it does not need to align with the critical point for control transfer under Chinese law, as there are already separate mechanisms for reversion of decision-making power in cases of control transfer. The 20% cap proposed in the first draft can thus be retained as a reasonable limit. Additionally, when the decision-making power for share issuances reverts to the SM, another significant function can be realized. For example, existing shareholders who are unwilling to accept significant dilution of their holdings can vote against the proposal at the SM and exercise their dissenters' rights to request a buyback of their shares as a form of relief. This remedy serves as an important mechanism for resolving disputes among shareholders. For minority shareholders who disagree with the majority opinion, this provides an opportunity to exit the company. This function, absent in decisions made solely by the BoD, applies not only to single issuance cases but also to scenarios involving control transfers and low-priced issuances, as well as all other circumstances where decision-making power reverts to the SM. Finally, based on the analysis in Chapters 3 and 4, this paper attempts to propose specific recommendations for improvement from a legislative perspective. Article 152(1) of the Company Law (2023) could be revised as follows: "The articles of association or the shareholders' meeting (SM) may authorize the BoD to decide on the issuance of shares not exceeding the number of issued shares. However, in any of the following circumstances, the issuance shall require approval by the SM:

(1) The price of the newly issued shares is significantly lower than the reasonable price of the shares;

(2) The issuance of new shares results in a transfer of corporate control;

(3) The voting rights represented by the newly issued shares exceed 20% of the total voting rights represented by the company's issued shares."

5. CONCLUSION

After years of debate, the authorized capital system has finally been implemented in China. With the enactment of the *Company Law* (2023), many joint-stock companies are expected to adopt a "combination of the authorized capital system and the paid-in capital system" for capital formation. In the face of fierce competition, where companies must seize fleeting business opportunities, the inherent flexibility of the authorized capital system enables companies to better achieve this goal. By granting authorization through the articles of association or an SM resolution, the BoD can issue shares during the capital increase phase, significantly enhancing the efficiency of corporate financing. Alternatively, when a company faces a hostile takeover and seeks to fend off the "barbarians at the gate," the creative potential of the authorized capital system can provide various defensive measures. Whether employing a "white knight" strategy or implementing a "poison pill" plan, these are among the most effective anti-takeover mechanisms. Behind these seemingly sophisticated terms lies the institutional arrangement of the authorized capital system, which allows the BoD, once authorized, to independently decide on the issuance of shares or warrants. As an imported system, the authorized capital system, once rooted in China's commercial practices, will inevitably undergo a process of integration and evolution. Observing how this system matures and examining what new fruits of commercial and legal wisdom it may bear in the Chinese context will be a long-term task, one that deserves our careful attention and anticipation.

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