The prospect of regulatory alignment for an interconnected capital market between the UK and China: A takeover law perspective*

Abstract

The UK and China have launched the London-Shanghai Stock Connect Scheme to achieve an integrated capital market. In this article, the takeover market is used as an example to examine the extent to which regulatory alignment between the UK and China is possible. The focus is on the role of financial intermediaries in the two markets and how they may influence the governance model of transfer of corporate control by an open offer to the shareholders of the target company (a takeover bid). This article argues that without regulatory alignment such an integrated market is unlikely to be realised. There are differences between the UK and China in the economic model, ownership structure and institutional arrangements, which was reflected in the differences in interests served by takeover law in the two regimes. The design of the framework for takeover law in the UK empowers financial market participants, so as to attract capital to the London markets. In contrast, China's takeover law is mainly aimed at facilitating industrial restructuring and creating globally competitive national companies (national champions). Hence, the UK's shareholder-centred takeover model, with a strong focus on financial intermediaries and international investors, would not be easily replicated in China. However, the UK model could provide lessons for China to develop its takeover market, i.e. further its market structure reform, develop independent financial intermediaries and also attract an increasing number of investors.

Keywords: Takeover Code, UK, China, Stock Connect, Financial Services, Corporate Governance

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* Dr Joseph Lee, Senior lecturer in law, School of Law, University of Exeter; Mr Yonghui Bao, PhD candidate, attorney-at-law China, School of Law, University of Exeter.

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Introduction

Regulatory alignment is a means to achieve an interconnected market, which is an aim of the EU.[1] Similarly, the UK and China have been aiming to achieve an integrated capital market through the recently launched London-Shanghai Stock Connect Scheme, which would link the London and Shanghai Stock Exchanges. However, without regulatory alignment, an integrated market is unlikely to be successful,[2] or if it is implemented, its scope would be limited. For Chinese companies listed on the London Stock Exchange, the governing law for company law issues in a takeover will be Chinese law.[3] For English companies listed on a Chinese stock exchange (i.e. Shanghai), the governing law will be Chinese law.[4] Without regulatory alignment, the operating environments would be different for companies seeking to raise capital and investors seeking returns. Financial intermediaries such as investment firms and asset funds would have to operate in a different regulatory system and with different value chains. There would be limited synergies to be gained by companies, investors, and financial intermediaries, as they would continue to choose favourable places for raising capital, for realising their investment returns, and for gaining revenue. Without regulatory alignment, financial intermediaries would be unlikely to achieve synergy in their operations.[5]

In this article, the takeover market will be used as an example to examine the extent to which regulatory alignment between the UK and China is possible. We focus on the role of financial intermediaries in the two markets and examine how they may influence the governance model of transfers of corporate control by an open offer to the shareholders of the target company (a takeover bid). The preconditions for hostile takeovers include: sufficiently dispersed ownership structure,

[1] Kenneth Armstrong, "Regulatory Alignment and Divergence after Brexit", Journal of European Public Policy 2018 (25): 1099, 1117.
[2] Future Trade Relations between the EU and the UK: Options after Brexit (Working Paper, European Parliament).
[3] See "Regulatory Provisions of the CSRC on the Interconnection Depository Receipt Business of the Shanghai Stock Exchange and the London Stock Exchange (for Trial Implementation)".
[4] Ibid.
[5] Sebastian Di Tella, "Optimal Regulation of Financial Intermediaries", American Economic Review 2019 (109): 271, 313.

macroeconomic factors such as the traded value of target firms' equity being below their asset value, and the bidder having sufficient funding.[6] Until very recently, China's capital market did not fulfil such preconditions, especially on attractive targets with dispersed shareholding, and bidders' adequate funding.[7] The Vanke takeover case[8], an unsuccessful hostile takeover attempt by Baoneng, shows that hostile takeovers have become a reality in China's capital market.[9] This case demonstrated that crucial problems existed in the takeover market there: systemic risks raised by shadow banking, drawbacks of sectoral supervisions in the financial (takeover) market, vagueness of takeover regulations, state (or local governments) intervention and corporate governance issues, such as information disclosure.

There are four parts of this article. Part I focuses on how the role of the financial services industry in the national economy model influences the governance of the takeover market. Part II examines how such a role influences the ownership structure of listed companies, which, in turn, affects the rules for minority shareholder protection. Part III investigates how the institutional arrangements of the takeover regulatory framework might be influenced by financial intermediaries. Part IV draws some conclusions and discusses possible moves by the UK and China in the light of the stock connect development.

1. Economic model and the focus on its industry policy

1.1 Differences in national economies and the impacts on the takeover regulatory model

There is a distinct policy difference between the UK and China, and such a difference reflects in the countries' takeover policies and regulations. The financial services industry is a pillar of the current UK economy, and the takeover market provides major revenue to the industry's financing, advising, brokering, and asset management sectors. The financial services industry also performs an independent gatekeeping role to ensure a smooth and orderly takeover market. China is a manufacturing economy, and its financial services industry mainly serves the domestic economy.

[6] John Amour and David Skeel, "Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regime", Georgetown Law Journal 2007 (95): 1727, 1794.
[7] Hui Huang, "The Rise of Hostile Takeovers and Defensive Measures in China: Comparative and Empirical Perspective", European Business Organization Law Review 2019 (20): 363, 398.
[8] For introduction of facts of the Vanke takeover battle (by Baoneng), see https://www.scmp.com/business/article/2062335/five-things-you-need-know-about-battle-vanke.
[9] See n. 6.

There is little internationalisation in its financial services industry and it does not act as an independent gatekeeper for the takeover market. The Chinese market lacks the UK's independent professional investors in the Chinese capital market. Such a structural difference leads to a different approach to policy with regard to takeovers and hence, to different regulatory systems: the UK's is one of self-regulation[10] while the Chinese state uses a command-and-control model.[11]

1.2 UK's self-regulatory model and the influence of the financial services industry

The financial services industry is critical to the UK economy. The sector contributed £110 billion to the UK economy in 2017, which was 6.5% of total economic output; 50% of this was generated by the financial services industry in London. There were 1.1 million financial services jobs in the UK, which was 3.2% of all jobs. Exports of UK financial services were worth £61 billion in 2016, and imports were worth £11 billion. For 2016-17, the UK financial sector as a whole contributed £71.4 billion in taxes (which includes wider measures of taxation such as business rates), totalling 11.5% of total government receipts. Annual financial revenues from the UK industry are approximately £200 billion; £90-95 billion of this is domestic business, £40-50 billion relates to the EU, and £55-65 billion relates to the rest of the world. The London Stock Exchange, though not as large as the Shanghai or Tokyo Stock Exchanges based on capitalisation, is more international, with non-UK investors holding 53.9% of the value of the UK stock market at the end of 2016.[12]

Hence, the UK Corporate Governance Code and the design of the framework for takeover law empower financial market participants to attract capital to the London markets.[13] Financial market participants have direct steering power over the design, development, and decision making of individual cases as well as over areas for further reform. The Takeover Panel comprises up to thirty-six members, representing a breadth of expertise in takeovers, securities markets, industry and commerce. Twelve members are appointed by the major financial and business associations.[14] The

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[10] Joseph Lee, "Striking a Fair Balance in UK Takeover Law: Market Interests, Power of Regulation, and Enforcement", European Business Law Review, 2017 (4): 840.

[11] Chao Xi, "The Political Economy of Takeover Regulation: What Does the Mandatory Bid Rule in China Tell Us?", Journal of Business Law 2015 (12): 142, 164.

[12] See National Statistics, https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2016.

[13] See n. 10.

[14] Ibid.

hard law of the Companies Act 2006 simply confers powers on the panel to enforce the code but does not regulate the constitution of the panel, its composition or its power. The Takeover Code and Takeover Panel are beyond the immediate remit of Parliament and the Judiciary. However, it would be incorrect to say that the Takeover Code is soft law operating as the Corporate Governance Code does, or that it is hard law interpreted and enforced as the provisions of Companies Act 2006 are. The Takeover Code and the Takeover Panel are practical solutions to specific problems that financial market participants face and are aimed at ensuring a competitive market for corporate control.

Financial intermediaries play a role in providing finance, advisory services, and gatekeeper functions in UK takeovers. Unlike in China, UK banks are not restricted in providing financing to bidders. Lending is a commercial decision, and the government does not impose control or supervision of takeover funding. In fact, it is a requirement under the Takeover Code that the bidder needs to ensure funding is in place, which is usually provided by a letter of guarantee from a bank rather than by cash from the bidders' account.[15] And such bank letters of guarantee satisfy the Takeover Panel. Investment banks also provide advice on the processes of the Takeover Panel. Since investment banks are experienced in acting as a sponsor in an initial public offering, they are experienced in takeover processes, the valuation of share prices, and the impact of a bid on the secondary market. Although the Takeover Code does not require an advisor in the takeover process, as is required in an IPO, in practice, bidders and target companies appoint investment banks as advisers in both solicited (friendly) and unsolicited (hostile) takeovers.[16] Such practices are common because expert valuation reports are required for setting the offer price, preparing the financing, obtaining approval from the board and shareholders, and satisfying the pension requirement.[17] Investment banks also have better insight into setting the offer price, taking into account any subsequent revision due to the target board's rejection or a bid from a white knight.[18] The revenue gained by UK banks amounted to GBP 108-117 billion and a total of 2.2 million people were employed in professional services such as accounting, legal, and advisory services in the UK in 2016.

Investment banks also provide securities services. As investment banks provide securities intermediation services – holding securities in trust for the clients, they are in a better position to act as a proxy in a takeover fight, especially for the end investors who may not have detailed knowledge

[15] General Principle 5, Rule 24.16 and Rule 25.8, Takeover Code.
[16] Andriy Bodnaruk, Massimo Massa, and Andrei Simonov, "Investment Banks as Insiders and the Market for Corporate Control", The Review of Financial Studies 2009 (12): 4989, 5026.
[17] Ibid.
[18] Ibid.

of the bidder's offer or the target management's strategy as they decide whether to accept or reject. Investment banks, when holding the intermediated shares through investment funds and custodian services, are in a better position to gauge the market sentiment and mobilise votes in a takeover fight. For example, when Unilever was considering relocating from London to Rotterdam, the shareholders were mobilised to reject the board's suggestion. Investment banks played a significant role in this decision, as such a relocation would result in the loss of revenue for some of the banks, particularly if UK-based banks were not able to offer services to clients based in the EU due to the loss of the passporting right. Even though more than 50% of UK shares are held by foreign investors (end investors), UK banks provide custodian services for them. In other words, in the majority of cases, UK banks exercise voting rights, either as proxies or trustees, on behalf of their end investors, such as funds based outside of the UK.

Financial institutions act as gatekeepers in many ways. Since the takeover process is based on the detailed rules in the Takeover Code, it is unlikely for a non-market player to launch a random takeover bid without the necessary finance, advice, and securities services. Under China's circumstances, recent cases, such as Vanke takeover case (by Baoneng) revealed that financial intermediaries developed asset management plans (funds) which assisted commercial banks to conduct regulatory arbitrage.[19] In this model, the commercial banks charged a fixed rate from the leveraged bidder and financial intermediaries charged a commission fee from the leveraged bidders.[20] Asset managers gave the right of control of asset management funds to the leveraged bidder rather than the independent management.[21] Hence, the financial intermediaries lost their independent ability to manage the funds. In the UK, banks need to confirm the bidders' financing,[22] hence a financially under-prepared bidder is unlikely to satisfy the Takeover Panel about its ability to pay without the support of a reputable bank.[23] Furthermore, target companies, if listed on a UK exchange, are subject to corporate governance requirements[24] So such companies need to provide valuation reports to satisfy the board as well as its shareholders.[25] For the target company, the board needs to obtain an independent valuation report[26], which may cause the shareholders to accept or reject the offer.[27] Such independent advice from banks limits boards' conflicts of interest, such as CEOs' personal egos or board

[19] Liu Yan and Lou Jianbo, "Asset Managing Plans in a Corporate Merger", (2016)6 Tsinghua Law Review 64.
[20] Ibid.
[21] Ibid.
[22] Rule 19, Takeovers Code.
[23] Rule 24.8, Takeovers Code.
[24] Rule 24.10, Takeovers Code.
[25] Rule 3.1 and Rule 26.3, Takeovers Code.
[26] Rule 3.3 and Rule 16.2, Takeovers Code.
[27] Rule 25.2 (a), Takeovers Code.

entrenchment, in a takeover contest.[28] Furthermore, investment banks have better insight into the secondary market of different trading venues.[29] Therefore, information about prior dealings between the bidder and the target company is more likely to be known within the investment circle. This knowledge can prevent the bidders from avoiding having to pay the highest price obtained in the preceding 12 months before the mandatory offer is triggered, as is required under the Code to protect minority shareholders.[30]

1.3 China's economic model and lack of institutional investors

The experience of the UK as a leading global centre for international financial and related professional services, such as banking, equity and bond markets, and fund management industries, provides lessons for China with regard to its ambition to become a financial power house. For example, many scholars are suggesting that China should learn from UK's "twin-peak" financial supervision model to "balance the regulatory tasks for the over-concentrated risk in China's large banking sector but the underdeveloped securities market".[31] However, China has a different market structure than the UK's highly dispersed and liberalised market with its relatively concentrated ownership, strong state-owned or controlled enterprises that hold significant market shares, and non-independent financial institutions.[32]

The financial services industry is increasingly important to China's economy. The contribution of the financial sector to China's GDP growth has increased from 2183.68 billion RMB in 2009 to 7061.03 billion RMB in 2018. The sector also accounted for 6.993 million people in employment in 2018 compared with 4.49 million in 2009.[33] Although the financial sector plays an increasingly significant role in the growth of the national economy, China has also experienced a soaring trade deficit with regard to the export and import of financial service industries from 2010 to 2012, with a deficit of 765 million RMB in the former and 2.86 billion RMB in the latter. The capital market in China has been criticised for a lack of sufficient professional institutional investors and it remains a retail investor-

[28] David Kershaw, Principle of Takeover Regulation (Oxford University Press, 2016) 284.
[29] Henri Servaes and Marc Zenner, "The Role of Investment Banks in Acquisitions", The Review of Financial Studies 1996 (3): 787, 815.
[30] Rule 9.5, Takeovers Code.
[31] Han Miao, "Twin Peaks Regulation after the Global Financial Crisis; A Reform Model for China", Asian Journal of Law and Economics 2017 (8): 1,30.
[32] John Armour, Brian R. Cheffins and David A. Skeel, "Corporate Ownership and the Evaluation of Bankruptcy Law in the US and UK" (ESRC Centre for Business Research, University of Cambridge, Working Paper No. 226).
[33] National statistics of China, see http://data.stats.gov.cn/easyquery.htm?cn=C01.

oriented market.[34] In recent years, the China Securities Regulatory Commission (CSRC), the watchdog of China's securities market, has vigorously promoted the development of institutional investors. Commercial banks, securities investment funds, insurance companies, pension funds, and securities companies have grown at a gradual pace.[35] Institutional investors are increasingly changing their role from passive shareholders and speculative traders to active shareholders engaging in the governance of their portfolio companies.[36] As a result, essential rules and regulations for protecting the interests of minority shareholders have been adopted.[37] There has been a series of cases in which institutional investors were in disagreement with the resolution of the board of directors and revoked board motions. For example, in 2010, the Shuanghui Group, which is listed on the Shenzhen Stock Exchange, intended to abandon the pre-emptive right, leading to some asset funds voting against and eventually revoking the board resolution. This case was regarded as the first case in which the institutional investors invalidated the plan of the major shareholders.[38] Subsequently, there have been several cases in which institutional investors actively participated in corporate governance and rejected the proposals of major shareholders. These efforts made by institutional investors actively brought the corporate governance rules into practice and promoted Chinese corporate governance standards.

Although the number of such cases and the level of institutional shareholders' engagement in corporate governance in China remain limited, there is an upward trend in the percentage of the total floating A-shares held by institutional investors, from 5% in 2003 to over 45% in 2016. [39] Among them, foreign investors hold 2.66% of the market shares. [40] The Corporate Governance Code of Listed Companies (2018 revision) emphasises the positive effects that institutional investors make to improving the corporate governance of their portfolio companies, and it encourages institutional investors and financial intermediaries to engage in the process of corporate governance. [41] If institutional investors are actively involved in their portfolio companies' corporate governance, they can act as efficient external monitoring mechanisms. For instance, when a company encounters a takeover bid, institutional investors could voice their opinions on whether the takeover bid should be accepted or rejected, based on their professional skills and with sufficient market information,

[34] Chao Xi, "Institutional Shareholder Activism in China: Law and Practice", International Company and Commercial Law Review, 2006 (17).
[35] As of 2018, the market value of funds in China amounted to 130 billion.
[36] See n. 33.
[37] Ibid.
[38] Ibid.
[39] The figure was 19.86% in accordance to the survey report conducted by OECD in 2017.
[40] WFE data in 2016; also see OECD Survey of Corporate Governance Frameworks in Asia 2017.
[41] Art. 78, 79, 80, 81 & 82 of Corporate Governance Code of Listed Companies.

through exercising voting rights, inquiry rights and advisory right. Hence, the active involvement of institutional investors is able to promote the development of an active market for corporate control.

Meanwhile, an increasing number of foreign institutional investors are participating in China's financial market following China's commitment to opening the capital market. Foreign institutional investors take a more active part in the corporate governance of portfolio companies as independent institutional investors, compared with domestic institutional investors. This is despite the fact that there are ownership requirements and currency restrictions for foreign investors, and these requirements are less likely to be removed entirely in the short term. However, some of the restrictions that have been in force for a long time have been relaxed as new policies and regulations are gradually introduced. For instance, in accordance with the Chinese-Foreign Equity Joint Ventures Law, the proportion of an investment that is contributed by foreign joint ventures generally had to be more than 25% of the registered capital of a joint venture.[42] Otherwise, foreign investors are not normally eligible to receive preferential tax treatment.[43] When the Foreign Investment Law (FIL) came into force in January 2020, the minimum shareholding requirements of foreign investors were removed, and this provides more flexible options for foreign investors as minority shareholders. In terms of currency restrictions, FIL does now allow foreign investors to remit their contributed capital, profits, capital gains, asset disposal income, intellectual property license fees, legally obtained damages and compensations, or liquidation proceeds overseas in RMB or any other foreign currency,[44] although in practice foreign investors are still not able to engage freely in cross-border remittances. [45]

FIL was interpreted as an olive branch to the US amid trade war negotiation. The law confirms that national policies favouring the development of enterprises will be applicable to foreign-invested enterprises (national treatment). [46] Meanwhile, it should be admitted that although FIL provides various ways in which the current broad principles of the law on foreign investment can be changed, further explanation is needed to clarify and guide the practice.[47] It is expected that foreign investors will play the role of independent institutional investors incrementally. In 2018, President Xi Jinping said that China will create a more attractive investment environment for foreign investors.[48] The Securities Law revision that came into force on 1st March 2020 amended the rules governing takeovers

[42] Art. 4, Chinese-Foreign Equity Joint Ventures Law.
[43] See Notice Concerning the Relevant Issues on Strengthening the Approval, Registration, Foreign Exchange Control and Taxation Administration of Foreign-Funded Enterprises.
[44] Art. 21, Foreign Investment Law.
[45] Mark Schaub et al., China Signals Improvements for Foreign Investors, (posted on Foreign Investment, King & Wood Mallesons, November 2019).
[46] Article 9, Foreign Investment Law.
[47] Alexander Chipman Koty, "China's New Foreign Investment Law" (Dezan Shira & Associates, 20 March 2019).
[48] See http://www.xinhuanet.com/politics/2018-04/10/c_1122660064.htm.

to enhance the requirements of information disclosure and strengthen investor protections. For instance, if an acquirer fails to comply with information disclosure rules, the corresponding voting rights of the acquired shares will be suspended.[49] There are also enhanced duties on acquirers. For instance, an acquirer is not allowed to withdraw a takeover bid within the period of acceptance, as specified in the takeover bid, and is also prohibited from lowering the acquisition price or the number of shares intended to be acquired and from shortening the acquisition period.[50] In conclusion, recent reforms and market developments, while still falling short of full "liberalisation", can make, and are intended to make, the Chinese takeover market more attractive to foreign investors.

1.4 The problem of shadow banking and its impact on the takeover market

As the takeover market develops, banks have been using off-balance-sheet lending to finance takeover bids.[51] Financial institutions play an important role in financing small and medium-size enterprise (SMEs) in China.[52] Compared with state-owned enterprises (SOEs), private enterprises encounter difficulties in obtaining bank loans. Due to the dominant position of SOEs in the market, they are regarded as qualified borrowers with lower default risks than SMEs.[53] As a result, SOEs and state sectors, such as local governments, rely heavily on the privilege of obtaining lower cost loans from state-owned banks. In contrast, SMEs, as the contributors of 60% of GDP, only receive 30% of bank loans. The financing needs of SMEs promote the development of "shadow banking" in China. Asset management products developed by various financial institutions, the major contributors to shadow banking, provide financing to SMEs and industries that are restricted in their ability to obtain bank loans as a matter of policy. However, this result has increased systemic risks. From 2016, unsolicited bidders have been financed by shadow banking financiers in the takeover of target listed companies, such as the takeover of Vanke by Baoneng.

The total amount of shadow banking amounted to 100 trillion RMB in 2018, leading to the IMF's warning of shadow banking's high risk to China's financial stability. China's regulators have also begun

[49] Art. 63, Securities Law (2019 revision).
[50] Art. 68, Securities Law (2019 revision).
[51] Shen Wei, "The Risk of China's Shadow Banking and Selection of Regulatory Tools", China Legal Science 2014 (04): 151, 177.
[52] Henny Sender, "Monetary Tightening by China to be Felt across Globe", Financial Times, 7 January 2011.
[53] SMEs as the creators of 60 per cent of China's GDP only enjoy 30 per cent share of bank loans.

to address the threats of shadow banking by strict enforcement of new regulations. However, the booming shadow banking industry has been providing liquidity to SMEs for over ten years and is unlikely to be closed entirely.[54] In addition, financial intermediaries have recently been taking an active part in financing hostile takeovers. In the Vanke case, several commercial banks and insurance companies financed the hostile bidder with a "high-leverage" strategy.[55] In response, policy makers introduced rules to regulate the financing of takeovers by financial intermediaries to reduce systemic risks. They have, for example, restricted the proportion of financial intermediaries investing in the equity market and attempted to govern the shadow banking business within the legal framework of the newly introduced asset management rule. At the same time, to support the 'optimisation of the industry structure',[56] which is a state economic policy, regulators require that banking financial institutions provide takeover loans in an active and steady manner rather than banks close all the channels for the financing of takeovers.[57] One of the distinctive requirements of this rule is that commercial banks are required to separate their asset management department and normal bank loan business departments by establishing a separate asset management subsidiary. If the parent companies are prevented from interfering in the activities of their asset management subsidiaries, the independent asset management industry could be an efficient institutional investor acting as an external monitoring mechanism.[58] The newly introduced rules on asset funds can help develop professional asset managers who can act as independent institutional investors.

1.5 The role of financial institutions implementing state policy

Financial institutions in China are more likely to be influenced by government policies than those in the UK.[59] In some cases, the goal of financial institutions' investments is not for profit maximisation but to implement policy guidelines issued by the government.[60] The majority of the major players in the securities market are state-controlled institutions via individual SOEs or a number of them.[61] The

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[54] Shadow Banking is a Necessary Adjunct to China's Financial Markets: PBOC Head (China Banking News, 17 December 2018).
[55] See n 7.
[56] Article 1, "Opinions on Promoting Enterprise Merger and Restructuring".
[57] Article 1, "Notice on Issuing the Guidelines for the Risk Management of Merger and Acquisition Loans Granted by Commercial Banks.
[58] Shen Wei, "Regulating Wealth Management Products" in "Shadow Banking in China: Risk, Regulation and Policy" (Edward Elgar Publishing, 2016) 104.
[59] Zhu Hongjun, "Replacement of Senior Managers and Firm Performance", Economic Science 2004 (4): 91.
[60] Ibid.
[61] Nicholas Loubere and Heather Xiaoquan Zhang, "Co-operative Financial Institutions and Local Government in China", Journal of Co-operative Organization and Management 2015 (3): 32, 39.

policy goals of governments could, therefore, exert great influence on investment decisions.[62] For instance, the CSRC released the "Regulations on Equity Management for Securities Companies (draft for comments)" in March 2018, which clearly indicates that the net asset of the controlling shareholders of securities companies should not be less than 100 billion RMB. In addition, there are also threshold requirements on profitability for the last five years and sustained profitability. Only 30 listed companies out of more than 3500 A-share listed companies in China meet the threshold requirement of 100 billion RMB on net assets, and most of them are larger-scale financial institutions and SOEs. As a result, the controlling shareholders of the majority of the 20 securities firms with the largest shares of the M&A market in 2017 were SOEs or state-controlled enterprises.

Furthermore, policy intervention by the government in the decisions of financial institutions and some investment decisions made by securities companies is common.[63] For instance, there were securities companies that established asset management plans to invest in SMEs and some private enterprises following the guidelines of the government to bail out SMEs and private enterprises, such as Guotai Junan Securities Company and Guoyuan Securities Company, which are state-controlled enterprises.

Due to their state-controlled status, securities companies may "pursue many non-economic goals and create non-economic criteria for assessing the performance of financial institutions".[64] Therefore, the research reports of securities companies are influenced by the policy goals of the government and assessment criteria established by regulators. For example, to tackle the financing difficulties of SMEs, the CBIRC added the growth of loan ratios for SMEs as one of the assessment criteria of the performance of commercial banks.[65]

It should be noted that optimising the market structure is a state policy. Based on this policy, regulators favour mergers and acquisitions in the market. Thus, the takeover law together with the economic model and reforms in the ownership structure provide an opportunity to develop an active market with corporate control. Additionally, under the influence of the policies, there is the possibility that financial intermediaries will be more willing to provide loans to bidders.

[62] Ibid.
[63] See n. 58.
[64] Ibid.
[65] "Notice on Further Improving the Quality and Effect of Financial Services for Micro and Small-sized Enterprises in 2019.

2. The ownership structure

2.1 The UK's dispersed model and China's concentrated model

The UK has a dispersed ownership structure, which has been achieved after almost five decades of industrial transformation,[66] in contrast to the dominance of controlling shareholders in many China's listed companies. Although dispersion in the ownership is a distinct feature of the UK capital market, the overall holdings of institutional shareholders (foreign and domestic) and retail investors varied over time. In the UK, the primary institutional clients of asset management firms are pension funds and insurance companies.[67] There was an increasing trend in the holdings of insurance and pension funds from 10 per cent and 6.4 per cent in 1963 to 23.6 per cent and 22.1 per cent in 1997 respectively.[68] The expansion of holdings of insurance and pension funds before the years around 1997 was due to the post-war punitive tax regime of investment income and savings of retirement.[69] During that time, institutional investors could exert influence on operations of portfolio companies. However, a sharp decrease in holdings of UK quoted shares by UK institutional investors followed in the years after around 1997. As the primary institutional clients, insurance and pension funds' holdings decreased to 4 per cent and 2.4 per cent respectively in 2018.[70] Such a downward trend was caused by various reasons, such as the change in tax regime for pensions, mark-to-market accounting and other regulatory changes.[71] In addition, the relaxation of exchange control in 1979 gradually led to a geographical diversification of the holdings of UK institutional investors, which was reflected in the decreased holdings of UK quoted equites by domestic investors and increased holdings by foreign

[66] John Coffee, "The Rise of Dispersed Ownership: The Role of Law and the State in the Separation of Ownership and Control", The Yale Law Review 2001 (111): 1, 82.
[67] "Asset Management in the UK 2017 -2018: The Investment Association Annual Survey", The Investment Association, September 2018.
[68] Office for National Statistics, Ownership of UK Quoted Shares 2018, see https://www.ons.gov.uk/releases/ownershipofukquotedshares2018.
[69] For detailed discussions, see Paul Davies, "Institutional Investors in the United Kingdom", in Theodor Baums, Richard Buxbaum and Klaus Hopt (ed), "Institutional Investors and Corporate Governance", (Berlin: de Gruyter, 1993).
[70] Office for National Statistics, Ownership of UK Quoted Shares 2018, see https://www.ons.gov.uk/releases/ownershipofukquotedshares2018.
[71] For detailed discussion, see Andrew Haldane, "The Age of Asset Management?", (Bank of England, 2014).

investors.[72] Specifically, from 1963 to 2018, the UK witnessed a sharp increase in the holdings of foreign investors from 7 per cent to 54.9 per cent. In 2018, over half of the foreign holdings were in the possession of institutions from North America (51.3 per cent), Europe (24.1 per cent) and Asia (15.7 per cent).[73] By contrast, the holdings of individual shareholders declined from 54 per cent to 13.5 per cent in the same time period.[74] Although over half of UK quoted equities have been held by foreign institutional investors, the UK remains one of the world's prominent centres for portfolio management on behalf of investors.[75] 40 per cent (3.1 trillion GBP) of all assets in the UK is still managed by the UK asset managers on behalf of overseas investors, which is unchanged from 2017.[76]

In such a dispersed shareholding environment, agency costs of shareholders are potentially high.[77] To deal with this problem, coordinated actions of shareholders in the UK system were conducted to influence the operations of portfolio (or investee) companies since 1960s.[78] There are two approaches for activist shareholders to influence portfolio companies' operations,: the first is to influence the management of their portfolio companies directly, and the second is to influence the rules that hold the management accountable to shareholders.[79] In terms of direct intervention into investee companies' operation, due to the considerations of prudential investment strategy and portfolio diversification, individual institutions normally hold relatively small portion of shares of any single investee company.[80] Hence, the cost of shareholder coordination for direct intervention in management of investee companies would be high. Alternatively, there is evidence supporting the proposition that institutional investors influence the governing rules of industry to make them more shareholder-friendly.[81] As will be discussed, the adoption of a self-regulatory Takeover Code is a consequence of financial intermediaries' contributions during the rule making process.[82] For instance,

[72] Paul Davies, "Shareholders in the United Kingdom", (ECGI Working Paper Series in Law, No. 280/2015);
[73] Office for National Statistics, see https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018#rest-of-the-world.
[74] Ibid.
[75] The Investment Association, "Investment Management in the UK 2018-2019: The Investment Association Annual Survey", (September 2019).
[76] Ibid.
[77] John Armour, Hansmann Henry and Reinier Kraakman, "Agency Problems and Legal Strategies", in Kraakman et al., (ed) "Anotomy of Corporate Law" (2nd, OUP, 2009).
[78] See n 72.
[79] Ibid.
[80] Ibid.
[81] Ibid; also see OECD, "The Role of Institutional Investors in Promoting Good Corporate Governance", (OECD Publishing, 2011)
[82] See n. 6.

the board neutrality rule under the takeover code provides opportunities for institutional investors to intervene in the management of portfolio companies.[83]

In theory, shareholder activism and takeovers are two kinds of governance mechanisms. The market for corporate control could be a disciplinary force as an external monitoring mechanism, known as 'Sword of Damocles', which incentivises corporate managers to take efforts to maximise corporate value and discipline complacent and inefficient managers.[84] It is submitted widely that the UK market for corporate control plays such governance role.[85] For instance, in the unsuccessful takeover bid for Illumina by Roche, it is argued that the takeover threat kept the management teams focused on shareholders' interests.[86] However, as Charkham argues, it would be better if institutional investors replaced inefficient management rather than leaving it to the takeover market to exert such a disciplinary force, which would ultimately be depending on the economic interest of a sufficient number of shareholders to sell or keep their shares.[87] Hence, the UK public policy recently encourages institutional shareholders to be actively involved in the management of portfolio companies to tackle the problem of short-termism in investment strategy. The introduction of 'Stewardship Code' sets high expectations of institutional investors to conduct responsible allocation, management and oversight of capital for creating long-term value for clients.[88] The Code emphasises the integration of investment and stewardship, and also requires investors to explain how they have fulfilled their stewardship duties.[89] Such pro-intervention policies could improve the governance of portfolio companies, so as to reduce the chance to become targets of hostile bidders. This may partially explain why the hostile takeovers become infrequent nowadays.

In the UK, control of the processes and outcome of takeovers has shifted from the state to the asset funds.[90] In China, the process of such a shift in control has only just begun,[91] with the policy of mixed

[83] Robin Hui Huang and Juan Chen, "Takeover Regulation in China: Striking Fair Balance between Takeover Contestability and Shareholder Protection", in Umakanth Barottil and Wai Yee Wan (ed), Comparative Takeover Regulation: Global and Asian Perspective (Cambridge University Press, 2018) 226.
[84] See n. 28.
[85] Ibid.
[86] LEX, "Roche/Illumina: Take a Chill Pill", (27 January 2012).
[87] Jonathan Charkham, "Corporate Governance and the Market for Companies: Aspects of the Shareholders' Role", (Bank of England Discussion Paper, No. 44, November 1989).
[88] UK Stewardship Code, see https://www.frc.org.uk/investors/uk-stewardship-code.
[89] Ibid.
[90] Matthew R. Bishop and John A. Kay, "Privatization in the United Kingdom: Lessons from Experience", World Development 1989 (17): 643, 657.
[91] Yusuf Shahid, Nabeshima Kaaru and Perkins Dwight, Under New Ownership: Privatising China's State-owned Enterprises (World Bank and Stanford University Press) 5.

ownership structure reform and new measures to address shadow banking. However, there is still a lack of sufficient regulation to ensure the independence of asset management, which cannot be achieved simply by takeover law and regulation. Although the new asset management rules came into force in 2018 to address shadow banking, the rules only provide a framework for developing an independent asset management industry and areas such as liquidity management and information disclosure about asset management subsidiaries were not addressed by these rules. It is unlikely in the short term or even in the longer term that international investors will make up the majority of the ownership of listed companies. The UK's shareholder-centred takeover model, with a strong focus on financial intermediaries and international investors, would not be easily replicated in China. At best, the Chinese takeover law aims at corporate structuring to facilitate mixed ownership control and to facilitate optimising the industrial organisational structure.[92]

2.2 The UK's dispersed shareholding market and its influence on the UK takeover market and its regulatory model

The high degree of dispersed ownership structure among UK listed companies along with the lack of the constraints of controlling stakes by governments, the vertical and horizontal cross-shareholdings[93] and the control by major shareholders allows shareholders, especially institutional shareholders and funds, greater opportunity to realise returns on a takeover.[94] An estimated 22% of the value of UK quoted shares is held by asset managers. Hence, a regulatory objective of the Takeover Code is to facilitate market participants, especially offeree companies, to realise returns on their investment.[95] These will in turn support better access by companies to external financing and investment because the fund industry plays an important role in raising capital.[96] Therefore, non-frustration rules (no post-offer defences),[97] mandatory bid rules,[98] no break fee arrangement,[99] no deal protection measures,[100] and the requirement to identify potential bidders by the offeree board[101] ensure that the opportunity to realise investors' returns on their investment are not eliminated by the offeree board (target board).

[92] See n. 83.
[93] See n 10.
[94] Ibid.
[95] Ibid.
[96] Asset Management in the UK 2016-2017, (The Investment Association Annual Survey, September 2017).
[97] Rule 21.1, Takeovers Code.
[98] Rule 9.1, Takeovers Code.
[99] Rule 24.16, Takeovers Code.
[100] See n 10.
[101] Rule 2.2, Takeovers Code.

Even the requirement regarding the offeror's financing arrangement[102] is less burdensome than that of some countries that require funds (cash) to be in place (in a bank account) before an announcement of the offer can be made. This reduces costs for the bidder.

The dispersed ownership structure in the UK is linked to its policy to develop the UK as not only the centre of the financial industry but also the hub of the fund management industry. The number and value of funds that London hosts is greater than those of Frankfurt and Tokyo. [103]The Frankfurt and Tokyo markets have a more concentrated share ownership structure and a high degree of cross-shareholding, which present some corporate governance problems.[104] The fund management industry in the UK offers investment outlets to both UK and international investors. Although 22% of UK listed shares are held by the fund management industry, shares beneficially owned by intuitional shareholders, such as pension funds and insurance companies, are intermediated through the fund management industry: investment schemes, hedge funds, and private equity houses. These funds invested in listed companies take a minority stake and seek investment returns, normally in the short term; they do not seek to take control of management. The level of the involvement of these funds in influencing management decisions, through shareholder activism or engagement, depends on their investment strategies based on their investment mandates or policies. In this regard, minority shareholder protection in the Takeover Code directly protects the interests of the fund management industry.[105] To further develop the fund management industry, the Stewardship Code was introduced with the aim of enhancing the accountability of fund managers to their clients.[106] Under the Code, fund managers should exercise their voting rights to hold the corporate management to account in accordance with the best practice principles in the Corporate Governance Code.[107]

The UK market significantly differs from the US market in the use of litigation as an investment strategy to hold the board to account and to realise returns on investment.[108] In the US, litigation is often used as an investment strategy, either to hold management to account or to obtain redress.[109] Class action

[102] Rule 24.16, Rule 25.8, Takeover Code.
[103] Youssef Cassis and Dariusz Wojcik, "International Financial Centres after the Global Financial Crisis and Brexit", (Oxford University Press, July 2018) 9, 14.
[104] Julian Franks and Colin Mayer, "Evolution of Ownership and Control around the World: The Changing Face of Capitalism", (Said Business School, University of Oxford Research Paper, April 2017) 19.
[105] See n 10.
[106] Arad Reisberg, "The UK Stewardship Code: On the Road to Nowhere?" Journal of Corporate Law Studies 2015 (12): 217, 253.
[107] Principle 2, The UK Stewardship Code.
[108] See n 32.
[109] Maya Steinitz, "The Litigation Finance Contract", William & Mary Law Review 2012 (2):455, 518.

lawsuits have been used against boards for giving misleading information or breaching their duties.[110] In takeovers, class action lawsuits have been used to prevent defences adopted by board managers in a takeover bid. Although in the UK, the Takeover Code removes such a litigation strategy from fund managers,[111] the non-frustration rules, the no break fee arrangement, and no deal protection measures empower fund managers and shareholders in the offeree companies.[112] Furthermore, the mandatory bid regimes ensure that the funds will 'share' the control premium.[113] The requirement that the offeree board identifies other potential bidders aims at maximising this control premium.

2.3 China's concentrated ownership structure and its reforms

Compared to the UK's dispersed shareholding model, China has a relatively concentrated shareholding structure, and SOEs account for a large percentage of the total market value. As of 2017, there are 953 state-controlled listed enterprises with 51.4% of the total market value of the total floating A-shares. Hence, hostile takeovers are rare in China. Although the ownership structure is still concentrated, China has witnessed a trend to increase capital market liquidity since 1978 when the national strategy of "reform and opening up" was adopted.

The current concentrated shareholding structure has been strongly related to China's political structure since the Chinese Communist Party (CCP) began to rule China in 1949. At that time, China adopted the style of the former Soviet Union's centralised and planned economy and ever since, SOEs have been regarded as part of the government. Corporate governance systems were therefore extremely similar to the system of state government. For instance, SOEs were owned by the state, and the senior managers were appointed or dismissed by administrative bodies. Furthermore, the operation of SOEs was not aimed at profit-maximisation but followed the plan of the state. Since 1978, whether national strategy of "reform and opening up" by Deng Xiaoping was adopted, an increasing number of listed companies have been transferred to the private sector.

The state has been gradually releasing power to the market by firstly, adopting the goal of establishing a socialist market economy, which was launched during the "Fourteenth National Congress of the CCP"

[110] Ibid.
[111] See n 10.
[112] Ibid.
[113] Ibid.

in 1992, and secondly, promoting privatisation through measures such as the "Split Shareholding Structure Reform" and "Mixed Ownership Reform". The outcomes of the various reforms have improved the market, although the market in China is still not as liberal as those of advanced market economies. Explicitly, the aim of SOE reforms was "to introduce the modern corporate governance system with the characters of separate ownership and management, defined property rights, explicit scope of powers and responsibilities".[114] After the completion of the 'split shareholding structure reform', all the shares of listed companies became freely tradable on the secondary market.[115]

According to the data released by the State-owned Assets Supervision and Administration Commission (SASAC), as of March 2018, over 90% of SOEs have completed the mixed ownership reforms. Based on China's SOE reforms, we expect that China will continue to release power to the market by deepening the SOE reforms, and SOEs will compete freely in the market with less administrative intervention while the process of perfecting China's characteristic legal systems and capital market continues. With the progression of a mixed ownership structure, the fundamental direction of the reform of state-owned assets and enterprises is to combine state-owned capital invested in companies with other social capital under mixed ownership. The state will invest in the company and be a non-controlling shareholder. That is, under mixed ownership, the state-owned economy will persist in the form of shareholders like its private counterparts. It is the investors of the companies rather than an administrative organ, which will realise the integration of state-owned capital and private capital and allow the mixed ownership enterprises to become true market players.

That is not to say that China will precisely mimic western capitalisation and corporate structure and establish a highly dispersed shareholding structure. There are differences in the nature of the firms, markets, cultures and political orientations between China and advanced economies that impede the convergence of corporate structure.[116] Some Chinese scholars have argued that the corporate governance regime in western countries is not appropriate for Chinese corporations because of the different legal and institutional arrangements, so the simple transplantation of rules from other

[114] See "The Decision on Several Issues regarding Establishing a Socialist Market Economy", 3rd Plenary Session of the 14th National Congress of the CCP, 1992.
[115] Cai Wei, "The Mandatory Bid Rule, Hostile Takeovers and Takeover Defenses in China", (SJD Thesis 2011).
[116] Lucian A. Bebchuk and Mark J. Roe, "A Theory of Path Dependence in Corporate Ownership and Governance", (1999) 52 Stanford Law Review 132.

jurisdictions may not combat Chinese issues.[117] It can even be dangerous to transplant corporate governance rules that ignore local realities.[118] Therefore, the transplant of advanced rules from developed financial jurisdictions needs to be adapted to the indigenous context.

Mixed ownership reforms are still steadily progressing.[119] The report of the "19th Congress of the CCP" established that China will deepen the reform of SOEs, develop a mixed ownership economy, and cultivate globally competitive world-class companies. Takeover is recognised by the Chinese government as an efficient tool for realising this aim.[120] In addition to the key sectors of the national economy and security, the Chinese government is gradually releasing power to the market regarding free trade. Under the mixed ownership structure guidance, the SASAC has ruled that if an SOE could be controlled by private sectors, the state-owned shares may flow out entirely or may remain in a non-controlling status.[121] The governor of the SASAC announced that the SASAC will encourage the subsidiaries of SOEs to be listed on the Science and Technology Innovation Board, a newly introduced board in the Shanghai Stock Exchange, which is a Chinese version of the Alternative Investment Market in the UK. Additionally, according to the SASAC's announcement, the SASAC will, through a variety of approaches, promote the restructuring of these kinds of SOEs and achieve a diversified ownership structure.

2.4 Ownership structure and takeover law in China

The monitoring function of the takeover market has been well developed in advanced economies; by contrast, this kind of market is underdeveloped in China. Before the Split Shareholding Structure Reform, two-thirds of the total shares of listed companies in China were non-tradable, and therefore, it was impossible for an acquirer to take over a target through share acquisitions in the secondary market without friendly negotiation or approval by state administrative bodies.[122] A study conducted

[117] Zhang Xianchu, "Globalization of Corporate Governance and Lessons from Emerging Economies", in Wu Zhipan and Hamada Michiyo (eds), *Corporate Governance and Capital Markets Supervision,* (Peking University Press, 2003) 82,109.
[118] Lutz-Christian Wolff, "Making Perfect Corporate Governance Rules: Mission Impossible?", (2004) 7 Corporate Governance International 21.
[119] Ibid.
[120] See "Opinions on further Optimising M&A Market Conditions".
[121] See http://finance.people.com.cn/n/2013/1220/c70846-23901072.html.
[122] "Report on China's Corporate Governance 2009: The Market for Corporate Control and Corporate Governance", (Fudan University Press, 2009).

in 2009 revealed that tender offers are rare in the Chinese market.[123] In most M&A cases, there are strong political connections between the acquirer and target company.[124] However, under the guidance of the mixed ownership structure reform, the state has gradually released power to the market and plays the role of a non-controlling shareholder in the majority of situations. In addition, the state council has recognised the positive effects of takeovers and published guiding opinions on promoting takeovers and restructuring activities to "optimise the industrial organizational structure, accelerate the transformation of the economic development mode and structural adjustment and improve the development quality and benefits".[125]

The takeover regulations in China also favour takeovers, which are regarded as an efficient tool for market structuring and promoting the national economic reform plan.[126] China's state-led restructuring of industries through scaling up industrial concentration and cultivating globally competitive champions plays an essential role in favouring takeovers to optimise the market structure.[127] The "Interim Provisions on the Management of the Issuing and Trading of Shares" was the first experiment under the Chinese Securities Law. The takeover regulations of these provisions were substantially incorporated into the Securities Law of 1999, which provided a framework for takeover law in China.[128] Although the Securities Law of 1999 provided substantial provisions about takeovers, it was still not precise enough in practice to guide the takeover of listed companies.[129] Subsequently, the CSRC established the "Measures for the Administration of the Takeover of Listed Companies (Measures for Takeovers) 2002" to provide a preliminary, workable regulatory regime for takeovers to improve the efficacy of takeover regulations. Subsequently, the "Measures for Takeovers" were revised by the CSRC in 2006, 2012, 2014 and 2020.

2.4.1 Non-frustration rule

Under the Chinese takeover regulations, takeover defensive tactics should not be adopted without shareholder approval at a general meeting. However, a defensive tactic could still be adopted without

[123] Ibid.
[124] Jing Chi, Qian Sun, Martin R. Young, "Performance and Characteristic of Acquiring Firms in the Chinese Stock Markets", (Massey University Working Paper, March 2009).
[125] "Opinions of the State Council on Promoting Enterprise Merger and Restructuring (Guowuyuan Guanyu Cujin Jianbing Chongzu de Yijian)" (State Countcil, No. 27, 08 August 2010).
[126] Ibid.
[127] See n 11.
[128] See n. 83.
[129] See n. 115.

shareholder approval, if it "does not have a crucial impact on asset and liabilities of target or those defensive tactics are parts of ordinary business operation of the target, or adopted before the takeover bid announcement".[130] Hence, compared with their UK counterparts, under China's board neutrality rule, there is considerable room for adopting ex post defensive tactics by the target management. In practice, there are various types of defensive tactics adopted by Chinese listed companies, though the legality of such tactics is unclear.[131]

Anti-defence rules under China's takeover law are vague about providing guidance for the practice.[132] The law provides that the target board "shall not erect any improper obstacles to the takeover by misusing its authorities".[133] However, the question of what kinds of obstacles should be regarded as improper obstacles is unclear.[134] In terms of ex post-defensive defences, the rule of board neutrality in China follows the board neutrality principle in the UK Takeover Code. Various defences could effectively deter hostile bidders and delay the development of the market for corporate control. In addition to takeover defences adopted by the listed companies, the company law revision in 2018 eases the conditions for allowing listed companies to buy back shares, and this can be used as a defence by targets.[135]

A cross-shareholding structure could also effectively impede unsolicited takeovers, as shown in Japan.[136] The increasing number of hostile takeovers is one result of the crucial decline in institutional cross-shareholding of listed firms in Japan.[137] Even if the company law does not explicitly address the issues of cross-shareholding, the "Anti-monopoly law" together with several administrative regulations restrict the scope of cross-shareholding in listed companies to protect consumers' interests and prevent market manipulation.[138] In addition, there are several rules restricting the cross-

[130] Article 8 & 33, "Measures for the Administration of the Takeover of Listed Companies".
[131] Wei Cai, "Anti-takeover Provisions in China: How Powerful Are They?", (2011) 22 International Company Law Review 314.
[132] Ibid.
[133] See n 11.
[134] Wangwei Lin, May Lihong Xing and Wenjuan Tan, The Vanco takeover – revisiting the takeover defences regulation in China, (2017) 38 Company Lawyer 153, 154.
[135] Laurie Simon Bagwell, "Share Repurchase and Takeover Deterrence", The RAND Journal of Economics 1991 (22): 72, 88.
[136] See n 10.
[137] Curtis Milhaupt, "In the shadow of Delaware? The Rise of Hostile Takeovers in Japan", (2005) 105 Columbia Law Review 2171, 2216.
[138] Qiu Zehao, "The Diliemma of the Cross-shareholding Structure and the proposal for Regulatory Improvement", Legality Vision, 2017 (3): 100.

shareholding structure of financial institutions and companies that invest in financial institutions.[139] Although lawmakers may have negative opinions of cross-shareholding structures, there are as yet no uniform laws and regulations restricting cross-shareholding structures in listed companies.[140]

2.4.2 Mandatory takeover bid rule

Although there is a UK-style mandatory takeover bid rule in China's takeover law, an empirical study suggests that the majority of mandatory bid obligations have been exempted by the CSRC, and the mandatory bid rule exits in name only in China.[141] Before the revision of "Measures for Takeovers" in 2020, if bidders were under any of the circumstances prescribed in article 62 or 63, bidders and their concerting parities may apply to the CSRC for the exemption of mandatory bid obligations.[142] The CSRC is responsible for reviewing if the bidder's meets the exemption requirements. A research revealed that from 2004 to 2010, the total number of takeovers triggering the mandatory bid obligation was 733; 706 of the mandatory bid obligations were exempted by the CSRC, which accounted for 96.32% of the total number of takeovers triggering the mandatory bid obligation.[143] There is a suggestion that the mandatory takeover bid should be abolished.[144] Unlike the mandatory bid rule in the UK, proportional takeover bids are allowed in China when the bidder triggers the mandatory bid obligation.[145] If the shares tendered by the target shareholders exceed the scheduled purchase amount, the bidder can carry out the acquisition on a proportional basis (or the pro rata basis).[146] Furthermore, if a bidder purchases the shares of a listed company by means of a takeover bid, the proportion of shares to be purchased shall not be lower than 5% of the issued shares of target in accordance with "Measures for Takeover 2014".[147] The revision 2020 did not change the proportional partial bid rule in essence. Prohibiting the adoption of takeover defensive tactics together with frequent exemptions of mandatory bid obligations has significantly relieved the financial burden of bidders.[148]

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[139] Article 9, "Guiding Opinions on Strengthening the Regulation of Non-Financial Enterprises Investing in Financial Institutions.
[140] Zhang Zixue, "Studies in the Regulation of Corporate Takeover Defences", (PhD thesis, China University of Political Science and Law, 2008).
[141] See n 115.
[142] Art. 61, "Measures for Takeovers 2014".
[143] Ibid.
[144] Ibid.
[145] Article 24, "Measures for Takeovers 2014".
[146] See n. 115.
[147] See Article 25, "Measures for Takeovers 2014".
[148] See n. 115.

In the 2020 revision of the "Measures for Takeovers", the requirement to apply to the CSRC for exemptions from mandatory bid obligations has been removed, and bidders are exempted automatically if they meet the requirements under article 62 or 63 of the "Measures for Takeovers".[149] In addition, compared to the previous version, the revised one sets out the circumstances in which bidders are exempted from mandatory bid obligations.[150] As will be discussed in great detail in the next section, there is empirical evidence supporting the argument that the exemptions that CSRC granted in the past were biased in favour of the interests of SOEs[151]. The revision in 2020 allows bidders to be exempted from their mandatory bid obligations without CSRC's approval, and therefore the scope for CSRC's bias is reduced. Furthermore, the Securities Law 2019, as the superior law of the "Measures for Takeovers", introduced several new rules on M&A activities. In particular, the mandatory bid obligation under the Securities Law is now triggered when bidders acquire 30 per cent of the voting shares of the targets.[152] However, in the revised "Measures for Takeovers 2020", the threshold for the mandatory bid obligation is when bidders acquire more than 30 per cent of the issued shares of the target, rather than 30 per cent the voting shares.[153] Hence, the threshold for mandatory bid obligations under the "Measures for Takeovers" is lower than that set under the Securities Law. The "Measures for Takeovers", as a CSRC's departmental regulation that provides detailed practical M&A rules based on its superior law, i.e. the Securities Law, should be consistent with the Securities Law. The current divergence can cause misunderstandings in practice.

Although the revised Securities Law[154] and Corporate Governance Code[155] attempt to improve the corporate governance of listed companies and to promote the development of the market for corporate control, the essence of the rules on takeovers remains unchanged. The proportional partial bid rule is still effective and considerable room remains for listed companies to adopt draconian takeover defences without shareholders' approval.[156]

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[149] Art. 61, "Measures for Takeovers 2020".
[150] Art. 62 & 63, "Measures for Takeovers 2020".
[151] Chao Xi, "The Political Economy of Takeover Regulation: What does the Mandatory Bid Rule in China Tell Us?", Journal of Business Law 2015 (2): 142, 164.
[152] Art. 65, "Securities Law 2019".
[153] Art. 24, "Measures for Takeovers 2020".
[154] "Securities Law of the People's Republic of China" (2019 Revision).
[155] "Code of Corporate Governance for Listed Companies" (2019 Revision)
[156] See n. 92.

3. The institutional arrangements of the Takeover Law framework

3.1 Policy based regulatory model

The UK model facilitates a smooth and orderly takeover market with the financial services industry controlling the drafting, administrating, and enforcing of takeover law. The state has very limited power to control takeovers. The legitimacy issue remains a moot point, although it did raise some issues in the negotiations of the Takeover Directive at the EU level. There is no plan in the UK to change this self-regulatory model to a statutory model. Even though the UK courts can, both in terms of expertise and resources, deal with takeover law issues, there is no immediate plan to give the adjudicatory function to the courts, i.e., the financial list of the commercial court.

The Takeover Code contains principles that are developed into detailed rules and guidance notes. Although parties should observe both the spirit of the general principles and rules, the spirit of the general principles is paramount. The Panel can prevent a transaction that, although the transaction complies with the letter of the Code, breaches the underlying purpose of a particular provision.[157] The Panel has the ability to grant a dispensation from the rules where the transaction adheres to the spirit of the general principles. Such a principle-based governance provides flexibility to takeover governance, which also allows the Panel to issue guidance to supplement the rules. Furthermore, the Panel can also embody the practices – the rulings of the Panel – through amendments to the Code following the consultation process. The constitution of the Panel and the processes to amend the Code are not regulated by law. The courts and parliament have limited roles in the rule-making, decision-making, and adjudication processes.[158] To date, the legitimacy of the Panel and Code has not been questioned by the legal community. Neither has there been any attempt to reform the Takeover Panel or to introduce a statutory Takeover Code. The self-regulation of the takeover market remains the cornerstone of the regime.[159] The legitimacy of such a self-regulatory takeover regime can be justified on the basis of resources and expertise.[160] It is recognised that the takeover market focuses on the interests of investors and those who facilitate market transactions. In the UK, the majority of these

[157] See n. 10.
[158] Ibid.
[159] See n. 28.
[160] Tunde Ogowewo, “Tactical Litigation in Takeover Contests”, Journal of Business Law, 2007: 589,619.

entities are financial intermediaries. Hence, the resources for law making, adjudication, and administration of the takeover market should be provided by the market players. Taxpayer money should not be spent on the takeover market, which is not relevant to non-market players.[161] Equally, the courts – especially the Commercial Court and the Chancery Court, should deploy their resources to hear cases that are of wider societal implication. Regarding expertise, the Panel, represented by the players in the financial markets, has insight into the trading practices, corporate governance issues, and dynamics of the markets. Some of the issues are not immediately apparent to non-market players, such as the fact that the announcement requirement falls on the target management. As London is a financial centre with great economic significance to the UK, expertise is important to ensure the competitiveness and stability of the London financial markets.[162] Such a de-centralised and professionalised governance regime minimises direct state intervention and the impact of lengthy court cases on financial stability.

However, other stakeholder interests, such as employee job prospects, employees' pensions, community development, and long-term investor commitment, can be overlooked.[163] These stakeholders' interests are not enshrined in the general principles of the Takeover Code.[164] Despite some rules designed to protect these interests,[165] they give measurably less protection than the protection given to investors in the market, such as asset funds.[166] Many jurisdictions, such as Hong Kong and Singapore, have modelled their takeover laws on the UK Takeover Code, but neither Hong Kong nor Singapore follows a similar institutional arrangement in terms of their constitutions. To avoid appeals cases being reviewed by the courts, senior ex-judges sit as members of the Appeal Panel.[167] Such an arrangement substantially removes the legal risk of cases being argued in the courts.[168] There is no evidence to suggest that government agencies have direct influence over the law-making processes, appointment of members, and decisions of the Panel.[169] Although the Financial Conduct Authority (FCA) has the power to impose sanctions on parties for transgressing the Takeover Code, the FCA does not have the power to amend the rules or enforce the Code. Other departments, such as the Department for Business, Energy and Industrial Strategy, which oversees the development of

[161] See http://www.thetakeoverpanel.org.uk/the-code/fees-and-charges.
[162] See n. 10.
[163] Chrispas Nyombi, "A Critique of Shareholder Primacy Under the UK Takeover Law and the Continued Imposition of the Board Neutrality Rule", International Journal of Law and Management, 2015 (57): 235, 264.
[164] Ibid.
[165] Department for Business, Innovation and Skills Ensuring Equity Markets Support Long-Term.
[166] See n. 28.
[167] See http://www.thetakeoverpanel.org.uk/.
[168] See n. 10.
[169] See n. 28.

company law, do not have formal power to interfere with Takeover Code enforcement.[170] The recent Green Paper on corporate governance reform published reviews of the impact of takeover law on other stakeholders. Although the paper suggests the implantation of heightened protection for stakeholders other than employees, there is very little momentum to extend the power of government or to provide more power to stakeholders to control the outcomes of a takeover.[171]

3.2 China: The late comer to adopt a takeover market

The Shanghai and Shenzhen Stock Exchanges were established in 1990, and at that time, there were no unified regulations for the capital markets. Instead, various rules, regulations, measures, notices and guidelines applied.[172] After the "Fourteenth National Congress of the CCP" agreed to create a socialist market economy in 1992, takeovers of listed companies were first regulated by the "Interim Provisions on the Management of the Issuing and Trading of Shares" promulgated in 1993. These provisions established the initial framework for takeovers in China and were mainly disclosure rules for takeover bids and competitive bids.[173] During the early 1990s, the Hong Kong stock market was the essential channel through which SOEs could raise financing.[174] Thus, Hong Kong financial experts had the opportunity to suggest that China adopt Hong Kong's takeover law[175] at a time when Hong Kong's legal framework and laws were mainly based on the UK legal regime. Thus, many of the "the Measures for Takeovers" in China were borrowed from the UK Takeover Code via the Hong Kong Takeover Directives.

Mandatory bid rule was transplanted into China and initially codified in article 88 of the Securities Law, [176] which was introduced as part of the protection of the principle of the equality of opportunity.[177] Before the amendment of the Measures for Takeovers in 2006, the 2002 version of the mandatory bid was transplanted from the UK Takeover Code in all its material aspects: [178] the CSRC

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[170] See n. 10.
[171] Ibid.
[172] Yu Guanghua and Gu Minkang, Law Affecting Business Transactions in the PRC (The Hague, London, Kluwer Law International 2001) 88.
[173] Hui Huang, Securities and Capital Markets Law in China, (Oxford: Oxford University Press, 2014).
[174] Ibid.
[175] Yu Guanghua, "Does One Size Fit All? Transplanting English Takeover Law into China", in Cheryl R. Lehman (ed), Corporate Governance: Does Any Size Fit? (The Netherlands, Elsevier Ltd, 2005) 49.
[176] See n. 83.
[177] Ibid.
[178] See n. 11.

had full discretion to exempt mandatory bid obligations;[179] the consideration paid by the bidder followed the highest price rule;[180] and the acquisition of 30% of target shares triggered the mandatory bid obligation.[181] In addition, the 2002 Takeover Measures were strongly antipathic to partial bids.[182] According to the 2002 Measures for Takeovers, the acquisition of 30% or more would trigger the mandatory bid obligation, and partial bids were not allowed.[183] However, in the 2006 version, the general bid rule was amended to the proportional partial bid rule.[184]

The rationale behind the amendment of the mandatory bid rule in 2006 reflects competition between different interest groups. Although China and the UK shared broadly similar takeover law, the interest served by the takeover laws in the two regimes are completely different. The UK Takeover Code is influenced by financial intermediaries and serves the interest of promoting financial services in the UK. However, in China, the Takeover Law mainly serves to facilitate industrial restructuring and the goal of creating globally competitive national companies, which was re-emphasised by President Xi Jinping on the "19th Congress of the CCP". This policy has also been reflected in the Takeover Law in China, for example in the existence of proportional partial bids, non-frustration rules and reduced disclosure requirements.

Authorities regard solicited takeover as an efficient tool for promoting China's goal of deepening the reform of SOEs in order to develop a mixed ownership economy and to cultivate globally competitive, world-class companies.[185] In 2010, the state council announced guidance opinions on promoting takeovers and restructuring activities to "optimise the industrial organizational structure, accelerate the transformation of the economic development mode and structural adjustment and improve the development quality and benefits".[186] In the context of promoting an active market for corporate control, the rationale behind frequent exemptions of mandatory takeover bid obligations by the CSRC and the existence of proportional partial bids are aimed at promoting the development of a takeover market to facilitate the national economic reforms.[187] Strict enforcement of the mandatory bid rule would frustrate takeovers. As a result, proportional partial bids were allowed in the 2006 Takeover

[179] Article 49, "Measures for Takeovers 2002".
[180] Article 34, "Measures for Takeovers 2002".
[181] Article 13, 14 and 23, "Measures for Takeovers 2002".
[182] See n. 11.
[183] Article 13, "Measures for Takeovers 2002".
[184] Article 24 and 25, "Measures for Takeovers 2006"
[185] See "Opinions of the State Council on Promoting Enterprise Merger and Restructuring".
[186] Ibid.
[187] See n 115.

Measures, and the non-frustration rule was introduced.[188] In addition, the Takeover Law in China has also clearly expressed that if the bidder acquires the target company in order to bail out the target from financial difficulty, the bidder may apply to the CSRC for an exemption from the mandatory bid obligations.[189] An empirical study revealed that between 1993 and 2005 approximately 80% of the listed companies undergoing takeover and reorganisation survived rather than becoming delisted because of poor performance.[190]

Under the 2002 Measures for Takeovers, a UK-style general bid rule was adopted, and shareholders can be protected by the enforcement of mandatory bid obligations.[191] The CSRC has full discretion to decide whether a takeover is value-creating or value-destroying in order to determine whether an exemption to the mandatory bid obligation will be granted.[192] Due to the exceedingly high cost of a mandatory bid for all the remaining shareholders of the target company, the waiver of a mandatory bid could greatly lighten the financial burden of the bidder. In other words, the CSRC uses its power to reduce the costs for bidders for the purpose of facilitating corporate restructuring. Although the Measures for Takeovers of 2006 still allow the grant of exemptions to the CSRC, the allowance of a proportional partial bid makes exemptions from the mandatory bid obligations less crucial than before because, even if no exemption is granted, the bidder can still continue the acquisition process by launching a proportional partial bid.

3.2.1 CSRC approaches to the non-frustration rule and de facto defensive tactics

As mentioned in the last section, there are several types of defensive tactics that have been adopted by various listed companies to impede unsolicited bids, though the legality of anti-takeover provisions remains unclear under current regulations.[193] These defensive measures aim to provide protection against possible unsolicited takeovers.[194] Defensive tactics may stop the bidder from gaining actual control of the target, even if the bidder has gained a controlling block of the target's shares.[195] One

[188] Article 8 and 24, "Measures for Takeovers 2006".
[189] Article 49, Measures for Takeovers 2006.
[190] Yang Hua, "Takeover and Restructuring and Value Creation of the Listed Companies, (Beijing: China Financial Publishing House 2007) 70.
[191] Article 13, "Measures for Takeovers 2002".
[192] Article 49, "Measures for Takeovers 2002".
[193] For the detailed discussions, see part II of this chapter.
[194] See n. 131.
[195] Ibid.

study shows that, among the sample of 150 listed companies in China, 73 adopted defensive tactics, and over three-quarters of the remainder were controlled by the dominant shareholders.[196]

These existing defensive tactics can make hostile takeovers costly and difficult to conduct successfully.[197] A case study revealed that Chinese listed companies have established a range of defensive tactics in their articles of association, such as restricting the voting rights of hostile bidders, staggering the board regime and the provision of golden parachutes. The CSRC and courts have failed to provide guidance on the validity of such defensive tactics.[198] Some scholars have argued that the 'letter of concern' issued by stock exchanges, a non-binding regulatory measure (soft law), has positive effects on regulating takeover defences.[199] However, the letters of concern issued by exchanges as a soft-law normally express concerns in specific cases, rather than providing a universal guidance to the whole industry. More importantly, the implicit permission for defensive tactics given by laws and by the CSRC shows that the regulator prefers friendly takeovers to hostile takeovers[200] to achieve the goal of optimising the market structure. This could be one reason why hostile takeovers are rare in China.[201]

Financial regulators are also frequently involved in hostile takeover battles in China. In the Vanke case, for instance, the Chairman of CSRC publicly commented harshly on the bidder's (Baoneng) high-leverage strategy and described the hostile share purchasing as "barbaric".[202] The CIRC, the national insurance watchdog, also called such share purchasing "risky" and suspended a product issuance of certain insurance companies through which Baoneng raised most of the capital to acquire Vanke's shares. Following the financial regulators' intervention, Baoneng announced that it would not seek control of Vanke and reduced its shareholding in Vanke incrementally to 15% as of September 2018.[203]

Baoneng's announcement was also related to the actions taken by two other major shareholders of Vanke: China Resources, a state-owned enterprise, and Evergrande, a real-estate developer. They announced that they would transfer their shares entirely to Vanke's white knight Shenzhen Metro, a

[196] See n. 91.
[197] See n. 131.
[198] James Si Zeng, "Regulating Draconian Takeover Defences with Soft Law: Empirical Evidence from Event Studies in China", (2019) 20 European Business Organization Law Review 823, 854.
[199] Ibid.
[200] See n. 92.
[201] Ibid.
[202] Caixin, https://www.caixinglobal.com/2017-01-14/baoneng-backs-off-from-fight-over-vankes-control-101044053.html
[203] See n. 7.

SOE at the local level. China Resources and Evergrande shareholdings were 15.3% and 14.1% respectively before the start of the bidding process, compared with Baoneng's 25.4%.[204] As a result, Shenzhen Metro replaced Baoneng as Vanke's largest shareholder. The decision of China Resources to transfer its shares in Vanke may have been influenced by SASAC's view that "the Central SOE should not compete for benefits with local enterprises" and that China Resources was required to cooperate with the Shenzhen city government.[205] Such SASAC requirements may have pressured China Resources to transfer its shares in Vanke to Shenzhen Metro which backed target management fully.[206] Shenzhen City Government also encouraged Evergrande to transfer its shares to Shenzhen Metro.[207]

The result was that this hostile takeover attempt was ended by state intervention. In this case, the state acted as a "white knight" by blocking Baoneng's unsolicited bid. As mentioned, amendment to takeover law in China is part of the programme for national economic reform and corporate restructuring. This means that the law does not have the same logic as the UK's non-frustration rule, which was adopted to maximise shareholder value. Based on CSRC's implicit permission for takeover defences[208] and frequent administrative interventions into takeover battles,[209] one could reasonably infer that regulators prefer friendly to hostile takeovers.

3.2.2 Lack of independent market players and the role of SOEs and SASAC

Under the UK takeover market, takeover law is driven by the interests of financial intermediaries. However, the situation in China is significantly different. As mentioned, the main goal of takeover law is to facilitate state-led national economic reforms in China, and SOE reform is one of the crucial parts

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[204] China Daily, http://www.chinadaily.com.cn/business/2017-01/13/content_27941918.htm.

[205] An Ran, "The Future of Vanke after New SOE Alliance", https://cbk.bschool.cuhk.edu.hk/the-future-of-vanke-after-new-soe-alliance/; also see Sheng Hua, Control and Governance with Vanke Style, (Oriental Publishing, 2017) 158.

[206] Ibid.

[207] Sheng Hua, Control and Governance with Vanke Style, (Oriental Publishing, 2017) 148.

[208] Empirical studies revealed that, in many listed companies' articles of associations, an array of draconian takeover defences has been adopted, which harms shareholders' interests. However, these defences are regulated by a soft-law approach, rather than prohibited by the securities regulatory authority (CSRC), i.e. stock exchanges issue 'letters of concern' to listed companies. For detailed discussion, see James Si Zeng, "Regulating Draconian Takeover Defenses with Soft Law: Empirical Evidence from Event Studies in China", (2019) 20 European Business Organization Law Review 823, 854; also see Robin Hui Huang, "The Rise of Hostile Takeovers and Defensive Measures in China: Comparative and Empirical Perspective", 2019 (20) European Business Organization Law Review: 363, 398.

[209] Such as hostile takeover battels between *Nanbo Float Glass Co., Ltd., v. Baoneng Investment Group* (bidder), Yili Industrual *Group v. Sunshine Insurance Group* (bidder), and *Gree Electric Appliances Industrial Group v. Foresea Life Insurance* (bidder).

of this reform.[210] Thus, SOEs are important market players in China that own and control the majority of securities companies, insurance companies, commercial banks, pension funds and social security funds.

Larger numbers of professional and independent institutional investors can be expected after the introduction of the new set of asset management rules. Before the regulation of asset management industries, asset funds, which were not independent, were the channels through which commercial banks were able to evade regulatory restrictions to provide bank loans to restricted industries and unqualified borrowers. Asset funds frequently enabled commercial banks to whitewash their balance sheets, which is the main type of shadow banking business that increases systemic risk in China's of the financial system.[211] The role of the independent external monitoring mechanism cannot be fulfilled effectively. Several cases such as the takeover of Vanke (by Baoneng) and Sunriver (by Longwei Media) indicate that commercial banks offer loans to bidders in order to take over listed companies through such channel-type businesses.

Asset funds are the ideal professional institutional investors to fulfil the gatekeeper role in the financial market and should not be used as channels or tools for commercial banks to evade regulatory restrictions on the provision of loans. Lawmakers have therefore begun to regulate such channel-type businesses with the hope of creating more professional institutional investors and managing systemic risks. The newly announced regulation requires commercial banks to separate their asset management departments from the rest of the bank in order to establish an independent subsidiary and prevent the asset management department from becoming the tool through which banks whitewash their balance sheets. Additionally, the regulation requires that asset management subsidiaries of banks perform the duties of faithfully and diligently managing the property on behalf of investors upon commission.[212] Most importantly, the law releases the restriction on banks' asset management subsidiaries to directly invest in the equity market.[213] In addition, although the percentage of foreign institutional investors is insignificant at this stage, regulators, such as the state council, the CSRC and the CBIRC, have gradually begun to open the capital market to foreign institutional investors, as mentioned in the previous section.

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[210] See n. 11.
[211] Sun Guofeng and Jia Junyi, "Defining China's Shadow Banking and Assessing Its Scale – Seen in Term of the Creation of Credit Money", (2015) 11 Social Sciences in China 97, 98.
[212] See "Measures for the Administration of Wealth Management Subsidiary Companies of Commercial Banks.
[213] Ibid.

SOEs play an active role in the takeover market in China, and takeovers are regarded as an efficient way to promote SOE restructuring under the guidance of the mixed ownership structure reform. At the same time, SOEs are also responsible for bailing out some private companies that face financial difficulties and assisting in the development of private enterprises. According to the announcement of the SASAC, as of 2018, 32% of mergers were conducted by SOEs taking over private companies with the intention of diversifying the state investment portfolios and assisting in the development of private enterprises.[214]

On the other hand, in the situation involving an SOE as a bidder, approval by the relevant department of the state, such as different levels of state asset supervision and administration organs, is needed before such transactions can be launched.[215] Although under the mixed ownership structure reform, SOEs welcome private investors, thus fulfilling the requirement of a mixed ownership structure, transactions involving state-owned shares can be executed only with administrative approval in most occasions.

4. Regulatory alignments and Stock Connection Scheme

Regulatory alignment is key to cro ss-border investments and financial services. For example, one of the principal purposes of the EU Takeover Directive was to promote the integration of national economies constituting the 'single market', which was proposed as a harmonised legal framework for takeovers in the EU.[216] The idea is was that regulatory alignment could provide a level playing field and enhance legal certainty.[217] In the London-Shanghai Stock Connection Scheme, however, it operates through issuing, listing and trading global depository receipts (GDRs) on London Stock Exchange and Shanghai Stock Exchange. For Chinese companies listed on the London Stock Exchange, the governing law for company law issues in a takeover will be UK law. For English companies listed on Shanghai Stock Exchange, the governing law will be Chinese law. As discussed above, due to the

[214] Ibid.
[215] Article 4, "Measures for Takeovers 2020".
[216] Paul Davies, Edmund-Philipp Schuster and Emilie Van de Walle de Ghelcke, "The Takeover Directives as a Protectionist Tool?", (ECGI Working Paper Series in Law, No. 141/2010, February 2010).
[217] Ibid.

differences in the economic model, ownership structure and institutional arrangements, the takeover law in China differs from the UK Takeover Code. Such differences in takeover law between UK and China would not provide a level playing field under this stock connection scheme. For instance, under the UK Takeover Code, if bidders trigger mandatory bid obligations, shareholders of target company are eligible to share control premiums. By contrast, in accordance to Chinese takeover regulations, bidders are normally required to acquire additional five per cent of target shares on a pro rata basis, rather than obliged to acquire all outstanding shares of target companies. In terms of adopting takeover defensive tactics, in the UK it is prohibited to apply defensive tactics to block imminent bids without shareholders' approval and board neutrality rules require target board to consider shareholders' interests. Whilst, as discussed, board neutrality rules under Chinese takeover regulations leave considerable room for adopting defensive tactics by target board without shareholders' approval. Hence, differences in the level of investor protection may deter investors to conduct a takeover under the stock connection regime. The absence of regulatory alignment is likely to be a major obstacle to the success of the stock connection scheme.

5. Looking forward

China is in an equivalent historical position to that of the UK over the last few decades in terms of the privatisation of some SOEs and the liberalisation of its capital market. However, the UK and China are in different stages of their economic development and have different legal and political structures. China's takeover regulations were mainly transplanted from UK Takeover Code via Hong Kong Takeover Directives in the early 1990s.[218] Hence, there are some similarities. To be specific, both China's Takeover Measures and UK Takeover Code apply the shareholder primacy governance model and the board neutrality rule to allocate powers between target shareholders and management. The adoption of defences is in principle restricted, albeit with significant differences between the two jurisdictions, and a mandatory bid obligation will be triggered if the acquirers hold a certain percentage of the target shares. Neither country relies on the development of the concept of the fiduciary duty of management to control the takeover process. The CSRC and other policy markers play more decisive roles in the development of takeover policy and law than do the courts; policy plays the most important role in takeover law development in both countries. In the UK, the takeover market forms part of the UK's international financial services market so shareholder democracy and

[218] See n. 134.

equal treatment go hand-in-hand in supporting the development of the industry. In China, takeovers are mainly used to facilitate corporate restructuring and court-made norms may not be put in place sufficiently quickly to accommodate the requirements of state policy. Although the takeover regulations in China were initially translated from the UK Takeover Code, China's approach has gradually deviated from the UK model as it seeks a regulatory model that fits in with the nature of its political system.

For now, the two largest world economies are experiencing major geo-political challenges - Brexit and the US-China Trade War. The UK's Brexit politics will require the UK to seek new global trading partners and, more importantly, to find ways to maintain its leading status as a global financial centre.[219] Leaving the EU is unlikely to have a major impact on takeover law in the UK. Rather, the UK may relax some of its rules to attract incorporation in the UK, listing on UK exchanges, and asset funds domiciled in and managed from the UK. These measures can increase inbound M&A. For outbound M&A, China remains an attractive market for UK companies. The mixed ownership policy and the new FIL provides an opportunity for foreign companies to enter the Chinese capital market by either buying controlling stakes in Chinese companies or in some of the subsidiaries of SOEs.[220] The recent measures cracking down on shadow banking, and the new FIL may also encourage UK financial services firms to start providing financial and advisory services to the parties in the takeovers. Some funds may also participate in the takeovers. However, the regulatory regime for asset funds is still in the developmental stage in China. The regulatory risk of a UK fund launching a direct, unsolicited takeover would be difficult to mitigate as regulatory attitude towards foreign funds operating in China is still unclear.[221]

For the foreseeable future, the UK will continue to be open for foreign takeovers. It is possible that a Chinese company may launch an unsolicited bid to acquire control of a UK company.[222] Since the UK does not apply reciprocity rules in takeovers, UK listed companies can be taken over more easily by Chinese companies than Chinese companies by UK companies. The UK Takeover Code does not contain reciprocity clauses as permitted by the EU Takeover Directive to allow UK companies to use defences. Hence, regulatory alignment can level the playing field.

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[219] "The Political Economy of Brexit and the UK's National Business Model" (Sheffield Political Economy Research Institute Paper No. 41, May 2017).
[220] China: State Owned Enterprises Reform (Foreign and Commonwealth Office, 7 August 2017).
[221] Ibid.
[222] For example, the contest between Chinese Company China National Offshore Oil Corporations (bidder) and US Unocal was the first big unsolicited takeover, which occurred in 2005.

China has committed to open up its capital market to foreign investors, as it has with the London-Shanghai Stock Connect, QFII and the Shenzhen-Hong Kong Stock Connect Regime. In this context, the role of the takeover market should be expanded to include the function of serving market restructuring, such as providing an efficient external monitoring mechanism, attracting inbound investments and promoting the development of the financial market. To achieve these goals, the UK model may have some lessons for China.

5.1 Takeover Laws and Regulations

In the UK, the non-frustration rule and mandatory bid rule are the cornerstones of promoting the smooth development of the market for corporate control and protecting investors' opportunities to receive abnormal returns when there is a hostile bid.[223] However, as established in Part 3, in order to achieve the goal of establishing world-leading champions, the non-frustration rule and mandatory bid rule in China's takeover law have deviated from their originally intended purpose. The CSRC grants implicit permission to listed companies to adopt defensive tactics, although whether such defenses comply with the law and regulations is unclear. Proportional partial bids are also allowed in China, unlike the UK where the mandatory bid rule is strictly enforced.

With China's commitment to opening up the capital market and to deepening reforms to mixed ownership structure, the takeover law should grant enhanced protection to investors and promote the development of the market for corporate control. In doing so, takeover law in China should strike a fair balance between the contestability of takeovers and shareholder protection in order to attract inbound investment and promote the development of an active market for corporate control. In the UK, the mandatory bid rule is effective in enhancing the opportunity for shareholders to share control premiums and thus attract inbound investment.[224] However, proportional partial bids and excessive exemptions from mandatory bid obligations granted by CSRC have meant that the mandatory bid rule exists in China in name only.[225] UK-style strict enforcement of the mandatory bid rule should be instigated in order to attract inbound investment and to protect shareholders' interests. Proportional partial bids and CSRC's exemptions of mandatory bid obligations of bidders may be allowed, but only in exceptional cases. Draconian anti-takeover defensive tactics harm the interests of investors because

[223] See n. 10.
[224] Ibid.
[225] See n. 115.

they prevent investors from obtaining control premiums[226] so China's takeover regulations should restrict them severely. Even if defensive tactics are allowed, the power to make decisions should be vested in the shareholders meeting, rather than the board of directors, in order to avoid a conflict of interests.

5.2 Market Players

As established in Part I, the market for corporate control in China could be an efficient external monitoring mechanism which is especially important when internal monitoring mechanisms are weak in China. To develop such an active market for corporate control, the role of financial intermediaries should not be overlooked. Under the UK model, financial intermediaries perform an independent gatekeeping, financing and advising role but in China, non-bank financial intermediaries mainly act as the channel for commercial banks to conduct off-balance deposit-taking and loan-making business (regulatory arbitrage), which comprises the main part of China's shadow banking system.[227] Hence, to establish an active market for corporate control as an external monitoring mechanism, it is imperative for financial intermediaries to be able to operate independently. Introducing a fiduciary duty regime into the asset management industry in order to emphasise financial institutions' duty towards their clients is a possible way of promoting independent operation of non-bank financial intermediaries in China.

5.3 Regulatory Models: CSRC Centralism and Self-Regulation Model

In the process of the state-led scaling-up of industry in China, administrative orders are applied to mergers more frequently than is takeover law.[228] This is because when the reform of market structure began, the majority of market shares were held by SOEs, but takeover law is applied only when corporate control is transferred in the capital and securities markets.[229] However, under the mixed ownership structure, an increasing number of takeovers could be expected in the capital and securities market because of an increasingly dispersed shareholding. This means that a comprehensive takeover law and an effective and unbiased regulatory model are essential.

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[226] See n. 196.
[227] See n. 51.
[228] See n. 11.
[229] Ibid.

In an effective market for corporate control, the regulators should ensure a level field for market players and counteract the greater ability of SOEs to lobby for the adoption of their favoured regulations.[230] An empirical study revealed that "*the CSRC appeared to be systematically more responsive to the waiver applications of mandatory bid obligations from SOEs than from private individuals. Within the generic grouping of SOEs, the higher the level of government that ultimately controls the acquirers, the speedier the approval process was*".[231] Hence, the UK's principles-based self-regulatory model which limits the function of the state and judiciary, can serve as a blueprint for developing an independent regime under the supervision of the CSRC. This deserves further research.

Conclusion

Regulatory alignment can level the playing field in cross-border M&A activities. However, the UK is an open market for foreign takeovers while there are still many restrictions against foreign investors launching unsolicited bids in China. Although China is committed to a gradual opening of its capital market, the establishment of an active takeover market is still at an early stage. There are distinct differences between the UK and China in both takeover regulations and policy, due to differing economic models, ownership structures and institutional arrangements.

Structural differences between China and the UK dictate different policies with regard to takeovers in these two countries. The UK operates a self-regulatory model while China has opted for a command-and-control model. In the UK, the takeover market offers major revenue to the financial services industry's financing, advising, brokering, and asset management sectors. The self-regulatory model ensures the smooth development of the takeover market. At the same time, financial intermediaries in the UK perform an independent gatekeeping role in that market. However, the takeover market in China mainly functions to serve the domestic economy. China's state-led restructuring of industries through scaling up industrial concentration plays an essential role in using takeovers to cultivate globally competitive national champions.

[230] Ibid.
[231] Ibid.

In terms of ownership structures, the UK enjoys a high degree of dispersed ownership and is less constrained by government controlling stakes and cross-shareholdings. Hence, institutional investors have more opportunity to realise their investment returns. The dispersed ownership structure in the UK is linked to its policy of developing London as a centre for international financial industry and the hub of the global fund management industry. By contrast, China's ownership structure is relatively concentrated, despite the various ownership structure reforms have been adopted to release state controlling stakes. As a result, it is difficult to conduct unsolicited takeovers at present. Nevertheless, as the mixed ownership structure is progressively reformed in China, there is room for developing an active market for corporate control.

The UK model also facilitates the development of the takeover market since the financial services industry is involved in the drafting, administration and enforcement of takeover law. The state has limited power to intervene and control takeovers. In China, however, takeovers are mainly used for corporate restructuring and market optimization and the proportional partial bid rule, the low level of information disclosure requirements, and a Chinese-style board neutrality rule have been introduced to realise this goal.

This article shows that an interconnected market between China and the UK, or an EU style cross-border takeover market, is unlikely to be realised without regulatory alignment which is currently not achievable. However, the UK's experience provides some lessons for China's continuing corporate reform, for the development of China's takeover market, and for its goal to develop Shanghai or Shenzhen into an international financial hub.