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AN INSIDE JOB: TAKEOVERS IN CHINESE CAPITAL MARKETS

UN INSIDE JOB: *ADQUISICIONES CORPORATIVAS EN EL MERCADO DE VALORES CHINO*

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Chinese Stock Exchanges are on the rise. Companies are lucrative and trading is getting sophisticated on a day-to-day basis. Upon this scenario, the following paper takes a closer look on the framework upon which takeovers may happen, the takeovers strategies available in Chinese jurisdiction and the applicable defenses that target companies may use against such attempts.

Finally, this paper compares the regulation of Takeovers in China with that of highly developed markets, such as the United Kingdom and the United States. The opinion of this paper is that though unsophisticated Chinese stock exchanges have undertaken proper measures in adapting foreign regulations into its own business idiosyncrasy to regulate the takeover phenomenon.

Key Words: Stocks; China; Capital Markets; Stock Exchanges, defences.

Las operaciones bursátiles chinas están en auge. Las compañías son lucrativas y el comercio, día tras día, se está volviendo cada vez más sofisticado. Frente a este escenario, el presente trabajo proporciona una mirada más cercana al marco de referencia en el que diversas adquisiciones pueden ocurrir, a las diversas estrategias de adquisición disponibles bajo el ordenamiento jurídico chino y a las defensas aplicables que las compañías, blanco de adquisiciones hostiles, pueden usar para defenderse contra estos intentos de absorción.

Finalmente, este trabajo compara la regulación de las adquisiciones en China frente a las que ocurren en mercados más desarrollados, como el del Reino Unido o el de los Estados Unidos. Es la opinión de este ensayo que, aunque aún no sean tan sofisticadas, las operaciones realizadas en la Bolsa de Valores china han empleado las medidas apropiadas en adaptar regulaciones extranjeras dentro de su propia idiosincrasia de operaciones de negocios para regular el fenómeno de la adquisición de empresas.

Palabras clave: Acciones; China; Mercado de capitales; Bolsas de Valores, defensas corporativas.

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"With increasingly limited resources and fierce competition world widely, it is important to propel M&A's among (domestic) enterprises".
The State Council of the Peoples Republic of China – September 6, 2010

I. INTRODUCTION

Considering our background, having been raised under a strong western worldview, our understanding of Chinese business and financial ideologies is far from outright acknowledgement. Such absence of familiarity generates vast skepticism that can only be dismissed by proper investigation that may lead to understanding the principles that rule the reasonability of the Chinese business and financial structure.

Therefore, to relief the anxiety of the unknown, and to thrive into understanding the strange, the focus of the following investigation is in compelling relevant information that shall help any western dissident to grasp a very important phenomenon in the Chinese Capital Markets, "Takeovers"; these have some interesting features that will be discussed below.

The structure of this work is as follows: First, a brief explanation of the concepts of shares followed by a presentation on the different types of shares which may be traded by Chinese and foreign investors. Then, a definition of Takeovers and some aspects of their different types allowed in the Chinese Capital Markets, the involved regulators and supervisors, as well as some issues regarding Takeovers on the Chinese Exchange Markets. Furthermore, an analysis of the applicable Takeover defenses as used in China. Finally, a comparison of Takeovers on the Shanghai and Shenzhen Exchange Markets with its similarities with other capital markets.

II. UNDERSTANDING STOCKS

There is a big difference between the ownership of something tangible and intangible. The law has special interest in defining both types of property, as their transmission effects arises from different foundations. The initial overview is related to tangible goods, for example a cell phone. Through the human senses a cell phone can be seen, touched, heard, etc. Therefore, our brain feels and understands it exists. Hence, it is easy to imply the property of tangible goods, as it is usually assigned to the one possessing the good.

However, how can we infer the ownership of an intangible good, for example a Company? The property scheme of a company is defined by its shareholders' structure. Shareholders have certain rights inherent to their ownership and the company's decisions. However, shares are intangible assets, which differ from each other.

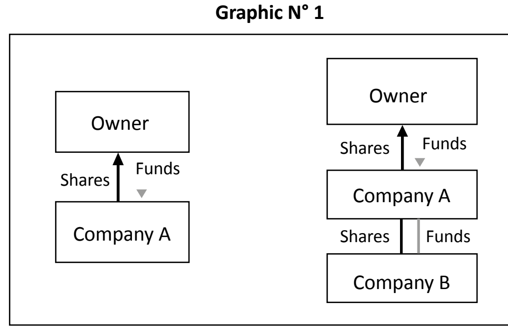
A. Stock Ownership

A share is a legal creation, with financial value that represents aliquot participation in the capital stock of a company. The capital stock of the company is the sum of funds disbursed by its owners for subscribing shares when first issued.

As shares grant aliquot ownership of a company, its holders have certain rights over it. These rights are political and economic, as the right to vote in the Shareholders Meeting and the right to participate in the distribution of profits.

In this sense, holding a share grants ownership of the company that issued such share. This ownership scheme is the **direct ownership** of a company (Company A). However, if the company issuer of the shares also owns shares issued by another company (Company B), then the owner of the shares of Company A will also **own** Company B. This ownership scheme (i.e., through an intermediary) is called **indirect ownership**. The following illustration shall be helpful to differentiate between these concepts:

Graphic N° 1



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In this way, the owner may exercise its shareholder rights directly in Company A and indirectly into Company B, given that it has enough shares in Company A as to influence its decisions in Company B.

B. Chinese Shares

As to frame our analysis, it is important to define the different types of shares available in the Chinese Capital Markets. There are multiple share classes, as the Chinese Government still limits direct foreign investment in its trading markets. Companies incorporated inside the People's Republic of China territory (i.e., Mainland China) are authorized to issue different classes of shares depending on the place where they will be listed and the investors that will be allowed to acquire them. In addition, there are some other share denominations which, though they may be related to companies incorporated inside Mainland China, are listed on overseas capital markets. Below is a brief description of each class of share:

a) **A shares**: Issued by companies incorporated in Mainland China and listed in the Shanghai or Shenzhen stock market. These shares are quoted in Renminbi (RMB) and may only be acquired by residents of the People's Republic of China (PRC) or Qualified Foreign Institutional Investors (QFIIs) and Renminbi Qualified Foreign Institutional Investor (RQFIIs).

b) **B shares**: Issued by companies incorporated in mainland China and listed in the Shanghai or Shenzhen stock market. The main difference with the A shares is that B shares are open to foreign ownership and locals with appropriate foreign currency dealing accounts. These types of shares are traded on the Shanghai stock market in US dollars and on the Shenzhen exchange in Hong Kong dollars (HKD).

c) **H shares**: Issued by companies incorporated in Mainland China but nominated by the Central Government for listing and trading in the Hong Kong exchange market. These shares are traded in HKD and are also available for international investors ownership.

d) **N Shares**: Issued by companies incorporated outside the PRC but controlled by Mainland China entities, individuals or companies. These shares are listed on the NASDAQ exchange or in the New York Stock Exchange (NYSE).

e) **Red Chips**: Issued by companies substantially owned, directly or indirectly, by Chinese state entities. These shares are traded on the Hong Kong Exchange in HKD.

f) **P Chips**: Issued by non-state-owned companies, incorporated outside Mainland China but controlled by Mainland citizens and listed in HKD on the Hong Kong exchange market.

g) **S Chips**: These are traded on the Singapore Stock Exchange, issued by companies incorporated outside the PRC but controlled by Mainland Chinese companies, entities and/ or individuals.

For further analysis, this paper will only focus on A and B Shares, because the "Takeover" parameters considered bellow are concentrated on transactions that may happen on the Chinese Capital Markets, or in other words, only on the Shanghai and the Shenzhen Stock Exchange.

III. A BRIEF INTRODUCTION TO CHINESE STOCK EXCHANGE MARKETS

There are two stock exchanges in Mainland China: the Shanghai Stock Exchange and Shenzhen Stock Exchange. According to the President of the Shanghai Stock Exchange, Mr. Huang Hongyuan, in a paper published in May 2015 by the City of London Corporation[1], by the end of 2014 the total market value of all stocks in both Shanghai and Shenzhen markets summed up USD$ 6 trillion. If considered jointly as one exchange, Mr. Hongyuan says it would rank second in the world. An analysis by Market Grader Capital[2] details the composition of both stock exchanges markets as of May 31, 2015, in the following way:

Stock Exchange	Listed Companies	Market Capitalization (USD BN)	% Change in Last 12 Monts
Shangai	919	3,425.00	185%
Shenzhen	1,572	3,997.00	203%
Mainland China Total	2,491	7,422.00	194%

1 Paper published by the City of London Corporation titled "EXPERT PERSPECTIVE ON CHINA'S CAPITAL MARKETS" available at: https://www.cityoflondon.gov.uk/business/economic-research-and-information/research-publications/Documents/Research-2015/Chinas_capital_markets.pdf [Last consultation on Dec. 6, 2016]

2 Analysis made by Market Grader Capital available at: http://www.marketgradercapital.com/publications/MarketGrader-Capital_Shanghai&ShenzenExchanges_White_Paper_July_2015.pdf

Even in such a bullish performance, predicting the prospect of Chinese Stock Exchanges is a harsh labor. By 2014, some experts prognosticated a crash in 2015, while other reputable firms such as Credit Suisse[3] predicted that the Chinese Stock Exchanges would become the second biggest stock exchange by 2030. However, as previously stated, the Chinese Stock Exchanges was already the second biggest in the world by May 2015.

As of December 7, 2016, and even after the turbulent June 2015 period of the Chinese Stock Exchanges, this statement remains accurate, as the Chinese Stock Exchanges are still jointly the second biggest exchange market in the world. According to their official webpages, the Shanghai[4] and Shenzhen[5] Stock Exchange numbers are as follows (Exchange Rate of 6.6 RMB x USD):

Stock Exchange	Listed Companies	Market Capitalization (USD BN)
Shangai	1,209	4,445.00
Shenzhen	1,888	3,546.00
Mainland China Total	3,097	7,991.00

Considering the aforementioned bullish performance of the Chinese Exchange Markets, it is even more important to understand the opportunities it presents and how to take advantage of them.

IV. TAKEOVERS OF CHINESE LISTED COMPANIES

A. Takeover Definition

A takeover is a transaction whereby a person obtains control of a listed company through directly or indirectly acquiring voting shares of the target company. Therefore, it is essential for this analysis to determine what control of a listed company means under Chinese regulation and practice. According to King, Wood & Mallesons, an investor will be deemed to control a listed company in any of the following circumstances (Yi Zhang, 2014, p. 4):

a) The investor is a Controlling Shareholder that holds more than 50% of the shares in the listed company;

b) The investor can actually control over 30% of the share voting rights of the listed company;

c) The investor controls the appointment of more than half of the members of the board of directors through actual control of share voting rights;

d) The investor, by virtue of share voting rights that it directly holds, is able to have a major influence on the resolutions of the shareholders' general meeting of the company; or

e) Other circumstances recognized by the CSRC.

B. Types of Takeovers

1. Takeover by Offer (Hostile)

A Takeover by Offer concerns an investor willing to obtain the control of a listed company by means of a voluntary or legally required proposal to each of the shareholders of the target company (also known as a 'General Offer') or to some of the shareholders of such company (or a 'Partial Offer').

If the shares held by a purchaser of a listed company after its intent of acquiring listed shares represent more than 30% of the total issued shares of the company, such investor will be obliged to proceed by means of Takeover by Offer, unless expressly exempt by the China Securities Regulatory Commission [hereinafter, CSRC][6,7]. The afore-

3 Prediction made by Credit Suisse Research which states the following: "2030 forecast composition of global equity market capitalization by country (total USD284.2 tn)" and a graphic of this information available at: https://twitter.com/csresearch/status/487591643856764929/photo/1

4 Market overview of the Shanghai Stock Exchange available at: http://english.sse.com.cn

5 Market overview of the Shenzhen available at: http://www.szse.cn/main/en/MarketStatistics/StatisticsBySecurities/

6 Information regarding the China Securities Regulatory Commission available at: http://www.csrc.gov.cn/pub/csrc_en/

7 Takeover Regulation, Article 48, Measures for the Administration of the Takeover of Listed Companies of the Decree 35 of China Securities Regulatory Committee available at: http://www.fdi.gov.cn/1800000121_39_4237_0_7.html

said purchaser includes the direct investor and any person that may act in concert[8], and their interests held shall be calculated collectively. It is noteworthy stating that the shares to be acquired by means of a hostile takeover shall never represent less than 5% of the outstanding shares issued by the target.

When a Takeover by Offer is carried out, the price paid for the shares shall never be lower than the highest price paid by the purchaser in the acquisition of shares on the target company during six months prior to the day of publication of such offer. The payment can be made in cash, legally transferable securities or a combination of both. When the acquisition is intended to be made in cash, the purchaser must deposit at least 20% of the total price in a bank previously designated by the Securities Registration and Clearing institution. On the other side, if it is intended to be paid by securities, upon the announcement of the Takeover by Offer, such securities shall be transferred to the SD&C.

The Takeover by Offer period varies between 30 and 60 days, unless there is a competing offer. The purchaser is prohibited to revoke its takeover offer within the takeover period. Shareholders that have already accepted to transfer their shares may only withdrawal its acceptance until three days prior to the expiration of takeover period, through a communication to the securities company.

Upon the expiration of the takeover period under a Partial Offer, if the numbers of shares of shareholders willing to sell is greater to the offer made, the shares shall be acquired in a prorate basis. A purchaser that issued a General Offer shall purchase all the initially accepted shares under the offer, once the takeover period is over.

2. Takeover by Agreement

In contrast to the aforementioned, the Takeover by Agreement implies than the intended purchaser makes a private offer to certain shareholders of the target- listed company. In that sense, this mechanism does not imply a legally defined takeover period, as the negotiations are made directly between the purchaser and the shareholders. But is important to acknowledge that by means of the private agreements with shareholders of the listed company, the control of the company will change in favor of the purchaser.

Some legal requisites apply to the Takeover by Agreement that if not complied, will require the purchaser to necessarily make the acquisition through a Takeover by Offer. First, the legal bylaws of the target company shall not establish any restriction to this type of transaction. Then the sum of the shares held by the purchaser added to the number of shares to be purchased shall not exceed 30% of the total shares issued by the company. However, both of these provisions can be exempted by an express authorization issued by the CSRC.

It is worth noting that if the purchaser reaches through this type of acquisition share interests for more than 5% of the issued shares, but less than 30%, the purchaser will have to disclose the share interests as stipulated by law.

3. Management Buyout Takeover

The Management Buyout supposes an acquisition of the shares of a listed company by its company's directors, supervisors, senior management personnel, employees or any other controlling entity or individual entity or individual of the target company. For such acquisition to proceed, the company must have efficiently implemented a corporate governance structure. Also, the company has to be controlled by at least 50% of independent directors actively participating on the board of directors.

The Management Buyout requires a previous approval by at least two thirds of the independent directors and shall be adopted by half of the independent shareholders with voting rights. Furthermore, an asset evaluation of the company shall be provided by an independent financial advisor, which shall issue an opinion regarding the assets and the takeover. The opinions by the directors and by the financial advisor shall be revealed to the shareholders before the acquisition.

C. Supervising Authorities

All of the Takeovers in the Chinese Stock Exchanges are supervised by the CSRC, which is the main regulatory authority on takeovers and changes in shareholding of listed companies. The CSRC powers can go from making the parties dialogue to mediating disputes, and even suspending or terminating the takeover attempt.

In addition to the CSRC, the following authorities may supervise the takeover if it falls into their scope of supervision:

8 Acquisition of shares through third parties acting in favor of a single acquirer.

a) Ministry of Commerce (or MOFCOM)[9]: Examination and approval of issues concerning industrial policy, change of enterprise nature and industrial monopoly, during the takeover process.

b) State Administration for Industry and Commerce (or SAIC)[10]: Examination and approval of issues concerning the change of enterprise registration and industrial monopoly during the takeover process.

c) Industrial Supervision Authority: If the target business scope is in an industry limited with respect to foreign investment.

d) State-Owned Assets Supervision and Administration Commission (or SASAC)[11]: If the takeover is related to state-owned shares of listed companies.

e) State Administration of Foreign Exchange (or SAFE)[12]: Supervision the funding source and turnover of foreign exchange in foreign acquisitions.

f) Shanghai/Shenzhen Stock Exchange (Stock Exchange)[13]: Organizes the trading and provides services for the takeover of listed companies and the associated changes in share interest, implements real-time monitoring of securities trading activities, and supervises the conscientious performance of information disclosure obligations in the takeover of listed companies and the associated changes in share interest.

g) China Securities Depository and Clearing Corporation Limited (SD&C)[14]: Provides services in connection with the registration, deposit and clearing involved in the takeover of listed companies and the associated changes in shareholdings.

D. Some Issues Regarding Takeovers in the Chinese Stock Exchanges

Takeovers are supposed to be used as mechanisms to enhance efficiency, as they theoretically improve the long-term interests of both the company and the purchaser. The company can benefit from reducing fixed costs as they will be spread through greater resources; and also through combining strategic assets and managerial expertise, by getting more equity for investment and reducing costs of capital, among others.

Nevertheless, takeovers in the Chinese Capital Markets are a disincentive due to certain issues. The main issue on the Chinese Capital Markets is the huge barriers to initiate Civil Law suits under the People's Courts, as to revoke resolutions or rescind illegal actions carried out on such markets. This is a result of the insufficient institutional capacity of regulators and other entities involved, which shall be advocated on enforcing legal standards. Low punishment levels produces low level of compliance by the parties involved on transactions, which creates legal uncertainty, and in that sense, builds major investment uncertainty which serves as a disincentive for sophisticated investors.

V. PROTECTING MINORITY SHAREHOLDERS

As takeovers are focused on gaining control of the company to maximize return on investment, it is feasible for an acquirer to gain control and then exploit the company for its own benefits. As to gain control the acquirer may deal only with one shareholder holding control and then take advantage of it (selling to a looter), collude with a major shareholder for him to acquire a controlling quota first (fraudulent conduct) or even with the current management (by sale of corporate office). Bellow, we can point to a brief explanation of how these circumstances affect minority shareholders:

[9] Information regarding the Ministry of Commerce of the People's Republic of China available at: http://english.mofcom.gov.cn/

[10] Information regarding the for Industry and Commerce of the People's Republic of China available at: http://home.saic.gov.cn/english/

[11] Information regarding the State-owned Assets Supervision and Administration Commission of the State Council available at: http://en.sasac.gov.cn/

[12] Information regarding the State Administration of Foreign Exchange is available at: http://safe.gov.cn/wps/portal/english/Home.

[13] Information regarding the Shanghai/Shenzhen Stock Exchange available at: http://english.sse.com.cn/ / http://www.szse.cn/main/en/

[14] Information regarding the China Securities Depository and Clearing Corporation Limited available at: http://www.chinaclear.cn/english/About/about_index.shtml

a) Selling to a looter: In expectancy to maximize its own profits, the acquirer may gain control of the company and adopt a resolution by which to sell the strategic assets of the company into another company; probably wholly-owned by him and not shared with minority shareholders. This leaves the minority shareholder of the target with a company missing its strategic assets and therefore diminishing the value of its shares and doomed to fail.

b) Sale of Corporate Office: To gain control of the target without having to buy the controlling quota of shares, the acquirer may collude with the board of directors as to personally reward them if they resign and nominate in their replacement a person related to the acquirer. Therefore, he would have gain control without buying shares and could thus take decisions within the company in pursuit of its self-interest and not of the company.

c) Fraudulent Conduct: The acquirer may also collude with a shareholder who holds a majority of shares but not the controlling quota yet, as for him to buy enough shares to hold a controlling quota and then sell this controlling quota. The first buy-up of shares by the shareholder would be at market price as any other acquisition of shares, but then when he sells a controlling quota he could sell it for a premium as shares giving control over the company are worth more than shares that do not. Therefore, this precludes the minority shareholders from also receiving a premium price for their shares when after all they were to be sold as provide control of the company.

Such scenarios prevent minority shareholders from obtaining proper financial gains from their shares and put them in a risky situation, as their shares value may drop drastically within days, or even hours. Therefore, regulation seeks to protect minority shareholders from harmful actions that may be undertaken by and between majority shareholders and acquirers.

A. Mandatory Bids

A mandatory bid is an imposition on an acquirer of a listed company to compulsorily make an offer to acquire the remaining un-acquired shares whenever his acquisitions reaches or surpasses a certain threshold. According to article 88 of the Securities Law[15], where an investor holds 30% of the shares of a listed company via transactions on the stock exchanges and continues to purchase shares, it should extend a takeover bid to all shareholders of the listed company to purchase all or part of the remaining shares.

The purpose of having a mandatory bid rule is to ensure equal treatment between shareholders of the target company in relation to the price they can get for selling their shares on a takeover. Without a mandatory bid rule, the minority shareholders would sell their shares at market price but not at a premium price, since their stocks alone do not have an intrinsic value for which to pay an over-the-market price (premium); even, if the acquirer in the takeover is a looter or a raider he may have to sell his stock under-the-market price as it is possible for the company's valuation to decline.

Meanwhile, the majority/controller shareholder who sold stocks to the acquirer would have likely seized a premium for such sale as its stock-quota grants control over the company; and by providing control, such share-quota is worth more than the sum of the individual shares there comprised. Hence, the same exact security would be exchanged at different prices.

Therefore, the mandatory bid provides that if there is a change of control in the company (the acquisition or surpassing of 30% voting shares) the acquirer must launch a bid for the remaining un-acquired shares. This guarantee the minority shareholders that want to leave the company due to the change of circumstances, to do so at the best possible price they can get for their shares.

The price offered for shares in a mandatory bid according to Chinese regulation must not be lower than the either the highest price paid within the last six months to the takeover or the average price in the 30 days before it. In this way, the minority shareholders option to transfer their shares at the same price at which the majority shareholder did and in virtue of a situation generated by such majority shareholder is maintained.

B. Acting in Concert & Disclosure Rule

As to avoid the acquisition of a controlling quota of shares through third parties acting in favor of a single acquirer, Chinese law has regulated the scenarios in which this could happen and decreed to

[15] The Securities Law of the People's Republic of China which has been effective from January 2006 and amended in June 2013 can be found at: http://www.china.org.cn/english/government/207337.htm

treat them as if it was only one acquirer. Chinese takeover regulation is conscious that in business is common to see persons with *Guanxi*[16] acting in favor of one another, expecting to receive favors sooner or later, in order to avoid legal obligations attached to a person's shareholding such as a mandatory bit rule.

Therefore, Chinese takeover regulation has come up with a rebuttable list in which it is presumed that investors who fit in it are acting in concert unless they can prove otherwise. This list includes persons related to the acquirer, such as the controlling parent company, sibling companies, subsidiaries, companies with largely the same management team, a finance provider, the key management personal and their spouses, and the individual controlling shareholders and their spouses.

In order to detect the possibility of people acting in concert, the Takeover Regulation commands that whenever an investor acquires any share quota between 5% and 20% it must disclose basic information about itself and their concert parties. In addition, if an investors acquires any share quota between 20% and 30% it must, it must also present: (i) information on its controlling shareholder and control structure of its concert parties; (ii) the price paid for the acquired shares; (iii) the existing or potential same-industry competition between its concert parties and the target company; (iv) its plans on changing assets, business, employees, organization structure; (v) the major transactions between its concert parties and the target company within the last two years; and, (vi) a financial advisor's report on the acquisition and its influence on the target company and its shareholders.

VI. DEFENSES AGAINST HOSTILE TAKEOVERS

According to the Chinese regulation[17], the Board of Directors of the company owes fiduciary duty to its shareholders. In regard to a takeover scenario, this implies than prior to a bid the Board may defend the company's interest in the spectrum of the duty of care and the duty of loyalty to its shareholders[18]. Then, after a bid, the Board may not take decisions related to the takeover by itself, needing necessarily the consent of the shareholders to act jointly[19]. The most common defenses used in China against hostile takeovers are the White Knight, Filing Complaints and the Amending Provisions defense.

By using a **White Knight Defense**, the target company seeks for a friendly or related investor to acquire its shares and thus preventing it from being acquired by the hostile acquirer (or black knight). An example of its use in China comes from the target company Guangfa Zhengquan whose managers, in order to prevent its acquisition by hostile acquirer Zhongxin Zhengquan, incorporated Shenzhen Jifu to buy 12.25% of its shares while at the same time convinced its shareholders Liaoaning Chengdu and Juling Aodong to increase its participation. After using this defense, the three related/friendly investors held 66.7% of the voting shares and the hostile acquirer withdrew its offer.

When using a **Filling Complaints Defense**, the target company files complains before the regulatory authority alleging statutory breach by the hostile acquirer in order to make the takeover process lengthier and bureaucratic; as to discourage the acquirer from taking over the company. An example of this defense was used in the first ever hostile takeover in China, when the target Shanghai Yanzhong filed complaints before the CSRC against its hostile acquirer Shenzhen Bao'an for an allegedly disclosure breach and being backed by the bank (which at the moment was forbidden for takeovers). As a result, the CSRC mediated the complaint and held the share agreement valid but fined the acquirer with a million yuan and obliged it to maintain the management in its position.

The **Amending Provisions Defense** implies modifying the corporate bylaws as to "change the rules of the game" within the company and its shareholders, and thus discourage the acquisition from the hostile acquirer as his acquisition may not grant him full control. An example of this defense in mainland China is the use by the target Datong Youtian who, in order to prevent its hostile takeover by Aisha Gufen, changed its bylaws in relation to the nomination of board-members; the change implied that only long-term shareholders may

16 A cardinal notion in Chinese idiosyncrasy, which highlights the influence and relevance personal and social relationships have on all other aspects of life (such as the corporate and political sphere).

17 Article 147 and Article 148 of the Company Law of the People's Republic of China available at: http://www.fdi.gov.cn/1800000121_39_4814_0_7.html

18 Takeover Regulation, Article 8 of the Decree 35 of China Securities Regulatory Committee available at: http://www.fdi.gov.cn/1800000121_39_4237_0_7.html

19 Takeover Regulation, Article 33 of the Decree 35 of China Securities Regulatory Committee available at: http://www.fdi.gov.cn/1800000121_39_4237_0_7.html

nominate members to the board and that such nomination shall be approved by current board-members. At the end, the hostile acquirer filed a complaint against the CSRC who declared such amendment as void.

A. A case of a takeover and the defenses used against it

China Vanke Co., Ltd., is the World's No. 1 builder of homes by sales, who was facing a struggle between its management and its major shareholder, Mr. Wang Shi, Chairman and also founding member. On such scenario, the company became target of a hostile takeover by the Baoneng group, whose founder, Mr. Yao Zhenhua, has been buying shares and increasing its participation through subsidiaries, to become one of the major shareholders of the target company.

To prevent the hostile takeover, Mr. Wang Shi reached an asset restructure plan worth USD$ 6.9 billion with Shenzhen Metro Group, by which the latter would become the largest shareholder of Vanke Co. However, as such plan would dilute the holdings of Baoneng Group and China Resources Group as major shareholders, they stated that they would oppose the use of this **White Knight Defense**.

In the midst of this struggle, Vanke Co.'s biggest competitor Evergrande Group took action and acquired USD$ 5.3 billion worth of A-Shares, surpassing Vanke Co as the largest World's property developer by sales. However, they later sold their stake to Shenzhen Metro Group at a USD$ 1.04 billion loss. Likewise, China Resources Group sold all its stake to the Shenzhen Metro Group.

After this corporate feud, the White Knight (Shenzhen Metro Group) became the largest shareholder in Vanke Co steering the second largest shareholder and Black Knight (Baoneng Group) to sell its stake in Shenzhen's Stock Exchange, which is doing so by liquidating the nine asset management plans set-up to acquire said shares. The terms in which Baoneng Group's divestment remains to be seen but is has been very interesting to see a sophisticated takeover struggle in the highly-concentrated and less-sophisticated Chinese Market.

VII. LEGAL TRANSPLANTATION AND SOME RECOMMENDATIONS

The Chinese Takeover Regulation is a good transplantation of the regulations in which it was based; basically, the United Kingdom's Regulation on Takeovers and on a lesser extent the United States'. An appropriate decision while implementing such regulation on China was to adapt the transplanted rules to the idiosyncrasy of the People's Republic of China and to its way of doing business.

Nevertheless, the Takeover market in Mainland China is still under-sophisticated in contrast to the countries from which such regulation was taken. Some key issues to consider are the following:

"Due to insufficient institutional capacity, Chinese courts set up stringent preconditions for hearing securities related civil cases, which created significant and, insurmountable barriers for plaintiffs to bring cases to court" (Chen, 2014, p. 27).[20] The Courts of the People's Republic of China are yet not sophisticated enough as to handle lawsuits involving takeovers. The CSRC has taken positive steps on the implementation of internal panel of experts to act as counsels for different cases. However, such panels may –and should– also act as an Arbitration Court in order to generate legal certainty for investors (separating government influences on private cases).

– The Takeover regulation of the People's Republic of China shows a positive effort on implementing a rebuttal list by which people are deemed act when acquiring listed shares. However, shifting the burden of proof in all cases into the acquirer may have an undesired effect, as the acquirer may not rebut the fact that he is acting in concert even when he is not. After all, proving a fact is easier than proven the inexistence of fact.

– Common defenses against hostile takeovers, such as those called **Poison Pills**, may be impossible to apply in China as the Securities Law forbid shareholders plan as such by requiring participants in securities issuances to have equal legal status.

– The extensive regulatory administrative approvals to which a takeover may be subject can impose significant costs on the acquirer. As the price to be offered in the takeover is sometimes prefixed at a minimum which is calculated in relation to the date in which the offer is launched, the buzz in the market generated by the fact that such offer is under regulatory examination for approvals may soar up the shares' prices; causing, therefore, overpricing the takeover for the acquirer.

[20] Chen, J. (2014). "Regulating the Takeover of Chinese Listed Companies". New York: Springer, p. 27.

– As explained above, Chinese takeover law does not fully assure shareholders equality when facing a takeover. This ideology (shareholders' equality) is regulated on UK's takeover law as a Mandatory bid for any change in control of the target. On the contrary, US law does not share such concept but establish different rules to protect shareholders of any acquirer's unfair behaviors, as well as to protect minority shareholders from controlling shareholders' prejudicial actions.

Our position is that China's decision to not fully assure shareholders absolute equality –but protect the minority shareholders– is correct, as such follows suit that Chinese listed companies' ownership is highly concentrated. Consequently, we consider appropriate the scenario opted by Chinese regulation as to allow Partial Offers in mandatory bids since a General Bid for all the outstanding shares may result in the acquirer's incapability to finance the purchase of all the shares if the remaining shareholders chose to accept such bid.

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