

Navigating the New Company Law-Class Share & No-Par Value Share

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The recent amendments to the PRC Company Law (*New Company Law*) mark a significant turning point in the corporate governance and equity structure landscape for businesses operating within the PRC. Among the most notable changes are the introduction of the class share system and the no-par value share system—innovations that promise to offer unprecedented flexibility and strategic advantages to joint-stock companies incorporated in China.

The class share system allows for the issuance of shares with differentiated rights, enabling corporations to tailor their share structure in a manner that aligns with their strategic goals and investor base. Meanwhile, the adoption of the no-par value share system removes the traditional nominal value per share requirement, facilitating a more dynamic approach to share pricing and capital raising. This article aims to provide a comprehensive overview of these pivotal changes, dissecting their potential impacts on corporate operations, investor relations, and the broader market dynamics.

I. Class Shares

A. Class Shares Permitted under the New Company Law

Under the PRC Company law (revised in 2018) (*Current Company Law*), companies are generally limited to issuing a single class of shares, with each share enjoying the same rights to vote, dividends, and capital distribution upon liquidation, and any exceptions are to be separately provided by the State Council. This one-size-fits-all approach, while simplifying the share structure, often limits the strategic flexibility of companies, particularly those seeking to attract different types of investors or to incentivize certain groups such as founders, employees, or strategic partners.

The new class share system under the New Company Law provides a legal framework for companies to issue shares with differentiated rights, which means that a joint-stock company can now create multiple classes of shares, each with its own set of rights and privileges as set out in the company's articles of association. For example, a company could issue Class A shares with multiple voting rights per share, aimed at retaining control in the hands of founders, and Class B shares with limited or no voting rights but potentially preferential dividend rights, targeted at investors looking for financial returns rather than control.

We set out below the class shares listed under the New Company Law that joint-stock companies are allowed to issue:

- **Voting Rights:** The new system allows for shares that can have different voting rights (either super or limited voting rights), enabling companies to customize their governance structures more finely and address the needs of various stakeholders more effectively.
- **Dividend Rights:** Joint-stock companies can now issue shares that have different rights to dividends (either preferential or inferior rights to dividends or capital distribution upon liquidation), providing flexibility in how profits or residual property upon liquidation are distributed among shareholders.
- **Transfer Restricted:** Transfer-restricted shares are a category of shares that come with certain conditions limiting their transferability such as those subject to the consent of the company. This feature is designed to encourage shareholders, especially key employees, founders, and strategic investors, to maintain their investment in the company over a longer horizon, thus fostering stability and a focus on long-term value creation.

B. Legislative History for Class Share System

China's exploration of class share system dates back to the early stages of its adoption of the "company" system. The concept of "preferred shares" occurred as early as the early 1990s when the then National Economic System Reform Commission issued the "Regulations on Joint-Stock Companies." At that time China did not yet have a formal company law in place. According to these Regulations, a joint-stock company may issue ordinary shares and preferred shares. While the return for ordinary shares was not fixed, dividends must be paid on preferred shares on a fixed rate of return, and preferred shares enjoyed preferential distribution of residual assets in the case of liquidation.

Around the same time, Shenzhen government issued the "Interim Provisions on Shenzhen Joint-Stock Companies", which provided that "preferred shareholders generally do not have voting rights. However, if the company fails to pay dividends on preferred shares for three consecutive years, preferred shares may also be granted voting rights on a one share, one vote basis." The provisions also provided that the company may decide in its articles of association whether and how preferred shares may convert into ordinary shares, whether preferred dividend distribution should be accumulative or not and etc.

In December 1993, China adopted its first Company Law, which provided that "The State Council may make separate provisions for the issuance of other types of shares in addition to the shares specified in this Law." However, for some time after that, there was no significant progress in China's legislation and practice regarding preferred shares or class shares.

In November 2013, the State Council released the "Guiding Opinions on Carrying Out Pilot Projects for Preferred Shares", followed by the China Securities Regulatory Commission (CSRC) issuing the "Administrative Measures for Pilot Projects on Preferred Shares" in March 2014. These measures established regulations for the issuance and trading of preferred shares by both listed and unlisted public companies. Subsequently, listed companies and those traded on the National Equities Exchange and Quotations (NEEQ) began issuing and trading preferred shares.

Up to this point, China had not witnessed shares with varying voting rights. However, in late 2018, the CSRC introduced a series of documents permitting red-chip companies with differentiated voting rights structures to enter the A-share market through the issuance of Chinese depository receipts. It was during this period that such corporate governance arrangements began to gain widespread recognition and explicit regulation within China's legislative framework.

In January 2019, the CSRC issued the "Implementation Opinions on Establishing the Science and Technology Innovation Board and Piloting the Registration-Based System on the Shanghai Stock Exchange", calling for the establishment of the STAR Board and enabling companies with unique equity structures to undergo public offerings and list on it. Subsequently, in April 2019, with the launch of the STAR Board by the Shanghai Stock Exchange, STAR Board listing rules were introduced, including a dedicated chapter on shares with differing voting rights. This pilot initiative was later expanded to encompass other boards of the PRC stock exchanges.

The class share system as provided under the New Company Law is built upon these prior explorations, effectively consolidating the experiences gained. As explained by the Legal Work Committee of the National People's Congress in the context of the company law amendment, the provisions on the class shares are designed to meet the needs of different investors "by introducing provisions of class shares that have been widely utilized, including preferred shares, subordinate shares, shares with special voting rights, and transfer-restricted shares." While the legislative provisions regarding the class share system do not introduce major breakthroughs compared to its development in practice, their formal establishment within the New Company Law is poised to facilitate the further development and application of class shares in practice. By codifying these practices, the New Company Law provides a clearer, more structured legal framework that encourages the adoption and innovative use of class shares, aligning with the diverse investment needs of the market.

C. Construction of a Layered Protection System Tailored for Class Shareholders

With the formal establishment of the class share system, the New Company Law introduces special protections and restrictions for shareholders of different class of shares.

This begins with the requirement under the New Company Law that the rights and obligations associated with each class of shares must be explicitly outlined in the company's articles of association. Specifically, the following should be included in the articles of association of the company issuing class shares: (i) the number of shares for each class and their respective rights and obligations; (ii) the distribution order of profit or the residual property of the class shares; (iii) the voting rights of the class shares; (iv) the transfer restrictions of the class shares; (v) measures to protect the interests of minority shareholders; and (vi) any other matters related to the issuance of class shares deemed necessary by the shareholders' meeting.

The New Company Law further clarifies the statutory voting mechanisms for class share shareholders regarding major corporate decisions such as amendments to the articles of association, capital increases or decreases, mergers, divisions, dissolutions, or changes in the corporate form. It requires, in addition to a two-thirds majority of the voting rights held by the shareholders present at the shareholders' meeting, a two-thirds majority of the voting rights held by the shareholders present at the class share shareholders' meeting.

Moreover, as compared to the initial consultation draft, the New Company Law has added a new provision as the second paragraph of Article 144, which stipulates that even if a company has issued shares with special voting rights, the appointment and removal of supervisors or members of the audit committee shall still adhere to the "one share, one vote" voting mechanism. The implementation of the class share system is expected to pose various challenges to the corporate governance and the balance of power among various shareholders, underscoring the importance of the independence and efficacy of supervisors and audit committee members from potential dominance by class shareholders holding "super voting rights". The inclusion of the new provision in the second paragraph of Article 144, signifies a positive and forward-thinking approach in tackling these issues.

D. Impact of the Class Share System on Financing and Listing of PRC Companies

1. Providing Institutional Protection to Special Shareholder Rights in Investment and Financing Transactions

Before the implementation of the class share system, the rigidity of PRC company law limited the adoption of diverse and complex shareholder rights arrangements. Companies and investors had to resort to contractual provisions to establish special rights and obligations, which could lead to uncertainties in enforcement, inconsistencies across transaction documents, and potential disputes. The New Company Law addresses this issue by formally acknowledging the three most commonly utilized types of class shares in business transactions. The recognition provides institutional safeguards for special shareholder rights within the framework of company law, offering businesses and investors greater flexibility in organizing corporate finance, which, in turn, is expected to boost investment and financing activities.

While the issuance of other share types still requires regulation by the State Council, indicating that any special arrangements not covered by the three types outlined in Article 144 are not formally recognized under the company law, the adoption of the class share system represents a significant initial step towards enabling transaction parties to implement investment structures according to their preferences.

2. Potential Impact of the Class Share System on the Listing of Domestic Enterprises

Since 2019, the listing rules of various stock exchanges in China have already permitted the listing of companies with differential voting rights, and a number of companies with differential voting rights arrangements have successfully got listed on the A-share market. Their differential voting rights arrangements, as established pursuant to the applicable listing rules, are substantially in line with the requirements of the New Company Law. Such arrangements include provisions that prohibit the issuance of the super voting shares after listing and restrict super voting powers on certain critical matters. Therefore, we anticipate that these existing setups can be seamlessly integrated with the implementation of the New Company Law without significant disruptions.

In the A-share IPO process, a longstanding stipulation mandates that issuers possess undisputed ownership of shares, devoid of significant ownership conflicts that could precipitate a change in control. Additionally, any distinctive shareholder rights, such as those tied to value adjustment mechanisms, are typically expected to be eliminated prior to the IPO application, creating a "vacuum

period" where these rights are temporarily set aside.

With the official recognition of class shares under the New Company Law, will this practice undergo a transformation? Our current evaluation suggests that the alterations introduced by the New Company Law primarily reinforce existing norms. Therefore, it is likely that the requirement to eliminate special rights arrangements during the IPO application phase will persist in the foreseeable future. On the other hand, now that these special rights are formally acknowledged by the New Company Law and are no longer solely contractual constructs, as long as they do not impede clear share ownership or other listing criteria, it appears that IPO regulators may lack sufficient grounds to mandate their removal.

II. No-Par Value Shares

A. No-Par Value Shares Permitted in the New Company Law

The New Company Law allows a joint-stock company to issue shares without assigning a nominal or par value based on the company's articles of association. By issuing no-par value shares, the company is required to allocate at least half of the proceeds from the share issuance to the registered capital, with the remaining portion classified as the company's capital surplus. The specific amount of the proceeds from the issuance of new shares to be allocated to the registered capital must be determined by a shareholders' resolution.

A joint-stock company may also convert all issued par value shares into no-par value shares or all issued no-par value shares into par value shares according to its articles of association.

B. Understanding the Concept of "Par Value"

The par value, also known as the face value of a share, is the nominal value of a share of stock as indicated on the appearance of the stock certificate, denoted in "RMB per share" and is used to represent the amount each share contributes to the total equity of the company. For companies that use par value shares, the total equity of the company is equal to the product of the par value per share and the total number of shares issued.

Currently, except for a few cases such as H shares issued by red-chip companies domestically and stocks of companies like Zijin Mining (601899) (0.1 RMB per share) and Luoyang Molybdenum (603993) (0.2 RMB per share), the par value of stocks traded on domestic stock exchanges is usually RMB 1 per share.

Since the first enactment of the Company Law in 1993, China has consistently adhered to a par value system, accompanied by the implementation of a stringent capital paid-in system known as the statutory capital system. While China has progressively transitioned away from the capital paid-in system (with some aspects reintroduced in the New Company Law as explained under our previous article [Navigating the New PRC Company Law - Capital Adequacy](#), the par value system has remained intact. We believe that the par value system has primarily served the following two functions:

■ **Protecting the Rights of Creditors and Investors:** In times when information disclosure systems were less developed and channels for information dissemination were scarce, creditors and investors had limited means to evaluate a company's capital adequacy and debt repayment capacity, often relying on the registered capital amount on the company's business license. In this context, the par value system assigns a specific value to each share issued by the company, helping quantify the capital represented by each share. By explicitly stating the face value of shares and prohibiting issuance below this amount, the par value system sets a minimum threshold for the company's capital, ensuring capitalist authenticity and adequacy.

■ **Attracting Investors:** At the inception of the Company Law, China's stock market was in its early stages, with investors having limited knowledge and experience in investments. Abstract notions like stocks and securities were unfamiliar to many. In such a setting, paper stocks with specified par values served as a tangible representation that aided investors in grasping the value of stocks. These face values provided investors with an intuitive understanding, guiding them in assessing the worth of stocks and

influencing the subsequent trading and transferring prices. This approach, to a certain extent, helped attract investors who were navigating the complexities of the evolving stock market landscape.

C. Rationale for Introducing the No-Par Value Share System

As China's Company Law, established three decades ago, and its stock market, which has weathered over 30 years of fluctuations, evolve with time, a reassessment of the par value share system is imperative. The introduction of the no-par value share system, a key facet of the current company law revision, is underpinned by theoretical frameworks and practical considerations, notably evident in the following aspects:

1. Facilitating Financing and Trading Activities to Alleviate Some Corporate Challenges

According to Article 127 of the Current Company Law, shares are required to be issued at a price not lower than their par value. However, in situations where a company's actual share value drops below the par value, particularly during times of financial distress, the constraints set by the par value share system on issuance prices can create a legal obstacle to the company's refinancing efforts. Acknowledging this issue, the New Company Law introduces the no-par value share system to offer a viable solution for companies to navigate developmental challenges.

2. Adapting to International Trends

Par value shares were once a common choice worldwide. However, an increasing number of countries and regions are now adopting the no-par value share system.

In 1912, the state of New York in the United States was the first to pass a law allowing the issuance of no-par value shares, followed by other states. Some states have entirely replaced the par value share system with the no-par value system, while others have allowed both systems to coexist, giving companies the choice. The EU's Second Company Law Directive provides companies with the choice between the par value share and the no-par value share systems. Germany, Japan, and South Korea have also adopted systems where both par value shares and no-par value shares coexist, while Singapore and the Hong Kong region of China have completely abolished the par value share system and fully adopted the no-par value share system.

The New Company Law adopts a legislative model that allows companies to choose between par value shares and no-par value shares, in line with international legislative trends.

3. Providing Legal Basis for Overseas Companies to Access the PRC Capital Market

As reforms in the domestic capital market in China continue to progress, China now permits red-chip companies registered overseas to issue shares and be listed on the A-share market under specific conditions. Currently, several red-chip companies have successfully completed domestic listings, such as CR Micro (688396) (its shares have a par value of 1 Hong Kong dollar per share), BeiGene (688235) (par value at 0.0001 US dollars per share), and SMIC (688981) (par value at 0.004 US dollars per share), all incorporated in the Cayman Islands and, according to the Cayman Islands Companies Law, free to choose the currency of their share par value.

On the other hand, China Mobile (600941) registered in the Hong Kong region, operates under the Hong Kong Companies Ordinance, which has fully adopted the no-par value share system, hence its shares have no par value.

The par value configurations of the aforementioned red-chip companies comply with the corporate legal framework of their places of incorporation but diverge from the par value share system adopted by the Current Company Law. This has necessitated specific and sometimes intricate discussions with the securities regulators and other relevant authorities during their A-share listing process, including without limitation on the topics of the share par value, the necessity of foreign currency denomination, and the considerations related to protecting creditors' rights, and safeguarding investors. The embracement of the no-par value share system will pave many of the obstacles for future red-chip companies to tap into the PRC capital market.

D. Challenges that the Implementation of the No-par Value Share System May Face

The introduction of the no-par value share system in the New Company Law represents a significant reform of the statutory capital system in company law. This change necessitates a series of comprehensive and interconnected modifications across the existing company law structure, including relevant judicial interpretations, to fully integrate and operationalize the no-par value share system. Furthermore, it will also require adjustments to laws in related fields, such as securities laws and regulations.

Following the implementation of the New Company Law, companies are empowered to opt for either the par value share system or the no-par value share system. However, the successful execution of this choice demands concerted efforts from all relevant stakeholders. It will be critical to monitor how regulatory authorities, securities registration and settlement institutions, and other market participants interpret and implement the new system. Additionally, the timely adaptation of registration systems and associated infrastructure to cater to the evolving requirements of market entities, along with ensuring that investors and creditors comprehend and appropriately respond to the no-par value share system, will require continued practical assessment.

Conclusion:

In conclusion, the incorporation of the class share system and the no-par value share system in the New Company Law signifies a significant reform in China's company capital structure. The introduction of the class share system establishes a legal framework for Chinese enterprises to issue class shares, catering specifically to the needs of Chinese businesses, particularly in venture capital and private equity financing sectors. On the other hand, the adoption of the no-par value share system reflects the evolution of the statutory capital system and aligns with international legislative trends. This system has the potential to boost financing and trading activities, as well as alleviate obstacles encountered by certain companies.

Nevertheless, the development of comprehensive supporting regulations and systems remains essential. For market oversight and management bodies, securities regulatory authorities, entrepreneurs, or investors, grasping, effectively utilizing, and responding to the class share system and no-par value share system will involve a gradual learning process. Only through the development of comprehensive supporting regulations and systems can the full potential of these reforms be realized, fostering a more flexible and dynamic capital market environment in China.

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