論　説

Power Allocation in Hostile Takeover Regulation : Rethinking Chinese Fiduciary Duty, Board Neutrality Rule and Shareholder Rights

敵対的買収規制における権力配分：中国の信認義務、取締役会の中立義務の規制および株主の権利の再考

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Introduction

In 1990, China established its securities market. Only three years later, the first hostile takeover took place and succeeded. In the following two decades, China witnessed several takeover attempts and the highlight case of *Vanke vs. Baoneng* in 2016 once again captured people's attention, calling for the improvement of Chinese takeover law.

A hostile takeover era is coming. In 2015, the Supreme People's Court called off the 10-year ban on private loans between non-financial institutes[(1)], and China Banking Regulatory Commission removed its prohibition for merchant banks to fund takeovers. Since then, P2P lending and internet insurance instruments began to thrive for the first time in Chinese history[(2)]. Meanwhile, the Shanghai Securities Composite Index of Chinese stock market plummeted from its peak of 5178.19 in June 12th, 2015 to under 3000 in 2016, during which most listed companies in China lost more than 30% of their market value[(3)]. The stock market is still in distress in 2017, and the cumulative stock price of some ST-companies are close to their bust-up value. The concentrated ownership structure in Chinese listed companies was once the biggest obstacles for barbarians to knock at the gate, however, the Share Split Reform beginning in 2005 made the non-tradable shares of the State tradable and gradually reduced the level of ownership concentration in Chinese listed companies[(4)], which paved the way for hostile takeovers to emerge in a large scale.

However, in hostile takeover domain, China is grossly not ready in terms of dispute resolution and law enforcement. The legal framework of Chinese takeover Regulation is a mixture of practices transplanted from overseas, notably U.S, U.K and E.U. The U.S approach highlights a modified business judgment rule to review directors' fiduciary duty in takeovers by the court. The U.K approach empowered a self-regulatory entity - the "City Committee" to resolve takeover disputes and the court is kept out of the process. Drawing experiences from the U.K, the E.U approach centers the Board Neutrality Rule, which deprives management of the power to adopt any takeover defenses unless authorized by shareholders.

The Chinese hodgepodge intended to absorb the very essence of all the foreign experiences. In China law, the *Administrative Rules on Acquisition* has substantive rules on directors' fiduciary duty, and the board neutrality rule can be found both in *Company Law* and *Securities Law*. Besides, CSRC established the *Audit Committee of Mergers and Acquisitions* based on the "City Committee" of U.K.

During the last two decades, this Chinese "a-little-bit-of-everything" regime failed to provide enough and clear guidance to participants in takeovers, and caused uncertainty and anxiety in the Chinese market. Under the supply-side reform to vitalize enterprises, the whole Chinese industries are in desperate need of takeovers to better utilize social resources. Hence, an underperformed takeover law system can damage the well-being of the society as a whole.

Some scholars attribute the failure of law transplantation in China to "local factors" or "cultural antipathy"[5], but the real reason was China transplanted laws from abroad without understanding their intrinsic qualities. Thus, poor adoption of foreign laws leads to poor local regulatory effects. Then, what is the internal logic of the foreign law? How should China improve its takeover regulation? Which model is the fit one for China? What kind of rules should be reserved and what kind of rules should be abandoned?

This paper aims to answer those questions with an in-depth review the Chinese takeover legal framework, and to give suggestions for the power allocation in takeover regulations in China by revealing the true merits of takeover regulations in U.S and E.U. Part I, II, III demonstrates the takeover regulatory framework in U.S, E.U and China respectively. Part IV examines the Chinese regime empirically by digging into the ex-ante and ex-post defensive measure in hostile takeovers. Part V analyses the crucial elements in Chinese takeover law and Part VI offers suggestions for the improvements.

The fiduciary-duty-centered U.S approach is the very opposite of the Board-Neutrality-Rule-centered E.U approach. In order to sustain growth, the E.U model which facilitates takeovers is more optimal for China. In line with this, CSRC's substantive intervention seems to be a better substitute for the implementation of a court-review fiduciary duty system in China and the already existed Mandatory Bid Rule should be modified accordingly. Meanwhile, the Board Neutrality Rule

should be suspended when facing extremely high-ratio leverage buyouts.

In sum, this paper argues that the Chinese takeover regime should favor the primacy of the shareholders over the will of board of directors; but the different types of shareholders should also be identified. In companies with concentrated ownership structure, the agency costs between majority and minority shareholders are high, and the minority shareholders should be empowered with more preponderance in adopting takeover defenses.

I. Legal Framework of U.S Takeover Regulation

I begin with the two most prominent takeover legal regime - the U.S and E.U approach.

The legal framework of American takeover regulation has attracted enormous attention academically, and in this part I focus on three resources of American takeover law - Federal Status, judicial decisions from the Delaware Court of Chancery and State Statutes.

A. Federal Status: The Williams Act of 1968

Takeover activities were incorporated into federal regulation since 1968, when congress of U.S passed the Williams Act. The Williams Act was an amendment of the Securities and Exchange Act of 1934 that regulated tender offers and other takeover related actions, but most important of all, the fundamental goal of this Act was to ensure

enough information disclosure to shareholders, so that they could make informed decisions that are best of their interest.[6] At that time, abuses with cash tender offers was everywhere in the U.S, and the Act aimed to require full and fair disclosure for the benefit of stockholders, meanwhile providing the acquirer and management equal chance to fairly present their cases.[7]

Therefore, two core aspects of Williams Act are: first, the mandatory information disclosure requirements; second, legal procedure for tender bids.

Section 13 (d), (e), (f), (g) mainly deals with acquirer's duty of information disclosure.[8] Any person, or group who acquires beneficial ownership of 5 percent or more of a class of equity securities must file with the SEC within ten days. Certain information disclosure includes: acquirer's identity and background, resource of the acquisition fund, purpose of this acquisition (including plans to liquidate the target company or adjust major business of the company), and to what extent the acquirer wants to obtain control.

Section 14 (d), (e), (f) stipulates certain rules for acquisition behavior,[9] for instance, shareholders have the right to withdrew their acceptance of the offer within 7 days from the first day of the offer. Tender offer must last for at least 20 days, and when there are more shares for sale than anticipated, the offeror has to acquire those shares on an equal proportion basis.

In sum, the Williams Act serves as the base line of tender offer activity which requires acquirer conform to the minimum requirement of information disclosure and equal price payment. The Securities and Exchange Commission (hereinafter SEC) is the federal governor of securities activities in the U.S, and SEC monitors the U.S securities market under the guidance of Williams Act. Meanwhile, SEC also has other laws that governs false statement, fraud and misleading behavior, but the most important element in American hostile takeover regulation - the fiduciary duty of directors, is oversaw by the court.

B. Judicial decisions from Delaware Court: Unocal, Revlon and Sotheby Rule

Federal regulation makes up only a small fraction of American takeover regulation. Judicial decisions of directors' fiduciary duty, is the core of American regulation. Although every state of American has its own law, most large companies of American were registered in Delaware, whose corporate law is the most advanced one and whose Chancery Court represents the highest efficiency in U.S.[10]

The far-reaching case of Unocal Corp V. Mesa Petroleum Co. case in 1985 established the interim standard to review directors' action in response to a hostile takeover. In this case, the corporate raider, Mesa Petroleum, who was nationally famous for greenmail, held 13% of Unocal's Share. It then launched a two-tier tender offer for Unocal's 37% outstanding shares: the front side of this tender is 54 dollars per share paid by cash, and the end side is 54 dollars per share paid by

junk bond. Considering the offer price being too low and the chance of greenmail being too high, the Unocal board intended to launch a selective self-tender offer plan, in which if Mesa had obtained 64 million shares of Unocal, the Unocal board would purchase shares from stockholders other than Mesa at 72 dollars per share. Hence, the plan once triggered, would enable Unocal repurchase 49% outstanding shares except those hold by Mesa. The Supreme Court of Delaware ruled the validity of this self-tender.(11)

In this case, the Supreme court realized the directors were of necessity confronted with a conflict of interest, for they might very possibly be superseded if the acquisition succeeded. Because of the conflict of interest, the traditional Business Judgement Rule was not enough to prevent them from injuring shareholder benefits. Therefore, the Court established a two-part reasonableness-based tests, to determine whether directors of the board were legitimated to take defensive measures. Under this test, the defendant - directors of the board, was required to prove that: first, they had reasonable ground to believe that a danger to corporate policy and effectiveness existed because of another person's stock ownership, and; second, the defensive measures which they were taking were reasonable in relation to the threat posed.

What also worth noting is that the Supreme Court did not require the board to get approval of the defenses from shareholders, and did not restrict directors' concern of the acquirer and the company to shareholders' benefits alone, which empowered the directors to have

even larger discretion when facing hostile takeover. Concerns of directors could include: price and timing of the offer, illegality of the acquisition, impact on related party such as employee, creditors and even customers.

The two-part reasonableness-based test established in the Unocal case is a modified version of the Business Judgement Rule, and it is the defendant, not the plaintiff, bears the burden of proof. This is because the conflict of interest is almost inevitable in the use of takeover defenses.

In the same year of 1985, based on the foundation of the Unocal rulings, the Delaware court upheld a poison pill (an aggressive shareholder rights plan) as a legitimate exercise of business judgment by Household International's board of directors in Moran v. Household International, Inc. This case is the first one in which a U.S state court upheld a poison pill as a legitimate reaction to hostile takeover.[12]

In 1986, a landmark decision of the Delaware Supreme Court on hostile takeovers was ruled in Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. The Supreme Court restricted freedom of the board in taking defensive measures. The acquirer - Pantry Pride of MacAndrews & Forbes Holdings, Inc., offered a price of 40-42 dollars per share for Revlon's outstanding shares. The management thought the price was simple not sufficient and therefore launched a series of takeover defenses. The share repurchases by the target company didn't scare

away the company raider, rather, Pantry Pride became quite determined and raised the price of his offer from 47.5 dollars per share all the way to 56.25 dollars per share. When recognizing Revlon was inevitable for sale, the Revlon board still brought their white knight - Forstmann into the game, with whom the management provided a series privileged terms such as a waiver of the restrictive covenants as well as a huge amount of cancellation fee. The acquirer then resorted to the court for an injunction on Revlon's plan.(13)

The court opined that, the initial takeover defenses by Revlon board was reasonable and proportionate, which fitted the best interest of shareholders. However, the situation had dramatically changed, when the sale of the company became inevitable. Under this circumstance, it was the duty of the board to search for the highest bidder, rather than to retain control of the company. Hence, it is improper for the board to offer favorable terms to a non-shareholder third party in order create difficulties for the less-favored acquirer. Directors of the board breached their duty of care by creating unnecessary obstacle that might well impede the auction.(14)

The Revlon case reveals that, when sale of a company become inevitable or has already begun, the duty of the board switches from protecting the company into obtaining the highest price for the benefit of the shareholders. In short, the board role becomes an "auctioneer" - responsible for transferring the company to the highest bidder, with no intention to frustrate it.

In two subsequent Case: Paramount Communications, Inc. v. Time, Inc. and Paramount Communications Inc. V. QVC Network Inc., has provided certain guidance on directors' duty under Revlon situation and non-Revlon situation. The court had strengthened its judicial review on management's behavior. And Revlon's duty is triggered "when a corporation initiates and active bidding process seeking to sell itself or to effect a business reorganization involving a clear break-up of the company[15]", and "where, in response to a bidder's offer, a target abandons its long-term strategy and seeks an alternative transaction also involving the breakup of the company[16]".

In 1995, in the case of Unitrin, Inc. v. American General Corp., the Delaware Court had further interpreted board of directors' ability to use defensive measures, such as poison pills or buybacks, in reaction to hostile takeover. This case demonstrates an approach to corporate governance that favors the primacy of the board of directors over the will of the shareholders. According to the court ruling, once independent directors has ratified the use of takeover defenses, they are allowed as long as those measures are not "draconian" and within the reasonable boundary of the imminent threat.[17]

In 2014, in the widely-controversial case of Third Point LLC v. Ruprecht (often referred to as the Sotheby case), the Delaware Court of Chancery further endorsed the primacy of the board of directors over the will of the shareholders.

"…Third Point had claimed that Sotheby's directors had violated their fiduciary duties in order to obtain an impermissible advantage in a proxy contest with Third Point by (i) adopting a poison pill in anticipation of the proxy contest and (ii) refusing to provide a waiver to Third Point from certain of such poison pill's terms…The Court held that Third Point was not reasonably likely to succeed on the merits on such claims based on its findings that the Sotheby's board of directors had identified legitimate and legally cognizable threats to the company's corporate policy and effectiveness and that the board's actions were proportionate responses to the threats posed and were not preclusive of a proxy contest…

…[Therefore], the Delaware Court of Chancery denied the motion of Third Point LLC and its co-plaintiffs for a preliminary injunction to enjoin Sotheby's from holding its annual meeting…" (18)

Court's predilection for directors of the board is quite obvious in American legal system, but the reason is deeply hidden in the judge-made law system. For a long time, compare with legislation and self-regulatory mechanism, litigation is considered to be less influenced by interest groups, this especially submitted in common law jurisdictions - those who participated in litigations have to agree on previous rulings, and it's almost impossible for any participant to step-by-step affect the climate of the law, which is simply way too time consuming and expensive. However, in U.S corporate governance regime, judicial precedent may, little by little, time by time, move towards into a status

where directors are given more primacy. The defendant in the takeover suits are usually the directors, when D&O insurance and golden parachutes counteract the financial risks, they however face their loss in reputations, especially when defeated in court. Meanwhile, as they have the resources their company has to offer, they intend to pacify conflicts using money. But they cannot prevent the acquisition party from applying injunctions from the court, therefore, most takeover disputes come from injunctions applied by acquirers. Goal of the acquirers is to obtain control of the company, but litigation can at most disarm management from takeover defenses, which benefits all potential acquirers as a whole. This free-riding problem usually prevent acquirers from litigations, and those conflicts usually get pacified one way or another.[19] In another words, the directors of the board, as repeated players in those game, naturally have better information and resources to win in litigations.

Judges are faced with cases that are brought to them, and legal precedents are accumulated on judge-made law. As a consequence, in American corporate law regime represented by Delaware, the board has the primacy and ascendency, not the shareholders or acquirers.

C. State Statutes

Except the federal law enforced by SEC and fiduciary duty ruled by the court, another important source of American Law is the State Anti-Takeover Law. Those law are regarded as less impartial, as most of them favor the corporations incorporated in their states, protecting

target companies thoroughly from acquisitions outside the state. Those laws have gone through three generations of development, and are very common in most of the states.[20]

The first generation of State Statutes is aiming at regulating offer bids, by empowering the state regulator the authority to review the merits of the offer and sufficiency of information disclosure; or in its direct goal, protect specific local industry. For instance, when Belzbergy Family, who was notorious for greenmail, threatened to takeover Arvin Industries in Columbus Indiana, the state regulator imposed a long waiting period to review the merits of the offer in favor of Arvin Industries. Arvin hired 2000 local employees and gave support to local education.

However, powerful and compelling as they were, some State Statutes were nullified by the Supreme Court. For example, in 1982, the waiting period imposed by Illinois statue was considered to have breached the Interstate Commerce Clause in American Constitution in Edgar v. Mite Corp case. The Supreme Court held that local state should not turn a deaf ear to non-local shareholders' interests when protecting local investors' rights.[21]

The second generation of anti-takeover law focus on the protection of information disclosure, among which the most famous and most efficient one was called "Control Share Acquisition Statute". Under this law, a bid acquring the target company has to be approved by the

majority of disinterested shares. In 1987, the Supreme Court upheld Indiana's "Control Share Acquisition Statute" in CTS Corp. v. Dynamics Corp. of America. According to the Indiana statute, outstanding shares where the part exceeds 20% carries no voting right, unless this independent shareholder obtained voting right for this part of his shares in general meetings of shareholders.[22] "Fair Price Statute" is also quite common in State Statutes, which requires acquisition to be approved by supermajority of shareholders unless they all get the equivalent best price of the acquirer. Another kind of State Statute is the "Stakeholder Statute", which permits management consider the interest of all stakeholders rather than stockholders alone.[23]

The third generation went even further in protecting target companies. "Freeze Statute" of New York prohibits a merger within 5 years of an acquisition that gives control to an offeror unless that transaction was approved by the target company's directors before the acquisition itself. And "Disgorgement Statute" of Pennsylvania requires any person owning more than twenty percent of a corporation's shares to disgorge any profit realized within an eighteen month's period. Most third generation State Statutes survive the Constitutional Challenge of the Federal Courts.[24]

In conclusion, the American corporate law represented by Delaware, the directors of the board have the primary power of major corporate issues - including the use of defensive measures. In contrast, shareholders are passive and inactive. Mergers, acquisitions, sale of

corporate assets and even modification of company's article normally does not require shareholders' approval. Except those powers clearly specified in state laws and in the certificate of incorporation that belong to shareholders, all other powers are executed by directors of the board, which gives directors of the board more primacy and primary decision-making authority.

II. Legal Framework of European Takeover Regulation

European Countries has their own takeover laws, which is famous for its comprehensiveness. The European Directive on Takeover Bids is now the centerpiece of European takeover regulation, it provides provisions and regulations on takeover bids in all member states of the European Union.

The notion of "a united European takeover law" came from the research by Committee of the European Union on unifying European's internal market. In 1985, in a landmark document *Completing the internal market: white paper from the commission to the European Council,* Committee of the European Union mentioned its will to improve the procedure of offers of shares to the public. Then, in 1989, Committee of the European Union drafted the *Proposal for a Thirteenth Council Directive on Company Law Concerning Takeover and Other General Bids* based on the foundation of British *City Code on Takeovers and Mergers.* This proposal contained basic equal treatment rule for shareholders and depicted the rudiment of the general duty of the acquirer and

management of target company. The acquirer was requested to provide sufficient information, and once exceeds certain percentage of shares the acquirer has to mandatorily obtain all outstanding shares through offer bids.[25]

This proposal didn't work out under drastic critics from U.K and Germany. Although based on British City Code, the U.K Department of Trade and Industry feared that codifying the non-statutory self-regulation code might impair Takeover Panel's speed and flexibility. And European's industry feared that such a united law might pave the way for trivial suits all over Europe.

A new takeover directive proposal was handed in by the Committee in 1996 after negotiating consequently with member states. This new proposal was based on the previous one, but cancelled the mandatory application of certain rules and regulations and member states can thereby choose rules and regulations from the Directive so far as relative and reasonable protections for minority shareholders were in place.[26] To address the U.K.'s fear of losing discretionary power, Article 4(6) clarified the supervisory authority in each member state: *"This Directive does not affect the powers of the Member States to designate judicial or other authorities responsible for dealing with disputes and for deciding on irregularities committed in the bid procedure nor does it affect the power of Member States to regulate whether and under which circumstances parties to a bid are entitled to bring administrative or judicial proceedings. In particular, this Directive does not affect the*

power which courts may have in a Member State to decline to hear legal proceedings and to decide whether or not such proceedings affect the outcome of a bid. This Directive shall not affect the powers of the Member States to determine the legal position concerning the liability of supervisory authorities or concerning litigation between the parties to a bid".[27]

This new proposal again failed unify the interest of all member states. The Takeover Panel in U.K fear that it may open the Pandora's box for expensive litigations; Netherland expressed their concerns over the absolute ban on takeover defenses by directors of the board without shareholders' approval.

After a series of failure in the beginning of 2000s, the Committee asked the leading scholar in European corporate governance - Jaap Winter to establish a team unit to propose and draft another unified Takeover Directive. Winter's mission was to bring up a proposal, to strengthen and unify European Industry, and to improve the efficiency of a single market in Europe. This time, "a level playing field" was the core, and Winter's team invented the "Breakthrough Rule" and other institutional creation to ensure shareholders being treat equally.[28]

Winter's new proposal, like all previous ones, faced severe attacks. Sweden was particularly unhappy for the "Breakthrough Rule" nullified more than half of its listed companies' dual equity structure. Germany also harshly objected the "Breakthrough Rule" as lots of share transfer

limitation existed in German listed companies.[29]

After continuous negotiations and compromises, the Italian Representative worked out the idea that allow corporations to freely choose laws to adopt under the board neutrality role. This compromise proposal solved the long time haggle between member states and thereby acquired wide-range acknowledgement. In 2004, The European Directive on Takeover Bids was finally passed after revising the compromise proposal for several times.

The 2004 European Directive on Takeover Bids intended to harmonize the takeover regulation of all 27 member states. The deadline for each member state to deploy the Directive was the end of 2006, and almost all countries had finished this mission by then.

A. General Clauses

Like the clauses in Chinese Securities Law and American SEC's regulation, Article 8 of the Directive deals with information disclosure of the offer and acquirer: *"Member States shall ensure that a bid is made public in such a way as to ensure market transparency and integrity for the securities of the offeree company, of the offeror or of any other company affected by the bid, in particular in order to prevent the publication or dissemination of false or misleading information"*.[30]

The European Directive has extremely thorough requirement for information disclosure of the acquirer,[31] which could be used as the

paradigmatic pattern for other countries in information disclosure. It not only concerns about specific information a company has to offer, but also the way in which it should be offered.

Those General Clause are not the essential part of European Takeover Law, the following part I will focus on three most important paradigms of European Directive on Takeover Bids - the Mandatory Bid Rule, the Board Neutrality Rule and Breakthrough Rule, which illustrate this "compromised" Directive has its own unique strengths.

B. Mandatory Bid Rule

The Mandatory Bid Rule is the first pillar of the European Takeover Directive, which requires the acquirer to buy all outstanding shares through offer bids. This is exactly the opposite of American's free acquisition style. Article 5 of the Directive is about protection of minority shareholders, the mandatory bid and the equitable price.

Essential of Article 5 is, any individual who has obtained sufficient shares to secure control has to acquire all outstanding shares by offer bids at an equitable price. Article 5(3) allows each member state according to their needs and situation to set their threshold percentage respectively. The so-called equitable price is actually the "highest" price an acquirer paid for the same shares within a certain period, a period which each member states have discretionary power to set for themselves. The supervisory authority in each member state are empowered to adjust the "equitable price" according to the declared

criteria.[32]

Some member states have exemptions from the mandatory bid rule, among which Ireland and Germany has many situations under which the acquirer is exempt from tender offer bids. Anyway, the European Directive leaves the member states with considerable room to define their own mandatory bids requirement, only when the acquisition has reached certain thresholds does the publicly offer bid become compulsory.[33]

C. Board Neutrality Rule

The European Directive requires directors of the board to be subject to the Board Neutrality Rule, when facing hostile takeovers. Thus the board, generally, should not take any actions as responses to takeovers. Article 9 concerns the obligations of the board of the target company.

According to Article 9, once the board are aware of the offer bids, they should not take any actions that may frustrate the acquisition activity before obtaining authorization from shareholders, except finding the alternative potential offeror to join the bid. Hence, shareholders under the Directive are given the primary decision-making power in takeover defenses, and for directors of the board, almost any anti-takeover actions are violation of Article 9 as they are obstacles for takeovers in nature, unless otherwise instructed by shareholders. Article 9 also stipulates that when authorized by shareholders to take defensive measures, the directors of the boards are no longer subject to the Board

Neutrality Rule.[34]

The intriguing part of Article 9 is the two specifically mentioned take-over defenses - the former was allowed and the latter was banned. Article 9 permits the board to find "white knight", even without shareholders' approval, and it explicitly forbids issuing any shares that may impede the acquirer obtaining control.[35] Hence poison pills are not allowed under the European Directive, and neither, issuing new shares can hardly be a useful defensive measure.

D. Breakthrough Rule

The Board Neutrality Rule has frozen the board from taking actions, but it pales in comparison to the Breakthrough Rule, which straightway voids all previous arrangements which enable voting leverage of the management - be it stated in the Articles of Associations or elaborated in shareholding agreements. The Breakthrough Rule in Article 11 of the Directive is the most controversial one in the Directive, but we have to admit that it encourages the prosperity of hostile takeovers.

The Directive requires "equitable compensation" to those shareholders whose voting leverage was nullified by the Breakthrough Rule, but it does not clarify how should this compensation be fulfilled. Such responsibility falls on the head of each member states and is left unsolved even until today. Article 11 also stipulates that, once the acquisition is open to public, within the duration of validity of the

tender offer, any limitations and restrictions on share transfer do not apply between the acquirer and acquiree - those share transfer restrictions are frequently seen in German listed companies. Moreover, any restrictions on voting power in general meetings of shareholders are not applicable as well. Finally, when acquirer obtain more than 75% voting capital, any extraordinary rights which limit share transfer or voting power and any special rights to appoint or remove directors of the board are void, and holders of multiple votes securities only have one vote per share in the first general meeting held by the acquirer.[36]

All in all, the Breakthrough Rule makes the control shareholder and incumbent directors of the board impossible to have disproportionate control power over the company. They are no longer shielded by voting leverages and restriction on share transfer, rather, they have to compete with the acquirer for further corporate control. This kind of rules are seldom seen in other countries or regions, but they do largely decrease the agency cost between minority shareholder and the controlling shareholders.

E. Opt-outs and Exemptions

The most creative clause in the European Directive, is the optional arrangements of voluntary application of the Board Neutrality Rule and the Breakthrough Rule, as stipulated in Article 12: *"[m]ember States may reserve the right not to require companies as referred to in Article 1(1) which have their registered offices within their territories to apply Article 9(2) and (3) and/or Article 11."*[37]

The existence of Article 12 ensures that the takeover regulations in Europe today are diverse and manifold. Despite the same foundation, every member state has large discretionary power in adopting core rules that are suitable for them. Meanwhile, the discretionary power is ultimately left to shareholders as they have the final say on whether to write certain rules into their Articles of Association in their general meetings. Also, when faced with acquirers who doesn't apply those rules, companies choose to adopt them can temporarily discontinue its application of those rules. In sum, Article 12 makes the European Directive more flexible than ever.

Ⅲ. Legal Framework of Chinese Takeover Regulation

A. Regulator

The China Security Regulatory Commission (hereinafter CSRC) is the main regulator in Chinese Securities Market, who has the ultimate and exclusive right over takeover disputes as a technocrat, just like the SEC in the United States. In 2006, CSRC established a special unit to address takeover relative affairs - the Audit Committee of Mergers and Acquisitions (hereinafter ACMA), which consists of related experts and professionals on a part-time basis. Opinions on takeover issues from ACMA represents the state-of-art conclusive view of CSRC. In recent years, the CSRC has lowered its administrative intervention in Mergers and Acquisitions, partly by eliminating administrative approval requirement and entitling oversight power to stock exchange and CSRC dispatched offices.[38]

One thing worth noting is that public censure from CSRC sometimes has the same prohibitive effect to certain behaviors in takeovers, just like substantive laws do. For instance, "Bao Wan dispute" is a significant event in the capital market of China in 2016. With the help of insurance funds, a relatively small company - Baoneng in 2016 managed to knocked on the door of Wanke - a Chinese real estate giant, and simultaneously the door of Geli - a Chinese air conditioner manufacturer giant. Since then, universal insurance as the representative of the insurance funds frequently appeared in the capital market and placards.(39) On December 3rd, 2016, chairman of CSRC, Mr. LIU Shiyu condemned "barbaric" leveraged company buy-outs by some asset managers using illegal funds. Liu said China's capital markets had seen a series of "abnormal phenomena" lately, challenging the bottom line of China's financial law and regulations.(40) "You launch leveraged buy-outs using illegitimate money, turning from a stranger to a barbarian at the gate, and ultimately becoming a robber in the industry. That is unacceptable." Two days after LIU's speech, On December 5th, 2016, China stocks slumped on Monday morning, with the blue-chip index set for its biggest fall in six months.(41) LIU's warning against "barbaric" share acquisitions alone restraint the wild growth of leverage buy-out in China, at least for now. Meanwhile, the sale of universal insurance is called off by China Insurance Regulatory Commission.(42)

B. Law and Provisions

In China, the regulatory provisions governing takeover defenses today can be found in several laws as well as administrative rules promulgated by the CSRC, including *People's Republic of China's Company Law* (hereinafter 2014 Company Law as it came into effect on 1st March 2014)[43], *People's Republic of China's Securities Law* (hereinafter 2014 Securities Law as its last amendment is in 2014)[44], *Administrative Rules on Acquisition of Listed Company* (hereinafter 2014 Administrative Rules on Acquisition as its last amendment is in 2014)[45]. And, although not functioning as a substantive rule, *Guidelines on Articles of Association of the Companies Listed in China* (hereinafter 2016 Guidelines on Articles of Association as its last amendment is in 2016)[46] provides useful guidelines on corporate charters of Chinese listed companies.

1. 2014 Company Law

Company Law is essential in takeover regulation, because it allocates the primary power between shareholders and directors of the board. The transfer of corporate control is a major event in nature and therefore it's important to clarify who has the ultimate power to adopt takeover defenses.

The Chinese Company Law is clearly shareholder centered as shareholders have the ultimate power over major corporate issues such as *"...(2) Electing and changing the directors and supervisors assumed by non-representatives of the employees and deciding the matters relating*

to their salaries and compensations; (3) Deliberating and approving reports of the board of directors;...(6) Deliberating and approving company profit distribution plans and loss recovery plans; (7) Making resolutions about the increase or reduction of the company's registered capital; (8) Making resolutions about the issuance of corporate bonds;(9) Adopting resolutions about the assignment, split-up, change of company form, dissolution, liquidation of the company;(10) Revising the bylaw of the company".[47]

By contrast, directors of the board seem to have much less power over corporate major issues. The basic role of directors of the board is *"...(2) Implementing the resolutions made at the shareholders' meetings".*[48] They are also in charge of working out company's plan on the increase or reduction of registered capital, issuance of corporate bonds, as well as plans on mergers and change of company forms, and etc. But, according to Chinese Company Law, all those plans have to be approved by the shareholders before they come into position.

As most takeover defenses primarily concern with the major issues of the company, in theory, the ultimate and last decision power of takeover defenses lies in the hands of shareholders rather than directors of the board. Shareholder approval as the final check of takeover defenses largely limited directors' discretion in adopting defensive measures.

Except the rules concerning power distribution among major corporate

issues, 2014 Chinese Company Law also has several mandatory rules that prohibit certain types of takeover defenses. Article 104 stipulates that *"[w]hen a shareholder attends a meeting of the shareholders' assembly, he shall have one voting right for each share he holds. However, the company has no voting right for its own shares it holds."*(49) This "one-share-one-vote" rule directly voids any shareholding arrangements aim to benefit from vote leverage mechanisms. Insurance of different classes of shares with different voting power is strictly prohibited by this rule and therefore the dual-class equity structures, which are quite common in Anglo-American and European countries, are hard to find in Chinese Listed Companies. Some companies in China circumvent this rule by stock pyramiding, and circular shareholding.

Article 127 requires that *"[t]he issuance of shares shall comply with the principle of fairness and impartiality. The shares of the same class shall have the same rights and benefits", meanwhile, "[t]he stocks issued at the same time shall be equal in price and shall be subject to the same conditions. The price of each share purchased by any organization or individual shall be the same."*(50) As all shares of the same class shall carry the same rights and benefits, all stocks issued at the same time shall worth same money and are subject to same conditions, insurance of securities that has discriminative effect is illegal according to Chinese Company Law. Therefore, Chinese management cannot adopt poison pills when facing hostile acquisitions.

Repurchase of company shares as a basic defensive measure is pervasive

not only in the U.S or U.K, but also even in Asian countries like Japan or Korea. However, Article 144 in 2014 Company Law disqualifies repurchase of company shares as a defensive measure. In China, a company can purchase its own shares only in the following circumstances: "…*(1) To decrease the registered capital of the company; (2) To merge another company holding shares of this company; (3) To award the employees of this company with shares; or (4) It is requested by any shareholder to purchase his shares because this shareholder objects to the company's resolution on merger or split-up made by the assembly of shareholders.*"[51] Meanwhile, the repurchased share should be either written off within ten days of the purchase or transferred to employees with n one year.

2. 2014 Securities Law

Securities Law is M&A immediately related, and is the most important law governing acquisition behaviors.

In order to prevent short-term share price sparks benefits, Article 47 serves as a "Disgorgement Statute" in Chinses Securities Law. Article 47 stipulates that "*[w]here a director, supervisor or senior manager of a listed company, or a shareholder who holds 5% or more of the shares of a listed company sells the shares of the company within six months of purchasing such shares, or repurchases the shares within six months of selling such shares, the gains therefrom, if any, shall belong to the company, and the board of directors of the company shall recover such gains.*"[52] This article effectively constrains the impulse of corporate

raiders to get disproportionate revenues from cashing out at a "good" timing or dismantling the company for sale. Several of Securities Law's provisions regulate the target company management and hostile acquirer's behavior in takeovers. For instance, Chinse Securities Law has intact information disclosure requirement.

The mandatory report and announcement requirement is of great importance in Securities Law. Article 86 requires that *"[w]hen, through securities trading on a stock exchange, the shareholding of an investor, or the deemed joint-shareholding of an investor and others in virtue of agreements or other arrangements, has reached 5% of the issued shares of a listed company, the investor shall, within three days from the date on which such shareholding becomes a fact, report in writing to the securities regulatory authority under the State Council and the stock exchange"*,[(53)] during this period, *"[t]he investor shall not continue to purchase or sell the share of the said listed company"*.[(54)] If the investor wants to further acquire shares of the company, *"every 5% increase or decrease in such shareholdings thereafter shall be reported and announced"*.[(55)]

On July 27th, 2015, the "Hu brothers" was sued at Intermediate People's Court of Lhasa for their malfunction on July 15th, 2015, when they acquire 6.4% of an A-share listed company called Tibet Tourism Co., Ltd, they didn't report to securities regulatory authority and the stock exchange. The "Hu brothers" was then subject to an administrative penalty of around 100,000 RMB. This trivial event had triggered the

discussion domestically about the validity of Hu brothers' voting right after violation of the securities law. Until now there is no conclusion of whether the shares obtained secretly should carry the voting power or not, and the 100,000 RMB's fine seems to be too little cost compare to the huge benefit of acquiring shares in a way that was undetectable by target companies. Meanwhile, it is still not clear that when hostile acquirers violate this rule, should the target company resort to the court for help, or make complaints directly to CSRC.

Besides information disclosure requirements, Article 77, Article 78 and Article 79 govern false statement, fraud and misleading behavior - which is known as the three original sin in Chinese securities market.

Issuance of new shares is another huge thing in Chinese Securities domain. Article 13 requires the company who makes public issuance of new shares meet certain conditions: *"(1) having a sound and well-functioning organizational structure; (2) having sustainable profitability and being financially sound; (3) having had no false entries in its financial and accounting documents for three years immediately preceding the application, and no other major illegal activities attributable to it; and (4) such other conditions as may be so prescribed by the securities regulatory authority under the State Council and so approved by the State Council"*.[56]

This rule on share insurance makes it almost impossible for management to frustrate a hostile takeover by issuing new shares. The

target company has to satisfy certain conditions in order to issue new shares, most of which are hard to meet when share prices are at a low ebb - exactly the time corporate raiders attack. Moreover, in China, even if insurance of new shares does not have so many merits-review requirement, it still cannot be used as a takeover defense, because it usually takes too long to obtain approval from the issuance examination commission. According to Article 22, "The securities regulatory authority under the State Council shall establish an issuance examination commission which shall, pursuant to law, examine the applications for share issuance."(57)

Another very important element of the Securities Law, is its provision of the mandatory bid rule. Article 88 requires an investor launch a tender offer to purchase shares when reaching 30% of the issued shares of a listed company.(58)

This Chinese mandatory bid rule is different from other countries because it's not entirely "mandatory". Because of ownership concentration in Chinese Listed Companies, normally the acquirer purchase shares from the dominant shareholder by negotiation; this is also a reason why hostile takeover is not frequently seen in China. This rule only ensures that when reaching 30% shareholding of a listed company, continuing acquiring shares by the acquirer can only achieved by launching tender offer to all shareholders. Meanwhile, Article 62 of the 2014 Administrative Rules on Acquisition has provide three certain conditions under which the acquirer is exempt from the mandatory bid rule,(59) which caused the "tender offer exemption" become a very common

in Chinses securities market.

Till now, the most important elements that are still missing in Securities Law, are rules to clarify what kind of defense measure is available and to what extent can they be adopted. The whole Chapter four of 2014 Securities Law is about Acquisition of listed companies in China, but not one single rule addresses takeover defense issue directly. Then, in Article 101 the law maker supplements that *"[t]he securities regulatory authority under the State Council shall formulate specific measures for acquisition of listed companies in accordance with the principles of this Law..."*[60] And in accordance with this article came the Administrative Rules on Acquisition, first edition of which was promulgated by CSRC in 2002.

3. 2014 Administrative Rules on Acquisition

The 2014 Administrative Rules on Acquisition is now the core of Chinese anti-takeover regulation. The first version of Administrative Rules on Acquisition was promulgated by CSRC in 2002, and was the first regulation with direct and clear rules on takeover defenses.

a. Fiduciary Duty in Chinese Law

Article 8 is a general rule on directors' duty when employing anti-takeover activities: *"[t]he directors, supervisors and senior managers of a target company shall assume the duty of loyalty and duty of care, and shall equally treat all the purchasers that intend to take over the above company."*[61]

In terms of Chinese fiduciary duty, article 8 used the term of "the duty of loyalty and duty of care". Indeed, the same terminology can be well found in Chinese Company Law, in Article 148: *"[t]he directors, supervisors and senior managers shall comply with the laws, administrative regulations, and bylaw. They shall bear the duty of loyalty and duty of care…"*[(62)] This duty of loyalty and duty of care is sometimes interpreted as obligation of fidelity and obligation of diligence, but they function equivalently to fiduciary duty in Anglo-American legal regime. The Company Law uses a series of prohibitive stipulations to define what "duty of loyalty" is. For example, *"[n]o director, supervisor or senior manager may accept any bribe or other illegal gains by taking the advantage of his powers, or encroach on the property of the company"*[(63)] and *"[n]o director or senior manager may commit any of the following acts: (1) Misappropriating the company's fund…(6) Taking commissions on the transactions between others and the company into his own pocket; (7) Illegally disclosing the company's confidential information…"*[(64)] and so on.

The Company Law does not elaborately define the "duty of care", it only reveals the consequence directors, supervisors or senior managers have to afford when they failing to obey so in Article 150: *"[w]here any director, supervisor or senior manager violates any law, administrative regulation, or the bylaw during the course of performing his duties, if any loss is caused to the company, he shall be liable for compensation."*[(65)]

When Company Law is somehow ambiguous about what "duty of care"

should be, the Guidelines on Articles of Association has reiterate it clearly in its recommended templates of corporate charter for listed companies. For example, *"[m]anagement should exercise their powers prudently, conscientiously, and diligently, and ensure all commercial activities of the company conforms with the law, administrative rule and national economic policy, and commercial activities of the company should not exceed its scope of business"*,[66] and *"[m]anagement should provide the board of supervisors with information and materials in need, should not hinder them performing their duty"*.[67] At the same time, the Guidelines on Articles of Association has made it clearly that companies can add according to the de facto situation as well as their needs the requirement of duty of care in their company constitutions.[68]

b. Board Neutrality Rule in Chinese Law

Article 33 of 2014 Administrative Rules on Acquisition provides some guidance for Board Neutrality Rule: "During the period after the announcement of a takeover bid and before the completion of the takeover bid, except for continuing ordinary business and executing resolutions made by the general meeting of shareholders, target company management, without the ratification of the general shareholders' meeting, should not cause major impacts on the assets, liabilities, entitlements or business performances of the target company by disposing of assets, engaging in external investments, adjusting the main businesses, providing guarantees or loans and others".[69]

Although it can be interpreted from several perspectives, the basic

principle in this article was supposed to be, without shareholder approval, directors of the board should not take any action in response to an imminent threat. As we will discuss in the next chapters, this Chinese Board Neutrality Rule has very big loopholes and does not function properly in takeover issues.

4. 2016 Guidelines on Articles of Association

Guidelines on Articles of Association is not substantive law in nature, it is more like a guidance book on how should listed companies construct their constitution to maximum the corporate governance efficiency. It works as an exemplary template of corporate charter, and so long as it does not violate relevant law and regulations, listed companies can add more practical rules according to their needs or adjust certain phrases or expressions in the Guide line to meet the individual requirements.

Although no need for ratification to do so, such amendments should be specially announced to the public when the board makes announcement of revision of the articles of association. Therefore, listed companies are able to introduce takeover defenses in their corporate charters as far as they don't violate the on-going law and conform with the procedural rule of announcement.

IV. Empirical Research on Chinese Hostile Takeovers: Provisions and Cases

To understand how takeovers are regulated and how powers are allocated in takeover laws, this chapter focuses on the takeover defenses in hostile takeovers.

Based on the time when takeover defenses were used, they could be broadly divided into two types - ex ante defenses and ex post defenses.[70]

Ex ante defenses are defensive measures that have already in place before the takeover bids, normally it appears as anti-takeover articles in corporate charter. As the corporate charter has to be approved in the general meetings of shareholders, theoretically the shareholders have the final say of such provisions. However, due to the inherent agency costs exist between the management and shareholders, directors of the board usually use their position to affect the corporate charter in favor of their interests.

Ex post defenses are defensive measures taken by management of the target company after the emergence of the takeover bid, and it has many different types. In sum, while ex ante defenses are proactive and precautionary, ex post defenses are usually passive and targeted.[71]

A. Ex ante defenses in China

According to an empirical research by Professor Hui HUANG, anti-

takeover provisions are quite common in Chinese listed companies, especially those with a disperse ownership. He conducted a research of 300 Chinese A-share company, and over half of them adopted such provisions. Most of those who didn't adopt these provisions have a controlling shareholder who holds more than 30% of the company share.

There are seven different types of anti-takeover provision in Chinese listed companies.

The first type stipulates that anyone holds more than 5% or 10% share of the company has to get approvals from the directors of the board or general meetings of shareholders to acquire more shares, otherwise those shares acquired carry no director nominating right or voting right.

The second type of anti-takeover provision is to empower the board with the authority to review new directors nominated by shareholders. This means the board has to right not to bring the proposal for approval after they review the nomination. In other words, the ultimate nomination power falls in the hand of the board.

The third type is to raise the substantive standard for shareholders to nominate directors of the board. For example, there are provisions that require shareholder with over 5% shares to hold those shares for a certain period (usually 180 days or half year). Some companies even require the election of directors to be approved by a supermajority of

75% present shareholders at general meeting.

The fourth type is to pose qualification requirement for chairman of the board or directors of the board. For example, chairman and directors should at least have worked in the company for six months before they are eligible for nomination. Apparently, this increases the difficulty for the hostile corporate raider - usually outsiders of the company - to set their foot into the board.[72]

The fifth type is the staggered board provision, which is brought from Anglo-Saxon countries. Under this provision, the term of office for directors is usually three years, and each general meeting of shareholders can only reelect part of - usually one third - incumbent directors, which poses uncertainty and delay for the acquirer to take real control of the company. The basic theory of staggered board provision is to divide the directors of the board into three group, and every general meeting can only replace one group, thus the acquirer has to wait for at least two rounds to obtain the majority seat in the board.

The six type requires removing directors at their tenure must have reasonable cause. Apparently, if incumbent directors are not dismissed, the acquirer cannot appoint directors that represent their interests. Article 47 in Chinese Company Law prohibits the dismissal of management without cause, but this rule was deleted in the 2005 company law revision. But in practice, many Chinese listed companies

choose to retain this requirement in the corporate charters, and this is also recommended by the 2016 Guidelines on Articles of Association in Article 96: *"[t]he director is elected or replaced by a shareholders' meeting. His period of service is [number of years]. When a directors' period of service expires, he can be reelected. Before a directors' period of service expires, the shareholders' meeting cannot terminate his duties without a reason*(73)*…"*

The seventh type is the "Golden Parachutes Provision", which is very common in U.S, this provision provides management of the company with generous compensation - in form of cash or securities, or the combination of both - if they are to be removed from office during their tenure. As such compensations are usually extremely bounty, the acquirer may think twice before they begin to change the board.

The eighth type, which is very seldom and highly controversial in China, as observed by Professor Hui HUANG, I call it "the hidden poison pill". As stated in corporate charter of Tecon Biology Co.Ltd - an A-share listed company in Shenzhen stock exchange: when hostile takeover happens, and shareholder except the acquirer, who individually or collective hold 20% or more shares of the company, has the right to request, in writing, the board of directors to take defensive actions in response to the hostile takeover, so far as such defensive measure does not violate the law and regulations. According to this provision, the management of the board can take actions to frustrate the takeover bids by simply a written request from any eligible shareholders.(74) This

provision is highly controversial in that, the general meeting of shareholders usually has the primary power in adopting defensive measures, not a single shareholders and any shareholder group along. On the other hand, the constitution of the company is approved by the general meeting itself, therefore, such provision may have its legality for its existence.

The Last type, is to require amending anti-takeover provisions need supermajority votes presented on the general meeting, which makes those defensive constitutions easy to impose, but hard to remove.

In sum, anti-takeover constitutional provisions are either to install obstacles to the acquirer purchasing shares, or to set up barriers to the acquirer controlling board of directors.

B. Ex post defenses in China

In the past two decades, most target boards in China resisted hostile takeovers, although not all of them adopted defensive tactics. Here are several examples of takeovers with defensive responses.

1. Shenzhen Baoan Group Co., Ltd VS Shanghai Yanzhong Industrial Co., Ltd

The first hostile takeover in China can trace back to the early 1993. The Chinese securities market was established in the beginning of the 1990s, and it was only less than a month when corporate bodies were allowed to open their account to invest in stock market in Shanghai

that this landmark hostile takeover in Chinese history happened.

The hostile acquirer, Shenzhen Baoan Group Co., Ltd (hereinafter Baoan), consecutively acquired shares of the target company, Yanzhong Industrial Co., Ltd (hereinafter Yanzhong) through its three affiliated companies from September 3rd 1993. Within a month's time, Baoan had held approximately 20% shares of Yanzhong and become its largest shareholder. This event was a huge BOOM in Chinese securities market and the mass of people were provoked, considering Baoan's sneak attack contemptible and rude. Yanzhong claimed in media that the hostile takeover would endanger the emotional link of old shareholders and its thousands of employees.(75)

Yanzhong Industry made a complaint to the CSRC and accused Baoan of violating the information disclosure requirement. According to Yanzhong, Baoan purchased those shares confidentially and didn't make reports and announcements as requested by the law before they already became the largest shareholder. Baoan even further acquired more shares simply ignoring the suspension requirement, as stipulated in Article 47 of the Interim Administrative Regulations on Share Issuing and Trading.(76) Yanzhong Industry also questioned the legality of the fund Baoan used to make the acquisition. The registered capital of Baoan was only 10 million RMB, and the bids was funded by bank loans, which was strictly prohibited in Chinese Law.

The CSRC mediated the disputes between the two parties, and the share

acquisition was, surprisingly, upheld by CSRC. Baoan was fined 1 million RMB for violating the reporting and announcement requirement - a relative small price for breaking the law.(77) Therefore, despite several other anti-takeover measures Yanzhong had adopted, the hostile acquirer finally obtained control of the target company after appointing two directors into the board.

2. Dagang Oilfield Group Ltd VS Shanghai ACE Co., Ltd.

In 1998, Dagang Oilfield Group Ltd (hereinafter Dagang) and its affiliated corporations collectively purchased 10.01% shares of Shanghai ACE Co., Ltd (hereinafter ACE), and the hostile acquirer intended to replace its board. After Dagang announced the bid, ACE subsequently amended its corporate charter for two times in May, 1999.

The first amendment required electing directors or supervisors conforms to a three step procedure: first, the board of directors shall consult with shareholders' opinion; second, the board screens the qualifications of the candidates; and third, the board put forward the final candidate list for approval. This requirement in fact empowered the board of ACE to remove whatever candidates they are not fond of.

The second amendment largely increased the standards of the nomination right of shareholders - only those shareholders who individually or collectively hold more than 10% of the total shares for more than 180 days have the right to nominate, which deprived the acquirer of the right to replace the board.

In an attempt to nullify these amendments, Dagang invited many legal professionals to discuss the illegality of such anti-takeover provisions, and ACE also invited experts and professors to testify the validity of those anti-takeover provisions. Academics and practitioners had been debating the legitimacy of those amendments for several months. Finally, Dagang Oilfield filed a complaint to CSRC, who later granted the injunction of the revise of the corporate charter. Finally, the ACE management failed to entrench its power and lost control of the company.

3. Shanghai Xinlv Fuxing City Development Co., Ltd VS Liaoning Jindi Construction Group Co., Ltd

In 2002, Shanghai Xinlv Fuxing City Development Co., Ltd (hereinafter Xinlv) intended to take over Liaoning Jindi Construction Group Co., Ltd (hereinafter Jindi), this is one of the seldom case one could find in China, when the target company employed the "Scorch Earth" strategy - stripping out its valuable assets to make the target company less attractive. The target board also found their way to rejected the nomination of directors by the hostile acquirer. This takeover batter lasts for four years and Xinlv finally paved its way for the control of Jindi in 2006.

4. Wanhe Group VS ST Meiya Co., Ltd.

The target company - ST Meiya Co., Ltd (hereinafter Meiya) was in severe financial distress for more than 2 years. In 2003, its former controlling shareholder - Guangdong Heshan state asset regulator,

transferred its state shares in Meiya to Wanhe Group by agreement, without negotiating with the management. Wanhe then obtained 27.49% shares of Meiya at 1.0107RMB per share. This disclosed contract had aroused strong objection from the incumbent management, who claimed in the media and general meeting of shareholders that this share transfer was impairing long-term interest of the company, and the acquirer had no relevant experiences in running an entity far different from its own business domain.[78] Almost all other shareholders and employees of Meiya objected this share transfer. Under the pressure, Guangdong Heshan state asset regulator had to cancel its cooperation with Wanhe Group and negotiated with the Meiya management.

5. GOME Electrical Appliances Holding Limited VS Sanlian Commercial Co.,Ltd.

In February 2008, Longjidao Construction Limited Company (hereinafter Longjidao), a company of only 10 million registered capital, obtained 10.9% shares of Sanlian Commercial Co.,Ltd (hereinafter Sanlian) through judicial auction in Shandong Province. Longjidao was further found out to be a 'shadow' acquirer, and the real acquirer behind the curtain was GOME Electrical Appliances Holding Limited (hereinafter GOME) - the nationwide electronic device retail giant in China. GOME announced its takeover of Longjidao and thereby gained the control of the Sanlian. Sanlian then filed a lawsuit to the High Court of Shandong Province, claiming that the indirect takeover by GOME breached the information disclosure and suspension requirements. However, the case was rejected by the court, alleging that the lawsuit

was filed in a wrong procedure and did not fall in the criteria for case acceptance.(79) In the end, Sanlian was acquired by GOME.

6. Maoye International Holdings Ltd VS Shenzhen International Enterprises Co., Ltd

From November 7th to December 16th 2008, Maoye International Holdings Ltd (hereinafter Maoye) and its affiliations increased their shareholding in Shenzhen International Enterprises Co., Ltd (hereinafter Shenzhen International) to 10% of its total shares. Shenzhen International attempted to use a poison pill which including a share allotment plan and director nomination limitation to frustrate Maoye's attack. However, the second largest shareholder of Shenzhen International - Shenzhen Tefa Group abstained in the vote on the poison pill, and the poison pill didn't pass. Shenzhen International then organized the shareholder group to protest Maoye's hostile takeover, and at the end the takeover failed.

Poison pills are hardly seen in Chinese takeover market. Many observers like me are still wondering what would happen if the motion of the poison pill by Shenzhen International Enterprises was approval by the general meetings of shareholders, as poison pills with discriminative effect seems to be prohibited in the company law.(80)

7. Baoneng Group VS Vanke Co., Ltd

China Vanke Co., Ltd (hereinafter Vanke) is the leading real estate company in China, with its main business in real estate development

and property service. Vanke has covered 66 cities in mainland China by the end of 2015, and has now been involved in dozens of real estate development projects in Hong Kong, Singapore, San Francisco, New York City and London.[(81)] Baoneng Group (hereinafter Baoneng), also founded in Shenzhen, is much less known and much smaller in size than Vanke, but has a rather diversified business domain including real estate, finance, logistics, medical service, agriculture and so on.

From July to December, 2015, Baoneng and its affiliations acting in concert consecutively acquired Vanke-A Share from the stock market. And by December 17th, 2015, Baoneng group collectively held approximately 24% of total shares of Vanke, exceeded the China Resources Corporation and became the largest shareholder. Baoneng funded its acquisition through issuing corporation bond and the highly-controversial Universal Life Insurance.[(82)]

Chairman of Vanke, Mr. Shi WANG declared Baoneng as an unwelcome person, and began taking defensive measures as response. China Resources Corporation whereafter increased its shares, but didn't surpass Baoneng's shareholding. On December 24th, Vanke annouced AnBang Insuance to be its white knight, but AnBang eventually didn't achieve enough shareholding. Lucky for Vanke, the staggered provision in its corporate charters made Baoneng Group impossible to fully control the board, at least temporarily.[(83)]

From December 21st 2015, Vanke-A share was suspended for trading for

several months. On March 13th, 2016, Vanke suddenly in the annual company report announced its memo on major asset transaction with Shenzhen Metro - another white knight for Vanke instead of the previous one. But only four days later, China Resources Corporation, who has supported Vanke unconditionally for the past decades, publicly objected Vanke's cooperation with Shenzhen Memo and claiming the management had bypassed the board of directors to reach this agreement. On June 17th, the Vanke board approved the cooperation with Shenzhen Metro, despite all three directors from China Resource Cooperation objected it. China Resource Cooperation subsequently claim the board meeting had procedural irregularities. China Resource Corporation invited many legal professionals and academic scholars to issue opinions about the illegitimacy of Vanke's Board meeting. And although experts had "in accordance" claimed that the board meeting procedure was illegal thus its legal impact should be nullified.[(84)] No decisive conclusion was drawn from the CSRC or the court.

On July 19th, Vanke filed complaints to CSRC and Shenzhen Stock Exchange, alleging that the funds Baoneng used to finance its acquisition is illegal. But CSRC later upheld the validity of funds in Baoneng's wealth management scheme.[(85)] In August 2016, the takeover dispute had a twist, when Evergrande Group - another Chinese real estate giant announced its participation into the takeover battle.[(86)]

On December 3rd, 2016, chairman of CSRC, Mr. LIU Shiyu condemned "barbaric" leveraged company buy-outs by some asset managers using

illegal funds. Liu said China's capital markets had seen a series of " abnormal phenomena" lately, challenging the bottom line of China's financial law and regulations.[87] After Liu's Speech, Baoneng Group had been laying low ever since.

On January 12th, Huarun transferred all its Vanke A-share to Shenzhen Metro thorough share transfer agreement. One day later, the Evergrande Group made an announcement stating that they have no intention further acquire Vanke's share. Baoneng Group and Shenzhen Metro all made conservative statement that "for their strategy on development, it's too early to exclude the possibility that they may further increase their shares in Vanke in the next 12 months".[88]

The Vanke and Baoneng dispute is still going on. It's very hard for us to predict how it will end. But one thing is for sure, the Chinese regulatory framework is far from enough to provide certainty in takeover issues.

8. Other takeover cases in China

The Chinese securities market has grown rapidly from its establishment in the early 1990s. There were several hostile attempts during the past two decades, some of them succeeded, while others failed. Except the cases we mentioned above, there were other examples worth noting. Most target companies adopted defensive tactics as response, but the some of them didn't. But it's highly possible because of such defensive tactics were now known to the public or so.[89]

In 1996, Guanzhou Sanxin Industry attempted to takeover Shanghai Shenhua Shareholdings Co., Ltd, but was defeated by the white knight.

In 1999, Guangzhou Tongbaihui Service Co., Ltd's hostile takeover of Shandong Shengli Corporation Limited was defeated by the dominate shareholder of Shandong Shengli through increasing its shareholding.

In 2001, three takeover attempted were seen in China. First, Huajian Electronic Co., Ltd tried to obtain control of Jinan Baihuo Co., Ltd, however, the takeover was rejected by the board of directors of the target company, who defeated the acquirer by passing a board resolution.

The second case was Yuxin Group takeovers Founder Yanzhong Technology Group. Yuxing Group become Founder Yanzhong Technology Group Co., Ltd's largest shareholder by purchasing shares from the secondary market. The acquirer prepared to submit a proposal to the general meeting, in order to select their directors into the board. The corporate charter authorized the incumbent board to review the directors, but the standards and requirements were very vague and ambiguous. As the incumbent management and the largest shareholder could not settle their disputes, the acquirer attempted to call on an interim shareholder meeting, which was frustrated by the incumbent management by filing a lawsuit to the court, claiming the call on interim shareholder meeting didn't follow the due process.

The third case in 2001 was Shanghai High Resolution Digital Vision System Co., Ltd's takeover of Founder Yanzhong Technology Group Co., Ltd, and the latter frustrated the takeover bid by increasing shareholding.[90]

V. Rethinking Chinese Legal Framework: A Comparative Perspective

It is submitted that Chinese takeover law first borrowed experiences from England, but not entirely. CSRC's Audit Committee of Mergers and Acquisitions is the Chinese version of (although not as powerful as) the Panel on Takeovers and Mergers of England, and the rules in Chinese takeover law bear lots of resemblance to (although not as thorough as) the British City Code on Takeovers and Mergers. However, the Chinese law interpretation process and enforcement is very different from the U.K, and with the court from time to time participate in takeover issues, it's very hard to say China and U.K shares legal framework in takeover issues in common.

As we mentioned above, the Chinese takeover defense regulation is mainly consisted of five types of rules: first, shareholders as the primary decision-making authority in corporate governance, as stipulated in 2014 Company Law; second, ban and prohibition on certain types of defensive measures, as stipulated in 2014 Company Law and 2014 Securities Law; third, a Chinse mandatory bid rule, as stipulated in 2014 Securities Law and 2014 Administrative Rules on Acquisition;

fourth, fiduciary duty of the management, as stipulated in 2014 Administrative Rules on Acquisition and 2016 Guidelines on Articles of Association; fifth, the Chinese version of board neutrality rule, as stipulated in 2014 Administrative Rules on Acquisition. The China Security Regulatory Commission is the main regulator in Chinese Securities Market and has the ultimate and exclusive right over takeover disputes as a technocrat. CSRC established he Audit Committee of Mergers and Acquisitions which consists of related experts and professionals on a part-time basis to deal with takeover relative affairs.

Therefore, in form and in its concrete rules, the modern Chinese Framework is mixture of similar regulations in U.S, U.K and E.U. We have given considerable paragraphs in our takeover related laws to define and address fiduciary duties. Also, those key elements from European Takeover Directive - mandatory bid, board neutrality role and breakthrough role - are all observed, although in different forms, in Chinese takeover regulatory framework. It seems that Chinese policy makers were trying really hard to make sure the Chinese takeover law is thorough and embracive, but in practice, many serious problems occur.

A. Fiduciary Duty and Board Neutrality Rule - cannot have both

As a Chinese proverb goes, you cannot have fish and bear paw at the same time. Fiduciary Duty and Board Neutrality Rule is the fish and bear paw in takeover regulation.

Fiduciary Duty as its core to U.S takeover legal framework is like Board Neutrality Rule being the centerpiece in European approach. In U.S takeover regulatory system where highlight the importance of fiduciary duty, we found that it is the court, rather than any other regulatory authority, that deals with the most essential business in takeover disputes. When court has developed a mature and stable system - the modified business judgement rule - to address directors' duty in takeovers, other laws seem to be less important. In the European approach, when Board Neutrality Rule were enforced as mandatory, for instance, in U.K, then the court lost its primacy in takeover regulation.

We don't usually see SEC deals with takeover cases in U.S, nor do we notice any court participation in U.K. The truth is, Fiduciary Duty and Board Neutrality Rule represent two very different paths in takeover regulation. We can only have "either of them" but not "both of them".

The Fiduciary Duty path of U.S centers the court in dealing with takeover issues, it favors the primacy of the board of directors over the will of the shareholders. And directors can adopt defensive measures without the approval from general meetings of shareholders. To some extent, the U.S system has inhibiting effects on hostile takeovers where management of the company enjoys sense of security. And it is the directors, not the shareholders, have the decision-making power in takeovers.

The Board Neutrality Rule path of E.U or U.K requires directors of the board take no action when hostile takeover happens unless the shareholders say otherwise, which gives shareholder the primary power to review the merits of the offer. Directors of the board cannot take any defensive measures that may frustrate the offer bid. To a certain degree, the E.U or U.K approach has promotive effect on hostile takeovers where acquirers face lower uncertainty in takeovers. And it is the shareholders, not the directors, have the primary authority in takeovers.

We cannot inhibit takeovers from happening while at the same time promote it, just like we cannot empower shareholders and directors simultaneously. Choosing between those two paths sets the keynote of climate of takeover regulations in China - are we restraining takeovers from happening, giving more sense of safety to corporate managements? Or should we facilitate hostile takeovers and benefit from better allocation of resources and synergy effect of affiliations? This might be the most fundamental question policy makers have to face when choosing its future path. We will address this problem again in the next chapter, but it is very clear that Fiduciary Duty and Board Neutrality Rule are opposite to each other and it is ridiculous to see them both exist in one legal jurisprudence.

B. Chinese Fiduciary Duty - too general and too broad

Article 8 in 2014 Administrative Rules on Acquisition provides the general rule on directors' fiduciary duty. Article 148 of 2014 Chinese

Company Law defined fiduciary duty as duty of loyalty and duty of care. Then, duty of loyalty was enumerated in several prohibitive stipulations in Article 148 and Article 149 in Company Law. The Company Law does not elaborately define the "duty of care", it only reveals the consequence when directors, supervisors or senior managers have to afford when they fail to obey so in Article 150. And Article 98 of 2016 Guidelines on Articles of Association provides certain examples of how directors and management could fulfill their duty of care to the company.

Despite so many words and paragraphs were used to clarify what fiduciary duty is in Chinese corporate governance, the fiduciary duty is still too vague and blur for legal practitioners. All those articles in Chinese law used general terms such as "treat all the purchasers... in a fair manner", "protecting interests of a company and its shareholders", "should not...cause improper obstacle to takeovers" or "should not cause damages to the lawful rights of the said company or its shareholders". Those general term are necessary, especially for emergencies and new situations. However, without detailed, definitive and deterministic clauses to support its back, those general regulations alone left many critical questions in takeovers unsolved, and thereby caused mass uncertainty in Chinese takeover markets.[91]

For instance, what manner is "fair" and what is not? What obstacle is proper and what is not? How to define the lawful rights of a company? And how to define the lawful rights of shareholders? Answers to those

questions are critical, in order to eliminate uncertainties in Chinese market. However, another even more important question is that, who is responsible for the ultimate answers to those questions in China, the court, or CSRC ? The U.S approach is somehow inspirational to this question.

From the U.S experience, we know that clarifying fiduciary duty is never easy. Instead of writing down simple principles of fiduciary duty one by one, the Delaware court employed a two-part reasonableness-based tests, to determine whether it is legitimate for the board to take defensive measures. Under this test, the defendant - directors of the board, was required to prove that: first, they had reasonable ground to believe that a danger to corporate policy and effectiveness existed because of another person's stock ownership, and; second, the defensive measure which they were taking was reasonable in relation to the threat posed.[(92)]

Compare to Chinese practice, this two-part reasonableness-based test is definitely better because: first, it is more flexible in defining fiduciary duty; second, it is more stable and produced more certainty.

The inclination of Delaware courts is to favor the primacy of the board of directors over the will of the shareholders. This inclination provides high level of certainty to the board and they thereby adopt defensive measures as respond to unwilling takeovers confidently. In China, expressions and interpretations in Chinese Law on fiduciary duty are

too general and too simple, as we have seen in many cases above, almost all takeover defenses adopted by the management were regarded as "controversial" with different "reasons", even when hostile takeovers in China are usually deemed "immoral".

In the U.S system, it is the court that governs the most essential part of takeover activity, while SEC only deals with procedural issues. If China choose to adopt an American approach, then court must actively participate in takeover disputes - not in a way Delaware courts did, but at least provide certain and clear interpretations and guidance on takeover law.

C. Chinese Board Neutrality Rule - too minute and too narrow

Article 33 of 2014 Administrative Rules on Acquisition provides substantive guidance for Board Neutrality Rule. "...During the period after the announcement of a takeover bid and before the completion of the takeover bid, target company management...without the ratification of the general shareholders' meeting, should not cause major impacts on the assets, liabilities, entitlements or business performances of the target company by disposing of assets, engaging in external investments, adjusting the main businesses, providing guarantees or loans and others."[93]

The principle of this term was supposed to be "for management of the target company, without shareholders approve, no defensive measures should be taken". However, as we have seen in article, in its effort to

"clarify" board's duty in takeovers, the law maker on the contrary put obscured "limitations" on board's role of "not doing something".

First of all, "During the period after the announcement of a takeover bid and before the completion of the takeover bid…", means this article does not apply to defensives measures employed "before the announcement of a takeover bid". Second, "should not cause major impacts on the assets, liabilities, entitlements or business performances of the target company...", means this article does not apply to takeover defenses that "do not cause major impacts on the assets, liabilities, entitlements or business performances of the target company". In other words, under Article 33, as far as defensive measures do not cause major impact on the target company, or such measures were taken before the announcement of the bid, then the management do not need shareholders' approval for taking such defenses.

Therefore, instead of prevent the management from taking defensive measures, Article 33 provides the board with a loophole, through which the board could circumvent shareholder approve and adopt certain types of defensive measures. When fiduciary duty in Chinese law seems to be too broad and too general, the board neutrality rule seems way over specified.

The European Directive on Board Neutrality Rule is elaborated, but it's key point is quite clear and unequivocal. According to Article 9, once the board are aware of the offer bids, it should not take any actions

that may frustrate the acquisition activity before obtaining authorization from shareholders, except finding alternative potential offeror to join the bid.[94] Article 9 (1) through (6) has thoroughly considered the time span and all different kinds of situations, also the procedure of obtaining authorization. If China is to adopt the European path of takeover regulation, then the Directive provides a very good example of real Board Neutrality Rule.

D. Chinese Mandatory Bid Rule - too rigid and too inflexible

Article 88 in the 2014 Securities Law lays the ground of Chinese Mandatory Bid Rule. *"[w]here through securities trading on a stock exchange, the shareholding of an investor, or the deemed joint-shareholding of an investor and others in virtue of agreements or other arrangements, has reached 30% of the issued shares of a listed company, if further acquisition is to be pursued, a tender offer of acquisition shall be launched pursuant to law to all of the shareholders of the listed company for acquiring all or part of the shares of the listed company."*[95]

Therefore, the Mandatory Bid requirement in China is mandatory in that when purchasing shares more than the 30% threshold, further share acquisition should be undergone through the form of a tender offer. But in European Directive, the Mandatory Bid Rule is mandatory in that when purchasing shares over certain threshold, the acquirer has to purchase all outstanding shares through offer bids. Therefore, the Chinese version of the Mandatory Bid Rule is less "mandatory" in content.

When European countries adopt the Mandatory Bid Rule, they aim to offer protection for minority shareholders by ensuring they have been treated in the same manner as the blockholders, who commonly existed in European companies. Most Chinese listed companies have a similarly concentrated ownership just like European companies, hence it is reasonable to adopt the same strict Mandatory Bid Rule in China. However, as far as the acquirer is free to choose the amount of shares he wants to purchase, the minority shareholders face certain possibility of being squeezed out through future coercive deals.

The threshold of the Chinese Mandatory Bid Rule is 30%, which is exactly the same as in U.K. However, the U.K adopts a Mandatory Bid Rule with 30% threshold is because 30% shareholding in U.K is normally enough for taking control, which is not the same case in China. Normally, controlling shareholder in Chinese listed companies hold more than 30% of total shares, therefore 30% may be grossly inadequate to secure control. The fact is, in China, there are companies with extremely high level of ownership concentration such as national banks and insurance companies; and there are a few companies with very dispersed ownership concentration, therefore, we should learn from the European Directive and give corporations the power to settle the threshold for themselves in their company constitution, otherwise the Chinese Mandatory Bid Rule is simply too rigid and too inflexible to adapt for the needs of Chinese market.

E. Power Allocation in Chinese Takeover Regime: Clear in Theory but Ambiguous in Practice

Company Law, in whatever countries, has certain inclination of power allocation. The U.S law, for instance, directors of the board have preponderant power of corporate issues. While in most European countries, shareholders are given more primacy in corporate decision-making.

The Chinese Company Law has clear-cut provisions that empower shareholders with more decision-making power, while the board acts as its executor in major decisions. In areas of takeovers, Article 8 of 2014 Administrative Rules on Acquisition clearly states that "…target company management…should not cause damages to the lawful rights of …its shareholders". Then, what is the lawful rights of shareholders stated in the company law that should be protected specifically during a takeover?

The first and most important lawful right of shareholders in takeovers is to vote on major issues of the corporation. Article 38 of Company Law states that *"[t]he shareholders' meeting shall exercise the following functions: (1) Determining the company's operational guidelines and investment plans… (5) Deliberating and approving annual financial budget plans and final account plans of the company…(6) Deliberating and approving company profit distribution plans and loss recovery plans… (8) Making resolutions about the issuance of corporate bonds… (10) Revising the bylaw of the company…"*[96] Therefore, almost all major

issues have to be discussed in the general meetings of shareholders and the board should not deliberately deprive shareholders of the opportunity to discuss the merits of those issues.

The second lawful right of shareholders in takeovers is the right to elect directors into the board or to dismiss the board. Article 38 of Company Law states that *"[t]he shareholders' meeting shall exercise the following functions:… (2) Electing and changing the directors and supervisors assumed by non-representatives of the employees and deciding the matters relating to their salaries and compensations…"*(97) Shareholders have the fundamental right to determine who is suitable for the seat in the board of directors.

The third lawful right of shareholders in takeovers is to call on an interim meeting. Article 40 of Company Law states that *"[t]he shareholders' meetings shall be classified into regular meetings and interim meetings…The regular meetings shall be timely held according to the bylaw. Where an interim meeting is proposed by the shareholders representing 1/10 of the voting rights or more, or by directors representing 1/3 of the voting rights or more, or by the board of supervisors, or by the supervisors of the company with no board of supervisors, an interim meeting shall be held"*(98). So shareholders representing 10% voting rights or more are granted the right to call on an interim meeting.

The fourth right of shareholders in takeovers is to put forward interim

proposals before the general meetings of shareholders. Article 103 of Company Law stipulates that *"[t]he shareholders separately or aggregately holding 3% or more of the shares of the company may put forward a written interim proposal to the board of directors 10 days before a shareholders' assembly is held. The board of directors may notify other shareholders within 2 days and submit the interim proposal to the meeting of the shareholders' assembly for deliberation. The contents of an interim proposal shall fall within the scope to be decided by the shareholders' assembly, and the interim proposal shall have a clear topic for discussion and matters to be decided".*[99]

In sum, the right to vote on major issues, the right to elect or change directors of the board, the right to call on an interim meeting and the right to put forward interim proposals are the four fundamental rights granted to the shareholders by the company law, hence those mandatory rules should not fall into the scope of corporate autonomy in takeovers. However, in practice, those four lawful rights of shareholders are not well protected in takeover activities.

The first type of ex-ante anti-takeover provision in China, as we mentioned above, stipulates that anyone holds more than 5% or 10% share of the company has to get approvals from the directors of the board or general meetings of shareholders to acquire more shares, otherwise those shares acquired carries no director nominating right or voting right. This is a blatant contravene of shareholders' fundamental right to vote and nominate directors. Moreover, provisions raising the

substantive standard for shareholders to nominate directors of the board, are all virtually limiting shareholders fundamental right to vote or nominate. The most absurd thing of these anti-takeover provisions is that shareholders have to get boards' nod for the right to vote and nominate directors; even worse, such provisions are widely adopted in Associations of Chinese listed companies.

Another quite common anti-takeover provision is to empower the board with the authority to review new directors nominated by shareholders, this is plausible at first sight as it could prevent shareholders from abusing their powers. But if the provision is distorted in such a way when the ultimate decision power of directorship appointment falls in the hands to the board of directors, such provisions are widely used by the management to entrench their control of the company. As directors review shareholders' nomination first, and then bring proposals to the general meeting, theoretically there are chances that shareholders' nominations are never approved by the board review, which has become a common phenomenon in recent years. Therefore, in my humble opinion, it's ok to review new directors nominated by shareholders, but the review standard must be clear-cut and not draconian.

And the most controversial anti-takeover provision, as we mentioned above, enables directors to take defensive measures simply on a written request from a large shareholder. This provision directly transfers the power of adopting defensive measures from the general meeting to any large shareholders other than the acquirer, which blatantly ignores

minority shareholders' opinion and contravenes the Company Law.

Meanwhile, some post ante takeover defenses in practice, also turned deaf ear to shareholders' fundamental rights.

In the *Yuxin Group VS Founder Yanzhong* case of 2001, shareholder's right to call on an interim meeting was not respected, nor was the right to nominate their candidates for directors into the board. In the *Xinlv VS Jindi* case, the "Scorch Earth" strategy employed by Jindi in its attempt to hit off Xinlv was a complete violation of the Chinese Broad Neutrality rule. And the management of Jindi found their way to rejected the nomination of directors by the hostile acquirer. In the *Baoan VS Yanzhong* case, the CSRC upheld the validity of share purchase of the acquirer even though it clearly breached the reporting and announcement requirement.

The CSRC failed to take action against the adoption of certain takeover defenses which blatantly violate relevant laws. Even worse, when controversial events occurred, the court failed to provide enough interpretation or guidance on the concept of fiduciary duties in the takeover cases. The High Court of Shandong Province simply rejected the Sanlian's litigation accusing GOME breaching procedural requirements.

As CSRC and the court being unable to provide firm and sound legal guidance, experts and scholars become another group of forces to fill up

the vacuum. As we saw in the previous cases, in *Dagang VS ACE* case, legal professionals were invited to discuss the legality of such anti-takeover provisions; also, in *Baoneng VS Vanke* Case, experts and scholars gathered together to discuss whether Vanke's directors meeting violated certain procedural requirements.

In short, the takeover regulation in China is problematic both in terms of substantive law and enforcement, which causes the imbalance of power allocation in takeovers as well as uncertainty among the market.

VI. Suggestions for Improvement

A. A Legal System That Favors Takeovers - E.U Approach over U.S System

Takeover law should maximize shareholders' benefit. This opinion is firmly grounded in that U.S takeover law, European Directive and Chinese company law all have relevant general clauses. Besides, such provisions on shareholders' protection can be found in local laws of very state in U.S and every member state in the European Union. Generally speaking, under any legal jurisdiction, mechanisms that facilitating takeovers usually benefit company value and thereby increase shareholders' welfare for four reasons.

First of all, acquirers plan to take over a company because they believe they can better utilize the resources of the target company, at least better than the incumbent management. Indeed, the company value will

rocket up if its potentiality is released out by better management.[100] The acquirers are willing to pay more than the market price simply because they saw a better future of the target company, and shareholders can enjoy the premium paid by the acquirers in advance without taking any risks.

Second, the synergy effect in takeovers increases the company value tremendously. The total value of two companies merged with each other is far bigger than their individual value combined, because of economies of scale and economies of scope.[101] Also, excessive management can be cut off to further reduce expense.

Third, when management faces the opportunity of being replaced, they tend to work harder to maximize shareholders' benefits. In other words, corporate governance improves simply because of potential takeovers. Management have to decrease waste and inefficiency and keep their stock price high as much as they could, because poor-management usually gives rise to decrease in stock price and thereby makes the target company more vulnerable.

Fourth, takeovers make capital market more efficient. In a highly-competitive market, when a company's stock price is underestimated, acquirers usually rush on like a swarm of hornets, until the market price reflect its true value.[102]

In China, the corporate governance problem is especially severe,

compared to its counterpart in American or Europe.

The No.1 corporate governance problem in China is the agency costs of controlling blockholder and insiders' control because of no functional proprietor of the state-owned shares. A very large proportion of shares in Chinese listed companies is state-owned shares, however, the State-owned Asset Supervision and Administration Commission performed badly over the past two decades, and the state-owned largest shareholder as the supervision entity of the management is virtually non-existent, and insider control problem is very serious.(103)

Moreover, the supervisory board and independent director system functioned awfully in China.(104) Due to poor institutional transplantation, it is almost impossible for the supervisory board to "supervise" the management, and independent directors in China are no more than "rubber stamp" of the board of directors.

Under these circumstances, takeovers, especially hostile takeovers, may be a cure to Chinese corporate governance, especially when China gradually open its capital markets. In order to sustain growth, the Chinese government adopted supply-side reform to vitalize Chinese enterprises. Therefore, the whole industries are in desperate need of takeovers and reorganizations to better utilize social resources. In other words, a legal framework that facilitate takeovers is more optimal for China.

The E.U approach in nature better facilitates takeovers than the U.S approach, from this aspect, China should adopt a "board neutrality rule" centered takeover regime and discard the "fiduciary duty" centered regulatory approach.

To adopt the E.U approach, first of all, the Administrative Rules on Acquisition of Listed Company should make it clear that without shareholder approval, the board of directors should not take any defensive measures. This is not to suggest a blanket ban on all takeover defenses, but the shareholders have the final say to adopt ex post defenses.

Second, fundamental rights of shareholders as stipulated in the Company Law should be respected in takeover activities. Shareholders' right to vote on major issues, to elect and nominate directors of the board and to call on interim meetings should not be violated by any means.

Third, although most contents in the E.U Directive have promotive effects for takeovers, the Mandatory Bid Rule is an exemption. The U.S freestyle is even better than the Chinse Semi Mandatory Bid Rule. Therefore, the Mandatory Bid Rule should be abolished in China.

B. A Modified Chinese Board Neutrality Rule

We mentioned the four benefits to the market and shareholders of takeovers above: better allocation of resources, synergy effects between

cooperation, better corporate governance and more precise market estimation. Then, why should the law intervene in takeovers? One answer to this question is because of the naturally existed conflicts of interests, or in other words, agency costs, between different participants of takeovers.

The first agency cost exists between the management and shareholders. When takeover emerges, it brings premiums for shareholders, which is good for them. But this is definitely a nightmare for the incumbent management, who will almost absolutely be replaced if takeover succeeds. Therefore, instead of thinking what's best for the company and shareholders, the management intends to think for themselves at this time and they would find every room to out-maneuver the acquirers by adopting defensive measures. If the management successfully frustrate the offer bids, the shareholders won't enjoy the premiums of the offer and if the takeover is really a value-adding one, the board of directors are entrenching their control at the cost of better management and long-term revenue of the company.

The second agency cost exists between the dominant shareholders and minority shareholders. There are two kinds of agency costs among dominant shareholders and minority shareholders. The first one is, when a company has a controlling shareholder, this shareholder usually also controls the board using his overwhelming voting rights. Hence, when takeovers are imminent, this dominant shareholder can cut deals with the acquirer, offers them his portion of the total shares and saves

the acquirers the trouble of public offering, by doing this the controlling shareholder enjoys the premiums of share prices that do not have to share with other shareholders. The second situation is much worse, when a dominant shareholder exploits company resources at the expenses of minority shareholders, this dominant shareholder and the board represents this shareholder do not want to lose control of the company. Therefore, they tend to hit back those potential reformers of the company who may eventually bring good to shareholders of the company as whole. Also, by frustrating the acquirers' attempt, the dominant shareholder closed the gate for minority shareholders to cash out at a reasonable market price, or to have a better management of the company in the future.

In sum, the ultimate goal of the Company Law is to reduce the agency costs that come with opportunism. Those agency costs usually come into being between: 1. shareholders and the management; 2. minority shareholders and controlling shareholders.

In fact, different jurisprudence has different types and levels of agency costs. In countries where share ownership structure is dispersed, the agency costs between minority shareholders and controlling shareholders are almost non-existent, but the shareholders and management agency costs are relatively high. On the contrary, in countries where share ownership structure is concentrated, the agency costs between shareholders and the management are low, but minority shareholders and controlling shareholders' agency costs are high.[105]

Thus, the Company Law in different countries have different goals and systematic design. When the U.S law are designed to mitigate the agency costs between shareholders and management by a Business Judgement Rule centered legal system, countries with concentrated ownership structures like China and most Member States of the European Union deals with the agency costs between minority shareholders and controlling shareholders.

We illustrate that China should take an E.U path and highlight the Board Neutrality Rule as the center of its takeover regulatory framework. However, the naturally high agency costs among minority shareholders and controlling shareholders determined that a "broad" Board Neutrality Rule is grossly inadequate.

In my humble opinion, a "modified" Board Neutrality Rule should be applied in China. In the normal Board Neutrality Rule, when takeover happens, directors of the board should not take any actions that may frustrate the offer bid unless the general meeting of shareholders say otherwise. In my "modified" Board Neutrality Rule, when takeovers are imminent, directors of the board should not take any actions that may frustrate the offer bid unless the majority of minority shareholders say otherwise. Hence, it is not for the general meeting, but rather, the minority shareholders that have the final say of takeover defenses.

As ownership structure is different from companies to companies, the corporate charter should have clear standards of "minority

shareholders". On the other hand, if the minority shareholders really only make up an extremely small portion of company shareholders, then it is not appropriate for a group of people this small to decide such major issues in takeovers, thus it should be the non-controlling shareholder, as well as the minority shareholders as a whole to decide whether takeover defenses should be adopted. And the corporate charter also has to define the shareholding threshold of controlling shareholders.

This "modified" Board Neutrality Rule has three advantages. First of all, it largely mitigates the agency costs between minority shareholders and controlling shareholders. Second, it encourages takeovers from happening as the adoption of defensive measures are more difficult than before. Third, it benefits the shareholders as a whole by benefiting directly from the real "shareholders' rights".

The disadvantages of this "modified" Board Neutrality Rule is also obvious. First, the minority shareholders are usually very dispersed, and it's very hard to gather them together to vote. Also, the minority shareholders have little knowledge and information about the company business, and it's difficult for them to make really splendid decision. Vote Proxy mechanism seems to be a solution to these two disadvantages, but it also brings new agency costs between the minority shareholder and the proxy entity.

C. Discriminate Fund Resources in Takeovers

The major concerns on Chinese takeover regulation nowadays, are not only on the agency costs. The focus in 2017 is the source of the funds used in takeovers. Most of takeovers in China are leveraged buyout, which means the funds to acquire the target company are borrowed elsewhere to meet the cost of acquisition. "The assets of the company being acquired are often used as collateral for the loans, along with the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital."[(106)]

Currently in there is no substantive rules on requirement of takeover's funding source in Chinese Company Law, Securities Law or Administrative Rules on Acquisition of Listed Company. The CSRC, on the other hand, publically expressed its concerns on the sources of the money repeatedly those two years.

The highlight case of Baoneng taking over Vanke and Baoneng taking over Geli, majority of the funds used by the acquirer are leveraged capital, and more specifically, from insurance funds. CSRC's discontent with takeovers in China is mainly because the leverage ratio of some takeovers are amazingly high. And CSRC has taken numerous measures to deal with this problem.

In my humble opinion, the best way to regulate the venture capital in takeover market is to allow management adopt defensive measures to

acquisitions funded by high-leverage ratio capital. And CSRC's only participation in this is to decide whether the leverage ratio of the capital is too high.

When faced with takeovers, management of the company can make complaints to CSRC or the stock exchanges, who then decides if the leverage ratio of the acquirer is too high. If so, the management of the company can take defensive measures without the approval from shareholders. And if not, the management must strictly obey the modified Board Neutrality Rule.

By discriminating different funding source of the acquisition, the market itself put an end to exaggerated leverage buy-outs without hampering good takeovers from happening. And it is the CSRC or stock exchanges that decides the merit of the takeovers, not the management who is naturally faced with conflicts of interests.

Conclusion

Two major problems in Chinese takeover legal framework are as follows. First, directors' fiduciary duty should not co-exists with Board Neutrality Rule within the same jurisprudence. Second, when Chinese Company Law is shareholder-centered in theory, the fundamental rights of the shareholders are not well protected in takeovers domain.

The E.U approach is more pro-shareholders and pro-takeovers in

nature, thus better fits the need of China's ongoing supply-side reform and the call to protect shareholders. China should center Board Neutrality Rule as its basic principle in takeover law, and abandon the Mandatory Bid Rule which largely increase the costs of takeovers.

Moreover, the Board Neutrality Rule should be further modified considering the agency costs between minority shareholders and controlling shareholders are usually high in Chinese listed companies. In the normal Board Neutrality Rule, when takeover happens, directors of the board should not take any actions that may frustrate the offer bid unless the general meeting of shareholders say otherwise. In the "modified" Board Neutrality Rule, when takeovers are imminent, directors of the board should not take any actions that may frustrate the offer bid unless the majority of minority shareholders say otherwise. And corporate charters of listed companies should have their own clear-cut standards of "minority shareholders".

In China, the source of the funds in takeovers are the main concern of regulatory authorities, and it is submitted that extremely high-ratio leverage capital is detriment to the industries as a whole. When faced with takeovers, management of the company can make complaints to CSRC or the stock exchanges, who then decides if the leverage ratio of the acquirer is too high. If so, the management of the company can take defensive measures without the approval from shareholders. And if not, the management should strictly obey the modified Board Neutrality Rule.

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