論　説

Technical Rules in Chinese M＆A：A Scrutiny[†]

中国上場企業の取得技術のルールを改めて考える

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INDEX

Ⅰ. INTRODUCTION
Ⅱ. BACKGROUNDS
Ⅲ. THREE STATUTORY WAYS OF ACQUISITION IN CHINA
Ⅳ. THE CHINESE MANDATORY BID RULE
  A. *The Mandatory Bid Rule in UK and EU*
  B. *The Mandatory Bid Rule in China*
    1. *Acquisition through Tender Offer*
    2. *Acquisition through Negotiations*
    3. *Acquisition through Other Lawful Means*
Ⅴ. THE CHINESE SELL-OUT RIGHT
  A. *The Sell-out Right in the European Directive and Chinse Law*
  B. *Shortage of the Chinese Sell-out Right*
Ⅵ. THE EXEMPTION OF TENDER OFFER IN CHINA
  A. *Two Types of Tender Offer Exemption in China*
  B. *Loopholes and Deficiencies of Tender Offer Exemption*

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Ⅶ. SUGGESTIONS FOR IMPROVEMENTS
A. *Mandatory Bid Rule: A Rational Trigger*
B. *Sell-out Right: A Reasonable Burden Sharing*
C. *Exemptions of Tender Offer: A Time Limit and Share Increase Amount Limit in Need*
Ⅷ. CONCLUSION

Ⅰ. INTRODUCTION

In Chinese M & A, tender offer is a common way. Despite several amendments and revisions on the *Company Law, Securities Law* and the *Takeover Measures,* the current Chinese regulations on tender offer is rather complicated than thorough. This article scrutinizes the Mandatory Bid Rule, sell-out right and the exemption of tender offer in Chinese tender offers and then provides concrete suggestions for future improvement in M & A regulations.

Keywords: Tender Offer; Mandatory Bid Rule; Sell-out Right; Exemption of Tender Offer; M & A; Acquirer.

Ⅱ. BACKGROUNDS

In the M & A domain, corporate law scholars have debated for years the fiduciary duties of the board of directors, the rationality of anti-takeover measures, the gap between a court-dominant supervisory framework (us) and a self-regulatory system (uk), the balance between the acquirers and management board and so on. Yet heretofore very few researchers have examined deeply the technical rules in M & A.

This article attempts to fill this void in the literature through a careful scrutiny into the current Chinese tender offer regulation.

The *City Code on Takeovers and Mergers* (hereinafter the *City Code*) of UK in 1968 brought up a systematic regulation on tender offers. Tender offer as a principle way of acquisition was then adopted first in Anglo-Saxon countries and then in Asia.(1) In 1993, China established its national stock exchange. In *Interim Provisions on the Management of the Issuing and Trading of Stocks,* the State Council unequivocally clarified tender offer as a major way of company acquisitions.(2) Hereafter, the State Council and the China Securities Regulatory Commission successively promulgated the Chinese *Company Law, Securities Law* and *Measures for the Administration of the Takeover of Listed Companies* (hereinafter the *Takeover Measure*). After several amendments and revisions, the current Chinese regulations on tender offer is rather complicated than thorough.

Like UK and most EU member states, China has a Mandatory Bid Rule requiring acquirers holding securities of a listed company to a certain level launch an overall tender offer for all the outstanding shares of the target company.(3) UK's Mandatory Bid Rule has a trigger of 30% voting rights,(4) which is the same with the majority of EU member states.(5) China also set its Mandatory Bid Rule trigger at 30% level, but this 30% consists of 30% of the issued shares and 30% of the total shares.(6) Moreover, consequence of triggering the Mandatory Bid Rule is different according to how the acquirer crossed the 30% line in the first place.(7)

Compare with this overcomplicated Mandatory Bid Rule, the sell-out

right in Chinese tender offer is even more problematic. The Sell-out right originally comes from the EU. The *Directive 2004/25/Ec Of The European Parliament And Of The Council On Takeover Bids* (hereinafter the *European Directive*) provides minority shareholders with a sell-out right. If a bidder has obtained securities representing 90% of the capital carrying voting rights and 90% of the voting rights in the target company in a takeover, shareholders can require the majority shareholder bidder to buy out all their securities.[8] Drawing experience from EU, the Chinese Securities Law stipulates that shareholders can sell out their shares to an acquirer if the takeover bid causes the target company losing its listing status.[9] In China, the equity distribution requirement for listed company is very strict;[10] small listed companies must have their public-offered shares more than 25% of its total shares, while companies with registered capital over 400 million must have more than 10% public-offered shares.[11] The prevalent non-public shares in Chinese listed companies give rise to the fact that the sell-out right trigger is much lower than 90% in China.[12]

As deficient as the Chinese sell-out right is the exemptions of Mandatory Bid Rule in China. Exemptions of Mandatory Bid Rule has two types: application-based exemptions and the non-application-needed exemptions. Under extreme circumstances, acquirers do not even have to apply to get exemptions from the Mandatory Bid Rule. In conditions where the acquirer do have to apply to the China Security Regulatory Commission[13] (hereinafter *CSRC*) for the exemption, relevant regulations are either too loose or too vague.[14] Investors with ulterior motives can easily exploit those loopholes for obtaining corporate control, and once

an applicant has obtained exemption from the Mandatory Bid Rule, he could find a way to circumvent tender offer forever. This leaves abundant room for majority shareholders to outsmart and outmaneuver minority shareholders.(15)

All in all, current Chinse tender offer regulation incorporates a Mandatory Bid Rule too intricate and a sell-out right triggered too low; in addition, regulations on exemptions of the Mandatory Bid Rule in China are riddled with ambiguous articles as well as confusing explanations. This paper deeply examines the Chinese law in tender offer regulation, compares its substances with its counterpart in UK and EU, and offers material suggestions for future improvement. The rest of this article proceeds as follows. Part Ⅲ briefly introduces three statutory ways of acquisition in Chinese law. Part Ⅳ gives a thorough review of the Mandatory Bid Rule in China. Part Ⅴ illustrates the deficiency of Chinese sell-out right. Part Ⅵ carefully analyzes the exemptions of tender offer in China. Part Ⅶ discusses the future improvements for tender offer regulation in China and Part Ⅷ concludes.

Ⅲ. THREE STATUTORY WAYS OF ACQUISITION IN CHINA

According to Chinese Securities Law, an investor may acquire a listed company through tender offer, negotiations or other lawful means.(16)

If an investor adopts the means of tender offer to purchase shares of a listed company on his will, he may choose to either send out a **general tender offer** for all outstanding shares of the company, or

send out a **partial tender offer** for part of the company shares. Either way the tender offer is to all shareholders of the listed company.[17]

Tender offer provides shareholders with adequate protection and certainty. According to Chinese Law, in tender offers, the price of the shares must not be lower than the highest price at which the purchaser obtains within 6 months before the tender offer,[18] and shareholders can choose either cash or equitable legal transferable securities at their will.[19] Normally, the open term for the tender offer is no less than 30 days and no more than 60 days.[20] When the term of tender offer expires, the purchaser have to purchase all the preliminarily accepted shares. In partial tender offers, if there are more accepted shares than needed, the purchaser shall purchase the shares according to the sellers' shareholding ratio.[21] Those safeguarding provisions in Chinese law protects shareholders from coercive tender offers and ensure all shareholders are treated equally in takeovers.

Compare with tender offer, share-purchases through negotiations or other lawful means are usually more private, and do not necessarily have to alarm the public shareholders until the transaction is done or is inevitably to be done. In this way, it is more efficient and of lower cost for the acquirers. In *2014 Takeover Measure,* acquisition of a listed company through other lawful means refers to as indirect takeovers. In indirect takeovers, the participant is not a shareholder of the company, but he was entitled to securities carrying 5% to 30% voting rights through investment relationship, agreement or any other arrangement.[22] Acquisitions through negotiations or any other lawful means seem to have very little to do with minority shareholders.

In theory, acquisitions through tender offer are usually shareholders-friendly but management-harmful, as the acquirers could bypass the management and hunt for control of the company directly; on the contrary, acquisitions through negotiations or other means are pro management in nature and deprive public shareholders of the opportunity to exit with a share premium.[(23)] Although in major Anglo-American countries, acquisition through tender offer is the mainstream, in China, acquisitions thorough negotiations or other means are much more common.

Ⅳ. THE CHINESE MANDATORY BID RULE

Through whatever means of acquisition, when an acquirer or investor holds 30% of the issued shares of a listed company, further acquisition of the company shares must via tender offer.[(24)] China transplanted this Mandatory Bid Rule from European countries to protect the lawful rights and interests of the minority shareholders.

A. The Mandatory Bid Rule in UK and EU

In UK, the *City Code* clearly mandates that "any person, or together with persons acting in concert with him, acquires shares carrying 30% or more of the voting rights of a company whether by a series of transactions over a period of time or not", shall launch an overall tender offer for all the outstanding shares of the target company.[(25)] In EU, the *European Directive* has similar clauses. When natural or legal

person holds securities of a listed company to a certain level, mandatory bid through tender offer "shall be addressed at the earliest opportunity to all the holders of those securities for all their holdings"[26]. In US, the Williams Act of United States has no such Mandatory Bid Rule, it only requires all the shareholders to be treated equally in a fair manner, and acquirers shall purchase shares on a pro rata basis if the preliminary accepted shares exceed their estimation.[27]

In UK, once the acquirer obtained 30% of the voting rights of the company, the Mandatory Bid Rule applies. The European Council allows every member states to determine the "percentage of voting rights which confers control" according to their own circumstances[28], thus the trigger of the member states varies from lowest 25% to highest 66%.[29] Interestingly, in Denmark and Estonia, there is no fixed number of the Mandatory Bid Rule trigger, the rule applies whenever the acquirer "holds the majority of voting rights in the company or becomes entitled to appoint or dismiss a majority of the members of the board of directors"[30]. Despite the minute threshold difference between UK and EU member states, once the Mandatory Bid Rule is triggered, the acquirer has to bid for all the company shares through a general tender offer; no partial tender offer is allowed except extreme conditions.

B. The Mandatory Bid Rule in China

In contrast with UK and EU, partial tender offer is an important part of the current Chinese Mandatory Bid Rule. Only in rare situations does the acquirer have to send out general tender offers.

Furthermore, while China has a "30% trigger" of Mandatory Bid Rule just like UK and most EU member states, the Chinese 30% trigger contains 30% of the issued shares and 30% of the total shares, and the consequences of the Mandatory Bid Rule are different accordingly. In Chinese listed companies, noncurrent shares are very common. The Share Split Reform from 2005 made most of the non-tradable shares tradable, but a large fraction of shares are still strictly restricted from selling even until now.(31) As we will explain in the following context, the prevalent existence of noncurrent shares made the discrepancy between 30% issued shares and 30% total shares rather huge. Meanwhile, the consequence of the Mandatory Bid Rule is also different, depending on how the acquirer reached the trigger in the first place.

1. Acquisition through Tender Offer

If a purchaser reaches 30% of the issued shares of a listed company by securities trading at the stock exchange or by tender offer from the beginning, the purchaser can freely choose to send out either a general tender offer or a partial offer for further acquisition.(32) The proportion of target shares through a partial offer shall not be less than 5% of the issued shares of the listed company.(33) Meanwhile, if this purchaser reaches 30% of the total shares of the listed company, he can still freely choose to send out a partial tender offer increasing no less than 5% shares.

It is not hard to conclude that, for tender offer acquirers, the Mandatory Bid Rule is quite loose. Partial tender offer is applicable at both 30% of the issued shares and 30% of the total shares level.

Furthermore, even if the purpose of the acquirer is to delisting the listed company through takeover, this acquirer still does not have to send out a general offer, all he needs to do is to unconditionally accept all the preliminarily accepted shares including those exceed the acquirer's designated amount.[34]

2. Acquisition through Negotiations

If a purchaser reaches 30% of the issued shares of a listed company through negotiations, the purchaser can freely choose to send out either a general tender offer or a partial offer for further acquisition.[35] However, once his shareholding reaches 30% of the total shares of the company, he has to send out a general offer for all shares of the company.[36] The refore, for acquirers through negotiations, the Mandatory Bid Rule is relatively strict. Once the acquirer reaches 30% of the total shares of the company, the only way to further increase his shareholding is general tender offer.

3. Acquisition through Other Lawful Means

If any person is entitled to 30% of the issued shares of a listed company through any lawful means other than acquisition through tender offer or negotiation, then this obligee has to send out a general offer for all shares of the company.[37] In conclusion, the Mandatory Bid Rule is most strict for indirect acquirers. From 30% of the issued shares on, general tender offer has become compulsory.

Table 1. The Mandatory Bid Rule in China

	Purchase Through Tender Offer	Purchase Through Negotiations	Purchase Through ther Lawful Means
30% of Issued Share	Partial Tender Offer	Partial Tender Offer	General Tender Offer
30% of Total Share	Partial Tender Offer	General Tender Offer	General Tender Offer

To sum up, the Chinese Mandatory Bid Rule requires acquirers holding 30% of the issued shares and acquirers holding 30% of the total shares sending out either partial tender offer or general tender offer under different circumstances, for part or all outstanding shares of the company. In other words, whenever an acquirer or investor, individually or collectively, steps over the 30% issued shares line, tender offer seems to be the only legitimate way of acquisition; but whether a general tender offer is compulsory varies from case to case.

Obviously, partial tender offer is more cost-efficient than general tender offer.(38) After all, general tender offer is way too money consuming and usually leads to the failure of whole takeover attempt. On the other hand, the general tender offer can provide shareholders with far more certainty and convenience by ensuring all shareholders have the equal chance to sell out their shareholdings at a premium.(39) Under current Chinese law, stepping over the 30% trigger point through normal security trading or tender offer provides acquirers in China with the legitimate right to send out a partial offer in takeovers instead of having to bid for all the outstanding shares. From this aspect, the Chinese Mandatory Bid Rule is more acquirer-friendly than shareholder-

supreme; it promotes hostile takeovers from happening at the cost of minority shareholder protection. In reality, in partial tender offers, when preliminarily accepted shares exceed the purchasers' original plan, certain percentage of shares are detained in the hands of shareholders, price of which may very possible plummet after the takeover. In addition, the minority shareholder further may take a heavy toll once an acquirer chasing short-term gain consolidates its control power of the target company, as repeatedly observed in Chinese security market.

Ⅴ. THE CHINESE SELL-OUT RIGHT

Under certain conditions, a full-scope general tender offer may become mandatory after a partial tender offer takeover. The *Takeover Guideline* and the *2014 Securities Law* simultaneously endow minority shareholders with the right to empty their shareholdings when the equity distribution of the target company does not conform to the requirements for listing in stock exchanges any more. The shareholders other than the acquirer who still holds shares of the target company have the right to sell their shares to the acquirer who caused the alternation of equity distribution under the same conditions in the partial tender offer and the acquirer must purchase all those shares.[40] In other words, if the acquirer purchase the shares of a listed company through partial tender offer to the extent that the company is no longer eligible for listing, then the partial tender offer ultimately becomes a general tender offer, and the acquirer is responsible for all the shares that other shareholders want to sell. Those shares remained in other shareholders' hands are

either the shares shareholders did not plan to sell originally, or the preliminarily accepted shares that exceeds the acquirer's designated amount in previous tender offer; and now, they all become the acquirers' liability.

A. The Sell-out Right in the European Directive and Chinse Law

The Chinese stipulation is quite similar to the sell-out right specified in the *European Directive.* The *Takeover Directive* offers minority shareholders a sell-out right enabling them to require the majority shareholder bidder to buy their securities following a takeover offer if the bidder holds securities representing 90% of the capital carrying voting rights and 90% of the voting rights in the target company. This sell-out right goes hand in hand with a squeeze-out right that allows a majority shareholder bidder to require the remaining minority shareholders to sell out their shareholdings at a fair consideration.(41) Under either situation, the acquirer (or the majority shareholder) must pay for a reasonable share price in cash or the same transferable security in the previous tender offer. The right of sell-out and squeeze-out is a preemptory norm for all member states. Shareholders can exercise these rights within three months after the tender offer takeover. In practice, while most member states has a 90% threshold for the sell-out and squeeze-out right, over one fourth member states increased th eir threshold to 95%;(42) Latvia and Luxenberg set a 90% threshold for the sell-out right and 95% threshold for the squeeze-out right.(43)

In China, the sell-out right does not have a squeeze-out right

correspondingly, and the sell-out right itself is not entitled directly to shareholders. Every member state of the EU has a specific threshold for shareholders to exercise the sell-out right, but in China, the sell-out right triggers "automatically" once the company loses its listing status, regardless of the bidder's shareholding percentage, nor the public shareholders' will.

Article 51 of the *2014 Securities Law* illustrates the requirement of equity distribution if a company wants to be officially "listed". The public-offered shares shall be more than 25% of the total shares of the company; and for companies with a registered capital over 400 million RMB, the percentage of its public-offered shares shall not be less than 10% of its total shares.[(44)]

The public-offered shares refer to shares held by public individuals rather than legal persons or institutions.[(45)] Suppose a small listed company with 100% circulating shares (an "absolute public" company). According to the Chinese Law, if any acquirers obtained 75% of the company share, the company is no longer eligible for listing, and the acquirer has to afford all the remaining shares of the company. In this case, the threshold for shareholders exercising their sell-out right is 75%. However, in most listed companies in China, legal persons and institutional investors usually possess a certain percentage of shares, and most listed companies more or less have some non-public shares,[(46)] thus the threshold for exercising the sell-out right of public shareholders is even lower than 75%. In extreme situations, a company may not be eligible for listing if any acquirers obtained even less than 30% of the issued shares.[(47)]

B. Shortage of the Chinese Sell-out Right

In any Case, the acquirer should not be the only one to bear the consequences of listed company going private. When purpose of the acquirer is to delist the target company, it is reasonable that the acquirer shall unconditionally accept all the preliminarily accepted shares including those exceed the acquirer's designated amount, but demanding the acquirer to swallow all the company shares simply because the ownership distribution falls out of the listing norm is not reasonable at all. For instance, an acquirer with 30% shares planned to further purchase 5% shares through tender offer; meanwhile, other majority shareholders with more than 5% shares of the company slightly increase their shareholding by, say 4.99%, which is slightly below the 5% line to make public announcement.(48) Under this circumstance, if the company loses its listing status, requiring the acquirer alone to buy out all the trivial shares is not fair at all, because all other majority shareholders are together responsible for the status quo.

The judicial purpose of sell-out right is to protect the rights and interests of minority shareholders by offering them a fair opportunity to decently exit. In European countries, for a bidder with 90% of the capital carrying voting rights and 90% of the voting rights in the target company, taking care of the rest 10% is not a big deal. However, in China, the bidder has to take care of the remaining 25% and usually more shares of the company, yet very possible the bidder is still far away from being a "controlling shareholder" when this happens. In China and most countries, very few acquirers intend to buy out a

whole company in takeovers, other usually only bid for lowest necessary proportion of shares. After all, acquisitions are too costly and every penny counts. In China, the bidder is responsible for formally reporting to CSRC about the quantity and proportion of the designated shares, amount of capital required for the takeover, and sources and guarantees of capital before sending out tender offer.[(49)] They have to prove that they are financially sustainable for the designated tender offer. Nonetheless, most of the acquirers are far from well prepared for the remaining shares after the tender offer. Without enough funds, the sell-out right of shareholders is just words on page, yet it is not realistic for the law to require all acquires preparing enough money for all outstanding shares of the company in partial tender offers.

In some cases, the amount of the remaining shares is even bigger than the amount of shares the acquirer predetermined to bid. Compulsorily requiring the bidder to satisfy the sell-out right of the shareholders may result in the acquirers' opportunistic behavior, forcing them to dismantle the target company for quick cash.

Even if the acquirer do have to ability to afford the remaining shares, and obtained 100% shares of the target company in the end, it may still not be a good thing - the originally-was equity investor is now forced to be responsible for a business he is not fully familiar with. This may in turn hurt the company in the end, for the company may achieve greater development under the control, or joint-control of former industry professionals. Indeed, when exercising the sell-out right, the minority shareholders' interests are under through protection and they can exit the company in a fair manner, but the costs are

long-term interests of the employees, creditors, affiliated companies and others who bear connections with the target company.

Ⅵ. THE EXEMPTION OF TENDER OFFER IN CHINA

The Sell-out right is just tip of the iceberg of a problematic tender offer regulation, and the exemptions of the tender offer in China constitute the rest part. While in the law of UK or EU exempts acquirers from the "Mandatory Bid Rule" in certain conditions, the Chinese Law directly exempts acquirers from the tender offer.

A. Two Types of Tender Offer Exemption in China

In China, there are two types of tender offer exemptions - application-based exemptions and non-application-needed exemptions.[(50)]

Normally, the investors and its concerted parties have to apply to the CSRC for the exemption of tender offer, and CSRC shall respond to the application within 20 days by explicitly granting the exemption or passively not bringing any objections[(51)]. However, under certain circumstances, investors and its concerted parties can skip the application to CSRC, and go through the procedures of share transfer and registration directly, in Stock Exchange and in China Securities Depository and Clearing Corporation Limited (CSDC) respectively.

The circumstances are as follows. First, if the exemption of tender offer is approved by non-affiliated shareholders on general assembly of shareholders, plus the investor with more than 30% of the company

share promises not to transfer the shares within 3 years. Second, investor with more than 30% of the company share promises not to increase its shareholding than 2% every 12 months in the future. Third, investor with more than 50% shares increases its shareholdings of the company to a lesser extent that the status of a public listed company is on the hazard. Under those three situations mentioned above, the investors do not have to inform *CSRC* to make the share transfer. In addition, if the investor stamped the 30% line for reasons independent of his will, for instance, fulfillment of formerly agreed share repurchases schemes, inheritance, common brokerage and loan business of financial entities or retrieve of voting rights of the preferred stock, then application to CSRC for exemption is also not necessary.(52)

Except the circumstances mentioned above, when stepping over the 30% mandatory bid line, investors and its concerted party have to make formal written applications to *CSRC* for the exemption of tender offer. The application-based exemptions also have two categories - exemptions from increasing shares by means of tender offer and exemptions from sending a tender offer to all shareholders of the target company.

Purchaser can apply to CSRC for the exemption from increasing shares by means of tender offer in the following two situations. First, if the purchaser and transferor can prove that the share transfer will not cause alternation of control, as the transaction itself is in-between the entities under the same actual controller. Second, if the listed company is in serious financial distress and the investor intends to save the company through a reorganization scheme approved by the

general assembly of shareholders. Investor with a reorganization scheme must promise not to transfer its shares to any party within three years.[53]

Upon receiving the application, *CSRC* shall clearly grant or refuse the exemption within 20 working days. If *CSRC* rejects the exemption application, the investor and its concerted party shall either reduce their shareholding to 30% or less, or send out a general tender offer to all shareholders to bid for all outstanding shares if they persist to acquire more shares of the target company. If the exemption is granted, not only can the investor freely bid for any proportion of shares (more than 5%) through tender offer, but he can also increase his shareholding through means other than tender offer as well. Generally, negotiated acquisitions are much more preferred than acquisitions through tender offer, as it is less cost-consuming but more time-efficient.[54]

Purchaser can apply to CSRC for the exemption from sending a tender offer when gratuitous transfer, alternation or combination of state-owned assets approved by the government or the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council causes the 30% shareholding fact. In addition, a security holder does not have to send out a tender offer at all, if his shares exceed 30% of the issued shares of the company due to shareholder assembly approved share repurchase aiming at reducing the public share circulation. Upon sending the application, if the security holder does not receive any objections from the CSRC within 10 days, then the security holder can fulfill the share transfer and registration process directly without sending any tender offer. In fact, applicants for the

exemption from sending a tender offer are just normal securities holders, rather than purchasers or acquirers of the listed company; they hardly have any intentions to increase their shareholdings, not to mention acquiring the whole company.(55)

In short, Chinese law grant investors the right to exempt tender offers when: first, share purchase that will not cause transfer of control of the company; second, acquisition of shares approved by general assembly of shareholders; third, long-term shareholder increases its shareholding in a gentle manner; fourth, share-increase beyond the investors' will.

B. Loopholes and Deficiencies of Tender Offer Exemption

The logic and reason behind current tender offer exemption regulation is obvious. The law is to prevent acquirers from taking advantage of the tender offer exemption for short-term disproportionate return.

First, when share purchase will not cause transfer of the control, it seems that the stabilization and sustainable development of the company is insusceptible; the production and management activity almost remain exactly the way they were. It is especially true when the actual controller himself increases his shareholding - firmer control of the company means less constraint in decision-making. Second, in acquisitions approved by general assembly of shareholders, the acquirers usually act for either the interest of the major shareholders or the long-term benefits of the company; the acquirer has no hostile intentions and his acquisition is via friendly negotiations and considerations. Third, investors

promise not to transfer their share within three years have no chance to gain from short-term plunder behavior, they have bind themselves with the future three years' development of the target company. Fourth, a shareholder increases its shareholding slowly at least ostensibly indicates that temporarily he has no intentions for corporate control. At a speed limit of no more than 2% every 12 months, corporate raiders with high leverage-ratio capitals or those intend to dismantle the company for sale can do nothing but to give up their evil notion. Fifth, if increase of the share is beyond the security holders' will, it is hard to imagine that the security holders will make a fuss out of it.

At first glance, those regulations indeed can ensure the investors who increase their shareholdings to behave properly, but not in the long end. For instance, at the beginning, a founder and shareholder holds 51% shares of his company, the remaining shares are for financial purposes to expand the company scale. Gradually, when business is booming and the controlling shareholder realizes that it is not cost-effective to share profits with the minority shareholders, he may easily squeeze out the minority shareholders by any means other than tender offer to the margin extent that the company stays "listed". The agency cost between majority shareholders and minority shareholders is especially high in companies with concentrated ownership[(56)], and Chinese law particularly exempts the block shareholders from increasing shares through tender offer. In this case, from the beginning to the end, the minority shareholders cannot enjoy the premiums of the tender offer and their interests are at stake.

A more common scenario in China is as follows. A financially sound

institutional investor acquired 30% shares of the company via negotiations and other means. This shareholder then stays quiet and every 12 months, he increases 2% shareholding. According to Chinese Law, he does not have to send out tender offer for share increase, nor does he have to make any public announcements at all. After two years, when this shareholder acquires approximately 34% of the company share, he obtains the veto power on virtually all major issues of the company. According to Chinese Company Law, any resolutions on revising the corporate charter, increasing or reducing the registered capital, merger, split-up, dissolution or change of the company forms shall be adopted by shareholders representing 2/3 or more of the voting rights.(57) As in China, the Company Law largely ensures one-share-one-vote(58), thus shareholder with 34% company shares normally has 34% voting rights of the company. In this case, when board of the directors realized the potential hostile intentions of the shareholder, it is already too late.

Under the "2% per year Rule", a Chinese shareholder can unboundedly increases his shareholding without sending out tender offer, which is unimaginable in European countries. Early in 1971, UK, Norcos Corporation announced its acquisition intent for Venesta International. To prevent the company from takeover, an individual shareholder, Mr. David Rowland, began purchasing the company shares in secondary market. Despite the fact that the share purchase was extremely difficult and went rather slow, Mr. David Rowland eventually became the controlling shareholder of Venesta International(59). Nocors Corporation then made a complaint to the Panel on Takeovers and Mergers who later realized that Rowland's open market bulk buying "denied the

company's small shareholders the opportunity to sell at the favorable terms Rowland had offered".[60] Based on this case, a new rule was added into the *1972 City Code on Takeovers and Mergers* which require anyperson who purchased 40% or more of a company's shares to make a bid for the remainder, no matter how gradual he obtained those shares.[61] This rule lied the foundation for the long-standing Mandatory Bid Rule in *City Code on Takeovers and Mergers.*

In China, astute institutional investors can utilize other loopholes in tender offer exemption to usurp and seize the control of listed companies. For example, when an investor promised not to transfer the shares within 3 years and got approval from non-affiliated shareholders, he automatically qualifies for exemption from tender offer without notifying CSRC.[62] Indeed, this investor has to hold the shares of the company for 3 years, but this does not change the fact that he has obtained relative control of the company without offering an exit mechanism to the minority shareholders through a public tender offer. In China, social ties play critical part in many aspects of doing business. In the corporate world, while non-affiliated shareholders are supposed to be "non-affiliated", such a title does not cut their social ties with corporate in siders such majority shareholders, actual controller of firm or the controlling shareholder.[63] These bonds arise out of educational background, industrial overlap, shared regional origin, military service or even third-party connection, representing informal connections that are not captured in conventional measures of "non-affiliate".[64]

In short, a major flaw of Chinese tender offer regulation is that, once the applicant obtained exemption from CSRC, he could find a

way to circumvent tender offer forever. "Once exempted, always benefits." This leaves abundant room for majority shareholders to outsmart minority shareholders.

VII. SUGGESTIONS FOR IMPROVEMENTS

A. Mandatory Bid Rule: A Rational Trigger

The Chinese Mandatory Bid Rule has an initial trigger of 30% issued shares, while UK and most EU member states have a threshold at 30 % shares carrying voting rights. Considering the non-tradable state-owned shares account for a proportion impossible to ignore in total shares of most listed companies, the initial trigger point of Chinese Mandatory Bid Rule is much lower than UK and major EU member states. For wide range minority shareholders, it might be a good thing; but such a low-threshold Mandatory Bid Rule inevitably hinders takeovers from happening in the first place. Fewer takeovers means even fewer exit channel for minority shareholders, thus it is hard to say such a low-threshold of Mandatory Bid Rule is at the interest of minority shareholders.

In China, the minority shareholders have a nickname of "chives", becausethey are easily "harvested" by the majority shareholders in the Chinese stock market. The knotty problem behind is the much poorer corporate governance environment in China compared to its counterparts in UK or EU.

The biggest corporate governance problem in China is the agency

costs , insiders' control, and no functional proprietor of the state-owned shares. A very large proportion of shares in Chinese listed companies are 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, causing even severer insider control problems.(65)

Moreover, the supervisory board and the independent director system functioned awfully in China.(66) Due to poor institutional transplantation, it is almost impossible for the supervisory board to "supervise" the management, and independent directors in China are simply "rubber stamps" for the board of directors.

Under these conditions, when China gradually opens its capital market, takeovers, especially hostile takeovers, may be an ultimate cure to Chinese corporate governance. In 2016, 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 short, a higher threshold of Mandatory Bid Rule that facilitates takeovers is more optimal for China.

Even from the aspect of the policy maker, setting the trigger low was trying to protect minority shareholders, but allowing partial tender offers overflow the security market was definitely not. In UK and all EU member states, once the acquirers trigger the Mandatory Bid Rule, general tender offer becomes compulsory while partial tender offer is strictly prohibited. This is to ensure equal and fair treatment for all all shareholders without any omission. From the experiences of UK

and EU, when obtaining shares to the extent of triggering the Mandatory Bid Rule, the acquirer usually has already held sufficient voting rights that may confer control, and the minority shareholders are in a weaker position. Therefore, the compulsory requirement of general tender offer only hasvery little inhibiting effect on takeovers, but can improve minority shareholders' well-being significantly.

In sum, current Chinese Mandatory Bid Rule has a trigger so low that hostile takeovers can hardly happen, but, partial offers instead of general offers are too frequently allowed in takeovers that the interests and lawful rights of minority shareholders are ignored. A higher trigger, combined with a stricter general tender offer requirementis optimal and imminent for Chinese securities market. Meanwhile, considering state-owned shares percentage varies from company tocompany, and almost every listed company in China has its unique equity distribution, a flexible trigger is crucial. Denmark and Estonia has set a good example for China: "whenever an acquirer holds the majority of voting rights in the company or becomes entitled to appointor dismiss a majority of the members of the board of directors, he shall launch a general tender offer for all the outstanding shares of the target company.[67]" As when the acquirer could be deemed as "holdingthe majority of voting rights in the company or becoming entitled to appoint or dismiss a majority of the members of the board of directors, it is optimal for the general assembly of shareholders to decide, insteadof a fixed standard from the CSRC.

B. Sell-out Right: A Reasonable Burden Sharing

In European Takeover Directives, a bidirectional sell-out right and squeeze-out right co-exist with each other, whether to exercise these rights or not depends on the acquirers' or the shareholders' will. When this happens, the acquirer has obtained more than absolute control of the company, while the minority shareholders' together hold only insignificant amount of the company shares. In China, only sell-out right is entitled to the shareholders, and the trigger of the sell-out right is much lower than that of EU member states.

Maximizing shareholders' value and protecting minority shareholders' interests is crucial in any countries' Company Law. Nevertheless, it is also crucial to realize that, the acquirer, or the bidder per se, is a shareholder of the company. General tender offer, like any other tender offers, usually opens to public for more than 30 days. After the general tender offer, shares remained in other shareholders' hands are shares they donot want to sell after thorough consideration. In many cases, when equity distribution of the company does not match the requirements in Securities Law, the acquirer is still far away from becoming a controlling shareholder. In companies with institutional investors as the majority shareholders, or in companies with state-owned shares as the majority, even if the acquirer buy out the remainders, still, he could not become the de facto controller of the company.

Usually, a listed company losing its listing status is not solely due to an individual acquirer's purchase. When the market momentum is strong, any shareholders of the company may slightly increase their

shareholdings, including the majority shareholders and institutional shareholders. Thus, the acquirer should not be the only one to accept the residual shares when shareholders exercising the sell-out right.

Luckily, when a listed company is at the edge of delisting, CSRC would notify the acquirer, and the acquirer can choose to reduce his shareholding to such an extent that the company stays listed; but again, the responsibility unfairly falls on the shoulder of the acquirer alone.

In sum, the threshold of the current Chinese Sell-out Right is too low; like most EU member states, 90% is an optimal line for shareholders sell-out right. Moreover, it is rational that when minority shareholders exercising the sell-out right, all majority shareholders (according to their *shareholding ratio*) are together responsible for the remnant shares, but the acquirer reserves a preemptive right to acquire all the remnant shares. Meanwhile, if the acquirer choose to reduce his shareholding to keep the company stays listing, then he has the right to request other majority shareholders to do the same (according to their *share-increasing ratio*).

C. Exemptions of Tender Offer: A Time Limit and Share Increase Amount Limit in Need

In *the City Code*, there are certain exceptions from the Mandatory Bid Rule. For example, issuance of new securities approved by shareholders as consideration for an acquisition, rescue operation, acquisition of shares because of inadvertent mistake, holders of shares carrying 50% of the voting rights state that they would not accept the offer, etc.[68]

The *European Directive* grants the supervisory authority of each member state the power to waive Mandatory Bid Rules in order to take account of specific circumstances. Even so, Cyprus, Hungary and Latvia did not stipulate tender offer exemptions, thus in those countries, a general tender offer for all shares of the target company is unavoidable once the Mandatory Bid Rule is triggered. In other member states, normally, Mandatory Bid obligation does not apply to acquisitions by inheritance, gift, debt enforcement or marriage. Besides, supervisory authority of other member states grant acquirers exemptions from Mandatory Bid Rule for other various reasons. The most common ones are : changes of control is within the same group,[69] restructuring or rescue scheme,[70] temporary stepping over the mandatory bid threshold,[71] dominant influence was gained for the purpose of carrying out a merger or division,[72] acquisition of control as a result of the exercising of pre-emption rights,[73] stepping over the Mandatory Bid threshold as a result of measures taken by the target company or by another shareholder[74] and so on.[75]

Some member states have unique Mandatory Bid Rule exemptions. For example, shareholder cannot exert a significant influence on the target company (Austria), another person holds a higher percentage of voting rights (Finland), and the offeror has already obtained de facto control of the company below the Mandatory Bid Rule threshold (Germany) are all distinctive reasons for the exemptions of the Mandatory Bid Rule.[76]

Compared with UK or EU member states, Chinese law on tender offer exemption is too complex. The exemptions of tender offer are divided

into application-based exemptions and non-application-needed exemptions; moreover, the application-based exemptions are further divided into two categories - exemptions from increasing shares by means of tender offer and exemptions from sending a tender offer to all shareholders of the target company. Even worse, the languages and expressions in relevant provisions are rather obscure and vague. Sweeping generalizations in twisted clauses unexpectedly leave more loophole for investors with ulterior motives. In comparison, exemption regulation is more substantial and strict in UK and EU member states; the literal meaning of the clauses is quite simple but crystal clear.

In addition, for UK or EU member states, acquirers are just exempted from the Mandatory Bid Rule, but in China, acquirers are actually exempted from the tender offer. In UK or EU member states, even if acquirers obtained exemptions from the Mandatory Bid Rule, normally, the only way they could further increase their shareholdings is through tender offer; the acquirers just do not have to bid for all outstanding shares of the company. In contrast, in China, once the applicant has confirmed their exemptions from the CSRC, they can almost increase their shareholdings through whatever means possible. In practice, acquirers in China are scrambling to avoid even partial offers once they get the exemptions, and the minority shareholders are thereby isolated from the negotiation table.

In sum, the Chinse Mandatory Bid Rule exemption is too loose, and acquirers can freely increase their shares through ways other than tender offer once they get the exemption. Only tender offer, especially general tender offer for all outstanding shares, can provide minority

shareholders with sufficient guarantee; and exemptions of Mandatory Bid Rule should not be a convenient weapons for corporate control. In view of this, a time limit of exemption as well as an amount limit of share-increase is urgent for the current law. First, 3 years after the exemption of tender offer, if the investor still holds more than 30% shares of the target company, further acquisition of shares must through a general offer for all outstanding shares of the company. Second, less than 3 years after the exemption of tender offer, if the investor obtains more than 40% of the company share, further acquisition of shares must through a general offer for all outstanding shares of the company.

Ⅷ. CONCLUSION

This paper posed the question whether there is still room to improve the Chinese tender offer regulation in order to better protect minority shareholders and at the same time take acquirers' interest into consideration. The answer clearly is yes. Three indispensable parts of currently Chinese tender offer regulation - the Mandatory Bid Rule, the sell-out right and the exemptions of tender offers - are all rather complicated than thorough, excessive than consistent. While relevant laws in UK and EU are exemplary for China, we should not ignore the heterogeneity of the Chinese securities market.

Tender offer is a fundamental part in hostile takeover regulatory framework. Although still grossly not ready in terms of dispute resolution and law enforcement, a hostile takeover era is coming as China continues to open its capital market. Acquirers in China rack

theirbrains to circumvent acquisition through tender offer. A sound and developed jurisprudence over tender offer helps to improve the large and diverse takeover regulatory framework in China. When this comes, corporate governance problems in China may not be as severe as they used to be.

(1) Martynova, Marina, and Luc Renneboog. "A century of corporate takeovers: What have we learned and where do we stand?" Journal of Banking & Finance 32.10 (2008): 2155-2169.

(2) Interim Provisions on the Management of the Issuing and Trading of Stocks (股票發行與交易管理暫行條例) (promulgated by the St. Council, Apr. 22, 1993, effective Apr. 22, 1993), Art. 48(1),CLI.2.6224 (EN) (Lawinfochina) [hereinafter Stock Interim Provisions]

(3) Securities Law of the People's Republic of China (中华人民共和国证券法) (Decision of the State Council on Canceling or Adjusting a Group of Administrative Approval Items and Other Matters (No. 50 [2014] of the State Council), issued on August 31, 2014, effective on January 1, 2006), Art. 88, CLI.1.233280 (EN) (Lawinfochina) [hereinafter 2014 Securities Law].

(4) The Panel on Takeovers and Mergers, the City Code on Takeovers and Mergers (12th ed. 2016), Part F1, Rule 9. [Hereinafter the City Code].

(5) *See* infra note 21. In EU, 10 of 27 member states have set their trigger of Mandatory Bid Rule at 30%.

(6) *See* 2014 Securities Law, supra note 3, at Art.88. In Chinse law, 30% of the issued shares is different from the concept of 30% of the total shares. Meanwhile, there are three statutory ways of acquisition in Chinese takeovers, *see* discussion infra part Ⅱ.

(7) For example, when a purchaser acquires 30% of the issued shares of a listed company through securities trading on a stock market, further acquisitions shall be in the form of a tender offer. When an investor plans to purchase more than 30% of the issued shares of a listed company by

agreement, the part of shares that exceed the foresaid 30% must by means of tender offer. When an acquirer indirectly obtains more than 30% of the total shares of the listed company, the acquirer shall send a general tender offer to bid for all outstanding shares of the listed company, otherwise the acquirer shall reduce its shareholding of the listed company to 30% or less. About the complexity of the Chinese Mandatory Bid Rule, *see* discussion infra Part Ⅲ.

(8) Council Directive 2004/25, Art. 16, 2004 O.J. (L142) 8 (EC).

(9) *See* 2014 Securities Law, supra note 3, at Art.88.

(10) *See* 2014 Securities Law, supra note 3, at Art. 51 (3).

(11) For the purpose of convenience in this article, Chinese listed companies with registered capital less than 400 million are referred to as small listed companies while Chinese listed companies with registered capital more than 400 million are referred to as large listed companies. Moreover, it's worth noting that in Chinese Law, public-offered shares refer to shares held by public individuals rather than legal persons

(12) *See* discussion infra Part Ⅳ.

(13) The China Security Regulatory Commission 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.

(14) Measures for the Administration of the Takeover of Listed Companies (上市公司收购管理办法) (promulgated by the China Securities Regulatory Commission, May 17, 2006, effective on Sept. 1, 2006, revised on Aug. 27, 2008, revised on Feb. 14, 2012, and revised on Oct. 23, 2014), Art. 61 and Art. 62, CLI.4.237186 (EN) (Lawinfochina) [hereinafter the 2014 Takeover Measure]. Although first promulgated in 2006, the 2006 Takeover Regulation has been amended in 2008, 2012, and 2014 respectively.

(15) *See* discussion infra Part Ⅴ.

(16) *See* 2014 Securities Law, supra note 3, at Art.85.

(17) Id. at Art. 88.

(18) *See* 2014 Takeover Measure, supra note 15, Art. 35.

(19) Id. at Art. 27.

(20) Id. at Art. 37.

(21) Id. at Art. 43.

(22) Id. at Art. 56.

(23) Bratton, William W., and Joseph A. McCahery. "Introduction to Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation." (2015).

(24) *See* 2014 Securities Law, supra note 3, at Art.88. *See* also supra note 6 for a detailed explanation of the complexity of the current Chinese Law.

(25) *See* the City Code, supra note 4, Part F1, Rule 9.

(26) Council Directive 2004/25, Art. 5, 2004 O.J. (L142) 8 (EC).

(27) The 90th United States Congress, Williams Act (82 Stat. 455), Section 14d, Section 14e.

(28) Council Directive 2004/25, Art. 5(3), 2004 O.J. (L142) 8 (EC).

(29) Hungary and Slovenia have a triggering point of 25% voting rights; Austria, Belgium, Cyprus, Germany, Finland, Ireland, Italy, the Netherlands, Spain and Sweden have a triggering point of 30% voting rights; Greece, France, Luxembourg and Slovakia have a triggering point of 1/3 voting rights (33.33% voting rights);Czech Republic and Lithuania have a triggering point of 40% voting rights; Latvia, Malta and Portugal have a triggering point of 50% voting rights; Poland has a triggering point of 66% voting rights. *See* COMMISSION OF THE EUROPEAN COMMUNITIES. Report on the implementation of the Directive on Takeover Bids. Brussels, 21.02. 2007.SEC (2007) 268. Annex 2.

(30) Id.

(31) Linyao Tang, 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), TOHOKU Law Review 47 (2017):115. The Share Split Reform beginning in 2005 only made a portion of the non-tradable shares of the State tradable and just moderately reduced the level of ownership concentration.

(32) *See* 2014 Takeover Measure, supra note 15, Art. 24.

(33) Id. at Art. 25.

(34) Id. at Art. 37.

(35) Id. at Art. 24.

(36) Id. at Art. 47.

(37) Id. at Art. 56.

(38) Easterbrook, Frank H., and Daniel R. Fischel. "The proper role of a target's management in responding to a tender offer." Harvard Law Review (1981): 1161-1204. Partial offer is definitely cheaper, the acquirer only have to acquire as much shares as he needs.

(39) Id. Compare with partial offer, general offer provides minority shareholders more protection.

(40) *See* 2014 Securities Law, supra note 3, at Art. 97. *See also* 2014 Takeover Measure, supra note 15, Art. 44.

(41) Council Directive 2004/25, Art. 15, Art.16, 2004 O.J. (L142) 8 (EC).

(42) Austria, Czech Republic, Cyprus, Denmark, Estonia, Greece, Finland, Hungary, Ireland, Malta, Poland, Portugal, Spain, Slovenia and Sweden have a 90% threshold for both the sell-out and the squeeze-out right, while Belgium, Germany, France, the Netherlands, Italy, Lithuania and Slovakia have a 95% threshold for both the sell-out and the squeeze-out right.. *See* COMMISSION OF THE EUROPEAN COMMUNITIES. Report on the implementation of the Directive on Takeover Bids. Brussels, 21.02.2007. SEC (2007) 268. Annex 4.

(43) Id.

(44) *See* 2014 Securities Law, supra note 3, at Art. 51 (3).

(45) *See* supra note 12.

(46) Amighini, Alessia A., Roberta Rabellotti, and Marco Sanfilippo. "Do Chinese state-owned and private enterprises differ in their internationalization strategies?" China Economic Review 27 (2013): 316.

(47) Some companies issued exactly 25% or 10% public shares, and the rest 75 % or 10% are all non-public shares inside the company, thus any takeover attempt by a third party other than an individual may cause the listed company on the edge of losing its listing status.

(48) *See* 2014 Takeover Measure, supra note 15, Art. 14 and Art. 16. In share transactions, 5% is the trigger of mandatory report obligation.

(49) *See* 2014 Takeover Measure, supra note 15, Art. 29 (1), Art. 29 (4), Art. 29 (6).

(50) *See* 2014 Takeover Measure, supra note 15, Art. 61, Art. 62.

(51) Id. at Art. 62 (3).

(52) Id. at Art. 63.

(53) Id. at Art. 62.

(54) Id.

(55) Id. at Art. 63.

(56) Easterbrook, Frank H. "Two agency-cost explanations of dividends." The American Economic Review 74.4 (1984): 657.

(57) Company Law of the People's Republic of China (中華人民共和國公司法) (promulgated by Nat'l People's Cong., Dec. 29 1993, effective Jul. 1, 1994, amended Dec. 25, 1999, Aug. 28, 2004, Oct. 27, 2005 and Dec. 28, 2013, effective on March 1, 2014), Art. 43, CLI.1.218774 (EN) (Lawinfochina). [Hereinafter 2013 Company Law].

(58) Id. at Art. 126. In China, the 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. The 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.

(59) Prentice, D. "Take-Over Bids--The City Code on Take-Over and Mergers." McGill LJ 18 (1972): 385.

(60) Armour, John, and David A. Skeel Jr. "Who writes the rules for hostile takeovers, and why-the peculiar divergence of US and UK takeover regulation." Geo. LJ 95 (2006): 1764

(61) The Panel on Takeovers and Mergers, The City Code on Takeovers and Mergers (1972).

(62) *See* 2014 Takeover Measure, supra note 15, Art. 62.

(63) The title of "independent" or "non-affiliated" cannot fully cut the social ties in-between the parties involved. In practice, crucial figures to the company

more or less connect with the crucial figures of the company, such as CEO, CFO, manager, actual controller of firm or the controlling shareholder.

(64) In Accounting Standards for Enterprises No.36 (企業會計準則第36號), there are a series of listing rules as well as a negative list defining what exactly "affiliated party" is, but those definitions largely ignored the social connections between related parties.

(65) HUANG, Xing-luan, and Shen Weitao. "A study on Government Intervention Insider Control and M&As' Performance of Chinese Listed Companies [J]." Economic Management Journal 6 (2009).

(66) Yuetang, Wang, Zhao Ziye, and Wei Xiaoyan. "Does Independence of the Board Affect Firm Performance?[J]." Economic Research Journal 5 (2006): 62-73.

(67) Supra note 30.

(68) *See* the City Code, supra note 11, at Rule 9.

(69) Czech Republic, Denmark, Estonia, France, Italy, Lithuania, Poland and Spain.

(70) Belgium, Lithuania, Netherlands, Poland, Portugal, Spain.

(71) Czech Republic, Greece, Spain, and Finland.

(72) Estonia, Italy, Greece and Malta.

(73) Malta, Greece and Netherlands.

(74) Finland, Slovenia.

(75) Supra note 29. Annex 3.

(76) Id.