TAKEOVER LAW IN THE UK, US AND CHINA: A COMPARATIVE ANALYSIS AND RECOMMENDATIONS FOR CHINESE TAKEOVER LAW REFORM

Xiaofan WANG

Salford Law School
College of Arts & Social Sciences and Business & Law
University of Salford, Salford, UK

Submitted in Partial Fulfilment of the Requirements of the Degree of Doctor of Philosophy, July 2013

Table of Contents

List of Statutes

UK

City Code on Takeovers and Mergers

Company Act

EU

European Directive on Takeover Bids

US

Securities Act

Securities Exchange Act

Williams Act

China

Company Law

Securities Law

Measures for Regulating Takeovers of Listed Companies

List of Figures and Tables

Figures

Tables

List of Cases

UK

Bamford v Bamford [1790] Ch 212

Bristol and West Building Society v Mothew [1996] 4 AII ER 698

Criterion Properties Plc v Stratford UK Properties LLC [2004] UKHL 28

Great Easter Railway Company v Turner [1872] 68 Ch App 149

Hogg v Cramphorn [1967] Ch 254

Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821

Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821

Keech v Sandford [1726] Sel Cas Ch 61

Percival v Wright [1902] 2 Ch 421

Peskin v Anderson [2001] BCC 874

R v International Stock Exchange of the UK and Ireland, ex parte Else [1993] QB 534

R v Panel on Takeovers and Mergers, ex parte Datafin Plc [1987] QB 815

Re Smith v Fawcett Ltd [1942] Ch 304

US

AC Acquisitions Corp v Anderson, Clayton & Co 519 A 2d 103 (Del Ch 1986)

Amanda Acquisition Corp v Universal Foods Corp 877 F 2d 496 (7^{th} Cir 1989)

Aronson v Lewis 473 A 2d 805 (Del 1984)

Blasius Industries Inc v Atlas Corp 564 A 2d 651 (Del Ch 1988)

Brown v Halbert 76 Cal Rptr 781 (1969)

Citron v Fairchild Camera & Instrument Corp 569 A 2d 53 (Del 1989)

City Capital Associates v Interco 551 A2d 787 (Del Ch 1988)

CTS Corp v Dynamics Corp of America 481 US 69 (1987)

Donahue v Rodd Electrotype Co of New England 367 Mass 578, 328 NE 2d 505 (1975)

Edgar v MITE Corp 457 US 624 (1982)

Gerdes v Reynolds 28 NY S 2d 622 (1941)

Hanson Trust Plc v SCM Corp 774 F 2d 47 (2d Cir 1985)

In re Synthes Inc Shareholders Litigation No 6452 2012 WL 3641014 (Del Ch 2012)

Ivanhoe Partners v Newmont Mining Corp 535 A 2d 1334 (*Del 1987*)

Ivanhoe Partners v Newmont Mining Corp 535 A 2d 1334 (Del 1987)

Kahn v Lynch Communication System Inc 638 A 2d 1110 (Del 1994)

Kennecott Copper Corp v Curtiss-Wright Corp 584 F 2d 1195 (CA2 1978)

Linge v Ralston Purina Co 293 NW 2d 191 (Iowa Sup Ct 1980)

MacAndrews & Forbes Holdings Inc v Revlon Inc 501 A 2d 1239 (Del Ch1985)

Meinhard v Salmon 249 NY 458 (1928)

Moran v Household International Inc 500 A 2d 1346 (Del 1985)

Paramount Communications Inc v QVC Network Inc 637 A 2d 34 (Del 1994)

Paramount Communications Inc v QVC Network Inc 637 A 2d 34 (Del 1994)

Paramount Communications Inc v Times Incorporated 571 A 2d 1140 (Del 1989)

Perlman v Feldmann 219 F 2d 173 (2d Cir 1955)

Pogostin v Rice 480 A 2d 619 (Del 1984)

Revlon Inc v MacAndrews & Forbes Holdings Inc 506 A 2d 173 (Del 1986)

S-G Securities Inc v Fuqua Investment Co 466 F Supp 1114 (D Mass 1978)

Schreiber v Burlington Northern 472 US 1 (1985)

Unitrin Inc v American General Corp 651 A 2d 1361 (Del 1995)

Unocal Corp v Mesa Petroleum Corp 493 A 2d 946 (Del 1985)

Wellman v Dickinson 475 F Supp 783 (SDNY 1979), *aff'd* 632 F 2d 355 (2d Cir 1982)

Acknowledgements

I would like to express my deepest gratitude to Professor Alistair Alcock for his rigorous scholarship and insightful critiques that greatly helped refinement of my research. It has been an honour to work with him. Without his sophisticated knowledge of takeover law and academic guidance, I would not have been able to complete this doctoral thesis.

I am indebted to Judith Ross for her tremendous support. I am also deeply appreciative of Dr Mark James and Julie Adshead for their constructive suggestions. I am grateful to Dr Jingchen Zhao for his unreserved assistance. I thank the staff at Salford Law School for all the support they have generously provided during the course of my doctoral study.

I finally would like to thank my friends Boran Gazi and Helen Hou for reading my thesis and helping me communicate my ideas.

To my parents, my husband and my daughter

Shaoxi, *Qiansheng*, *Shengke* and *May*

Abbreviations

CCP	Chinese Communist Party
CSRC	China Securities Regulatory Commission
FSA	Financial Services Authority
IPO	Initial Public Offerings
MBR	Mandatory Bid Rule
MOF	Ministry of Finance
MOFCOM	Ministry of Commerce
NPC	National People's Congress
NFR	Non-Frustration Rule
OECD	Organization of Economic Cooperation and Development
PBC	People's Bank of China
QFII	Qualified Foreign Institutional Investors
SASAC	State-Owned Assets Supervision and Administration Commission
SEC	Securities and Exchange Commission
SOEs	State-Owned Enterprises
SSECI	Shanghai Stock Exchange Composite Index
UK	United Kingdom
US	United States
WTO	World Trade Organization

Abstract

Takeovers have become frequent in the United Kingdom (UK) and the United States (US) since the 1960s. However, in China takeovers are a relatively new concept and have only recently become more common. The Chinese government has attempted to create a clearer roadmap for the takeover players, and over the last two decades has developed a relatively complete and stable regulatory framework for takeovers. However, the Chinese takeover law is not immune to criticism. As such, it can be expected that the takeover regime will experience some fundamental reform in coming years.

Based on the understanding that various jurisdictions have adopted different ways to regulate takeovers, China needs to seek some ideas for improving the existing takeover law, in line with the global perspective. Thus, a comparative research method is employed in this study with the aim of obtaining a better understanding of Chinese takeover law based on the earlier experiences of the UK and US. The goal of this thesis is to make an in-depth comparative analysis of the takeover regimes across the UK, US and China and put forward recommendations for Chinese takeover law reform.

To summarise the thesis, descriptions of legal regimes in the UK and US are set out in Chapters 2 and 3 respectively. Chapter 4 compares these two regimes and explains how divergences have arisen. In order to compare the Chinese regime with the UK and US regimes, Chapter 5 provides a comprehensive discussion on how the takeover regime in China has evolved and regulates takeover activities. Finally, Chapters 6 and 7 critically examine the appropriateness of Chinese takeover law in its own legal context. Chapter 8 concludes the thesis, with recommendations for future legal reform.

Chapter 1 Introduction

Takeovers have become frequent in the UK and the US since the 1960s. However, in China takeovers are a relatively new concept, and these transactions were virtually non-existent 20 years ago. The first takeover transaction did not occur until 1993, but since the late 1990s and especially with China's accession to the World Trade Organization (WTO) in 2002, takeovers have seen a growing trend within China and have attracted increasing attention all over the world.

Although takeovers are now playing an increasingly important role in the development of China's economy, it is obvious that the practice is still developing. There is still a considerable gap between Chinese practice and commonly accepted standards, due not only to lack of experience, but also to more ideological difficulties.[1] However, the desire to improve the corporate governance of Chinese domestic companies, especially state owned enterprises, through takeover transactions has pushed the Chinese government to speed up legislation.

China has so far established a relatively complete legal framework for takeovers and a level playing field for takeover participants. This is not only boosting takeovers in terms of both scale and volume, but is also encouraging more private sectors to take part in takeover activities that were previously dominated by the state or quasi-state players.[2] However, the Chinese takeover law is not immune to criticism. As such, it can be expected that the takeover regime in China will experience some fundamental reform in

[1] For a more comprehensive description of the development of the Chinese takeover market from an international business perspective, *see* Guoxiang Song and Geoff Meeks, 'The Convergence of the Chinese and Western Takeover Markets' (2009) Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1505947> accessed 31 March 2010.

[2] Hui Huang, 'China's Takeover Law: a Comparative Analysis and Proposals for Reform' (2005) 30 Delaware Journal of Corporate Law 145, 147.

coming years and eventually be transformed into a modern market- (not government-) driven system governed by general takeover law.

1. Research Purpose

In response to the booming takeover market in China, takeovers have become a topical issue, receiving a massive amount of attention among policy makers, academic scholars and professionals alike. There is a large literature which attempts to address how to develop a healthy Chinese takeover market in general. Most of this literature focuses on topics such as what are the new scenarios and challenges in the Chinese takeover market, what makes a successful takeover deal, whether or not to allow foreign capital to gain controlling positions in Chinese companies through takeovers and how to improve the Chinese takeover regime to meet international standards.

From a legal perspective, without doubt, there seems to be a consensus that it is vital to regulate the Chinese takeover market by a set of well-designed rules. Based on the understanding that various jurisdictions have adopted different ways to regulate takeovers, China is beginning to seek some suggestions for improving the existing takeover law, in line with the global perspective. In the UK and US, there is an extensive body of theoretical and empirical studies on whether their experiences of takeover law are suitable for other countries (especially in Europe), considering the differences in their own legal traditions. However, real comparative analysis about the takeover law, particularly in the UK, US and China, is very rare. Little critical work has been undertaken on a legal framework for Chinese takeovers, based on extensive legal analysis of takeover regimes in the UK and US. This thesis attempts to fill the gap by making an in-depth comparative analysis across these three countries and putting forward recommendations for Chinese takeover law reform based on understanding the UK and US regulations.

With moves to internationalisation, efforts to achieve a unification of legal rules in different countries seem to be an increasing trend. However, the debate on whether this is always beneficial is ongoing.[3] What is clear is that policy-makers, scholars and practitioners have been seeking a common language in the takeover regulation to address similar problems raised by takeover activities. This comparative study of takeover laws will enable Chinese policy makers and jurists to better understand foreign attitudes towards takeovers; it will therefore be of interest to judges and lawyers who deal with takeover cases in China and to legal reformists, in general those who aim to improve the legal system of takeovers to meet international standards. Moreover, it is hoped that the outcome of this study will contribute to the improvement of Chinese corporate governance in the context of takeovers.

2. Research Scope

Economic reform in China, which did not begin until 1978, cannot be completed overnight due to the numerous political, ideological and economic obstacles. Although the Chinese government declared in 1993 that China would move towards a market-oriented economy, signalling the end of 44 years of socialist economic planning,[4] the remarkable development of its economy required many regulatory changes, which have been introduced in piecemeal fashion. As a result, it is not surprising that the enactment of different laws and regulations at different times, on different issues and by different law-making bodies, has created a multi-layered and partly incoherent legal system in China.

---

[3] For an extensive discussion on harmonisation of takeover regulation across Europe, *see* Marc Goergen and Marina Martynova and Luc Renneboog, 'Corporate Governance Convergence: Evidence from Takeover Regulation Reforms in Europe' (2005) 21 Oxford Review of Economic Policy 243.
[4] The Third Plenary Session of the 14th Central Committee of the Communist Party of China adopted A Decision on Certain Issues in Establishing a Socialist Market Economic System on 14 November 1993.

This is certainly true of China's takeover regulation, which is fragmented with different rules applied in different scenarios, e.g. the nature of the parties involved in the takeovers, the legal form of the target company, the acquisition mode and the sector to which the target company belongs. It is therefore an impossible task for this research to cover every aspect of the existing laws with respect to takeover transactions, and to compare all of them with the takeover regimes in the UK and US.

In China, numerous laws have been promulgated to regulate foreign participation in the capital market, including sectors permitted for foreign investment, qualification to invest in the stock market, transactional procedures, ownership percentages, and so on, while domestic investors and institutions are subject to another set of laws. This work approaches the subject of takeovers primarily from the perspective of domestic companies. The focus is therefore on takeover activities carried out by Chinese domestic companies on China's mainland. It will not include takeover transactions involving foreign-invested enterprises as either sellers or buyers in China. As a result, law solely governing foreign investment will not be discussed, and in particular those cross-border takeover transactions conducted inbound and offshore in Hong Kong, Macau and beyond are excluded.

Similarly, since foreign-related takeover transactions in China will not be addressed, national economic security and anti-trust issues will fall outside the scope of this research. For the same reason, government regulations on takeovers involving state industrial policies, market access or assignment of state-owned shares and approval procedures of the relevant departments of the State will not be covered. The research concentrates on the rules governing the mechanism for takeovers without government intervention. Moreover, as Davies and Hopt have pointed out, in privately held companies, hostile takeovers are more difficult to recognise than in publicly traded companies, and also the shareholders' agency problem is less obvious.[5] Hence, listed companies are the centre of attention in this thesis and the rules discussed mainly govern takeovers of companies with shares traded on a public market.

3. Research Questions

In a global context, it is common to see a country borrow or transplant another country's laws in the development of its own national legal system. However, any transplantation of foreign law is subject to local political and economic conditions. There are significant economic and political differences between China and the UK and US, so it is necessary to find out if either the UK or US model is suitable for Chinese takeover law. The general research question of this thesis is therefore how to improve the Chinese current takeover law when comparing with the UK and US takeover regimes.

In order to provide a systematic analysis of divergent forms of takeover regime in these two highly developed capital markets, the first two research questions to answer are what are the main differences between UK and US takeover law and why these differences exist. In the pursuit of optimal doctrines for China, by balancing the advantages and disadvantages of the contrasting takeover rules in the UK and US, an attempt is made to answer the following questions: whether their current takeover rules exist in Chinese takeover law and, if yes, whether they are beneficial and suitable for China's own political and economic environment; if not, what may be suggested as possible for Chinese takeover law reform.

---

[5] Paul Davies and Klaus Hopt, 'Control Transactions' in John Armour and others (eds), *The Anatomy of Corporate Law: a Comparative and Functional Approach* (Oxford University Press 2004) 227.

4. Research Methods

With the increase in cross-border activities and the effect of widespread political movements, there is a growing need for comparison of legal systems from different jurisdictions.[6] Comparative law seems to have become the centre of interest among academic scholars and legal practitioners worldwide.

4.1 Comparative Law and Objectives

Comparative law, defined by Rainer, is a branch of jurisprudence which leads research into various aspects of different legal systems and compares and analyses them.[7] It is regarded as a 'systematic application of the comparative technique to law',[8] involving comparison of two or more legal systems, or of parts of two or more legal systems. Making the comparison provides a deeper understanding of certain features of the subject being studied, and therefore better knowledge of the different rules and institutions that are compared.[9] Meanwhile, acquiring knowledge of foreign legal systems by comparison promotes a better understanding of one's own legal system.[10]

Comparative law is regarded as one of the most effective ways to gain a better understanding of one's own legal system.[11] It helps researchers to be aware of the fact that the laws of their own legal system are not the only solution in the world. Moreover, comparative law promotes a better understanding of the foreign legal systems embraced

---

[6] *See e.g.,* Oscar G. Chase, 'Legal Processes and National Culture' (1997) 5 Cardozo Journal of International and Comparative Law 1. The author compares differences between German and American legal systems and attempts to evaluate the proposed trans-national reforms.
[7] J. Michael Rainer, *Introduction to Comparative Law* (Manz 2010) 2.
[8] Walter J. Kamba, 'Comparative law: A Theoretical Framework' (1974) 23 International and Comparative law Quarterly 485, 489.
[9] Rodolfo Sacco, 'Legal Formants: A Dynamic Approach to Comparative Law (Installment I of II)' (1991) 39 American Journal of Comparative Law 1, 5.
[10] Joan Church and AB Edwards, 'Comparative Law/Comparative Method' in Hosten (ed), *Introduction to South African Law and Legal Theory* (Butterworths 1995) 1261.
[11] Rainer (n7) 5.

in the study. In other words, comparative law provides a broader perspective of other legal systems, rather than its successes and failures.[12] As Kamba has pointed out, the knowledge gained by comparing different legal systems may help legislators to 'fashion rules or principles of positive law'.[13]

Admittedly, comparative law as a method of legal research is applied for several closely related academic and practical purposes. Firstly, it can be used to prepare or create new legislation. Secondly, it makes a significant contribution to interpreting a particular law within a national legal order. As Sacco has observed, it is one of the distinctive features of comparative law that it plays an important role in the interpretation of legal norms of various legal systems.[14] Thirdly, the comparative method can be employed in legal studies and research to seek legal unification and harmonisation. Unification refers to the process of unifying two or more different legal systems into a single system, whereas harmonisation is to eliminate major differences and create minimum standards between different legal systems.

Last but not least, comparative law serves as a means for the legislature to inform itself about other countries' solutions and to gather ideas from their experience for future legal reform. It is argued that the study of foreign legal systems becomes a legitimate enterprise only if it results in proposals for the reform of domestic law.[15] It is important to bear in mind that the above objectives of comparative law should not be regarded as exhaustive. There is no reason to require that comparative law be limited to any particular purpose. A

---

[12] Rudolf B. Schlesinger, 'The Role of the "Basic Course" in the Teaching of Foreign and Comparative law' (1971) 19 American Journal of Comparative Law 616, 618.
[13] Kamba (n8) 487.
[14] Sacco (n9) 1.
[15] Rodolfo Sacco, 'One Hundred Years of Comparative Law' (2001) 75 Tulane Law Review 1159, 1160.

comparative researcher therefore enjoys 'considerable freedom in deciding which of these purposes to pursue in any particular study'.[16]

4.2 Comparative Law in Legal Reform

It is widely acknowledged that there are diverse solutions in different legal systems trying to solve similar types of social and economic problems. Finding good solutions should not be limited to the nationality of the respective legal system as law is not national in nature.[17] The transplantation of legal rules between different legal systems is therefore 'the most fertile source of [legal] development'.[18] Smits supported this view by stating that

> all legal systems share the common goal of finding and applying the best and most just legal rules. All legal systems try to approximate this goal, and it is likely that some of them will have succeeded earlier or more convincingly that others. This means that it is useful to compare the solutions reached elsewhere with domestic solutions in order to develop one's own law in accordance with that of other legal systems.[19]

When looking at the laws of foreign countries, except for promoting a greater understanding of similarities and differences, comparative law also helps to explain why these differences exist and to initiate possible law reform.[20] Seeking a good foreign model to follow is important for legal reform. However, it is more important to find out what solution to avoid based on other countries' experience. As such, comparison makes a

---

[16] Kamba (n8) 490.
[17] James Gordley, 'Comparative Legal Research: Its Function in the Development of Harmonized Law' (1995) 43(4) American Journal of Comparative Law 555, 555.
[18] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edn, University of Georgia Press 1993) 95.
[19] Jan M. Smits, 'Comparative Law and its Influence on National Legal Systems' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (OUP Oxford 2006), 487.
[20] Hiram E. Chodosh, 'Comparing Comparisons: In Search of Methodology' (1999) 84 Iowa Law Review 1025, 1027.

great contribution to understanding foreign laws which are to be or have been borrowed and one's own legal system against their own background.[21] According to Kamba, one of the most significant functions of comparative law is to help improving national legislation by modifying or abolishing its existing rules.[22]

The UK and US have two of the most advanced judicial systems in the world dealing with stock markets and takeover transactions. These two countries have similar capital markets and business practices where most publicly listed companies have dispersed ownership, and controlling shareholders are the exception. They have both recognised the positive impact of hostile takeovers on efficient corporate governance, and have established a risk-taking entrepreneurial culture which encourages the development of takeovers as a market for corporate control.[23] A well-developed takeover regime has been set up to regulate takeover activities within their own territories. However, surprisingly, each jurisdiction has adopted a strikingly different approach towards takeover regulation.

When searching for an optimal regulatory takeover model for China, a sensible starting point would be to examine the contrasting models of the UK and US. It is also inevitable and essential to compare these two most advanced takeover regimes in order to assess the current Chinese takeover position and put forward recommendations for legislative reform. Thus, a comparative research method is employed in this study with the aim of obtaining a better understanding of Chinese takeover law and put forward a reform proposal based on the earlier experiences of the UK and US.

---

[21] Sacco (n9) 3.
[22] Kamba (n8) 495.
[23] Paul Davies, 'The Regulation of Defensive Tactics in the United Kingdom and the United States' in Klaus J. Hopt and Eddy Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths Tolley 1992) 209-210.

Although there is plenty of literature trying to determine whether one country's particular takeover regulations are better than another's, this research does not support the view that there is a single best takeover model in the world, and will try to avoid evaluating one model as superior to another, as suggested by Ventoruzzo.[24] In this research, the comparison of the UK and US takeover laws is not undertaken to discover which is the best, but to identify the main differences between these two legal systems and explain why these differences exist, more importantly, to find out the implications to Chinese takeover law reform.

China is no longer the country which historically regarded itself as the centre of the globe, without questioning the various aspects of its own legal system. She is in closer contact with other countries than ever before. Chinese policy makers and legal scholars are beginning to examine the Chinese legal system in a comparative way without treating the law as a self-contained system of legal norms. Nevertheless, it is acknowledged that learning from foreign experience does not mean simple copying. The Chinese government is attempting to construct a modern legal system by learning from overseas experience but with Chinese characteristics. The value of the comparative legal research method adopted in this thesis is not only in understanding the different ways that takeovers are regulated in the UK and US, but also, more importantly, in seeing how best to improve existing Chinese takeover law by resolving the problem of which takeover rules are suitable to the Chinese environment.

[24] Marco Ventoruzzo, 'Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends' (2006) 41 Texas International Law Journal 171, 176.

4.3 Comparative Research Methods

It is generally recognised that there is no single, comprehensive and standard method to be applied to all comparative studies and research. Different techniques and procedures are employed according to the varied comparative purposes. In this research, since the comparison is invoked as an aid to legal reform, the comparative method generally involves the following: comparing the different legal systems; determining similarities and differences between the legal systems being compared; analysing whether and how the differences between legal systems are justifiable and proposing policy recommendations for furthering legal reform. All of these basic comparative methods will be used to find the most distinctive differences between UK and US legal systems, to examine China's system against these differences and then to propose recommendations for Chinese legal reform.

In terms of the comparative process, there are four stages in this research.[25] The first stage consists of a description of the legal norms and concepts concerned, an introduction to the relevant legal history and an examination of the legal solutions provided by the systems in question. Second, the identification stage is concerned with similarities and differences between the legal systems being compared. The third, explanation stage covers the analysis and explanation of the differences between the systems under consideration. Finally, in the proposal stage, recommendations for legal reform are put forward. These stages are not distinctly separate from each other and are not necessarily undertaken in a particular order.

[25] For a more comprehensive discussion on comparative methods, *see* John C. Reitz, 'How to Do Comparative Law' (1998) 46(4) American Journal of Comparative Law 617; TJ Scott, 'The Comparative Method of Legal Research' <http://web.up.ac.za/sitefiles/file/47/J%20Scott%20-%20Comparative%20research%20perspectives%20_Private%20law_.pdf > accessed 15 April 2013.

It is worth noting that simply contrasting provisions cannot be regarded as comparative law because this is limited to a normative description. Exploring the reasons why the different legal systems have adopted different rules to solve common factual problems is essential to the comparative method. In other words, comparison as a research method cannot be completed by merely identifying differences and similarities, but must go further and seek to explain the differences. As Reitz has observed, a significant part of comparative law is answering the question of how one legal system may achieve more or less the same result as another legal system without using the same rules.[26]

In this research, two sets of comparison are employed. The comparison of UK and US law is undertaken first, and this forms the basis of understanding Chinese takeover regulations as well as its comparison with the UK and US systems. After acquiring knowledge of legal systems in the UK and US, the second comparison is conducted between the UK, US and China, with the aim of analysing the full effect of the divergence between the UK and US on Chinese takeover regulation, and to discuss the appropriateness of the practice of Chinese takeover law in its own legal context.

5. Research Structure

This thesis begins with Chapter 1 (Introduction) and ends with Chapter 8 (Recommendations). The rest is structured in six chapters as follows:

Chapters 2 and 3, belonging to the first stage of the comparative process, description, explain the relevant takeover regulations from the perspective of the UK and US. For the purpose of comparison, the investigation of individual legal regime in the UK and US provides the conceptual understanding and thus contributes to identifying the similarities

[26] Reitz (n25) 628.

and differences in the next chapter. The aim of these two chapters is to form the theoretical basis for the comparison between the UK and US systems.

After the description of both the UK and US systems, Chapter 4 seeks to compare the ways in which these two countries regulate takeover activities and to explain the reasons for the divergence between these two legal regimes. This chapter involves two stages of comparative process, namely, identification and explanation. Of the numerous takeover rules, many are universal, but some are still controversial. In Chapter 4, two controversial rules adopted by the UK are viewed as the most distinguishing differences of takeover regulation in the UK and US, namely the non-frustration rule and the mandatory bid rule. These two rules are also considered to have particularly important effect on the process of takeover activities. Based on the finding of these contrasting provisions, in order to assess the two different approaches adopted in the UK and US, substantial attention is paid to exploring the effect of these two rules, and to see whether there are functional counterbalances respectively in the UK and US.

After explaining how the divergence of takeover law in UK and US has arisen, Chapter 5 returns to the first stage of comparison to undertake a comprehensive examination of the Chinese current legal regime. It begins with the institutional background in China, regarding a series of economic reforms and their effects on Chinese corporate governance. In the Chinese environment, the transplantation of foreign law is not only path-dependent but is also subject to the local situation with unique legislative and administrative settings. Before proceeding to make the recommendations, it is necessary to understand the ownership structure of Chinese listed companies and the implications for the development of the takeover market. The purpose of this chapter is to provide a better understanding of how the takeover regime in China has evolved; to pave the way for a comparison of the

Chinese model with UK and US models; and to put forward recommendations for Chinese takeover law reform.

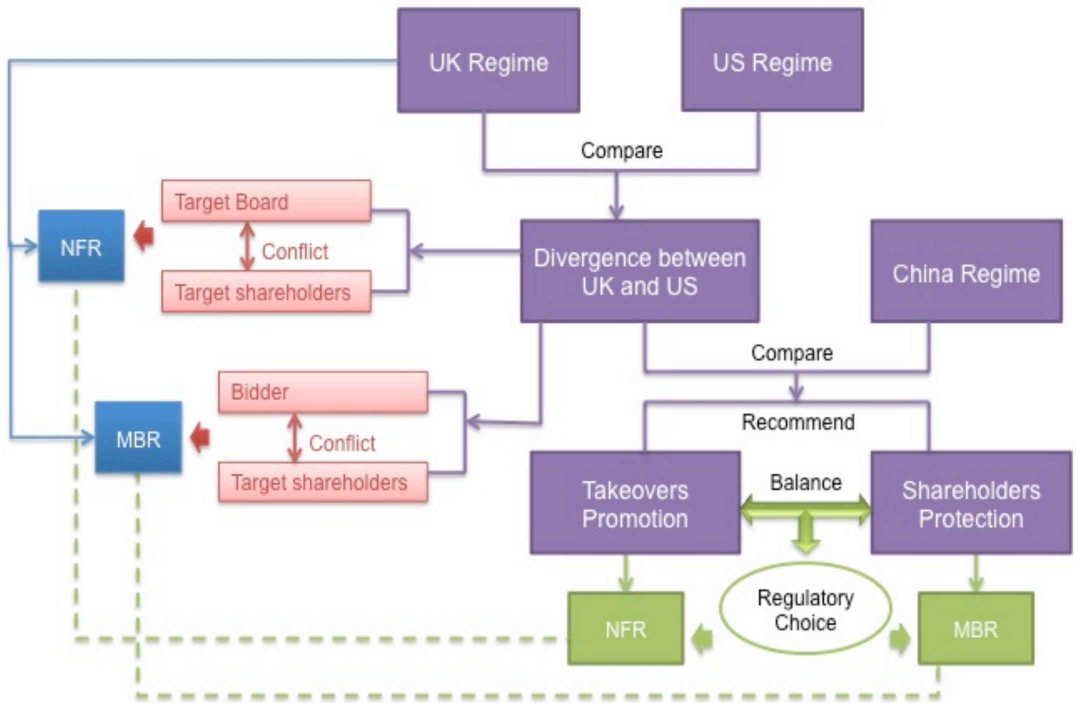
Chapters 6 and 7 critically examine China's current takeover regulations, followed by recommendations for Chinese legal reform in Chapter 8, to help Chinese legislators to improve the suitability of Chinese current takeover law when facing the trade-off between promotion of takeovers and protection of shareholders. Two comparative stages are involved in chapters 6 and 7: identification and explanation. Stage of proposal is in Chapter 8.

As the purpose of this thesis is to provide recommendations on Chinese takeover law reform, before discussing the specific elements of legal regime in China it is necessary to consider one crucial issue faced by the legislators: whether the effect of the takeover regulation is to facilitate or hinder hostile takeovers. There is a significant amount of literature debating whether hostile takeovers are good or bad. The literature which tries to justify the regulatory systems in the UK and US is reviewed in Chapter 6. This is deliberately delayed until a firm understanding is gained of how takeover regulations diverge in the UK and US and why this divergence has arisen.

Based on the examination of the arguments for and against takeovers, especially hostile takeovers, the goal of Chapter 6 is to find out: how defensive tactics should be employed, considering the relationship between the target board and target shareholders; who has the right to accept or reject the hostile takeover offer, shareholders or directors? Should the Chinese takeover law leave the shareholders to decide, as in the UK model, or protect board's right to defend against the hostile takeover as in the US?

In Chapter 7, the comparison of takeover regulations focuses on how the tender offer should be carried out, by examining the relationship between the bidder and target shareholders. The rules that protect target shareholders' interests against the opportunism of bidders, may also have an adverse effect on takeover market by facilitating competing takeover bids and thus potentially impeding takeovers. In particular, one of the most controversial rules of the equality principle, which requires the takeover bidder to make a general offer to the remaining target shareholders once it has acquired sufficient shares to obtain control of the target company, is comprehensively assessed in the Chinese context.

Figure 1-1 Structure of Thesis



6. Conceptual Background

Before discussing specific takeover regulations, it is necessary to provide a conceptual background and define the scope of certain key concepts and terms which are used throughout this work. The purpose of this section is to establish a common language to understand the analysis of the different takeover regimes which are examined in the following chapters.

6.1 Mergers and Acquisitions

It is acknowledged that similar terms can mean different things when applied in different scenarios or defined by different group of people, as in mergers and acquisitions.

From the accountant's point of view, who is left in control of the enlarged company after the takeover deal decides whether the transaction is a merger or an acquisition. In other words, the substance of the transaction is used to distinguish between mergers and acquisitions. Where two companies of similar size are combined, it does not matter whether the shareholders of the both companies exchange their shares for those in a newly merged company, or the shareholders of one of the merging companies exchange their shares for shares in the other merging company; the shareholders of the combined company mutually accept the risks and rewards of the new company and no one party to the merger obtains control over the other. This transaction is regarded by accountants as a merger. An acquisition, on the other hand, is characterised by the purchase of a smaller company by a larger one. The larger company can initiate a hostile offer to purchase the smaller firm in the face of resistance from the smaller company's management. After the deal is sealed, the larger company will receive control over the smaller one.

From the legal point of view, the mechanism used by the acquiring company determines whether the transaction is a merger or an acquisition. As a consequence, the real difference lies in how the purchase is conducted. If the acquiring company asks the target company's shareholders to agree to a reorganisation in return for cash or acquiring company's shares, this reconstruction is called a merger. However, if one company purchases another company's shares or assets and clearly establishes itself as the new owner, or the target company becomes a subsidiary of the acquiring company, the purchase is called an acquisition, no matter whether the target company ceases to exist and the buyer swallows the business, or the buyer merges the assets of the target company privately after it has become its subsidiary.

However, in this thesis, the term 'takeover' will be used simply to mean any merger or acquisition involving trading activities on the shares of a listed company with a view to acquiring corporate control, providing that there have been some public approaches rather than a purely private contract between the acquiring and target companies, e.g. buying shares in the target company, whether from all its shareholders or only the controlling shareholders, by private purchase agreement. Moreover, it needs to be stressed that 'acquirer', 'bidder', 'purchaser' and 'offeror' will be used interchangeably in this work to mean the party launching the offer for the target company.

6.2 Friendly and Hostile Takeovers

Takeovers can be either friendly or hostile. The distinction is normally based on whether the takeover is against the wishes of existing target directors and managers. Taking over a company by announcing offers to the target shareholders directly, without the support of the target board, is regarded as a hostile takeover, as against a friendly takeover where the target board welcomes the offer.[27] A hostile takeover occurs when an outsider seeks to obtain ownership of enough shares to be able to control the target company. The motives behind a hostile takeover may vary, but almost always involve at least the pursuit of

[27] John F. Weston and Mark L. Mitchell and John H. Mulherin, *Takeovers, Restructuring and Corporate Governance* (Pearson Prentice Hall 2004), 35-36.

financial gain, through replacing inefficient management of the target company in order to produce greater future profits, or incorporating the target's complementary assets into its own company for greater productivity, or breaking up a conglomerate target company to sell its component parts at a profit.[28]

Whatever the purpose, the hostile takeovers give the acquirer an opportunity to directly approach target shareholders without the need to negotiate with the target board.[29] However, generally speaking, hostile takeovers are more expensive than friendly ones as the bidding process may result in a higher premium because of the involvement of other competing bids, and extra fees such as investment bankers' fees and legal fees.[30] Friendly takeovers, on the other hand, have the risk of damaging the minority shareholders' interests, because a friendly takeover can be conducted outside the market via a private purchase agreement, in which controlling shareholders might accept a 'lower-than optimal price per share' without minority shareholders' participation.[31]

It should be kept in mind that the distinction between hostile and friendly takeovers may be less obvious than the terms suggest. Many seemingly friendly deals may have hostile components because the board's decision on whether to recommend an offer could be influenced by many elements; for example, its estimate of the bidder's chance of success in the hostile offer.[32] A friendly bid can actually be conducted under the threat of launching a hostile attack. As such, the starting point of a hostile takeover can be the target management. If the proposal is rejected by the target management, then the offer

---

[28] Barbara White, 'Conflicts in the Regulation of Hostile Business Takeovers in the United States and the European Union' (2003) 9 Ius Gentium 161, 166

[29] Jennifer G. Hill, 'Takeover, Poison Pills and Protectionism in Comparative Corporate Governance' (2010) European Corporate Governance Institute Law Research Paper No. 168/2010 <http://ssrn.com/abstract=1704745> accessed 3 May 2011, 2.

[30] Patrick A. Gaughan, *Mergers What Can Go Wrong and How to Prevent It* (John Wiley & Sons 2004) 15.

[31] Marco Ventoruzzo, 'The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?' (2006) Bocconi Legal Studies Research Paper No 06-07 <http://ssrn.com/abstract=819764> accessed 21 July 2011, 87.

[32] Erik Berglöf and Mike Burkart, 'European Takeover Regulation' (2003) 36 Economic Policy 171, 177.

can go straight to the target shareholders.[33] The bidder can threaten the target management by stating that if the offer is not recommended, the offer will be sent directly to shareholders. Similarly, a deal initiated as a hostile takeover can be completed as a friendly one.

6.3 Takeover Devices

Takeover transactions can be undertaken in various ways, used individually or collectively, namely mergers, purchase of shares on the market or a tender offer to all the target shareholders.[34]

6.3.1 Mergers

The traditional takeover device to achieve corporate reconstructions is the merger, which is initiated and controlled by a company's board, rather than its shareholders. Although a merger needs to be approved by shareholders,[35] it will be not easily achieved if an incumbent board opposes the merger proposal, because the board normally acts as goalkeeper to determine which transactions should be presented to shareholders for consideration.[36] Theoretically, shareholders are able to remove the board on their own initiative, but it is not easy for them to monitor the board and campaign for its defeat in a shareholders' meeting, due to coordination difficulties among dispersed shareholders.

---

[33] Gaughan (n30) 16.
[34] Note that a private purchase agreement with a small number of controlling shareholders is also one of the takeover devices, but it will not be discussed here as it is outside the scope of this study.
[35] In fact, it can and has been done by proxy battle, i.e. getting the voters of the target company to accept reconstruction. In the UK, for example, 75% of votes are required, rather than the usual 51%. Reconstruction can also have a tax advantage.
[36] Charles R.T. O'Kelley and Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials* (5th edn, APSEN 2006) 755.

6.3.2 Open Market Purchases

Open market purchase takes place where the acquirer simply negotiates with target shareholders and buys a certain amount of shares on the stock exchange over a period of time.[37] It can be used as a takeover device to obtain control in the target company when there is opposition from the incumbent management. However, this type of transaction is desirable only if there are a few controlling shareholders in the target company. Open market purchase might be incredibly costly if shares in the target company are widely held. Legal disclosure requirements normally make share prices spike immediately after the bidder announces the acquisition when triggering the threshold.

6.3.3 Tender offers / Takeover bids

Tender offers are made by the bidder directly to all shareholders of the target company, offering to purchase all or a certain number of the target company's shares at a specified price within a specified time, with the purpose of receiving sufficient acceptances to obtain control of the target company.[38] Tender offers are arguably the most advantageous method of acquiring the control of shares widely held in a company.[39] The hostile takeovers are mostly conducted by tender offer, which means the bid can be announced directly to target shareholders, bypassing the target management and board of directors. Of course, a tender offer can be conducted in a friendly manner if it is supported by the target board. If the bidder manages to obtain enough shares, he can take control of the target company either by using its majority status in a general meeting to replace the

[37] George Bittlingmayer, 'The Market for Corporate Control (including Takeovers)' (1998), 5 <http://ssrn.com/abstract=81808> accessed 16 July 2011.
[38] Davies and Hopt (n5) 225.
[39] Daniel R. Fischel, 'Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offer' (1978) 57 Texas Law Review 1, 6.

existing board with its own (called a proxy fight), or by merging the target company into its own company as a subsidiary.[40]

Unlike open market purchases, which may leave an offeror in a minority position with insufficient shares for control, a tender offer is exercised by private contract between the acquirer and the target shareholders on the condition of tendering enough of the outstanding shares to give control in the target company.[41] The bidder will normally offer a higher price than the current market value of those shares at the time of the offer.[42] Each target shareholder then has to make their own decision on whether to tender their shares to the bidder. If the target shareholders decide to tender their shares, once all the conditions to the tender offer have been satisfied, the bidder is obligated to buy the tendered shares from the target shareholders. The method of payment may vary, such as an exchange of cash, securities in the bidding company or a combination of these two.

In this study, the term 'tender offer' refers to a cash tender offer. This is because tender offers in cash are regarded as the most effective means now available for transferring corporate control from a resisting incumbent management to those who believe they can better manage the assets of the target company.[43] Moreover, because 'tender offer' is the term used in the US with the same meaning as 'takeover bid' in the UK, these two terms are interchangeable in this work.

---

[40] Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1996) 162.
[41] White (n28) 167. *Also see* Easterbrook and Fischel (n40) 162. The tender offer is also called voluntary transaction between the bidder and the target's investors.
[42] Ronald J. Gilson and Bernard S. Black, *The Law and Finance of Corporate Acquisitions* (2nd edn, Foundation Press 1995) 35.
[43] Patrick J. Davey, *Defenses Against Unnegotiated Cash Tender Offers* (Conference Board 1977) 1-4.

6.4 Takeover Defences

Takeover defences refer to techniques and strategies which may prevent the change of control over companies or make the target company less attractive to the bidder by raising the cost of a takeover or making it more complicated.[44] They are normally used by the target board or incumbent managers to defend an unwanted takeover bid, in order to preserve their positions in the target company. As hostile takeovers attempt increase, takeover defences are used by target boards more and more frequently to counter this threat. Takeover defences can be adopted both prior to and after the announcement of a bid (so called pre-bid defences and post-bid defences).[45] Given the great variety of defensive tactics that can used to thwart a hostile takeover, the following list comprises those being commonly adopted, but it is not necessarily exclusive. Although the defences are listed in two categories, there can be overlap between them.

Pre-bid defences are put in place in advance of any specific takeover bid, and serve to deter potential takeover bids by restricting the acquisition of shares in the target company or thwarting the exercise of control in the shareholders' meeting. Examples of pre-bid defences include: amending the articles of association to introduce poison pills (discussed below),[46] and/or staggered board (discussed below); 'dual-class stock', also known as 'super-voting stock', referring to differential share structures under which these stocks have disproportionately higher voting rights but low liquidity or dividend rights; and golden parachutes, which bind the target company to pay high compensation packages to incumbent directors and managers in the event of a change of control.

---

[44] Ventoruzzo (n24) 182.
[45] They are also known as prevention takeover defences and active takeover defences, *see* Gaughan (n30) 18.
[46] Although the poison pill technique can be adopted after a hostile takeover bid has been made, it is normally applied prior to the bid with the purpose of frightening the potential bidder.

Post-bid defences are used in the course of a takeover battle when an unwanted bidder has made an offer to the target shareholders. They include white knight (discussed below); greenmail, involving paying off a potential bidder in return for not undertaking a hostile takeover; an option to sell the most valuable business and assets ('crown jewel') of the target company, such as a patent or trade mark which may be of particular interest to the bidder, thus making the target company less attractive; share repurchase, referring to repurchase of its own shares by the target company to reduce the number of shares that are available for the potential bidder to buy and raise the share price above the bid price; Pac-Man defence involving launching a bid for the bidder's company by the target company.[47]

Some of the most typical and commonly employed takeover defences are worth discussing in more detail.

Poison Pills

Poison pills were invented by Martin Lipton in the US takeover battles of the early 1980s involving shareholder rights plans, which are amendments to the company's articles of association. They automatically trigger the issue of a large number of new shares to the target public shareholders rather than to the bidder, at a discounted price, by an event such as the bidder gaining a controlling block of the company's shares.[48] The most common poison pill is an arrangement where the existing shareholders of the target company will receive a large amount of convertible rights to preferred shares if a single shareholder obtains a specific percentage of the target's voting shares, which normally

---

[47] For a comprehensive list of takeover defences, *see* Suzanne S. Dawson and Robert J. Pence and David S. Stone, 'Poison Pill Defensive Measures' (1987) 42 Business Lawyer 423, 423.
[48] For a detailed examination of poison pill, *see* William Carney and Leonard Silverstein, 'The Illusory Protections of the Poison Pill' (2003) 79 Notre Dame Law Review 179, 181-2.

gives a controlling shareholding in the company, without approaching the target board. These preferred shares are convertible into ordinary shares at an extremely attractive price, normally half the market price.

More importantly, the potential bidder is not allowed to exercise the rights plans even if he holds shares in the target company. Poison pills are designed to dilute the bidder's shares in the target company because of the massive distribution of additional shares which are not available to the bidders. As Underhill and Austmann have pointed out, the employment of a poison pill not only destroys the bidder's voting majority, but also dilutes the bidder's investment in the target company.[49] Hence, although poison pills now take a variety of forms, they all have a common feature that discriminates against the hostile bidder.[50]

Poison pills have been widely used by target boards and described as 'the most powerful and effective' takeover defensive measure in the US.[51] According to Bebchuk et al, 'as long as the pill remains in place, no other defensive measures are necessary because the bid is completely blocked'.[52] Poison pills are used to prevent the bidder from exceeding the ownership trigger threshold and deterring them by essentially raising the cost of the bid.[53] A takeover bid will be more expensive to a prospective bidder with the existence of poison pills. It is therefore argued that following the invention of the poison pills, a target board is given the super power to easily fend off unwelcome takeover offers.[54]

---

[49] Underhill and Austmann (n48) 105.
[50] John P. Lowry, 'Poison Pills in U.S. Corporations – A Re-examination' (1992) Journal of Business Law 337, 341.
[51] Stephen Kenyon-Slade, *Mergers and Takeovers in the US and UK* (Oxford University Press 2004) 333.
[52] Lucian Arye Bebchuk and John C. Coates IV and Guhan Subramanian, 'The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy' (2002) 54 Stanford Law Review 885, 889.
[53] Tim Jenkinson and Colin P. Mayer, *Hostile Takeovers: Defence, Attack and Corporate Governance* (McGraw-Hill Book 1994) 33.
[54] John C. Coates IV, 'The Contestability of Corporate Control: A Critique of the Scientific Evidence on Takeover Defenses' (2000) 79 Texas Law Review 271, 276.

There has been notable deployment of poison pills over the last three years. In 2010, Pershing Square Capital Management and Vornado Realty Trust acquired 26% of shares in the retail giant J.C. Penney. J.C. Penny, which adopted a poison pill to avoid a larger buyout in the company by diluting their holdings with new offers, should there be an attempt to purchase additional shares. In 2011, Air Productions threatened to buy out Airgas. Airgas tried to deter the takeover by using a poison pill to place the stock price higher than Air Productions could afford to pay. Lundin, a copper and zinc mining company, used a poison pill to thwart a takeover by issuing new shares if a single company offered to buy 20% or more of the shares of the company.[55]

In addition to making the hostile takeover prohibitively expensive, poison pills give power to the target board to revoke the pill either before or after the occurrence of a triggering event, which enables the target board to consider a friendly takeover bid. Poison pills are usually redeemed if a target board wants to sell the company to a friendly acquirer. Their existence compels a potential bidder to approach the target board directly and negotiate a settlement with them before making a tender offer.[56]

Although there are arguments which claim that poison pills only serve to 'entrench management and encourage disaffected shareholders to litigate',[57] poison pills have been in widespread use due to their ability to delay a hostile takeover bid, giving the target board time to adopt other defensive measures and, more importantly, making the deal unattractive to the bidder by increasing the overall costs of launching a bid. The other reason for the popularity of the poison pills as a defensive tactic in the US, is that it can

---

[55] For more information about the cited three cases, *see* Kalen Smith, 'How Companies Use Shareholder Rights Plans (Poison Pills) to Fight Hostile Takeover' <http://www.moneycrashers.com/poison-pills-fight-hostile-takeovers/> accessed 10 April 2012.
[56] Barbara White (n28) 171.
[57] Donald M. DePamphilis, *Mergers, Acquisitions, and Other Restructuring Activities: An Integrated Approach to Process, Tools, Cases, and Solutions* (4th edn, Academic Press 2008) 112.

be adopted by the target board without the approval of target shareholders, in order to deter unwanted bids effectively and easily.[58]

Staggered board

A staggered board is a specific type of pre-bid defence designed to strengthen the target board's ability to remain in control.[59] The board is divided into several, usually three, parts of approximately equal size; and each can only be re-elected or removed in staggered years. As a result, even where a bidder has purchased a majority of the target's shares, it is unable to appoint a majority of the target board until two successive elections have taken place because only one-third of the board can be removed annually. The difficulty of replacing the existing board allows the target board to retain control for a longer time. The threat of delay is enough to force a bidder to approach the existing target board, as no bidder would wish to wait for at least two annual elections of directors to gain control of the target board.

In practice, the staggered board is often used in conjunction with poison pills to serve as an even more powerful anti-takeover mechanism. The staggered board makes it difficult for a bidder to replace the target board members either by initiating a proxy fight or re-election at a shareholders' meeting so that the new board can redeem the poison pills and the bidder can proceed with its takeover offer. It is argued that the combination of staggered board and poison pills provides enormous discretion to the target board to

---

[58] Jennifer G. Hill, 'Takeover, Poison Pills and Protectionism in Comparative Corporate Governance' (2010) Working Paper No. 168/2010 <http://ssrn.com/abstract=1704745> accessed 17 February 2013, 4; *also see* Lucian Arye Bebchuk and Allen Ferrell, 'A New Approach to Takeover Law and Regulatory Competition' (2001) 87 Virginia Law Review 111, 116.
[59] MDePamphilis (n57) 110.

fender offer a hostile bid and is proven to raise the odds of a target company remaining independent from 34% to 61%.[60]

White Knight

A white knight is a defence which allows the target board to find a more appropriate and friendly bidder to acquire the target company, following the receipt of a hostile offer from an unwelcome bidder. The alternative bidder, whose bid is recommended by the target board, is classified as a 'white knight'.[61] The white knight must be willing to acquire the target company on more favourable terms than the current bidder's offer, which could be a higher offer price or willingness to keep the target current board in place after the deal is sealed. In the face of a hostile takeover bid, the target board will recommend another bidder largely because it is deemed that a change of control in the target company is inevitable.[62]

7. Corporate Governance and Takeover Regulation

Put simply, corporate governance means governance of companies.[63] Companies, one of the three general forms of business organisation (along with sole proprietorships and partnerships), were designed to encourage the investment of capital by limiting shareholders' losses from bankruptcy to their investment, excluding assets held in their own name.[64] The Organization of Economic Cooperation and Development (OECD) issued its influential *OECD Principles of Corporate Governance* in 1998 and stated that corporate governance identifies the distribution of rights and duties of different

---

[60] *See* Bebchuk and Coates IV and Subramanian (n52).
[61] Jenkinson and Mayer (n53) 32.
[62] ibid.
[63] Note that 'company' and 'corporation' are used interchangeably in this thesis.
[64] John Armour and Henry Hansmann and Reinier Kraakman, 'What Is Corporate Law' in John Armour and others (eds), *The Anatomy of Corporate Law A Comparative and Functional Approach* (Oxford University Press 2004) 9.

participants such as board, managers, shareholders and other stakeholders in the corporation.

7.1 Corporate Ownership

It is generally recognised that shareholders have two forms of ownership right, cash flow right and control right. Cash flow rights enable shareholders to receive the generated profits of the company, while control rights give them voting rights to manage the assets they own in the company. There are two distinct types of corporate ownership internationally, depending on the level of concentration of these two shareholder rights, dispersed or concentrated.[65] It is argued that the concentration level of corporate share ownership is crucial in maximising the firm's value.[66]

Under dispersed ownership, both cash flow rights and control rights are widely distributed among the shareholders, and no single shareholder or a group of shareholders is able to control the company. In contrast, concentration ownership means that not only cash flow rights are concentrated, but also control rights are held by one or a group of controlling shareholders. When shareholding is dispersed, cash flow rights and control rights are usually linked together by 'one-share-one-vote' rules and thus result in freely tradeable dispersed control by numerous shareholders. However, in a company with concentrated ownership, these two types of right are separated and concentrated control in the hands of those who hold controlling shares in the company.[67]

---

[65] *See* Rafael La Porta and Florencio Lopez-De-Silanes and Andrei Shleifer, Corporate Ownership Around The World (1999) 54(2) Journal of Finance 471, 492-3.
[66] Harold Demsetz and Kenneth Lehn, 'The Structure of Corporate Ownership: Causes and Consequences' (1985) 93 Journal of Political Economy 1155, 1158.
[67] Markus Berndt, 'Global Differences in Corporate Governance Systems Theory and Implications For Reforms' (2000) Harvard Law and Economics Discussion Paper No 303 <http://www.law.harvard.edu/programs/olin_center/papers/pdf/303.pdf> accessed 31 March 2013, 9-10.

7.2 Agency Costs

Agency costs arise between two parties, principal and agent. When the agent promises to take action for the welfare of the principal, but acts in his own interest instead, agency costs are incurred.[68] Since there are many interested parties associated with business, principal and agent relations exist in various ways; for example, shareholders and management, controlling shareholders and minority shareholders, creditors and shareholders. The importance of corporate governance derives from a need to monitor the behaviour of different interested parties and to minimise the agency costs of these principal and agent relations.[69] This thesis focuses on the conflicts of interest between the target shareholders and directors in dispersed ownership companies and controlling shareholders and minority shareholders in concentrated ownership companies.

In a publicly held company, agency costs arise largely because of the separation of ownership and management. As Berle has famously pointed out, shareholders lose much of their control, particularly in a large company with a widespread shareholding, through the separation of ownership and management in the modern corporation.[70] Although shareholders are still the owner, they do not act in the same way as the traditional owner. In a dispersed shareholding company, each shareholder holds a very small percentage of the total shares outstanding, and thus has less and less incentive to oversee the operations of the company. For this reason, shareholders hire managers to deal with daily matters and expect them to pursue the business goals and maximise financial gains on their

---

[68] Armour and Hansmann and Kraakman (n64) 35.
[69] Z. Jun Lin and Linming Liu and Xu Zhang, 'The Development of Corporate Governance in China' (2007) Company Lawyer 195, 195.
[70] Adolf A. Berle, 'Corporation Powers as Powers in Trust' (1931) 44 Harvard Law Review 1049, 1146.

behalf.[71] According to Berle and Means, the wealth of a great number of individuals is aggregated under the direct control of a few professional managers.[72]

When managers are in charge of a company's daily affairs, shareholders are not usually in a position to change the actions of managers when they do not approve of them. Hence, there is potential conflict of interest between those who actually control the company and beneficial ownership.[73] When managers, the agents of the shareholders, pursue their own self-interest at the expense of shareholders, the owners of the company are said to incur agency costs. As Forstinger has observed, agency costs always exist to some extent and can never be completely eliminated.[74] As a result, under the dispersed ownership structure, the focus of corporate governance is to reduce these agency costs and make management accountable.

In the case of concentrated ownership companies, where the controlling shareholders are able to monitor the managers, there is less concern that the managers will take actions that are not in the best interests of shareholders. Nevertheless, agency costs arise between controlling shareholders who own the majority of the controlling interest, and non-controlling shareholders (minority shareholders). Concentrated ownership gives the controlling shareholder substantial discretionary powers to use the firm's resources to benefit themselves at the expense of minority shareholders; for example, transferring resources out of the company to parent or other related parties.[75] Hence, non-controlling

---

[71] Gaughan (n30) 215
[72] Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (Transaction Publishers 1991) 84.
[73] Frank J. Garcia, 'Protecting Nonshareholder Interests in the Market for Corporate Control: A Role for State Takeover Statutes' (1990) 23 University of Michigan Journal of Law Reform 507, 512
[74] Christin M. Forstinger, *Takeover Law in the EU and the USA: A Comparative Analysis* (Kluwer Law International 2002) 73.
[75] Chong-En Bai and others, 'Corporate Governance and Firm Valuations in China' (2002) <http://ssrn.com/abstract=361660> accessed 9 May 2013, 9.

shareholders are subject to agency costs when their interests are expropriated by the controlling shareholders.

7.3 Directors' Fiduciary Duties

In order to minimise the agency costs, a board of directors is elected by shareholders to look after their interests by overseeing management. The directors are usually members of management, apart from the chief executive officer and independent directors. As Easterbrook has pointed out, shareholders have ownership without control while directors have control without ownership.[76] The directors, in turn, appoint managers to run the company, and dismiss them on behalf of the shareholders. The directors do not generally monitor the company on a daily basis but receive periodic updates from management and review their performance through various financial statements.

As argued by Cheffins, the separation of ownership and control is central to both the success of the corporation and 'its gravest abuses'.[77] The main advantage of separation is that it enables company resources to be used more efficiently and managed towards a unified set of goals. However, it gives directors enormous power over the company, including the power to hire and fire its chief officer. There is a risk that directors may take advantage of their superior information to use corporate resources for their personal interest.[78] As Adam Smith stated,

> The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected that they should

---

[76] Frank H. Easterbrook, 'Manger's Discretion and Investors' Welfare: Theories and Evidence' (1984) 9 Delaware Journal of Corporate Law 540, 540.
[77] Brian R. Cheffins, Corporate Ownership and Control: British Business Transformed (Oxford University Press 2009), 14-16.
[78] Margaret McCabe and Margaret Nowak, 'The Independent Director on the Board of Company Directors' (2008) 23 Managerial Auditing Journal 545, 555.

> watch over it with the same anxious vigilance with which the partners in a private company frequently watch over their own. Like the Stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail more or less, in the management of the officers of such a company.[79]

At this point, the law enters to solve the problem and regulate directors to act in the interests of shareholders by imposing fiduciary duties on them. Directors' fiduciary duties are now a well-accepted body of law in almost all jurisdictions. 'Fiduciary' was defined by Millet L.J. as '… someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence … The principal is entitled to the single minded loyalty of his fiduciary'.[80] Therefore a fiduciary owes a duty to his principal and must act solely in the interest of that principal. This is the essence of fiduciary duties. When directors are insufficiently diligent and do not require managers to act in shareholders' interests, they breach these fiduciary duties.[81]

In the context of hostile takeovers, there is an even more severe conflict of interest between board and shareholders. Therefore, in addition to the fiduciary duties owed to shareholders by the directors when they monitor the management of the company, a set of specific duties is established by takeover regulations with which the target directors need to comply when attempting to employ defensive measures to fend off a takeover bid.

[79] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Random House 1776) 741.
[80] *Bristol and West Building Society v Mothew* [1996] 4 All ER 698, 716.
[81] Gaughan (n30) 215.

These duties can be more demanding than the fiduciary duties as shareholders are more vulnerable in the context of takeovers.

7.4 Market for Corporate Control

A functioning takeover market, also known as a market for corporate control, is claimed as a key corporate governance mechanism to mitigate agency costs in public held companies.[82] The market for corporate control is thought to be one of most vital concepts of corporate governance, allowing corporate control to shift to managers who can employ the assets more profitably. It is worth mentioning that a market for corporate control works well only when the target company's shares are in dispersed ownership, because small and scattered shareholdings are more likely be obtained in the stock market and thus make the takeover against management possible.[83]

During the 1960s merger wave, the concept of a market for corporate control was introduced by Henry Manne in his famous work *Mergers and the Market for Corporate Control*.[84] Manne has argued that, 'the lower the stock price, relative to what it could be with more efficient management, the more attractive the takeover becomes to those who believe that they can manage the company more efficiently'.[85] Later, Fischel agreed that 'the lower the market price of the securities compared to what it would be with better management, the more attractive the firm is to outsiders with the ability to take the firm over'.[86]

---

[82] Mike Burkart and Fausto Panunzi, 'Mandatory Bids, Squeeze-Outs and Similar Transactions' in Guido Ferrarini and others (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004) 743.
[83] Fischel (n39) 9.
[84] Henry Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110, 110.
[85] ibid 113.
[86] Fischel (n39) 5.

In a more recent restatement, according to Gilson the market for corporate control states that:

> a decrease in corporate profits, whether because of inefficient management or because of efficient but self-dealing management has diverted too much income to itself, cause the price of corporation's stock to decline to a level consistent with the corporation's reduced profitability. This creates an opportunity for entrepreneurial profit. If shares representing control can be purchased at a price which, together with the associated transaction costs, is less than the shares' value following displacement of existing management, then everyone – other than the management to be displaced - benefits from the transaction. Selling shareholders receive more for their stock than its value under previous management; new management receives an entrepreneurial reward through the increased value of acquired shares; the society benefits from more efficiently used resources.[87]

The market for corporate control is based on the theory of an efficient capital market, suggesting that share price accurately and promptly reflects the value of the firm based on all publicly available information. It is argued that, in an efficient capital market, the ability of its management could be one of the factors affecting the share price of the company. If a business is poorly managed, its share price will be lower than under more competent management. This poor management, reflected in the low share price, could attract a potential takeover bidder's attention. In other words, the tender offer at a premium price over the market price indicates that removing the incumbent management would generate more financial gain for the bidder.

---

[87] Ronald J. Gilson, 'A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers' (1981) 33 Stanford Law Review 819, 841-2.

Takeovers are therefore regarded as a key mechanism in determining the active allocation of corporate control by transferring inefficiently used assets to those who can use them more efficiently.[88] Allen has suggested that the company benefits from corporate control if it can be transferred freely between buyers and sellers, and its assets subject to most efficient use.[89] When there is a difference between a company's current share value, reflected in its potential value, added to by the more efficient management, the bidder can profit by buying and improving the management. In the meantime, shareholders gain from the shifting control because they receive a premium over the market price.

In addition to the financial gains from a takeover offer, as Easterbrook and Fischel have pointed out, shareholders benefit even if their company never becomes a takeover target.[90] Managers may have strong incentives to improve a company's performance to keep share prices high, so as to reduce the probability of being a target for a takeover bid, because the threat of a successful takeover bid often results in the replacement of current management. Monitoring by outsiders therefore poses a threat to management if they operate the company inefficiently.[91]

The market for corporate control, combined with the threatening role played by hostile takeovers in particular, is of great importance in creating incentives for management to maximise the welfare of shareholders. As a result, takeovers are regarded as an external corporate governance mechanism that disciplines managers to act in the interests of the shareholders. As Nuttall has stated, managers are more disciplined, operate more

---

[88] Donald Kummer and J. Ronald Hoffmeister, 'Valuation Consequences of Cash Tender Offers' (1978) 33 Journal of Finance 505, 505.
[89] William T. Allen, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 Cardozo Law Review 261, 269.
[90] Easterbrook and Fischel (n40) 173.
[91] Fischel (n39) 9.

efficiently, and pay more dividends to shareholders when there is the threat of a hostile takeover.[92]

7.5 Takeover Regulation

The regulatory framework is regarded as an important mechanism in establishing sound corporate governance and curtailing market misconduct.[93] Takeover regulation is defined as the body of rules under which takeover activities must be conducted within a particular system.[94] It constitutes an important part of corporate governance, affecting the level of shareholder protection and the development of the market for corporate control. Takeover regulation therefore influences the distribution of gains from takeovers among those parties whose interests are directly involved, namely the bidders, target board and target shareholders.[95]

From the bidders' perspective, they prefer rules that make takeovers easier and enable them to gain control of the target with fewer barriers. The target board, who want to retain their positions in the target company, prefer rules that make takeovers harder. When both bidders and target board have roughly equal resources, it is suggested that takeover regulation is not justified in favouring either side. In the face of a takeover, especially a hostile one, existing shareholders are very vulnerable as both the bidders and target board can expropriate their wealth. Hence, ensuring fairness and justice for shareholders is regarded as one of the main goals of takeover regulation. As Ferrarini and Miller have argued, takeover regulation should be reasonably even-handed as between bidders and

---

[92] Robin Nuttall, 'An Empirical Analysis of the Effects of the Threat of Takeover on UK Company Performance' (1999) Nuffield College, University of Oxford, Working Paper No. 5 < http://ssrn.com/abstract=155561 > accessed 12 July 2011, 5-7.
[93] Yuwa Wei, 'Maximising the External Governance Function of the Securities Market: A Chinese Experience' (2008) International Company and Commercial Law Review 111, 115.
[94] Ventoruzzo (n31) 6.
[95] Berglöf and Burkart (n32) 174.

target board, but principally aimed at protecting shareholders.[96]

However, shareholder protection rules may have an adverse effect on the takeover market. One of the fundamental dilemmas of takeover regulation is to balance the conflict of interest between bidders and target shareholders. The takeover regulation will be considered to be target-friendly when it makes hostile takeovers more costly for bidders, or even impedes them altogether. In addition, the target board potentially faces a conflict of interest between maintaining the independence of the target to keep their jobs and allowing the takeover to create value for its shareholders. This conflict is intensified in the context of hostile takeovers. As a result, a set of rules is required to govern the behaviour of directors and deal with the issue of who has the right to adopt takeover defences and decide whether to accept or reject a takeover bid.

In spite of the fact that promotion of an efficient takeover market and protection of shareholders can be consistent in some instances, in most situations they may be diametrically opposed.[97] A functioning market for corporate control cannot be achieved separately from the protection of shareholders. As Huang has suggested, the best possible takeover regulation 'consists of nothing more than trying to strike a balance between promoting takeover market and protecting shareholders' interests'.[98] However, takeover regulation cannot be neutral with regard to its outcome because it ultimately determines who win the battle and survive in the takeover market.[99] There are no specific figures to show how far shareholder protection should be at the cost of reducing the possibility or

---

[96] Guido Ferrarini and Geoffrey P. Miller, 'A Simple Theory of Takeover Regulation in the United States and Europe' (2009) NYU Law and Economics Research Paper No. 09-42 <http://ssrn.com/abstract=1497083> accessed on 12 July 2011, 3.
[97] Berglöf and Burkart (n32) 183.
[98] Huang (n2) 159.
[99] Ventoruzzo (n31) 6.

threat of takeovers. It is the legislator's job to make a trade-off on the basis of the particular political situation and the changing commercial environment.

Chapter 2 Takeover Regime in the United Kingdom

Takeover law in the UK has arguably the longest history in the regulatory experience of takeovers.[100] The conduct of takeovers and mergers is regulated by the Panel on Takeovers and Mergers (Takeover Panel) and subject to the principles and rules of the City Code on Takeovers and Mergers (City Code). The Takeover Panel and the City Code have traditionally operated without statutory backing. With the implementation of the European Directive on Takeover Bids 2004/25/EC (Takeover Directive), they have been given the force of law for the first time in their long history.

1. The City Code and the Takeover Panel

The City Code has developed since 1968 to reflect the collective opinion of those professionally involved in the field of takeovers, addressing issues such as appropriate business standards, fairness to shareholders, and an orderly framework for takeovers. However, the City Code was not enacted to determine the financial advantages of a takeover, as these are matters for the company and its shareholders to decide; nor does it deal with the public interest, which is within the scope of government and competition authorities.[101]

The Takeover Panel was established as an independent body to issue and administer the City Code and to supervise and regulate takeovers and other matters to which the City Code applies, in accordance with the General Principles and Rules set out in the City Code.[102] Under Section 942(2) of the Companies Act 2006, the Takeover Panel may ‘do anything that it considers necessary or expedient for the purpose of, or in connection with, its function’. The Takeover Panel’s main function is to ensure that shareholders are treated fairly, that they

[100] For a review of the regulatory history in the UK, *see* Robert R. Pennington, ‘Takeover Bids in the UK’ (1969) 17(2) American Journal of Comparative Law 159.
[101] City Code, Introduction 2(a).
[102] City Code, Introduction 1.

are not denied an opportunity to decide on the merits of a takeover, and that shareholders of the same class are afforded equivalent treatment by an offeror.

1.1 History of the City Code

In the UK, hostile takeovers did not occur until 1953, when Charles Clore, for the first time, sent a tender offer directly to the shareholders of shoe retailer J. Sears & Co.[103] He informed one of the J. Sears & Co. directors of his interest in purchasing the company and asked the board to recommend to its shareholders so that they can accept an offer from him. The board turned down his proposal. As Armour has argued, Clore's first attempt appeared as an enormous shock for the target board in particular, as well as for the City in general.[104] Responding to this, the target board was desperate to frustrate these unwanted bids, so as to protect themselves against losing their positions in the company.

The emergence of the hostile takeovers at that time is explained by a number of factors.[105] For the first time, the Companies Act 1948 required companies to disclose information on their current earnings, which made them more readily detectable by outsiders.[106] The sharply increasing tax burden on companies also caused a large reduction in company profits. According to the findings of Bull and Vice, generally speaking the dividend to shareholders was reduced from 52% of gross trading profits in 1938 to 20% in 1952.[107] Because of the low level of distribution to shareholders, share prices failed to keep pace with companies' growth. Furthermore, under the restructuring of British industry, the main focus of

---

[103] For more details regarding this case, *see* Richard Roberts, 'Regulatory Responses to the Rise of the Market for Corporate Control in Britain in the 1950s' (1992) 34 Business History 183, 185-7.
[104] John Armour, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' in John Armour and Jennifer Payne (eds), *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009) 112.
[105] For a more comprehensive analysis of the reasons for the emergence of hostile takeovers in the UK, *see* Andrew S. Johnston, 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 Cambridge law Journal 422, 427.
[106] Ross Cranston, 'The Rise and Rise of the Hostile Takeover' in Klaus J. Hopt and Eddy Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths Tolley 1992) 79.
[107] George Bull and Anthony Vice, *Bid for Power* (3rd edn, Elek Books 1961) 30.

manufacturing shifted from textiles and heavy capital goods to light electrical engineering and machine tools. These changes made the differences between efficient and inefficient companies more visible than before, so indicating a growing number of undervalued target companies that were taken over by the hostile bidders, with the aim of realising maximum profits on return.[108]

In another famous case in 1953, the board of Savoy Hotel Ltd adopted a complex scheme known as 'the Worcester Scheme' to frustrate a bid, with the aim of preventing a bidder from changing into offices its wholly owned subsidiary Berkeley Hotel Ltd, without the approval of its shareholders.[109] The Board of Trade appointed Mr. E. Milner Holland, Q.C., a leading barrister in company matters, to investigate the conduct of the Savoy Hotel's board, and to report whether the board's action was improper.[110] After the investigation, Mr. Holland concluded that the action of the directors was invalid, although they believed that it had been in the best interests of the company and its shareholders, because in his opinion, 'such a use of directors powers … however proper the emotive behind it, is not a purpose for which those powers were conferred on the Board …' and the shareholders of the Savoy Hotel were not given the opportunity to 'alter the decision of their present board as to the present or future use of the property of the Company' as they were not consulted.[111]

Uncertainty regarding the target board's right to take action upon a hostile bid emphasised its discretion in using defensive measures to thwart an unwanted bid. In the meantime, the hostile bidders were free to doing whatever they should to make their bid succeed. However, it was the target shareholders who really lost out in this practice, as they were not normally

[108] ibid 29.
[109] For more details regarding this case, *see* L.C.B. Gower, 'Corporate Control: The Battle for the Berkeley' (1955) 68 Harvard Law Review 1176, 1176-1194.
[110] Under Section 165 of the Companies Act 1948, the Board of Trade can appoint an inspector to report on the legal position.
[111] The Savoy Hotel Limited and the Berkeley Hotel Company Limited: Investigation under Section 165(b) of the Company Act 1948: Report of Mr. E. Milner Holland Q. C., 27. (Her Majesty's Stationery Office 1954).

given the opportunity to have voice an opinion on the takeover bid.[112] As a result, there was a strong need for regulatory intervention to protect shareholders' interests. In response to this, the courts applied the proper purpose doctrine to scrutinise takeover defences.[113] However, institutional investors, who were the main lobby group for takeover-related legislation in the UK, called for a Code of Conduct to regulate hostile takeovers by enacting proper law, because the delay caused by the litigation and the uncertainty of courts' decisions were not acceptable.[114]

As a result, in 1959, the Governor of the Bank of England set up a City Working Party, formed of representatives from institutional investment entities, merchant and commercial banks, and major organisations in City,[115] to produce the first set of regulations specifically dealing with takeovers, based on the philosophy that takeovers were beneficial to the business community if they were properly regulated. *Notes on the Amalgamations of British Businesses* (Notes) was published in October 1959, laying down the general principles that there should be no interference in the free market for the shares of companies, that shareholders are entitled to make the decision on whether to sell or retain their shares, and that shareholders should be given adequate and timely information in order to enable them to make a sound decision.[116] It can be seen that the principle of shareholder primacy was established at the beginning of regulatory experience of takeovers in the UK.

As Johnston has commented, the Notes was regarded as the first experiment in self-regulation in the UK in relation to takeovers, and in many ways shaped the form of the City

---

[112] Jonathan Mukwiri, 'The Myth of Tactical Litigation in UK Takeovers' (2008) 8 Journal of Corporate Law Studies 373, 374.
[113] *Hogg v Cramphorn* [1967] Ch 254.
[114] Johnston (n105) 442.
[115] The Issuing House Committee, The Accepting Houses Committee, The Association of Investment Trusts, The Committee of London Clearing Bankers, The British Insurance Association and the Stock Exchange.
[116] For more information about Notes, see Andrew S. Johnston, *The City Takeover Code* (Oxford University Press1980) 29.

Code that was to come later.[117] However, the absence of mechanisms for adjudication and enforcement meant that the Notes' influence on the UK takeover market was still inadequate in terms of protecting shareholders.[118] The increasing adoption of takeover defences by target boards, along with the call for a statute to regulate takeovers, led to revising and extending the Notes and, in 1967, the drafting of a new set of takeover rules by the Bank of England's City Working Party:[119] 'the City Code' came into effect on 27 March 1968. The Takeover Panel was established on the same day, to supervise the administration of the City Code and give authoritative rulings and advice on its application. The UK's non-statutory takeover regime was formally established at that point and was well received by City participants in general.

1.2 Implementation of the Takeover Directive

The Takeover Directive was adopted by the European Parliament and the Council of the European Union on 21 April 2004, after just over thirty years of negotiation. The first proposal of a directive with regard to takeover bids dates back to 1989. For the first time, minimum EU rules were set in force, governing takeovers of companies whose shares are traded on a regulated market.[120] The aim of the Takeover Directive was to promote the competitiveness of European companies, to strengthen the single market in financial services by facilitating cross-border restructuring, and to enhance minority shareholder protection within the European Union.[121]

---

[117] Johnston (n105) 432.
[118] John Armour and David A. Skeel Jr, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation' (2007) 95 Georgetown Law Journal 1727, 1759.
[119] The Confederation of British Industry and the National Association of Pension Funds were added to the membership of the City Working Party.
[120] For a definition of regulated markets, see article 4.1(14) of the Takeover Directive.
[121] Joseph A. McCahery and others, 'The Economics of the Proposed European Takeover Directive' in Ferrarini Guido and others (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004) 46.

The Takeover Directive had to be implemented by all European Member States no later than 20 May 2006. In response to this requirement, the UK Government implemented it by bringing into force the Takeovers Directive (Interim Implementation) Regulations 2006 (Regulations 2006) on 20 May 2006 to meet the implementation deadline for the Takeover Directive. The Regulations 2006 put the City Code and the Takeover Panel on a statutory footing for the first time. It ceased to have effect when the Companies Act 2006 (CA 2006) came into force on 6 April 2007. Under part 28 of the CA 2006, the rules set out in the City Code now have the force of law and the Takeover Panel now has a statutory status for making and enforcing the City Code.

Although the UK government had to implement the Takeover Directive and give the City Code and the Takeover Panel statutory backing, it had always intended to produce a system in compliance with the Takeover Directive, but, importantly, one in which the Panel could operate in practice much as before. Under the new statutory framework, the essential characteristics of the takeover regime overseen by the Takeover Panel have been recognised and preserved, including flexibility, speed and certainty in decision making, independence and regulatory autonomy, principle-based regulation, the involvement of key City and business participants in developing takeover rules, professional expertise in regulatory activities, and a consensual approach to regulation amongst those involved in the markets.[122] As the director general of the Takeover Panel, Mr. Robert Hingley, has emphasised, 'these characteristics are important to the financial community in order to avoid over-rigidity of the Rules and the risk of takeovers becoming delayed by litigation of a tactical nature, which may frustrate the ability of shareholders to decide the outcome of an offer'.[123]

---

[122] Department of Trade and Industry, 'Implementation of the EU Directive on Takeover Bids Guidance on Changes to the Rules on Company Takeovers' (2006) April.
[123] Robert Hingley, 'The Takeover Panel' in Maurice Button (ed), *A Practitioner's Guide to The City Code on Takeovers*

It is worth mentioning that there have been no dramatic changes to the content of the City Code since the implementation of the Takeover Directive in 2007. After all, the substantive content of the Takeover Directive was significantly influenced by the City Code and its key provisions.[124] As Johnston has noted, 'in terms of content, nothing has changed since the Directive was implemented, although some of the Code's provisions now have Parliamentary approval'.[125] Although the CA 2006 provides the Takeover Panel with statutory power to supervise takeover bids, it replicates the City Code's existing rules and procedures to the greatest extent possible.[126] The Panel continues to make rulings on the interpretation, application and effects of the City Code and to give directions as it did under the non-statutory system.

1.3 Overview of the City Code

The City Code comprises an Introduction, General Principles, Definitions, Rules and related Notes and Appendices, and the Rules of Procedure of the Hearing Committee. The rules may change from the time to time.[127]

1.3.1 Structure of the City Code

The City Code has been revised several times since it came into force in 1968. Its first version consisted of ten General Principles and 35 rules. It now contains six General Principles which provide the core regulatory philosophy and standards of commercial behaviour.[128] These six General Principles are all taken directly from Article 3 of the Takeover Directive. They replaced the original ten General Principles and apply to takeovers

---

and Mergers 2008/2009 (City and Financial Publishing 2008) 2.
[124] Such as the non-frustration rule and mandatory-bid rule, key elements of the City Code for decades, which also become fundamental provisions in the Takeover Directive.
[125] Johnston (n105) 488.
[126] Mukwiri (n112) 375.
[127] City Code, Introduction 1.
[128] City Code, Introduction 2(b).

and other matters to which the City Code applies. It is worth mentioning that although these principles all come from the Takeover Directive, they are mainly based upon the previous General Principles of the old City Code. They are expressed in broad general terms and the City Code does not define the precise extent of, or limitations on, their application. They are applied in accordance with their spirit in order to achieve their underlying purpose.

In addition to the General Principles, the City Code now contains 38 specific rules which fall into two categories: expansions of the General Principles and provisions governing specific aspects of takeover procedure. The rules are in some cases accompanied by extensive notes, setting out interpretations and practices which have become established through actual cases brought before the Takeover Panel or the Takeover Panel Executive. Although most of the rules are drafted in less general terms than the General Principles, they are framed in non-technical language and should to be interpreted so as to achieve their underlying purpose, like the General Principles. Therefore, their spirit must be observed as well as their letter.[129] The Takeover Panel will block actions that breach the spirit of the City Code, although they may comply technically with the rules of the City Code.

1.3.2 Jurisdiction of the City Code

The scope of the companies and transactions to which the City Code applies was substantially amended to reflect the implementation of the Takeover Directive. The Takeover Directive determines the scope of jurisdiction of the competent authority in any EU Member State by reference to the location of the registered office of the target company and the regulated market on which its securities are traded.

[129] City Code, Introduction 2(b).

Since the Takeover Directive was implemented in 2007, the City Code has applied to all offers for companies which have registered offices in the UK, the Channel Islands or the Isle of Man, if any of their shares are listed on a regulated market in the UK[130] or on any stock exchange in the Channel Islands or the Isle of Man. Therefore, an offer for a company whose shares are listed on a UK market that is not a regulated market, such as AIM or the PLUS Quoted Market, will only be subject to the City Code if the company satisfies the residency test. The residency test refers to whether the company's place of central management and control lies in the UK, the Channel Islands or the Isle of Man. When considering whether a company is resident, the Takeover Panel will look at the structure of the board, the functions of the directors and other relevant major influences on the management of the company.[131]

The City Code applies to a wider range of transactions than those covered by the Takeover Directive, which only applies to public, control-seeking offers. The City Code also applies to takeover bids, mergers and other transactions that are used to obtain or consolidate control of a relevant company, as well as partial offers to shareholders for shares in the relevant companies. Moreover, the City Code applies to all relevant transactions at any stage of their implementation, including offers that are in the contemplation stage but have not yet been announced.[132]

One of the main functions of the City Code is to regulate changes of control in companies. 'Control' is defined in the Definition Section of the City Code as an interest, or interests, in shares carrying 30% or more of the voting rights of a company, irrespective of whether such interest or interests give *de facto* control. Hence, the City Code does not apply to

---

[130] A list of regulated markets in the UK is maintained on the website of the Financial Services Authority at http://www.fsa.gov.uk/register/exchanges.do.
[131] For example, in the case of an investment trust, the identity and location of the investment manager will be considered by the Takeover Panel.
[132] City Code, Introduction 3(b).

acquisitions that result in the ownership of less than 30% of the target company's voting rights or to offers for non-voting and no-equity capital, except offers under Rule 15 regarding appropriate offers for convertibles, etc.

1.3.3 Enforcement of the City Code

The Takeover Panel has been responsible since 1968 for enforcing the rules contained in the Takeover Code, through a consensual approach with the parties engaged in the takeover activities. Before the implementation of the Takeover Directive, the Takeover Panel obtained its authority and backing through various bodies within the takeover market to which most companies and the Takeover Panel itself belong: the Bank of England, the Board of Trade, the London Stock Exchange, trade associations, investment banks and professional bodies, such as the Financial Services Authority (FSA). These bodies, represented in the City Working Party, all pledge to bind their members to the City Code and to impose sanctions on them if the Takeover Panel requests them to do so.[133] The takeover participants, therefore, comply with the Takeover Panel's rulings not because of any forceful approach but the threat of losing the necessary licence to practise in the City. As Sir John Donaldson MR has stated, the Takeover Panel

> enjoys no contractual relationship with the financial market…use their collective power to force themselves and others to comply with a code of conduct of their own devising … Perched on the 20th floor of the Stock Exchange building in the City of London, both literally and metaphorically it oversees and regulates a very important

[133] John Armour and Jack B. Jacobs and Curtis J. Milhaupt, 'The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework' (2011) 52 Harvard International Law Journal 221, 239.

> part of the United Kingdom financial market. Yet it performs this function without visible means of legal support.[134]

The Takeover Directive requires the supervisor of takeovers to be vested with all the necessary power to carry out its duties, including that of ensuring that parties to a bid comply with the rules made or introduced pursuant to the Directive.[135] Hence, since the implementation of the Takeover Directive in the UK, in the event of a breach of the City Code the Takeover Panel has had the statutory power to enforce the Code.[136] However, it can be argued that the Takeover Panel does not necessarily need these 'new' statutory powers, given the near-complete compliance with its rulings under the previous non-statutory system.[137] There has been no great change in the way the Takeover Panel works, although it is fair to say that it now has the legal power to enforce the City Code.

1.3.4 Relationship between the Takeover Panel and the Courts

As the supervisory authority to carry out regulatory functions in relation to takeovers, the English courts are reluctant to intervene in any ongoing takeover case and will only give guidance to the Takeover Panel at a later stage regarding how to avoid a similar error in the future. In *R v Panel on Takeovers and Mergers, ex parte Datafin plc,*[138] the Court of Appeal made it clear that litigation on takeover issues is not encouraged and decisions of the Takeover Panel would be set aside only under the very unusual circumstance when the panel is acting in breach of the rules of natural justice. In his judgement in the case of *Datafin,* Lord Donaldson MR introduced the non-intervention principle, by stating that:

---

[134] *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815, 825
[135] Takeover Directive, art 4(5).
[136] CA 2006, part 28.
[137] Alistair Alcock and John Birds and Steve Gale, *Companies Act 2006: The New Law* (Jordans 2007) 302.
[138] *R v Panel on Takeovers and Mergers, ex parte Datafin plc* [1987] QB 815.

> beyond a peradventure that in the light of the special nature of the panel, its functions, the market in which it is operating, the time scales which are inherent in that market and the need to safeguard the position of third parties, who may be numbered in thousands, all of whom are entitled to continue to trade upon an assumption of the validity of the panel's rules and decisions, unless and until they are quashed by the court, I should expect the relationship between the panel and the court to be historic rather than contemporaneous. … court to allow contemporary decisions to take their course, considering the complaint and intervening, if at all, later and in retrospect by declaratory orders which would enable the panel not to repeat any error and would relieve individuals of the disciplinary consequences of any erroneous finding of breach of the rules.[139]

Considering 'the highly sensitive and potentially fluid financial market', as Lord Bingham MR stated in a later case, 'the courts will not second-guess the informed judgement of responsible regulators steeped in knowledge of their particular market'.[140] Although the courts will normally not intervene in takeovers, it is admitted that the Takeover Panel's rulings are always subject to judicial review, although such review is rarely granted. Thus, it is pointless for a person bringing a judicial review to challenge the Takeover Panel's decision because the non-intervention principle adopted by the courts makes the litigation unlikely to be instantly helpful to his case.

Even when presenting the bill that led to the CA 2006 in parliament, Lord Sainsbury of Turville stated, in relation to takeover problems, that 'the Bill's provisions aim to ensure that tactical litigation seeking to delay or frustrate a takeover bid will not become a feature of our

---

[139] ibid 841.
[140] *R v International Stock Exchange of the UK and Ireland, ex parte Else* [1993] QB 534, 545.

takeover market'.[141] Before the Takeovers Directive was implemented the Takeover Panel worried that the consequence of giving itself and the City Code statutory backing would 'damage the consensual flexibility with which it had operated and lead to more obstructive litigation, a feature of takeovers in the US from which the UK has remained remarkably free'.[142] However, after the implementation, there has been no significantly enhanced scope of litigation.[143] In accordance with Section 961 of the CA 2006, the Takeover Panel is exempted from liability from the performance of its functions, unless it acts in bad faith. As the UK government indicated, the provisions in the CA 2006 would neither undermine nor be inconsistent with the restrictive approach in *Datafin*.[144] Until now, the relationship between the Takeover Panel and the courts has continued to follow the non-intervention principle of the *Datafin* case.

2. Shareholder Protection Rules

It is widely acknowledged that protecting the interests of shareholders is a common theme throughout the whole document of the City Code. It is regarded as a substantial and sophisticated body of rules aiming at ensuring good business standards and fairness to shareholders.

2.1 Sufficient Time and Information

In accordance with General Principle 2 of the City Code, the shareholders of a target company should be given sufficient time and information to consider any offers, including

[141] The Parliamentary Under-Secretary of State, Department of Trade and Industry, 'Company Law Reform Bill', 11 January 2006: HL Col 181 < http://www.publications.parliament.uk/pa/ld200506/ldhansrd/vo060111/text/60111-08.htm > accessed 4 March 2011.
[142] Alcock and Birds and Gale (n137) 298.
[143] Tunde I. Ogowewo, 'Tactical Litigation in Takeover Contests' (2007) Journal of Business Law 589, 619.
[144] Company Law Implementation of The European Directive on Takeover Bids: A Consultative Document (London, DTI, January 2005), para 2.38.

competing offers, for their shares on their merits and thus are able to reach a properly informed decision on a takeover offer.

2.1.1 Sufficient time

According to the City Code, an offer must initially remain open for at least 21 days after the date on which the offer document was posted.[145] This is the first closing date of an offer, although it can be extended by stating the next closing date.[146] After an offer has become, or is declared, unconditionally accepted, it must remain open for acceptance for not less than 14 days after the date on which it would otherwise have expired.[147] This rule gives an extra 14 days to any shareholders who have been unable to make a decision, or who wanted to see whether control would be passed over without their support. However, it is not necessary to keep the offer open for a further 14 days if it has been made clear in the offer document that the offer was accepted unconditionally from the outset.

The 'final day rule' in Rule 31.6 provides that the offer must become or be declared unconditional by the sixtieth day following the date on which the offer document was first posted to the shareholders. This rule imposes a regulatory deadline before which the offeror must secure the success of the offer, otherwise it will lapse. Rule 31.7 further provides that all conditions of the offer must be fulfilled (or waived), or the offer must lapse, within 21 days of the first closing date or of the date on which the offer becomes or is declared unconditional as to acceptances, whichever is later.

In the meantime, if an offer is revised, it must be kept open for at least 14 days following the date on which the revised offer document was posted.[148] Shareholders in the target company

---

[145] City Code, r 31.1.
[146] City Code, r 31.2.
[147] City Code, r 31.4.
[148] City Code, r 32.1.

are therefore given an additional 14 days in which to make a decision on the revised offer. Those shareholders who have already accepted the offer are given the right to withdraw their acceptance, even 21 days or more after the first closing date of the initial offer, unless and until the offer becomes unconditional as to acceptances on the sixtieth day after the posting of the initial offer document.[149]

As a result, the earliest date on which the target shareholder can withdraw their acceptance is 42 days following the posting of the initial offer document. The rationale behind this rule is to enable an accepting shareholder to change his/her mind at the last minute in the case of a competitive bid. It is common for a competing bidder or the target board in a hostile bid to try to take advantage of the existence of withdrawal rights, by sending withdrawal forms to the target shareholders, reminding that they are entitled to withdraw any accepted offer. Accordingly, the original bidder will also try to extract a waiver of this right by asking target shareholders with significant shareholdings to agree that acceptance is irrevocable.[150]

2.1.2 Sufficient information

Proper disclosure is an essential principle in maintaining a fair and efficient market. Hence a large number of rules deal with how to make sure that the target shareholders are both properly informed and advised. Takeover Panel Statement 2003/16 states that 'disclosure underpins market transparency which, in turn, constitutes a fundamental protection for shareholders and others who deal in the UK securities markets'. Rule 23 implements this philosophy by requiring that shareholders be given sufficient information and advice to enable them to come to a properly informed decision regarding the offer. Such information

[149] City Code, r 34.
[150] David Pudge, 'Conduct During the Offer; Timing and Revision; and Restrictions Following Offers' in Maurice Button (ed), *A Practitioner's Guide to The City Code on Takeovers and Mergers 2008/2009* (City and Financial Publishing 2008) 267.

should be available to shareholders early enough to enable them to make a decision in good time.

Article 6(3)(i) of the Takeover Directive, which is implemented by Rule 24.1 of the City Code, lists in detail the comprehensive information that the offeror must disclose in its offer documents to the shareholders, such as the offeror's intentions with regard to the future business of the offeree company, its strategic plans for the offeree company, and the long-term commercial justification for the proposed offer. The offer document should normally be posted to the target shareholders within twenty-eight days of the announcement of a firm's intention to make an offer.[151] In reality, the offer document is often posted as quickly as possible to increase the pressure on the target of a hostile bid, or to try to reduce the risk of there being a competing bid.

During an offer period, parties to a takeover and their 'associates' should publicly disclose all dealings in relevant securities by 12 noon on the business day following the transaction, in accordance with Rule 8.1 and Note 3. 'Relevant securities' includes the securities of the target that is being offered for, or which carry voting rights, and the securities of the offeror that carry substantially the same rights as any to be issued as consideration for the offer. Moreover, during an offer period, any person, whether or not an associate, who is interested (directly or indirectly) in 1% or more of any class of relevant securities of the bidder or target company, or as a result of any transaction will be interested in 1% or more, must publicly disclose their dealings.[152]

In addition to requiring sufficient information to be given to shareholders, Rule 19.1 requires that all the information about the offer must be produced to the 'highest standards of care

[151] City Code, r 30.1.
[152] City Code, r 8.3.

and accuracy' and be adequately and fairly presented. Accordingly, the language used in documents should be unambiguous, so as to reflect 'clearly and concisely' the position being described.[153] Rule 19.3 further provides that parties involved in an offer or potential offer should take care not to issue factually inaccurate statements which may mislead shareholders and the market, or create uncertainty. As a result, the person who is required to disclose the relevant information is also liable for the accuracy of the information he provides.

2.2 Equal Treatment

The primary goal of the City Code is to ensure that shareholders are treated fairly and are not denied an opportunity to decide on the merits of a takeover. The fair treatment of shareholders is fundamental to the spirit of the City Code and is covered by General Principle 1, which requires that all shareholders of a target company of the same class should be treated equally. This means a bidder is not allowed to announce a takeover bid which discriminates between classes of target shareholders. With respect to the information disclosure requirements mentioned above, the City Code also emphasises the importance of the equality of information provided to shareholders by stipulating that all target shareholders should be provided with the same information about the companies involved in a takeover transaction, and as nearly as possible at the same time and in the same manner.[154]

2.2.1 Equality of the Offer Price

In pursuit of shareholder equality, there are substantial requirements on the bidders to make sure the target shareholders have equal treatment in offer price. These rules are intended to avoid price discrimination and unequal treatment between shareholders who obtain a

---

[153] City Code, r 19.1 n 2.
[154] City Code, r 20.1

premium from the bidders for accumulating a block of shareholders prior to commencing a formal offer, and the other shareholders in the target company.[155]

According to Rule 6.1, if a bidder has acquired an interest in shares in the target company during the three-months prior to the commencement of the offer period, or during the period between its commencement and an announcement of a firm intention to make an offer, the offer to the target shareholders of the same class shall not be on less favourable terms. The same obligation exists where a bidder acquires any interest in shares in the target company during the offer period. Under Rule 6.2, after the announcement and before the offer closes for acceptance, if a bidder acquires an interest in shares at a higher price than the offer price, the offer should be revised to no less than the highest price paid for those shares.

2.2.2 Partial Offers Restriction

There is a great deal of debate in connection with the concept of partial offers, which are defined as those where the bidder offers to purchase the same percentage of every shareholder's holdings.[156] As a tactic to pressurise shareholders to tender, bidders might launch their offer as a two-tier bid in which they offer an above-market offer price only for that percentage of the shares necessary to give them majority control in the target company and announce a plan to merge out the remaining minority shareholders at a lower price following the change of control. Even if the bidder offers the same price for the remainder of the shares, there is a risk that the payment may be made much later or in the form of debt securities.[157] The effect of the two-tier bid is argued to have a similar coercive effect on the shareholders as does the partial offer, because the lower or much disadvantaged second-tier

---

[155] Kenyon-Slade (n51) 623.
[156] T. P. Lee, 'Takeovers – The United Kingdom Experience' in John H. Farrar (ed), *Takeovers, Institutional Investors, and the Modernization of Corporate Laws* (Oxford University Press 1993) 200.
[157] Guhan Subramanian, 'A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill' (1998) 23 Delaware Journal of Corporation Law 375, 402.

price is comparable to the expected value of the minority share after the partial offer succeeds.[158]

The ability of a bidder to launch a partial or two-tier offer puts shareholders under pressure to tender at the front-end, in order to avoid holding minority shares and gaining only the back-end of a second-tier offer once control has been transferred. In the UK, the City Code recognises the coercive effect of two-tier bids and treats them as partial bids by providing that, if a certain consideration is offered for part of each shareholder's holdings and a lower consideration offered for the balance, such an offer may be treated as a form of partial offer in spite of the fact that the offer is being made to all shareholders in the target company and the Takeover Panel's consent must be sought.[159]

The provisions of the City Code governing partial offers in particular are contained in Rule 36. According to Rule 36.1, every partial offer is always subject to the Takeover Panel's consent, although it further provides that the Takeover Panel's consent will normally be granted where the partial offer will not enable the bidder to hold 30% or more of the voting rights of the target company. This is because 30% is defined as a control threshold in the City Code.[160] Under the widespread shareholding structure in the UK, the City Code assumes that a person holding no more than 30% of shares does not have control over the company. In other words, Rule 36.1 implies that a bidder may acquire up to 29.9% of the target company's voting rights by private negotiation or partial offer, without any intervention from the Takeover Panel and the City Code.

---

[158] Victor Brudney and Marvin A. Chirelstein, 'Fair Shares in Corporate Mergers and Takeovers' (1974) 88 Harvard Law Review 297, 289.
[159] City Code, r 36.8 n 2.
[160] The Definition Section of the City Code states that acquiring interests in shares carrying 30% or more of the voting rights of a target company will enable the bidder to obtain effective control, irrespective of whether such interest or interests give *de facto* control.

In the case of a partial offer which could result in the bidder carrying 30% or more but less than 100% of the voting rights of a company, consent will not be granted by the Takeover Panel providing there are acquisitions 12 months before the offer.[161] The reason for this rule is to prevent favourable offers of these pre-purchases being made to certain shareholders and not to others, again in line with General Principle 1 of the City Code which requires that all shareholders of the target company be treated equally.

Furthermore, Rule 36.3 prohibits the acquisition of any interest in shares being made by the bidder either during the course of a partial offer or at any time in the 12 months after the end of the offer period if the offer was successful, except with the consent of the Takeover Panel. This rule also applies to partial offers that have resulted in the bidder carrying less than 30% of the voting rights of the target company, although the consent of the Takeover Panel will normally be granted for acquisitions of shares within twelve months of the end of the offer period. However, under a general offer for all of the target company's shares, a bidder is allowed to acquire target company shares through private or market purchases during the offer period, as long as the highest price paid is also available under the offer.

Where a partial offer is made which could result in the bidder carrying not less than 30% but not holding more than 50% of the voting rights of a company, the number of shares being sought must be stated precisely in the offer document, and the partial offer may not be declared unconditional as to acceptances unless acceptances are received for not less than the number of shares being sought under the offer.[162] As Gearing suggested, this rule prevents

[161] City Code, r 36.2.
[162] City Code, r 36.4.

bidders from acquiring effective control of the target company without paying the full price, 'that is the offer must be fully successful'.[163]

Rule 36.5 further requires that such partial offers must be conditional on the affirmative approval of the offer by shareholders holding over 50% of the voting rights in the target company (who are independent of the bidder and its concerned parties) no matter whether they intend to accept the offer or not.[164] This approval provides a significant protection against a coercive partial offer, by ensuring that shareholders holding over 50% of the voting rights approve the making of a partial offer. This is because if such partial offer is successful, the bidder could obtain control of the target company without giving all shareholders the opportunity to exit for 100% of their shareholdings in the target company.[165]

Where a partial offer is made that could result in the bidder holding shares carrying more than 50% of the voting rights of the target company, according to Rule 36.6 in order to warn of the bidder's controlling position, the offer document must contain specific and prominent reference to this and to the fact that, if the offer succeeds, the bidder will be allowed to acquire further shares (not subject to Rule 36.3) without triggering an obligation to make a general offer under Rule 9.

Moreover, in order to reduce the potential for shareholder inequality, it is required that a partial offer must be made to all the shareholders of the class to which the offer relates. If the shares accepted are more than the percentage the bidder wishes to acquire, the partial offer must be accepted on a *pro rata* basis in relation to the number of shares tendered by each

---

[163] Mark Gearing, 'Provisions Application to All Offers, Partial Offers and Redemption or Purchase by A Company of Its Own Securities' in Maurice Button (ed), *A Practitioner's Guide to The City Code on Takeovers and Mergers 2008/2009* (City & Financial Publishing 2008) 193.
[164] City Code, r 36.5.
[165] Gearing (n163) 193.

shareholder.[166] In the case of a partial offer for a company with more than one class of shares, if it gives the bidder 30% or more of the company's voting rights, a comparable offer must be made for each class of shares.[167]

It can be argued that in connection with General Principle 1 regarding equivalent treatment for shareholders, the shareholders in the target company receive wide protection, due to the fact that the City Code governs not only a specific takeover offer, but also pre-offer and post-offer share purchases.[168] On the one hand, as Kenyon-Slade has observed, the City Code, especially Rule 36, 'largely removes the most severe part of shareholder coercion and discrimination, by significantly restricting partial and two-tier bids'. It practically forces the bidders, who intend to obtain control of the target company, to make a general offer for all the shares of the target company.[169] On the other hand, it is not surprising to find that partial offers are a relatively rare phenomenon in the UK. This is probably because a partial bid itself is not regarded as a useful tactic from the bidder's point of view, because of the restrictions imposed by the City Code.[170]

2.2.3 Mandatory Bid Rule

UK takeover law led the way to the mandatory bid rule (MBR), which is regarded as one of the best known rules of the City Code. A mandatory bid refers to a general offer required by law when a person acquires a certain statutory percentage of shares in a company. However, this approach was not immediately introduced in 1968 by the City Code. In 1971, David Rowland purchased a large amount of Venesta International's shares in the market and hence

---

[166] City Code, r 36.7.
[167] City Code, r 36.8.
[168] Gearing (n163) 191.
[169] Kenyon-Slade (51) 570.
[170] Taking the period 2000-2005 as an example, there was typically no more than one case per year: the offer in April 2000 by the Halifax Group for up to 60% of the St James' Place Capital;, the offer in April 2001 by Zoo Hotels for up to 29% of the Groucho Club London;, the offer in March 2003 by Carnival Corporation for up to 20% of P&O Princess Cruises;, the hostile offer in April 2004 by GPG (UK) Holdings for up to 35% of De Vere Group; and the offer in December 2005 by Amor Holdings for up to 51% of Partridge Fine Arts.

succeeded in obtaining a controlling interest in the company without making a takeover bid. This led to concern by the Takeover Panel that under the current rules, there was no obligation on the person who has obtained control by a series of purchases in the market to buy the remaining shares in the company. Thus, in the case of *Venesta*, the Takeover Panel concluded that Rowland's open market purchase took away the opportunity of the minority shareholders of Venesta International to sell their shares at terms as favourable as Rowland offered.[171] In reacting to this event, the Panel proposed a MBR requiring any bidder purchasing 40% or more of a company's shares to launch a general offer on all the outstanding shares in the target company. This 40% threshold was lowered to the current level of 30% in 1974.

The MBR is now laid down in Rule 9 of the City Code, specifically designed to protect minority shareholders by regulating the situation under which a general offer must be made, as contained in Article 5 of the Takeover Directive. It is a classic application of the requirement for the equivalent treatment of all shareholders provided by General Principle 1, which states that 'if a person acquires control of a company, the other holders of securities must be protected'. The philosophy underlying this rule is that control of a company cannot be obtained by paying a premium price to the controlling shareholders, leaving the remaining non-controlling shareholders under a new controller, without offering the non-controlling shareholders the same price for their shares.[172] This was reinforced in the 1991 Annual Report of the Takeover Panel:

> if effective control of a company is obtained by the acquisition of shares, the principle of equality of treatment for shareholders requires that all shareholders should have the opportunity to obtain the price per share paid for that control (it will usually be a

[171] 'New Problem for the Panel' *The Times* (London, 18 December 1971) cited by Armour and Skeel, Jr. (n118).
[172] Hingley (n123) 11.

premium price) and that they should have the opportunity to get out of the company if they do not like what has happened.

In accordance with Rule 9.1, a bidder must make an offer to acquire all other equity shares of any class, whether voting or non-voting, and also to acquire any other class of transferable securities carrying voting rights, once it has acquired 30% or more of the voting rights of the target company. Rule 9.5 further grants all target shareholders the chance to sell their shares for the highest price paid by the bidder for shares to transfer control within the offer period and the 12 months preceding the announcement of that offer. Furthermore, any other conditions attached to mandatory bid offers are prohibited, even at higher levels of acceptance.[173] The City Code also acknowledges that in certain circumstances it would be inequitable and unnecessary to satisfy the equality of treatment principle by requiring a bidder to make a general offer. The situations in which the Takeover Panel may consider dispensing with the obligation to make a general offer are explicitly expressed in the City Code.[174]

3. Directors' Duties and Takeover Defences

Takeovers in the UK are subject to the City Code, while the directors' duties are generally governed by the common law and the statutory requirements relating to companies. When considering the defensive tactics available to target directors in facing a hostile takeover bid, their duties must first be taken into account.

[173] The City Code, r 9.3.
[174] For the detail of the dispensation situations, *see* Notes on Dispensations From Rule 9.

3.1 Directors' Fiduciary Duties under the Common Law

In order to regulate the behaviour of directors and prohibit them from exploiting personal interests while they are managing a company, the general approach taken by common law is to impose fiduciary duties upon them.[175] The UK is considered to be one of the first regimes to establish directors' fiduciary duties and to introduce the concept of the director as a trustee.[176] As agents of a dispersed group of shareholders, it is recognised by the business judgment rule that directors should be entrusted with managing the company's affairs and making major decisions. The court therefore should not interfere with the general operation of a company by its directors if their actions comply with their fiduciary duties.

These fiduciary duties grant discretion to directors who are running the affairs of the company on behalf of shareholders, as long as they act in good faith (*bona fide*) in what they consider to be the best interest of the company. The fiduciary duty of directors to act *bona fide* is expressed in the famous guiding statement of Lord Green in *Re Smith v Fawcett Ltd*: '[W]here the articles of a company confer a discretion on directors … [t]hey must exercise their decision bona fide in what they consider – not what a court may consider – is in the best interest of a company, and not for any collateral purpose'.[177]

In addition to this overriding duty, fiduciary duties also fall into several other categories: acting for a proper purpose,[178] acting with reasonable care and diligence,[179] not allowing personal interests to conflict with the interest of the company, [180] and not profiting from their

---

[175] Michael Hadjinestoros, 'Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to Their Companies' (2008) 19(2) International Company and Commercial Law Review 70, 70.
[176] Jennifer Hill, 'Corporate Scandals Across the Globe: Regulating the Role of the Director' in Guido Ferrarini and others (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004) 374. *Also see Great Easter Railway Company v Turner* [1872] 68 Ch App 149, 152.
[177] *Re Smith v Fawcett Ltd* [1942] Ch 304, 306.
[178] *Hogg v Cramphorn Ltd* [1967] Ch 254.
[179] *Aberdeen Railway v Blaikie Bros* (1854) 1 Macq 461. Also see *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62.
[180] *Keech v Sandford* [1726] Sel Cas Ch 61.

positions.[181] When facing an unwanted takeover bid, the directors' decisions on takeover defences are subject to their fiduciary duties, as are any other managerial actions.

The duty of acting for a proper purpose is a very important fiduciary duty imposed on the board by the common law, which requires that directors' decisions must be motivated by a proper purpose. The philosophy of the proper purpose doctrine is that directors are delegated the powers necessary to manage the company, but they cannot abuse these powers for a purpose beyond the scope of their delegation.[182] It provides the limits to the business judgement rule by requiring the court to examine the purpose behind the directors' activities, even if they act in good faith and in the best interest of the company. In the context of hostile takeovers, according to Dean, proper purpose duty can be interpreted as meaning that, even if they are acting in good faith in what they consider to be the best interest of the company, the directors should not attempt to obstruct a takeover by abusing their powers.[183]

In the case of *Hogg v Cramphorn Ltd*,[184] Cramphorn Ltd was the target of a hostile takeover for its ordinary and preferred shares, and its directors responded by creating a trust for the benefit of the employees, with themselves as trustees, and allotting to the trust a large block of unissued preference shares carrying ten votes per share. The directors regained control of Cramphorn Ltd by nominating the trustees and obtaining indirect control over the additional votes attached to these new shares. However, the shareholders of Cramphorn were not consulted on this arrangement initiated by the board.

Although the directors' decisions satisfied the business judgement rule by acting in good faith throughout, and in the company's best interest by allotting shares to employees and

[181] *Boardman v Phipps* [1967] 2 AC 46.
[182] David Kershaw, 'The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition' (2007) 56(2) International & Comparative Law Quarterly 267, 270.
[183] Janice Dean, 'Directors' Duties in Response to Hostile Takeover Bid' (2003) 14(12) International Company and Commercial Law Review 370, 370.
[184] *Hogg v Cramphorn Ltd* [1967] Ch 254.

enhancing their wealth, the court invalidated the new shares issued by the directors and held that they had violated their fiduciary duties because they had acted primarily for the improper purpose of preventing the takeover and enabling them to remain in control of the company.[185] As the court stressed, it would not 'permit directors to exercise powers … in such a way as to interfere with the exercise by the majority of its constitutional rights'.[186]

In the later case of *Howard Smith Ltd v Ampol Petroleum Ltd*, which is another leading case concerning directors' duty to act only for 'proper purpose', a defensive issuance of shares to the board's preferred bidder was held to be invalid by the court on the grounds that this action was an improper use of their powers and thus breached their fiduciary duties.[187] From both *Hogg* and *Howard Smith*, it can be seen that no matter whether the directors honestly believed that their actions were in the best interest of the company, they are only allowed to use their powers in a proper way and will breach their fiduciary duty if their motivation is improper.

3.2 Codified Directors' Duties under the Companies Act 2006

The CA 2006 codifies directors' fiduciary duties in Part 10; these were traditionally governed by common law. It is made clear in Section 170(3) of the CA 2006 that the directors' 'codified' duties are based on certain common law and equitable principles as they apply in relation to directors, and take the place of those rules and principles when it comes to the duties owed to a company by a director. Further, Section 170(4) of the CA 2006 requires that these duties be interpreted and applied in the same way as common law rules or

---

[185] ibid 266-7.
[186] ibid 268. However, it is accepted in the case of *Bamford v Bamford* that the improper allotment of shares can be ratified by a general meeting of shareholders. *See Bamford v Bamford* [1790] Ch 212.
[187] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

equitable principles, and that the corresponding common law rules and equitable principles be taken into account when interpreting and applying the codified general duties.

The provisions on the general duties of directors consist of a general introduction in Section 170, followed by seven specific duties in Sections 171 to 177:

(1) act in accordance with the company's constitution and exercise powers only for the purpose for which they are conferred;
(2) act in the way the directors consider, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole;
(3) exercise independent judgement but not fetter their discretion unless acting in accordance with an agreement which has been duly entered into by the company or in a way authorised by the company's constitution;
(4) exercise reasonable care, skill and diligence as would be expected of a reasonably diligent person;
(5) avoid direct or indirect interests that conflict with the interests of the company;
(6) not to accept benefits from third parties;
(7) declare the nature and extent of any interest in a proposed transaction or arrangement.

It is noteworthy that directors, who are appointed by the shareholders as agents of the company and act in the interest of the company as a legal entity, owe their fiduciary duties only to the company, but not *per se* in the interests of shareholders.[188] The CA 2006 codified the duties of directors and, in the meantime, under Section 170(1), expressly states that the directors' duties contained in the following sections are owed to the company and not directly to any others, particularly the shareholders. Indeed, directors' fiduciary duties are

[188] *Percival v Wright* [1902] 2 Ch 421.

only owed to shareholders in very rare circumstances. As in the case of *Peskin and another v Anderson and others,* Mummery LJ held that the fiduciary duties owed by directors to the shareholders 'are dependent on establishing a special factual relationship between the directors and the shareholders in the particular case'.[189] As a result, a shareholder wishing to claim for breach of fiduciary duty will have to bring a derivative suit against directors.

3.3 Non-Frustration Rule under the City Code

When faced with a hostile takeover, the protection of shareholders' interests by the proper purpose rule in common law is inadequate. This is because the court has to 'conduct a detailed examination of the factual context in which a decision was taken in order to ascertain the purposes behind [it]' and 'it caused considerable uncertainty and delay'.[190] Moreover, it is argued that the CA 2006 is also inadequate to protect the target shareholders as it simply reflects the common law position, requiring directors to act within powers and promote the success of the company for the benefit of its members as a whole.[191] As Parkinson has suggested, unless the law requires the directors to 'promote the success of the business venture in order to benefit the members', rather than the company as a whole, the protection of minority shareholders is totally inadequate.[192]

It is admitted that the regulation attempting to govern directors' behaviour when facing a hostile bid merely under directors' fiduciary duties is incomplete. In the takeover context, it should be clear that 'directors owe their duties to shareholders and other parties interested in takeover activities for which the company is involved'.[193] Indeed, Deakin and others have stated that the City Code 'embodies in a particularly clear way the principle that, during the

---

[189] *Peskin v Anderson* [2001] BCC 874, 880.
[190] Johnston (n105) 436.
[191] Jonathan Mukwiri, 'Implementing the Takeover Directive in the UK' (DPhil thesis, University of Leicester 2008) 75.
[192] John Parkinson, *Corporate Power and Responsibility* (Clarendon Press 1993) 77.
[193] Mukwiri (n191) 138.

course of a takeover bid, directors of the target company are meant to act as the agents of the shareholders'.[194] The adequate protection is only provided by the City Code, which imposes a higher standard of fiduciary duties on the directors than in common law.[195]

In the City Code, the ability of directors to defend against hostile takeovers is no longer judged by an investigation of their motivation. The common law approach has been replaced by the City Code rules which clearly stipulate that shareholders have the final say on the outcome of a takeover bid.[196] As a general principle, the City Code requires a target board of directors not to deny the target shareholders the opportunity to decide on the merits of the bid.[197] Without doubt, when facing a takeover bid, the most important duty the directors of the target company owe to the target shareholders is not to take any action designed to frustrate a takeover offer which the shareholders may want to accept.

The Takeover Directive has the same attitude as the City Code towards a board's ability to use takeover defences, setting forth a board Neutral Rule in Article 9(2), which requires the board of a target company not to take any action which may result in the frustration of the bid, without its shareholders' approval, from the time the target company is informed of a bid until the bid lapses. The UK government has opted into Article 9 of the Takeover Directive and retained the restrictions on boards' frustrating actions in Rule 21 of the City Code, the so called non-frustration rule.

As Kenyon-Slade has argued, General Principle 3, together with Rule 21, has established a fundamental framework for the manner in which takeover defences should be adopted in the

---

194 Simon Deakin and others, 'Implicit Contracts, Takeovers and Corporate Governance: in the Shadow of the City Code' (2002) ESRC Centre for Business Research, University of Cambridge Working Paper 254 <http://www.cbr.cam.ac.uk/pdf/WP254.pdf> accessed 17 July 2012, 14.
195 Mukwiri (n191) 75.
196 Armour and Skeel Jr. (n118) 1772.
197 City Code, General Principle 3.

UK.[198] It is made clear that directors may not use their powers to preclude the majority shareholders' right to determine the success or failure of a hostile takeover. The target board must be set aside when hostile takeovers are imminent so that shareholders can have the final say on whether to accept a takeover bid.[199] Moreover, it is worth mentioning that the requirement of gaining shareholder approval for 'frustrating' actions is also consistent with the common law approach, which prevents the transaction being in breach of the directors' fiduciary duties.[200]

Under Rule 21 of the City Code, NFR severely restricts the target board's ability to take any action which may frustrate any offer or *bona fide* possible offer or result in shareholders being denied the opportunity to decide on a bid on its merits, without the approval of the shareholders at a general meeting, once the target directors have reason to believe that an offer might be imminent. It should be made clear that 'once the target directors have reason to believe that an offer might be imminent' means during the course of an offer, or even before the date of the offer when the target board is first formally approached by the bidder with respect to the bid.

The defensive measures that a target board is not allowed to undertake, as specified in Rule 21, include issuing any further shares in the target company; granting any options on any unissued shares in the target company; creating or issuing any convertible securities or securities carrying the right to subscribe to company shares; making any disposal or acquisition of assets of a 'material amount' (a value of 10% or more); entering into any contracts other than in the ordinary course of business, without obtaining shareholder approval. It is worth noting, however, that the above list of prohibited actions is not

[198] Stephen Kenyon-Slade (n51) 694.
[199] Han-Wei Liu, 'The Non-Frustration Rule of the UK City Code on Takeover and Mergers and Related Agency Problems: What are the Implications for the EC Takeover Directive?' (2011) 17 Columbia Journal of European Law 5, 5.
[200] Underhill and Austmann (n48) 93.

exhaustive. The Takeover Panel must be consulted in advance if there is any doubt as to whether any proposed actions would fall within Rule 21.[201] As Davies has stated, the NFR covers all frustrating actions no matter whether they are specifically mentioned in the Rules or not, 'even the initiation of litigation on behalf of the target once an offer is imminent'.[202]

3.4 Directors' Duties as to Information

Although the NFR gives power to the shareholders of the target company and not its directors or management, to make the decision as to the acceptance of the takeover bid once a *bona fide* offer is imminent, it does not impose a 'passive rule' on the target board. In this sense, the board does not have to hold an absolutely neutral attitude towards a takeover bid. However, the City Code does impose another important duty on a board defending a hostile bid, which is related to information. It requires the target board to give the shareholders their opinion on the takeover bid, which may have an influence on the shareholders' decision on the offer. The advice given to shareholders may consist of criticisms on the price and terms of the hostile takeover offer and a recommendation not to accept it. The shareholders may have second thoughts on the offer. In addition, the directors have the right to put proposals to the shareholders which may have the effect of frustrating the bid, but such proposals cannot be implemented without the approval of shareholders.

In order to ensure that shareholders are properly informed when a company is faced with a takeover bid, the Takeover Directive requires directors to provide relevant and timely information to all shareholders. Section 943 of the CA 2006 implemented this by requiring the Takeover Panel to lay down certain rules. Accordingly, the City Code imposes a high standard of duties on directors when they are circulating information. General Principle 2 of

---

[201] City Code, r 21.1.
[202] Paul Davies, *Gower and Davies Principle of Modern Company Law* (Sweet & Maxwell 2003) 716. *Also see* Pudge (n150) 258.

the City Code requires the board of directors, when advising shareholders, to give its views on the effects of implementation of the bid on employment, conditions of employment, and the location of the company's places of business. This General Principle is supplemented by detailed rules.

According to Rule 25 and Rule 30.1, the board of the target company must give shareholders its opinion on the offer and the reasons on which it is based, in the board circular normally within 14 days of the posting of the offer document, no matter whether it is recommending for or against acceptance of the offer, or is remaining neutral. The board's opinion on the offer includes its views on the effects of implementation of the bid on all the company's interests. If there are different views on the takeover offer among the target directors, the minority directors' views must be published in the circular that is sent to the shareholders.[203]

The City Code also requires the target directors to accept responsibility for the information contained in any documents sent out to its shareholder. Rule 19.2 requires that the directors of the target company should be expressly responsible for the information provided in each document in connection with an offer, and confirm that this is to the best of their knowledge and belief (having taken all reasonable care to ensure that such is the case). None of the directors should be excluded from such a responsibility. If it is proposed, the consent of the Takeover Panel is required. According to Deakin and others, the significance of this rule is to establish a legal duty of care owed by the target directors to the shareholders to whom the information is issued, and in which case the directors do not owe the duties to the company as they owe general fiduciary duties to.[204]

[203] City Code, r 25.1 n 2.
[204] Deakin and others (n194) 8.

Together with Rule 3.1, this rule requires that, once the target board has been approached, it must hire a competent independent advisor whose advice on any offer must be made known to all the target shareholders in the board circular. If there is a disagreement between the target board and its independent advisor on the merits of an offer, or if there is failure to reach a firm recommendation, the target shareholders should be informed of the arguments for and against acceptance of the offer and the Takeover Panel should be consulted in advance.[205]

The Takeover Panel also states that financial advisors should be responsible for guiding their clients and any relevant public relations advisors, with regard to information releases during the course of an offer.[206] Financial advisors must consult the Takeover Panel whenever necessary and co-operate fully with it. As Kenyon-Slade pointed out, the requirement to appoint an independent advisor reduces the chance that directors will act in their own interests and not in the best interests of the company.[207]

3.5 Takeover Defences

The NFR in the City Code restricts, to a great extent, the directors' exercisable powers of adopting defensive measures when facing a hostile takeover bid, and ensures that the shareholders have the full opportunity to assess and decide whether or not to accept a takeover offer. The common law also has the same attitude towards this issue. In the case of *Howard Smith v Ampol Petroleum Ltd*,[208] the court rejected the attempt by the target board to transfer treasury shares to a favoured bidder in order to thwart a takeover bid, on the grounds that a majority of the shareholders were in favour of the offer.

---

[205] City Code, r 3.1 n 3.
[206] City Code, r 19.1 n 1.
[207] Kenyon-Slade (n51) 609.
[208] *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821.

However, it is worth noting that defensive measures are not forbidden at all in the UK. Directors are still able to take actions with frustrating effects, but the decision to undertake such actions lies with the shareholders at the general meeting.[209] Although the target board is prohibited from taking any action which may frustrate a takeover bid for the company, without obtaining post-bid shareholder approval, the board of the target company can still search for a white knight within the company's normal business operations, without this being authorised by the general meeting. White knights are generally accepted in the UK.[210] Although the competing bid may in practice frustrate the first takeover bid, a competing bid only means a second choice for the shareholder and is nevertheless an obstacle to the first bid.[211] Therefore, it should not be regarded as a takeover measure and subject to shareholder approval. Of course, the directors are still subject to their fiduciary duties and must treat all competing bidders equally when considering the extent of disclosure of information.[212]

Moreover, the City Code only curtails those bid-frustrating actions which are undertaken when a takeover bid is imminent. In response to an unsolicited takeover bid, what the NFR effectively limits is just post-bid defensive board action.[213] However, the board of a target company is still able to adopt defensive tactics in advance of any particular offer.[214] In other words, the target board may seek to embed pre-bid defences in the company structure at any time when an offer is not in contemplation, so as to secure their position in the target company.

---

[209] Federico M. Mucciarelli, 'White Knights and Black Knights - Does the Search for Competitive Bids Always Benefit the Shareholders of 'Target' Companies?' (2006) 3(4) European Company and Financial Law Review 408, 412.
[210] For example, in 2009, Fiat acted as a white knight, taking over Chrysler and saving it from liquidation.
[211] Paul Davies and Edmund-Philipp Schuster and Emilie Van de Walle de Ghelcke, 'The Takeover Directive as a Protectionist Tool?' in Ulf Bernitz and Wolf-Georg Ringe (eds) *Company Law and Economic Protectionism: New Challenges to European Integration* (Oxford University Press 2010) 145.
[212] City Code, r 20.2.
[213] Kershaw (n182) 270.
[214] Davies and Hopt (n5) 234.

In order to prevent pre-bid defences, Article 11 of the Takeover Directive introduces so-called 'break-through' provisions, which are optional for Member States to implement. The UK government decided not to implement the 'break-through' provisions but to allow companies with voting shares and trading on regulated markets to opt into these provisions if they wish to do so.[215] The reason why the City Code does not have provisions governing pre-bid defence is probably because 'the takeover regulation regime in the UK has not always concerned itself with pre-bid defences'.[216]

Although directors' actions in employing pre-bid defences are not governed by the City Code, they are still subject to their fiduciary duties as directors. Hence, in deciding how to defend the company against a hostile takeover by adopting any type of pre-bid defensive measures, directors have to act in good faith, in the best interest of the company as a whole, and use their powers for proper purposes under Section 171 of the CA 2006. As Pudge has remarked, directors' ability to effectively use pre-bid defences that will later frustrate a takeover are restricted by their fiduciary duties.[217] Non-compliance with these fiduciary duties could bring about a derivative suit to force them to withdraw their defence and compensate the company for any loss it may have suffered.[218]

As mentioned in Chapter 1, the poison pill is unarguably the most famous pre-bid defence. In the UK, there is no law expressly prohibiting the adoption of poison pills. In practice, however, they have been used relatively infrequently.[219] In the case of *Criterion Properties Plc v Stratford UK Properties LLC,*[220] the court found that the implementation of poison pills was an improper exercise of directors' power to frustrate a takeover bid and therefore

[215] CA 2006, ss 966-972.
[216] Mukwiri (n191) 60.
[217] Pudge (n150) 257.
[218] On derivative suits, see CA 2006, ss 260-264.
[219] David Kershaw (n182) 270.
[220] *Criterion Properties Plc v Stratford UK Properties LLC* [2004] UKHL 28.

held that they were invalid. From a technical perspective, the adoption of poison pills by the target board is not allowed without shareholder approval. According to Section 551 of the CA 2006, the issue of equity shares or rights over equity shares requires shareholder approval by means of a general meeting. Thus, poison pills involving the issue of rights need shareholder approval to proceed. However, approving the adoption of poison pills in advance to thwart potential takeover bids seems to have little point to target shareholders, as they have already been given the power to decide on the outcome of takeover bids by law. Therefore, the common use of poison pills in the UK is unlikely.[221]

In addition, the 'staggered board' provisions that can be used along with poison pills are generally not applicable as a defence in the UK. These provisions prevent the board from being replaced in a single action, which will largely reduce the chance of the poison pill being redeemed by the new board. However, under Section 168 of the CA 2006, the shareholders may, by ordinary resolution in a general meeting, remove a director before the expiration of his period of office, with or without cause.

[221] Jonathan Mukwiri (n191) 61.

Chapter 3 Takeover Regime in the United States

The feature of a dual regime with both federal and state laws distinguishes the US legal system from the UK's. This dual regime is the result of a system of federalism, where, under the US constitution, the federal government has limited powers while the states retain all powers except for those which are expressed as exclusive to the federal government. When both Congress and state legislatures enact laws to regulate the same activity, these laws coexist and both are applicable.[222]

Similarly, there are no comprehensive nationwide federal rules to govern takeovers in the US. Takeovers are regulated at both the federal and state levels, although the federal laws and their state counterparts each have their own focus. Securities regulation, tender-offers rules and antitrust law are within the scope of federal law, while corporate law, such as corporate charters and bylaws, directors' duties and takeover defence, is under the jurisdiction of the individual states. In particular, the rules governing the process of a tender offer and the disclosure of information to shareholders are regulated by federal laws and the target board's response to the offer is governed primarily by state laws.

1. Takeover Law at the Federal Level

In the US, companies issuing their shares to public investors are regulated by federal securities law.[223] The two most important securities laws are the Securities Act of 1933 (SA 1933) and the Securities Exchange Act of 1934 (SEA 1934), passed in the period following the stock market crash and the depression in 1929, when so many companies

---

[222] For a general overview of the American legal system, *see* Jay M. Feinman, *Law 101: Everything You Need to Know about the American Legal System* (Oxford University Press 2006).
[223] The public companies are also governed by the specific state securities laws, such as anti-fraud law and registration law. However, the only state law I will look at in this thesis is anti-takeover legislation.

went bankrupt and the investors lost their investment.[224] The overall objectives of these laws are to protect the investing public from securities market abuse and to assure an integral and fair capital market for all participants. In the context of takeovers, although these laws mainly regulate the issues of shares that may be less relevant, they do contain specific sections with regard to takeovers and mergers. By requiring prompt and full disclosure of relevant information, securities laws ensure certain filings with the Securities and Exchange Commission (SEC) if a company engages in a control transaction above a certain size.

1.1 SA 1933 and SEA 1934

The SA 1933 was designed to deal primarily with new issues of securities by requiring disclosure of information on any public offerings of securities, with the aim of helping investors make more informed decisions upon the disclosed financial information to which they had little access before. Under this Act, all companies issuing new issues must register with SEC and include proper statements and documents. All parties involved in preparing these documents are liable for any misstatement of facts or omissions of vital information. As the SA 1933 is primarily responsible for recording information when a public company issues new securities as consideration to acquire a target company, this Act is significant in that the acquiring company must register those securities intended to finance the takeover by filing a disclosure form with the SEC.

As mentioned above, the SA 1933 deals mainly with primary issues, whereas the SEA 1934 deals mainly with secondary market. Being passed after the SA 1933, with the aim of improving the availability of information, the SEA 1934 requires that an 8K filing

---

224 Gaughan (n30) 8.

must be made which 15 calendar days after the occurrence of certain specific events. Such events include the acquisition and disposal of a significant amount of assets. Acquisitions are considered to involve a significant amount of assets if the equity interest in the assets being acquired, or the amount paid or received in an acquisition or disposition, exceeds 10% of the total book assets of the registrant and its subsidiaries. One of this Act's significant contributions was to establish a national governmental body, the SEC, to regulate securities market and administer the securities law, in particular empowering the SEC to revoke or suspend the registration of a security if the issuer has violated any provisions of the SEA 1934.[225]

1.2 Williams Act of 1968

The other significant contribution of SEA is that it provides the basis for the amendments that were applicable to takeover transactions and primarily governs the activities of tender offers. This major amendment to the SEA was the Williams Act of 1968 (Williams Act) which is the law dealing with takeovers at the federal level. The Williams Act was passed to protect target shareholders by preventing secret or inappropriately coercive tender offers, in common with the trend in the UK where the City Code took effect in the same year. The Williams Act contains detailed disclosure rules requiring bidders and target board to disclose information about the offer, as well as basic procedural requirements concerning how tender offers may proceed.

The Williams Act is regarded as the key element of US federal securities legislation in connection with takeover bids.[226] According to Romano, what is remarkable about the Williams Act is that, 'despite the controversy swirling around takeovers over the past

---

[225] SEA1934, s 12 (j).
[226] Weston and Mitchell and Mulherin (n27) 27.

thirty years in the United States, the Act itself has not been amended in any fundamental way'.[227] Before proceeding to the tender offer rules, it is worth addressing the background of the Williams Act's creation and its subsequent effect.

1.2.1 Creation of the Williams Act

Prior to the passage of the Williams Act in 1968, various bidding tactics had been deployed in the US. As Alcock has pointed out, '[A]lmost everything was possible. There was little constraint on creeping control or protection of minorities. Potential bidders could privately buy shares or publicly purchase them in street sweeps'.[228] The takeover activities were conducted in an even aggressive way when a new takeover technique was discovered by the bidders. In the 1950s and early 1960s, it replaced the traditional takeover method of a proxy contest to acquire corporate control.[229]

This new measure was tender offers, in which a premium over the market price was offered to the target shareholders directly by the bidder for sufficient shares to achieve a shift of control. It enjoyed a number of advantages, in particular the relatively higher speed with which the takeover could be completed and the ability to by-pass the target board and deal directly with target shareholders.[230] These tender offers remained open for a very short period of time with substantially less public disclosure and could have any variety of consideration, such as cash, securities and even unquoted junk bonds.

In an offer where shares of the bidding company were offered as consideration for shares of the target company, the disclosure requirement of the SA 1933 provided limited

---

[227] Forstinger (n74) 75.
[228] Alistair Alcock, 'The Regulation of Takeovers' (2001) 5 Journal of International Financial Markets 163, 166.
[229] Samuel L. Hayes, III and Russell A. Taussig, 'Tactics of Cash Takeover Bids' (1967) 45 Harvard Business Review 135, 136-7. Before the 1960s, the proxy contest was regulated by the SA 1933 and the proxy rules of the SEA 1934.
[230] Armour and Jacobs and Milhaupt (n229) 242.

regulation. The bidder first needed to register such securities with the SEC in accordance with the SA 1933 and wait until registration was declared effective by the SEC before sending tender offer documents to target shareholders. On some occasions, the SEC might make comments on the preliminary registration statement that had to be resolved before the statement could be considered effective. Once this registration requirement was met, the process proceeded in a similar way to a cash tender offer, in which the bidder initiated the takeover offer by disseminating offer documents to target shareholders. However, before the passage of the Williams Act, the cash tender was totally unregulated.

Until 1968, the tender offers were often strategically used by the bidder to coerce the target's shareholders. It was called a 'Saturday Night Special' – a tender offer was made over a weekend with little or no disclosure of information which could enable the target shareholders to make an informed and fair decision. Since the bidder was typically not an insider in the target company, no insider trading rules required any particular disclosure by the bidder.[231] As a consequence, the bidder could make a tender offer without any disclosure other than the offering price and identification of a location to which shares should be tendered.

Moreover, because these offers were often on a first-come, first-served basis, the shareholders were under severe time pressure to make a decision. Shareholders of the target company could therefore be compelled to make pressured and uninformed rapid decisions; otherwise, if other shareholders accepted the bidder's premium and the offer succeeded, they might be left holding a minority interest in an 'illiquid' share controlled by the bidder and vulnerable to a 'squeeze out' merger at a lower price.[232] The difficulty for widely dispersed public shareholders to take collective action in response to a hostile

[231] Carney (n230) 927.
[232] Kenyon-Slade (n51) 52.

bid pushed target shareholders into tendering their shares to an unknown hostile bidder, even if the offer price was 'unfairly' low. In addition, the shortage of time available to respond prevented the target board from taking any defensive actions against the offer or advising their shareholders on whether to accept or reject the offer.[233]

The Williams Act was proposed in response to the increasing use of this coercive cash tender offer operated by a secret hostile bidder as a means of acquiring a shift in the control of public companies. As Senator Harrison Williams of New Jersey stressed, 'all shareholders should have such information so that they can make informed investment decisions on the basis of the same facts known by persons making the tender',[234] in October 1965 he introduced legislation seeking to protect shareholders through full disclosure and timing provisions. His initial efforts failed, but his second effort, initiated in 1967, succeeded.

The draft Williams Act was substantially modified during the Congressional hearings on the advice of the SEC. It became law on 29 July 1968 and was amended in 1970. The Williams Act was enacted as an amendment to the SEA 1934 by adding subsections (d) and (e) to Section 13 and subsections (d), (e) and (f) to Section 14. These amendments imposed important disclosure and procedural requirements upon tender offers with the aim of eliminating the coercion.

1.2.2 Effect of the Williams Act

The Williams Act established the basic procedural disclosure rules for tender offers in the US. The main objective of this legislation is to provide more opportunity for target shareholders to respond to the tender offer or consider other potential offers. According to

[233] Armour and Jacobs and Milhaupt (n229) 243.
[234] 113 Cong. Rec. 884, 855 (1967) (statement of Sen. Williams).

White, the focus of the Williams Act is on maximising the information and freedom of target shareholders faced with tender offers and enabling them to make the best decisions with regard to the value of their shares.[235]

Under the Williams Act, a minimum period during which a tender offer must remain open it required. This gives target shareholders sufficient time to make decisions. However, 'sufficient' time might not be enough for target shareholders, who may need further information to help them make more informed decisions. Thus, procedure and disclosure requirements during the takeover process are stipulated under which target shareholders can use the disclosed information to make more enlightened decisions. Especially in the context of tender offers in exchanging shares, disclosure of information enables target shareholders to gain more complete knowledge of the bidder company to which the target shareholders would belong.

Although, the Williams Act governs the whole process of a tender offer, it displays a strong desire to preserve a fair balance in takeover contests so that all participants can fully address their rights. Because of the concerns that a statute would entrench incumbent and perhaps inefficient management, Congress adopted a neutral stance between the interests of incumbent managers and those of bidders,[236] which is regarded as a key feature of the Williams Act by Tyson.[237] Indeed, as Senator Harrison Williams himself stated, extreme care had been taken in writing the legislation to 'avoid tipping the balance of regulation in favor of target management or in favor of the person making the takeover bid. [The Bill] is designed solely to require full and fair disclosure for the benefit

---

[235] White (n28) 173-174.
[236] Geoffrey Miller, 'Special Symposium Issue: Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England' (1998) Columbia Business Law Review 51, 55.
[237] William C. Tyson, 'The Proper Relationship Between Federal and State Law in the Regulation of Tender Offers' (1990) 66 Notre Dame Law Review 241, 278-79.

of the investors. The Bill will at the same time provide the offeror and management equal opportunity to present their case'.[238]

The Williams Act is, therefore, designed to create a level playing field between target board and bidders, and to empower shareholders to make decisions without coercion, by a set of disclosure provisions, antifraud rules, and substantive rules governing the conduct of tender offers. As Ferrarini and Miller have argued, both bidders and target board are reasonably equally represented at the federal level under the Williams Act.[239] However, it cannot be denied that the beneficiaries of the Williams Act are not only the target shareholders but also the target board when facing a tender offer.

From the target board's perspective, because of the obligations on bidders for full disclosure and keeping the tender offer open for a minimum period of time, the Williams Act not only gives target shareholders but also the target board sufficient information and time to respond to the offer. Moreover, it is primarily disclosure legislation and does not deal directly with matters in connection with the 'substantive fairness of corporate takeovers or defensive tactics'.[240] It is the state laws that govern the target board's defensive actions. As a result, as Amour and Skeel have argued, target directors clearly benefited from the passage of the Williams Act since they now had enough time to adopt defensive measures against a hostile bidder.[241] In this respect, the Williams Act has constrained bidders much more than the target board.

From the bidders' perspective, under the Williams Act bidders are prohibited from using their former tactics, and are subject to a set of obligations once a tender offer has been

---

[238] 113 Cong. Rec. 24, 664 (1967) (quoted in *Schreiber v Burlington Northern* 472 US 1 (1985), 8).
[239] Guido Ferrarini and Geoffrey P. Miller, 'A Simple Theory of Takeover Regulation in the United States and Europe' (2009) Cornell International Law Journal 301, 304.
[240] Kenyon-Slade (n51) 56.
[241] Armour and Skeel, Jr. (n118) 1772.

launched. Even it were not the intention of the drafters of the Williams Act to promote an auction market in which bidders have to compete with other bidders to acquire control after announcing the offer, generally speaking the actual impact of the disclosure requirements under the Act could raise the offer price and make takeover more costly; bidders would make only insignificant gains on average, hence possibly reducing the number of tender offers in the future.[242] Of course, it should be kept in mind that although the Williams Act does restrict the ability of the bidder to apply pressure on target shareholders to tender into the bid, it does not necessarily 'limit the ability of a bidder to succeed in a tender offer if the offer is made at a fair price and on an even handed basis'.[243]

1.3 Tender Offer Rules

Under the Williams Act, Section 13(d) governs the substantial disclosure obligations which provide an early warning system for target board and shareholders, alerting them to the possibility of changes in corporate control. Regulation 13D, promulgated by the SEC in Section 13(d), set forth the format and disclosure requirements for statements made in Schedules 13D and 13G. Moreover, Sections 14(d) and (e) with Regulations 14D and 14E promulgated by the SEC contain the rules governing the procedure of tender offers and the format and provisions of tender-offer statements made in Schedule TO. The purpose of these tender-offer rules is to ensure that investors are given adequate information and appropriate substantive and procedural safeguards to prevent undue shareholder coercion in the face of a tender offer.[244]

---

242 Kenyon-Slade (n51) 56.
243 Ferrarini and Miller (n238) 304.
244 Kenyon-Slade (n51) 104.

1.3.1 Definition of Tender Offer

Tender offers (known as takeover bids) first occurred in the UK in the early 1950s and in the US in the 1960s. In the UK, Section 971 of the Companies Act 2006 adopts the definition of 'takeover bids' directly from the Takeovers Directive:

> an offer make to the holders of the securities of a company to acquire all or part of such securities by payment in cash and/or in exchange for other securities. A bid may be either mandatory, if so provided by member states as a means to protect minority shareholders, or voluntary, - offeree company shall mean a company whose securities are the subject of a bid, - offerer shall mean any natural person or legal entity in public or private law making in bid in accordance with the legislation of the member state determined as provided for the Art. 4(2).[245]

However, no definition of 'takeover bid' can be found in the City Code. Nevertheless, as Kenyon-Slade has argued, in the UK the lack of definition of 'takeover bid' does not generate the same chaos as the absence of definition of 'tender offer' in the US, because the City Code 'adopts a "bright line" regulatory approach that looks to the percentage of the target's shares that are being acquired instead of the method of acquisition in determining whether the provisions of the City Code apply'.[246] A tender offer, in the UK, refers to an invitation sent from a potential purchaser to target shareholders to tender their shares for cash, in the hope of acquiring a non-controlling stake of less than 30% of the voting rights in the target company, which is not subject to the City Code.[247] It is therefore important to clarify that the term 'tender offer' used in this thesis specifically

[245] Takeovers Directive, art 2.
[246] Stephen Kenyon-Slade (n51) 51.
[247] In the UK, tender offers are governed by the Takeover Panel but under the Rules Governing Substantial Acquisitions of Shares.

means a takeover bid with the aim of obtaining control of the target company, as is the position in the US.

In US takeover law, there is no precise definition of the term ‘tender offer’. Although the Williams Act governs tender offers, no definition can be found in it. It was perhaps the intention of Congress to leave the definition of tender offer blank and give the Court flexibility to apply the Williams Act on a case by case basis. Consequently, the absence of a definition has generated a substantial number of cases brought before the courts in the US because the parties involved all chose to adopt the definition of tender offer most favourable to themselves.[248]

In *Kennecott Copper Corporation v Curtiss-Wright Corporation,*[249] the bidder purchased 9.9% of the target shares by approaching approximately 60% of the target shareholders and the court held that open market purchases without a deadline and without a premium offered did not constitute a tender offer. However, in *Wellman v Dickinson,*[250] the court set out eight factors, now called the *Wellman* factors, to identify the existence of a tender offer and therefore subject to the Williams Act. These eight factors are:

1. there is an active and widespread solicitation of public shareholders for shares of the target company;
2. the solicitation is made for a substantial percentage of the target company’s shares;
3. the offer to purchase is made at a premium over the existing market price;
4. the terms of the offer are firm rather than negotiated;
5. the offer is contingent on the tender of a fixed number of shares and possibly

---

[248] *See* Edward R. Aranow and Herbert A. Einhorn and George Berlstein, *Development in Tender Offers for Corporate Control: An Updating of a Prior Treatise on the Practical and Legal Problems Involved in Tender Offers* (Columbia University Press 1977) 1-35.
[249] *Kennecott Copper Corp v Curtiss-Wright Corp* 584 F 2d 1195 (CA2 1978).
[250] *Wellman v Dickinson* 475 F Supp783 (SDNY 1979), *aff'd* 632 F 2d 355 (2d Cir 1982).

specifying a maximum number of shares;

6. the offer is open for only a limited time period;
7. the offeree is subject to pressure to sell shares;
8. there are public announcements of a purchasing program that precede or are coincident with a rapid accumulation of large amounts of shares of the target company.[251]

However, it can be argued that not all of these eight factors have to be met to determine whether any share purchase activity constitutes a tender offer, and the courts have not treated all eight factors equally but have added more tests to define the term.[252] In *Hanson Trust PLC v SCM Corp*,[253] although the Second Circuit recognised that the *Wellman* factors are relevant to determining whether certain actions by a bidder constitute a tender offer, the court refused to regard the eight factors test as a 'mandatory litmus test'. In a district court's opinion in *S-G Securities, Inc. v Fuqua Investment Co*,[254] the court put forward more basic tests and held that a tender offer existed if a bidder publicly announced its intention to acquire a substantial block of a target's shares for the purposes of acquiring control of the company; and there was a substantial accumulation of the target's stock by the bidder through open market or privately negotiated purchases.

1.3.2 Information Disclosure

Schedules 13D and 13G Filings under Section 13(d)

---

[251] This last factor was added after the *Wellman v Dickinson* Decision.
[252] Stephen Kenyon-Slade (n51) 139.
[253] *Hanson Trust Plc v SCM Corp* 774 F 2d 47 (2d Cir 1985).
[254] *S-G Securities Inc v Fuqua Investment Co* 466 F Supp 1114 (D Mass 1978).

Under the US securities law, any substantial acquisitions of shares by a bidder may trigger specific disclosure duties once a certain threshold is reached.[255] The threshold is regarded as a signal of attempted shifting of corporate control, and certain information needs to be disclosed, such as the background and identity of the bidder, the source of the bidder's funds used for the acquisition, and the purpose of the acquisition, including any future plan to liquidate the target company or make any other major change to its business.

Schedule 13D

Under Section 13(d), any person who, directly or indirectly, acquires 5% or more of a company's equity security of any class, must publicly disclose such ownership by filing a Schedule 13D disclosure statement with SEC within 10 days of reaching the 5% threshold. This threshold level was first set as 10% but was later considered too high and changed to the more conservative 5%. Section 13d-3 provides that when two or more persons act as a partnership, limited partnership, syndicate, or other group for the purpose of acquiring, their combined shareholdings are considered as a 'person' for the purpose of the filing requirements of Section 13(d). Certain parties are exempt from this filing requirement, such as a member of a national securities exchange holding securities on behalf of another person, a pledge of securities acting in the ordinary course of business without voting power, and underwriters who happen to acquire securities for 40 days from the date the underwriter acquired the securities.[256]

Schedule 13G

The SEC, on 17 February 1998, made special provisions by adopting an amendment to Regulation 13D for those investors, usually institutional investors, who have beneficially

[255] James D. Cox and Thomas Lee Hazen, *Cox & Hazen on Corporations* (2nd edn, Aspen Publishers 2003) 1455.
[256] SEA 1934, rr 13d-3(d)(2) - (4).

held 5% or more of a company's shares but less than 20% of those shares in the previous 12 months and have not acquired or have no interest in changing or influencing the control of the company. In accordance with Rule 13d-1, such investors are required to file the much less detailed Schedule 13G instead of Schedule 13D.[257] Rule 13d-1(b) requires that Schedule 13G must be filed within 45 days after the end of the calendar year in which the filing obligation occurs. However, in the case of the institutional investor's beneficial ownership going over 10% of the class of equity securities, Rule 13-1(b)(2) requires that the initial Schedule 13G must be filed within 10 days of the end of any month in which it happens.

If a person who has filed a Schedule 13G changes his mind and determines to hold the securities with the purpose or effect of changing or influencing the control of the target company, and if the shareholding is more than 5% of the relevant class of securities, the acquirer must file a Schedule 13D within 10 days of such change of intent.[258] If the acquirer who has filed a Schedule 13G increases his shareholding to 20% or more of the relevant class of securities, a Schedule 13D must be filed immediately within 10 days after reaching the trigger holding.[259]

Amendments to Schedules 13D and 13G under Section 13(d)(2)

Rule 13d-2 requires a 'prompt' filing with the SEC and copies mailed by the acquirer to the issuer, when there has been a 'material change' in the facts that were set forth in Schedule 13D. It further specifies that an increase or decrease of 1% of beneficial ownership of a class of securities is considered material. As such, if a shareholder changes his intention to be a passive investor to influencing control of the issue, this

[257] *See* Amendments to Beneficial Ownership Reporting Requirements, Release No. 34-39538.
[258] SEA 1934, r 13d-1(e)(1).
[259] SEA 1934, r 13d-1(f).

would be a material change and he should file an amendment to Schedule 13D. The material change is required to be filed promptly as amendments to Schedule 13D. Generally speaking, a filing within 10 days of the material change could be considered as prompt unless the change is so significant that a delayed filing is not acceptable.[260]

Schedule TO under Section 14 (d)

Originally under the Williams Act, when a bidder intended to make a tender offer, he had to file a Schedule 14D-1. If the issuer himself makes a tender offer, a similar schedule, Schedule 13E-4, must be filed. Since both schedules relate to tender offers, either by the issuer or a third party, the SEC decided to combine these two schedules into one filing and provide a single set of regulations relating to the disclosure requirements for tender offers. A new disclosure schedule, a Schedule TO, replaced the old disclosure forms and came into force on 24 January 2000.[261]

Under Section 14(d), anyone intending to launch a tender offer must file with the SEC a 'Tender Offer Statement on Schedule TO' disclosing this intent, and must provide target shareholders with relevant information about the tender offer. Schedule TO contains more information with the aim of enabling the target shareholders to evaluate a tender offer more sensibly and make informed decisions about whether or not to tender. As Gaughan has stressed, this information disclosure on a tender offer is especially important when the bidder gives securities as consideration of the offer.[262]

A tender offer statement on Schedule TO must be filed with the SEC at the same time as the offer is made, and a copy must be hand-delivered to the executive offices of the target

---

[260] Brent A. Olson, *Publicly Traded Corporations: Governance & Regulation* (Thompson/West 2004) 14.
[261] *See* The M&A Release issued by the SEC in Release No. 33-7760; 34-42055; IC-24107; File No. S7-28-98.
[262] Gaughan (n30) 14.

company. A copy must also be hand-delivered to other bidders who have already filed a Schedule TO with the SEC with regard to any tender offer for the same securities, and to the securities exchanges on which the target company's securities are traded. The bidder is then required to submit a press release to the media. Schedule TO can also be used to update information contained in the Schedule 13D filing and to satisfy the reporting requirements under Section 13(d).

Target Board's Disclosure Obligation

The Williams Act originally imposed obligations to file a disclosure statement only on the bidder. In 1980, an amendment was added to the Act to require the target board to comply with disclosure requirements. Now, under Rule 14e-2 of Regulation 14E, it is required that the target's board of directors should respond to the tender offer within 10 business days from the commencement date of the offer, by advising its shareholders whether it recommends acceptance or rejection of the offer or remains neutral with regards to the tender offer or is unable to take a position towards it.[263] The target board must include their reasons for their position in respect to the tender offer. If there are material changes in the information previously supplied, the target board must disseminate to its shareholders amendments to the original recommendation statement.

1.3.3 Procedural Requirements

Duration of the tender offer

Rule 14e-1 requires the bidder to keep the tender offer open for at least 20 US business days before completing the purchase of the shares.[264] This requirement aims to give

[263] This requirement is equivalent to the target board circular under Rule 25 in the UK.
[264] Rule 14e-1(g)(3) defines 'business day' as 'any day, other than Saturday, Sunday or a federal holiday, and shall consist of the time period from 12:01 a.m. through 12:00 midnight Eastern time'.

sufficient time for target shareholders to fully evaluate the offer which has been sent to them directly. A modification of the offer is allowed during the entire period the offer remains open, but the length of the offer period then has to be extended. Under Rule 14e-1(b), the 20-day period must be extended by at least 10 business days if the bidder increases or decreases by more than 2% either the class of securities being bid under the offer or the consideration offered under the tender offer. It also provides that in order to extend the tender offer, the bidder must issue a public notice of such extension not later than 9:00 a.m. Eastern Time on the next business day after the scheduled expiration of the offer. If there are other competing bids and the shareholders need extra time to evaluate all the offers together, the tender offer may be extended. Unlike the UK's City Code, a tender offer in the US can be extended indefinitely without a time limit after which the tender offer must be closed.

Commencement of the Tender Offer

The date on which the offer is initially made is crucially important in a contested takeover battle because all the procedural and substantive disclosure provisions of the Williams Act and the requirement to file Schedule TO with the SEC are triggered upon the commencement of the tender offer. According to Rule 14d-2, the tender offer will begin at 12:01 a.m. on the date when the bidder has first 'published, sent or given' the means to tender to the shareholders of the target company. 'Means to tender' specified by Rule 14d-2(a) involves providing the letter of transmittal to the target shareholders or a statement informing them where the letter of transmittal may be obtained.

Shareholders' Withdrawal Rights

In the offer period the bidder must accept all shares that are tendered. However, under Section 14(d)(5), shareholders may decide not to tender their share to the bidder and withdraw the shares they tendered at any time during the first seven calendar days following the dissemination of the tender offer material by the bidder or at any time after 60 days from the date of such dissemination. Moreover, the SEC has extended the withdrawal period under Rule 14d-7. It stipulates that target shareholders can withdraw their tender for the whole open period of the tender offer, including the first seven calendar days after the dissemination of the offer.

Shareholders' Equal Treatment Rules

Rule 14d-10 provides that a tender offer must be open to all shareholders of the class of securities subject to the tender offer. The rule is designed to prohibit discriminatory tender offers with the intention of excluding certain shareholders. Furthermore, Section 14(d)(7) and Rule 14d-10(a)(2) require that, if the bidder increases the consideration offered at any time during the offer period, the bidder must pay this increased consideration to all those who have already tendered their shares at the lower price. The goal of this section is to ensure that all tender shareholders are treated equally and are paid the highest price pursuant to the tender offer, regardless of the date within the offer period that they tendered their shares. As Carney has argued, these rules contribute to reducing the pressure on the shareholders to tender early and give them time to consider the offer properly.[265] If a bidder only offers to buy part of the shares in the company and tender offers are oversubscribed, Rule 14d-8 requires the bidder to accept tendered shares

---

[265] Carney (n230) 928.

on a pro rata basis, according to the number of shares tendered by each shareholder during the period that the tender offer remains open, rather than purchasing first from the shareholders who tender first.

2. Takeover Law at the State Level

It should be kept in mind that, in the US, companies must follow the laws of the particular state in which they are incorporated. They may also have to comply with the laws of other states where they do business. In the context of takeovers, the behaviour of a target board when facing a hostile takeover bid is regulated by the state in which the company is incorporated, on which the federal securities law is silent. As Magnuson has observed, the takeover regulations at the federal level contribute only a small part of the rules governing takeovers.[266] It is the state law that retains the crucial task of governing defensive tactics and imposes fiduciary duties on the target directors during the offer period, which represent the main spirit of US takeover law.[267]

In the beginning of the 1970s, individual states passed their own statutes with regard to takeovers. The major difference among these statutes is their anti-takeover laws. Not surprisingly, the takeover law at the state level are more target-friendly than at the federal level and give massive protection to target boards against hostile takeovers, because of the 'large and non-diversified interests of local companies in attempting to use state legislation to defend themselves from hostile takeover'.[268]

---

[266] William Magnuson, 'Takeover Regulation in the United States and Europe: An Institutional Approach' (2009) 21 Pace International Law Review 205, 214.
[267] Forstinger (n74) 76.
[268] Ferrarini and Miller (n96) 9.

2.1 State Anti-takeover Laws

From 1982 to 1989, at least 34 states passed anti-takeover laws in response to intense lobbying by companies incorporated in the state, which claimed to be under the threat of takeovers and sought to adopt a protective statute. They threatened that if such a protective anti-takeover law was not passed, they would reincorporate in states that did have one.[269] Political pressure has also played an important role in the state legislatures because of the fact that takeovers launched by a raider from outside the state will mean a significant loss of jobs in the company taken over, as well as the loss of community support by the local companies, such as charitable donations.[270] Indiana, for example, enacted its first anti-takeover statute mainly aiming to protect Arvin Industries against the Belzberg family, which employed some 2000 employees in Indiana and provided substantial support to local schools.

These anti-takeover laws may take various forms, but their purpose is the same: to help local companies fend off hostile takeovers and make themselves more difficult to be taken over, especially by those from other states.[271] As White has observed, although there are variations among the states' anti-takeover statutes, the standard for regulating and reviewing hostile takeover activity is largely uniform across the states.[272] The state anti-takeover laws have gone through three generations of development, with different devices adopted by different states to protect their local companies and challenge hostile bidders.

---

[269] For example, the Pennsylvania anti-takeover law was passed partly as a result of the pressure from Armstrong World Industries of Lancaster, Pennsylvania, which feared being taken over by the Belzberg family of Canada. Dayton-Hudson and Boeing promoted anti-takeover laws in Minnesota and Washington respectively, while Harcourt Brace Jovanovich and Gillette promoted control share statutes in Florida and Massachusetts respectively.
[270] Kenyon-Slade (n51) 139.
[271] Gaughan (n30) 13.
[272] White (n28) 178.

2.1.1 First Generation

Shortly after the passage of the Williams Act, a wave of state anti-takeover laws emerged to give the directors of target companies powers beyond those of the Williams Act to resist hostile bids. These statutes imposed certain procedural and substantive requirements on the bidders with the aim of creating substantial obstacles for takeover bids.[273] The problem with these 'first-generation' state anti-takeover laws was that they gave state administrators the power to review offers on various grounds, such as substantive fairness and the adequacy of disclosures.[274] By holding a hearing to review the offers, it largely imposed delay between when an offer was filed and when it became effective.[275] Moreover, these statutes attempted to govern tender offers made for firms incorporated in other states and were argued to be unfair to bidding companies.[276] Thus, these statutes ultimately led to a judicial review and they were declared by various federal courts to be unconstitutional on the grounds that they interfered either with interstate commerce or with the federal supremacy of the Williams Act.

Edgar v MITE Corp.

In the famous case of *Edgar v MITE Corp*,[277] the US Supreme Court ruled that the Illinois Business Takeover Act was unconstitutional under the dormant Commerce Clause of the United States Constitution. The Illinois law required bidders to notify the target company and the Illinois Secretary of State twenty days before the offer became effective, and permitted the Secretary to block a nationwide tender offer for a state-affiliated target corporation if the bidder failed to comply with the disclosure laws of Illinois. It also

---

[273] Armour and Jacobs and Milhaupt (n132) 254.
[274] Stephen M. Bainbridge, *Mergers and Acquisitions* (2nd edn, Foundation Press 2008) 252.
[275] Magnuson (n265) 217.
[276] Patrick A. Gaughan, *Mergers, Acquisitions, and Corporate Restructurings* (John Wiley & Sons 2007) 37.
[277] *Edgar v MITE Corp* 457 US 624 (1982).

required the Secretary to hold a hearing at the request of shareholders owning at least 10% of the securities subject to the offer. The Supreme Court ruled that Illinois gave its resident shareholders 'speculative protections' and 'had no legitimate interest in protecting non-resident shareholders' or in 'regulating the internal affairs of a foreign corporation'.[278]

The challenge to the Illinois law made other states which had enacted similar anti-takeover laws to question their constitutionality and revise their provisions. However, belief that hostile takeovers were not in the best interest of the states was unchanged, and in order to continuously impede hostile takeovers, they had to seek a different approach to avoid the constitutional problems in *Edgar v MITE Corp*.[279] This paved the way for a second wave of state anti-takeover statutes.

2.1.2 Second Generation

The second generation state anti-takeover laws emerged in response to the lesson of first generation laws, and relatively narrowed their protection range. They tended to apply only to target companies that were incorporated within the state or that conducted a substantial part of their business activities within state boundaries. They were not directed at regulating disclosure in tender offers, as the first generation laws were. Instead, under the 'internal affairs doctrine', they focused on issues of corporate governance of companies incorporated in a specific state, which successfully avoided the constitutional conflict of the first generation because internal affairs traditionally are governed by the corporation law of the chartering state.

[278] *Edgar v MITE Corp* 457 US 624 (1982), 644.
[279] Carney (n230) 479.

The primary objective of the second generation anti-takeover statutes was to protect target shareholders from coercive takeovers.[280] These second generation statutes took several different forms. The earliest form is the so-called 'Fair Price' statute, which typically required certain specified transactions (including back-end freezeout mergers and second-step business combinations) with 'interested shareholders' (typically a shareholder holding more than 10 or 20%) to be approved by a supermajority of shareholder votes unless they all received the highest price paid by the offeror.[281] In a later form, the 'Control Share Acquisition' statutes provided that a bidder would not have voting rights upon reaching a certain controlling percentage of the target's voting power (for example, 20-33.3%, or 33.3-50%, or over 50%), unless this voting power was expressly conferred by the affirmative vote of a majority of the target 'disinterested' shareholders (of the shares not owned by the bidder).

CTS Corps v Dynamics Corporation of America

In the case of *CTS Corps v Dynamics Corps of America*,[282] the CTS Corporation fought off a takeover by the Dynamics Corporation based on the Indiana law which required the disinterested shareholders to determine in a shareholders' meeting whether an acquirer owning more than 20% of outstanding shares would have voting rights to the shares he held. Dynamics challenged the Indiana law by contending that it was unconstitutional on the grounds that it was pre-empted by the Williams Act and violated the Commerce Clause. The court ruled that the Indiana anti-takeover law was constitutional by denying

[280] Kenyon-Slade (n51) 176.
[281] *See* Conn. Gen. Stat. Ann. ss 33-840 to 33-842.
[282] *CTS Corp v Dynamics Corp of America* 481 US 69 (1987).

the existence of 'an interstate market for corporate control' protected by the Commerce Clause.[283]

The *CTS* decision, giving the Supreme Court's approval to the second-generation state anti-takeover laws by holding that they were not pre-empted by federal law, was regarded as a sign of a less enthusiastic attitude towards the social benefits that a takeover could bring in the US.[284] Within a short period of time after the *CTS* decision of 1987, more than 40 states enacted various types of anti-takeover law, attempting to take advantage of the new Supreme Court decision.[285] As Armour et al have claimed, most hostile offers in the US are now potentially subject to regulation under the second generation anti-takeover statutes.[286]

2.1.3 Third Generation

There then developed a third generation of anti-takeover laws, enacted from the end of the 1980s, intending to prohibit certain post-bid transactions. The best known are the 'Business Combination' statutes which prohibit an 'interested shareholder' who has obtained a certain percentage of the target company's voting right (such as 15% or more) from taking any post-acquisition 'business combination' transactions, such as back-end freezeout mergers in the case of a hostile takeover, for a specified period of time (such as five years) following the date on which such person becomes an interested shareholder, unless the business combination transaction was approved by the target board of directors

[283] ibid 94.
[284] Leo Herzel and Richard W. Shepro, 'Ups and Downs of US Takeover Defense' (1988) 9 Company Law 84, 84.
[285] ibid.
[286] John Armour and Jacobs and Milhaupt (n132) 247.

or a supermajority of disinterested shareholders, or met specified price and other conditions.[287]

Amanda Acquisition Corporation v Universal Foods Corporation

In *Amanda Acquisition Corp v Universal Foods Corp*,[288] the Amanda Acquisition Corporation, a subsidiary of the Boston-based High Voltage Engineering Corporation, launched a tender offer to acquire all the outstanding shares of Universal Foods, a Wisconsin corporation. It was prevented from proceeding by the Wisconsin Business Combination Act which requires a bidder who acquires 10% or more of a target company's voting share to receive the approval of the target board of directors or wait three years to complete the merger. Amanda Acquisition claimed that the Wisconsin law was pre-empted by the Williams Act and inconsistent with the Commerce Clause. The Seventh Circuit Court of Appeals denied both arguments and upheld the constitutionality of the Wisconsin anti-takeover law. In November 1989, the Supreme Court refused to hear a challenge to the Wisconsin anti-takeover law, which further confirmed the legal viability of state anti-takeover laws. Business Combination statutes, regarded as the most sophisticated form of anti-takeover statute, have been enacted in most of the states today.[289]

2.2 Directors' Roles in Takeover Defences

As described in Chapter 1, when facing a hostile takeover there is an inherent conflict of interest between target directors, who seek to maintain their jobs by deterring the offer, and their shareholders, who might benefit from the takeover by accepting the offer.

---

[287] *See e.g.,* New York Business Corporation Law, s 912 (McKinney Supp. 2002) and Delaware General Corporation Law, s 203.
[288] *Amanda Acquisition Corp v Universal Foods Corp* 877 F 2d 496 (7th Cir 1989).
[289] Kenyon-Slade (n51) 193.

Ideally, the regulation of board conduct is to pursue a balance between improper use of defences to serve directors' self-interests and proper use of defences to prevent that the tender offer is under-value.[290]

2.2.1 Directors' Fiduciary Duties

In the US, the federal laws do not interfere with the power of a target's board under its corporate charter. The state laws attempt to address this issue through a 'single and homogeneously defined standard' on the accountability of the target's board, known as fiduciary duties.[291] In the face of a hostile takeover, takeover defences are at the business discretion of the board of directors and can be widely adopted by the target board without shareholder approval. However, the adoption of these defensive measures by target directors must comply with their fiduciary duties to the company and its shareholders.

As a general rule, directors' fiduciary duties, beyond mere fairness and honesty, include the duty of care and the duty of loyalty. Directors are required to make decisions on all reasonably available information by the duty of care and to make decision in the interests of the company and its shareholders, not out of self-interest, by the duty of loyalty.[292]. As Benjamin Cardozo held in *Meinhard v Salmon*, '[m]any forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honour the most sensitive, is then the standard of behaviour'.[293]

---

[290] Larry E. Ribstein, 'Why Corporations?'(2004) 1 Berkeley Business Law Journal 183, 183.
[291] Klaus J. Hopt, 'Common Principles of Corporate Governance in Europe*?'* in Joseph A. McCahery and others (eds), *Corporate Governance Regimes: Convergence and Diversity* (Oxford University Press 2002) 259.
[292] David Lamb, 'United States of America: Directors' Duties under Delaware Takeover Law' (1994) 15(9) Company Law 283, 283.
[293] *Meinhard v Salmon* 249 NY 458 (1928), 464.

The US courts generally apply a number of procedural and substantive standards to determine whether a board of directors properly exercises their fiduciary duties, which are often collectively referred to as the 'Business Judgment Rule'.[294] The Business Judgment Rule is based on the essential notion that the management and affairs of a corporation are entrusted to its board of directors, whose decisions are made based on sound business judgement with due care and in good faith.[295] In *Aronson v Lewis*, the court defined the Business Judgment Rule as a 'a presumption that in making a business decision that directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company'.[296]

Under this rule, the board of directors are not liable for a mistake in business judgement if it is made in good faith and in what they believe to be the best interest of the company. It was addressed in *AC Acquisitions Corp v Anderson, Clayton & Co.*: when a court is required to review the propriety of business decisions by the board of directors, it will decline to evaluate the merits or wisdom of the decisions of board of directors who are elected by shareholders to manage the business of the company.[297] In other words, as Lamb has argued, 'the directors are afforded a presumption that they have fulfilled their fiduciary duties and in such circumstances the court will not substitute its judgement for that of the directors'.[298]

2.2.2 Delaware Court's Decisions

As described previously, the Williams Act is primarily a disclosure statute and does not directly govern the conduct of target boards in responding to, particularly in resisting, a

---

[294] *See Pogostin v Rice* 480 A 2d 619 (Del 1984), 627; *Aronson v Lewis* 473 A 2d 805 (Del 1984), 812; *Paramount Communications Inc v QVC Network Inc* 637 A 2d 34 (Del 1994), 41-42.
[295] Jeffrey Gordon and Harvey Nixon, 'The Outer Boundaries of the Poison Pill in US Takeovers' (1989) 4(3) Journal of International Business and Law 142, 146.
[296] *Aronson v Lewis* 473 A 2d 805 (Del 1984), 812.
[297] *AC Acquisitions Corp v Anderson, Clayton & Co* 519 A 2d 103 (Del Ch 1986), 111.
[298] Lamb (n292) 283.

hostile takeover bid. At the federal level, there seems to be no interest in regulating the takeover defences and instead, as Chancellor William Chandler stated:

> With minor exceptions, the United States Congress had shown no interest in adopting a statutory framework to regulate corporate decision-making. The [SEC] also expressed no interest in regulating takeover defences such as the poison pill. Moreover, the United States Supreme Court had essentially sidelined federal judges and state legislatures with respect [to] such corporate governance matters. Almost by default, state courts were left to fill this void and create dependable ground rules governing when corporate boards…might employ takeover defences…to deter, thwart, slow down or even stifle an ever increasing wave of hostile acquisitions.[299]

In addition, according to Alcock, it has never been open to the US federal authorities to establish nation-wide rules to regulate takeovers, because the corporation matter is within the jurisdiction of individual states and therefore the target's board's ability to employ takeover defences is not a matter for federal control.[300] As a result, the issue regarding how and to what extent the takeover defences can be employed by the target board is regulated through state legislative and judicial decisions and subject to regulatory competition among the individual states.[301]

In this competitive context, the standards of target directors' behaviour in facing a hostile takeover have been defined by a series of precedents in the State Delaware on a case by

[299] William B. Chandler III, 'Hostile M&A and the Poison Pill in Japan: A Judicial Perspective' (2004) Columbia Business Law Review 45, 49-50.
[300] Alistair Alcock (n228) 166.
[301] Kenyon-Slade (n51) 56.

case basis.[302] Over almost 30 years, the behaviour standards produced by the Delaware courts to regulate defensive board actions of a Delaware corporation in response to hostile takeovers, have 'completed the landscape of American tender offer regulation'.[303] Delaware is arguably the only state which has established a well-developed case law on the use of takeover defences by the target board.[304]

These cases play a particularly important role in regulating takeover defences, not only because Delaware was and continues to be the state where more US quoted corporations have chosen to incorporate than in any other state[305], but also because of 'the persuasive authority attributed to Delaware's courts in corporate law issues'.[306] Delaware's sophisticated court system has used very experienced and knowledgeable judges to decide corporate lawsuits. As a result, they have produced the most influential source of takeover law, and its rulings continue to influence other states. As Delahaye has observed, in states with less sophisticated takeover laws, practitioners frequently advise clients on the basis of Delaware law, and their jurisdictions are unlikely to be stricter than Delaware's.[307]

2.2.2.1 Unocal Duties – where the board intends to preserve the company's independence

In *Unocal Corp v Mesa Petroleum Corp*,[308] the Unocal board of directors launched a self-tender offer for itself with the aim of impeding the unwanted tender offer initiated by Mesa Petroleum. However, this self-tender offer excluded Mesa Petroleum who already owned approximately 13% of the outstanding Unocal shares. The Delaware Chancery

[302] Dana M. Muir and Cindy A. Schipani, 'New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others' (2005) 8 Legislation and Public Policy 279, 354.
[303] Armour and Skeel, Jr. (n118) 1761.
[304] Berglöf and Burkart (n32) 188.
[305] General Motors, Exxon Mobil, Wal-Mart and DuPont are among over 300,000 companies that have incorporated in Delaware. One-half of all New York Stock Exchange companies are incorporated there, along with 60% of the Fortune 500 companies.
[306] Ventoruzzo (n24) 187.
[307] Bernd Delahaye, 'Still Alive: Poison Pills and Staggered Boards As Hostile Takeover Defences – the Battle for Airgas' (2012) International Company and Commercial Law Review 211, 211.
[308] *Unocal Corp v Mesa Petroleum Corp* 493 A 2d 946 (Del 1985).

Court issued a preliminary injunction against the self-tender on the grounds that the company directors have a fiduciary duty to treat all shareholders fairly and that the self-tender unfairly discriminated against Mesa Petroleum.[309] However, a few days after the Chancery Court's opinion, as Shepro and Herzel described 'to the astonishment of most corporation lawyers', the Delaware Supreme Court held that a defensive self-defender offer that discriminated against a hostile bidder who was also a major shareholder of Unocal was valid.[310]

In reaching its decision, the court noted its concern that 'a director may be acting primarily in his own interests rather than those of the corporation and its shareholder' and adopted an 'enhanced scrutiny' standard that calls for 'judicial examination at the threshold before the protections of the business judgment rule may be conferred'.[311] When faced with hostile takeovers, the court modified the business judgement rule and required the board to meet the following two tests when trying to preserve the independence of the target company:

- A Reasonableness test which is satisfied by a demonstration that directors have reasonable grounds to believe that danger to the pursuit of a corporate policy and effectiveness exists if the company is controlled by the hostile bidder, and
- A Proportionality test which is satisfied by a demonstration that their defensive actions were 'proportionate' to the threat posed by the hostile bid and its effect on the company.

The Unocal case was particularly significant, as Muir and Schipani have explained, because it showed that Delaware courts 'are willing to scrutinize a decision to resist a

---

[309] *Unocal Corp v Mesa Petroleum Corp* Civil Citation No 7977, unreported opinion (13 May, 1985).
[310] Herzel and Shepro (n284) 84.
[311] *Unocal Corp v Mesa Petroleum Corp* 493 A 2d 954 (Del 1985), 954-955.

takeover attempt more closely than an ordinary business decision'.[312] The Unocal standard, also known as the 'enhanced business judgment rule', has frequently been used by Delaware courts as a standard for reviewing the conduct of target boards against hostile tender offers with the aim of preserving the company's independence.[313] It is argued that these are duties, along with the fiduciary duties governing almost all defensive measures taken by the target directors in response to a hostile takeover.[314] Once the Unocal duties have been satisfied, the normal presumptions about directors' behaviour under the business judgment rule apply.[315]

2.2.2.2 Revlon Duties — where change of control of the company is inevitable

In *Revlon Inc v MacAndrews and Forbes Holdings Inc,*[316] Revlon had given a lockup option on its health divisions to Forstmann Little & Co in the face of a hostile takeover attempt by Pantry Pride. The Delaware Chancery Court enjoined the lockup by holding that 'once the breakup of Revlon became inevitable… the board [had] to view its primary role as the promoter of bids, with price the dominant consideration.'[317] The Delaware Supreme Court ruled on the obligation of a target board of directors to recommend the transaction that will maximise shareholder wealth if it is certain that its company is going to be sold. In this context, the court said, '[t]he directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company'.[318]

---

[312] Muir and Schipani (n302) 354.
[313] Gordon and Nixon (n295) 143.
[314] Lamb (n292) 284.
[315] *Unocal Corp v Mesa Petroleum Corp* 493 A 2d 954 (Del. 1985)
[316] *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A 2d 173 (Del 1986).
[317] *MacAndrews & Forbes Holdings Inc v Revlon Inc* 501 A 2d 1239 (Del Ch 1985), 1250-1251.
[318] *Revlon Inc v MacAndrews & Forbes Holdings Inc* 506 A 2d 173 (Del 1986), 182.

The judgement in the case of *Revlon* continues to be cited in various cases and the rules introduced by the court came to be known as the *Revlon Duties*.[319] Where the takeover will result in change of control or break-up of the company, as Lamb has pointed out, the nature of the board's *Unocal Duties* changes.[320] The fundamental role of directors is to maximise the gains for their shareholders rather than to preserve the independence of the company. Therefore, *Revlon Duties* come into play when it is clear that the sale or breakup of the company is inevitable. The Delaware Supreme Court has clarified this point by noting that the duty of the target board of directors to be an auctioneer arises only if it is 'apparent' that a sale of the company is 'inevitable', which is not the case when the board is determined to remain independent.[321]

It is worth noting that although the lockup options were held to be invalid, the court did not go so far as to prohibit the use of the defences. If the defences are used to promote the auction process by favouring one bidder over another and thereby causing the offer price to rise, they could be consistent with the board's Revlon duties. However, defences are used to hinder the auction process are not valid. In other words, the directors' role changes from defender attempting to frustrate the sale to auctioneer seeking the highest price for shareholders.[322]

2.2.2.3 *Moran* Case -- where the board intends to adopt poison pills

Poison pills have been a common feature of US companies and more than half of them have adopted such plan in potential takeovers.[323] Courts in the US have generally been

---

[319] Joy Dey, 'Efficiency of Takeover Defence Regulations A Critical Analysis of the Takeover Defence Regimes in Delaware and the UK' (2009) Social Science Research Network <http://ssrn.com/abstract=1369542> accessed 2 January 2011, 13.
[320] Lamb (284) 284.
[321] *Ivanhoe Partners v Newmont Mining Corp* 535 A 2d 1334 (Del 1987), 1341.
[322] Magnuson (n265) 215.
[323] Lowry (n50) 341.
[323] Hill (n58) 7.

kind to the adoption of poison pills. In the case of *Moran v Household International, Inc*,[324] the target board adopted a poison pill and refused to redeem it. The Delaware Supreme Court upheld the legality of poison pills by concluding that their adoption by a target board was consistent with Delaware Law, despite the fact that they cause discrimination between the tender offer bidder and other shareholders of the target company.[325] The court based the validity of poison pills on the condition that an adoption of poison pills by the target board is subject to fiduciary duties and therefore open to judicial review, by noting that

> when the Household Board of Directors is faced with a tender offer and a request to redeem the rights, they will not be able to arbitrarily reject the offer. They will be held to the same fiduciary standards as any other board of directors would be held to in deciding to adopt a defensive mechanism, the same standard as they were held to in approving the Rights Plan.[326]

In most cases, Delaware courts are reluctant to order the target board to redeem the pill because the existence of the poison pill can act as a powerful defensive mechanism to protect undervalued target companies from opportunistic acquirers. As a result, apart from negotiating directly with the target's board and reaching a settlement before making any tender offer, if hostile bidders want to get over the barrier set up by the poison pill, they must first gain control of the target's board and redeem the poison pill afterwards. Their solution is to combine a hostile tender offer with a proxy solicitation to remove the incumbent target directors and replace them with their own board candidates who would

---

[324] *Moran v Household International Inc* 500 A 2d 1346 (Del 1985).
[325] ibid 1357.
[326] *Moran v Household International Inc* 500 A 2d 1346 (Del 1985), 1356.

redeem the poison pill after their election. Therefore, the arrangement of board elections became the critical factor influencing the target's defensive prospects.[327]

If the target company has a unitary board, where all members are elected at the annual meeting of shareholders, a bidder would have to wait for the next election to conduct a proxy contest. However, if the target company has staggered boards, this effectively prevents a bidder from obtaining control of the board in a single election. The bidder might have to wait even longer to replace the board. Correspondingly, the target board's ability to impose delays on a bidder in gaining control of a company could serve as a significant deterrent to the making of a bid in the first place.[328] It is therefore argued that when a poison pill is combined with a staggered board, it makes a hostile takeover difficult because the bidder cannot remove the poison pill by simply asking target shareholders to replace the board on one occasion. The Delaware Corporation Law allows boards to have two or three classes of directors.[329]

2.2.2.4 Subsequent Cases

In *Blasius Industries Inc v Atlas Corp,*[330] *Atlas*'s board amended the bylaws to expand its size by appointing two directors to fill the newly created board, in order to retain control of the incumbent board irrespective of the outcome of the proxy contest. Delaware Court of Chancery invalidated this defensive action by concluding that the action, intended to interfere with the shareholders' power to appoint a majority of the board, will constitute an unintended violation of the duty of loyalty that directors owe to the shareholders, even if the board are sincerely acting in the best interest of the company and not merely to

---

[327] Bebchuk and Coates IV and Subramanian (n52) 890.
[328] John C. Coates IV, 'Measuring the Domain of Mediating Hierarchy: How Contestable are US Public Corporations?' (1999) 24 Journal of Corporate Law 837, 853.
[329] *See* Del. Code Ann. tit. 8, s 141 (1991).
[330] *Blasius Industries Inc v Atlas Corp* 564 A 2d 651 (Del Ch 1988).

entrench themselves; unless the board can demonstrate a 'compelling justification' for undertaking it on the ground that the shareholder vote that installs the directors into office is what legitimates the directors' exercise of power. As Armour et al have stressed, the Blasius standard was 'designed to reinforce that principle as a matter of fundamental corporate law policy'.[331] This ruling protects shareholders' ability to respond to unsatisfactory management by exercising their voting rights or selling their shares to outsiders.

When the adoption of poison pills was held to be valid in *Moran*, it coincided with and arguably caused the decline of hostile takeover bids in the 1980s. During the recession in the United Sates in the 1990s, the number of hostile takeovers continued to go down, largely because of the elimination of the major financing sources for hostile takeovers. In *City Capital Associates v Interco,*[332] the Delaware Court of Chancery recognised that the board of directors would seriously harm shareholders' interests by using a poison pill, and gave the shareholders the right to decide for themselves whether to accept a non-coercive offer. Chancellor Allen expressed some concerns about Unocal's duties and ordered the redemption of a poison pill by saying that 'in the setting of a non-coercive offer, absent unusual facts, there may come a time when a board's fiduciary duty will require it to redeem the rights and to permit the shareholders to choose'.[333] The court came to this conclusion on the grounds that a non-coercive takeover offer constitutes a relatively mild threat so that the board's defences should be accordingly prohibited and shareholder choice should not be frustrated in relation to the threat posed. Any poison pills therefore had to be redeemed if used by the target board to resist a non-coercive tender, because

[331] Armour and Jacobs and Milhaupt (n132) 265.
[332] *City Capital Associates v Interco* 551 A 2d 787 (Del Ch 1988).
[333] ibid.

their use to defeat a non-coercive tender offer was not proportionate to any legitimate threat by the tender offer.

However, one year later the Delaware Supreme Court rejected the balanced rule of *Interco* in *Paramount Communications Inc v Time Inc*,[334] by describing it as a 'narrow and rigid construction of *Unocal*' and 'reject[ed] such approach as not in keeping with a proper *Unocal* analysis'.[335] The court suggested in the *Paramount* case that almost anything would be considered a legitimate threat justifying the use of a poison pill to reject any bid indefinitely. *Time*'s board's self-serving conclusion of *Paramount*'s tender offer as 'inadequate' was found sufficient justification for denying their shareholders the opportunity to decide for themselves whether or not the offer was adequate.[336]

Paramount also established the legitimacy of a set of defences, regarded as 'just-say-no-defences' allowing the target board to 'just say no' to a premium bid that a majority of target shareholders preferred, on the grounds that it was aiming to protect the interests of employees and other constituents.[337] As a result, *Paramount* gave the target board significant power to 'just say no' to any takeover bid regardless of the target shareholders' preference, if it was justified by the long-term strategy that directors believe would eventually generate greater wealth for shareholders. *Paramount,* therefore, enables the target board to manoeuvre more freely in adopting takeover defences, even if the sale of the target company is inevitable.

In the 1990s, there were two cases which clarified the directors' duties in takeover defences; they were argued to imply the broadened scope of directors' ability to adopt

---

[334] *Paramount Communications Inc v Times Incorporated* 571 A 2d 1140 (Del 1989).
[335] ibid 1153.
[336] *Paramount Communications Inc v Times Incorporated* 571 A 2d 1140 (Del 1989), 1153.
[337] Robert A. Prentice and John H. Langmore, 'Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They Be Allowed To?' (1990) 15 Delaware Journal of Corporate Law 377, 377.

defensive measures.[338] First, in *Paramount v QVC Network*,[339] the Delaware Supreme Court clarified the circumstances in which the *Revlon* duties apply and held that it would apply enhanced scrutiny of target board's actions based on the *Revlon* doctrine, but only when the defensive action was taken after a change in corporate control or a break-up of the target company was inevitable. In other words, when the sale of the company is inevitable, the directors no long face threats to their company policy and effectiveness, and their main duty is to secure the best-value takeover offer reasonably available for the shareholders, discharging their fiduciary duties to the end.

In the second case, *Unitrin v American General*,[340] decided in 1995, the court allowed an independent board to approve takeover defences as long as they were not 'draconian' and were within a 'range of reasonableness'. It was emphasised that the board should be allowed to take strong steps to oppose takeover bids by expanding the range of possible defensive actions that directors can adopt, from the 'proportionality' test set by *Unocal* to a less clearly defined 'range of reasonableness' in response to the perceived threat.[341] *Unitrin* is regarded as the leading case concerning the board's ability to use takeover defences to thwart an unwanted takeover bid; it demonstrates the state law's attitude towards takeover defences, which favours the primacy of the target board over shareholders' choice.

The existence of the precedents of the Delaware courts clearly demonstrates a regulatory response of widely extending the target board's ability of employing takeover defences to resist a hostile takeover, as long as the board acts in good faith and satisfies reasonable investigation. As Smith has argued, after *Unitrin* resulted in modification of the *Unocal*

---

[338] Magnuson (n265) 215.
[339] *Paramount Communications Inc v QVC Network Inc* 637 A 2d 34 (Del 1994).
[340] *Unitrin Inc v American General Corp* 651 A 2d 1361 (Del 1995).
[341] ibid 1387-1388.

duties in 1995, it was hard to find a defensive measure that would be claimed invalid by the Delaware courts, particularly the Delaware Supreme Court, which routinely deferred to defensive actions by target boards.[342]

[342] Gordon Smith, 'Poison Pill Forum: The Revival of Interco' (2010) Conglomerate <http://www.theconglomerate.org/2010/09/poison-pill-forum-the-revival-of-interco.html> accessed 3 April 2013.

Chapter 4 Comparative Analysis of the Divergence between the UK and US Takeover Regimes

1. Two Sets of Conflicts of Interest

When looking at the legal questions raised by takeover activities to be resolved by the UK and US takeover laws, a distinction can be made between two types of conflicts of interest: the conflict between the target board and target shareholders, and the conflict between the bidder and target shareholders. It needs to be made clear that takeover rules, unlike for example, listing rules, are not intended to address the tension which arises between the shareholders of the bidder and its board in relation to the decision to acquire the target company. Therefore, this particular conflict of interest will not be discussed in this thesis.

As can be seen from Chapters 2 and 3, although the UK and the US have relatively similar capital markets and corporate governance, each jurisdiction has adopted a strikingly different approach towards takeover regulation. In order to analyse the differences between the two systems, this comparison will focus on two issues: what defensive tactics can be employed affecting the relationship between the target board and target shareholders; and how the tender offer should be carried out affecting the relationship between the bidders and the target shareholders.

2. Conflict between the Target Board and Target Shareholders

In the UK and US, most publicly listed companies have dispersed ownership, and controlling shareholders are the exception. The consequence is that the board of directors is very powerful. As Hopt has observed, although the directors are agents of the company, their interests are not 'generally aligned with those of shareholders'.[343] The rules laid down in takeover law in connection with director' duties are attempting to seek a balance between freedom of action taken by the directors to manage the company and possible abuse of their power for their private interests.[344]

In the context of a takeover, especially a hostile takeover, the conflict of interests between target directors and shareholders is severe, and the issue of directors' duties is particularly complex.[345] As Davies and Hopt have found, when facing a hostile takeover, there is a tension between the shareholders' freedom to sell shares they hold in the target company and 'a recognition that sales of shares sufficient to produce a control shift have consequences for the policies of the company which would normally call for a decision of the board'.[346] Therefore, the critical question here is whether and to what extent the directors of the target company should be allowed to adopt defensive measures to resist the tender offer which shareholder may wish to accept. As Gilson has pointed out, in the regulation of board conduct, there is a sensitive balance between giving directors the freedom to employ takeover defences against an unwanted bid and restricting the defences to encourage a market for corporate control.[347]

When a takeover bid is announced, it is broadly understood that the target board and shareholders have very different attitudes towards the bid. On the one hand, shareholders generally have a welcome attitude towards it because in a tender offer they are usually

---

[343] Klaus J. Hopt, 'Comparative Company Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press 2006) 1183.
[344] Ventoruzzo (n31) 25.
[345] Blanaid J. Clarke, 'Directors' Duties During an Offer Period—Lessons from the Cadbury PLC Takeover' (2011) UCD Working Papers in Law, Criminology and Socio-Legal Studies Research Paper No. 44/2011 <http://ssrn.com/abstract=1759953> accessed 8 March 2012, 1.
[346] Davies and Hopt (n5) 230.
[347] Ronald J. Gilson, 'Unocal Fifteen Year Later (And What We Can Do About It)' (2001) 26 Delaware Journal of Corporate Law 491, 495.

given an immediate opportunity to sell their shares above market price.[348] They might benefit from the takeover bid by selling their shares in the target for a premium, to maximise the current value of their shares. They might, however, tender their shares out of fear that, if they do not, then the bidder might still gain control, in which case the shareholder would be left with low-value minority shares in the acquired target.[349] In addition, the possibility of a hostile bid helps to discipline the managers if a takeover does happen. Thus, shareholders normally have a good incentive to sell their shares when faced with a tender offer.

On the other hand, target directors' incentives are likely to diverge from those of the shareholders. As Bainbridge has argued, if the hostile bid is successful and a change of control takes place, the bidders who would be the majority shareholder would replace the board of directors and remove the existing managers in order to control the target company.[350] As a result, when hostile takeovers occur, the target board may not be perfectly faithful to the shareholders and may be expected to pursue their own interests at the shareholders' expense.[351] They may seek to avoid losing their positions in the target company by adopting defensive measures to deter potential acquirers from the right to run the target company, although the defending board usually attempts to justify their resistance as being in the best interest of the shareholders.[352] However, the defensive tactics they frequently use may fight off even a value-maximising takeover bid.

---

[348] B. Espen Eckbo, 'Bidding Strategies and Takeover Premiums: A Review' (2009) 15 Journal of Corporate Finance149, 149.
[349] Lucian A. Bebchuk, 'The Pressure to Tender: An Analysis and a Proposed Remedy' (1987) 12 Delaware Journal of Corporate Law 911, 912.
[350] Bainbridge (n274) 26-27.
[351] Note that the terms "directors", "managers" and "management" can be used interchangeably when representing a group of interests in opposition to the shareholders.
[352] Yoon K. Choi, 'The Choice of Organizational Form: The Case of Post-Merger Managerial Incentive Structure' (1993) 22 Financial Management 69, 70.

2.1 UK's Response

In accordance with the statutory duties introduced by the CA 2006, directors of UK registered companies have a duty to promote the success of the company and only take action for the purpose for which they were appointed. In the case of takeovers, the directors are subject to certain additional duties pursuant to the City Code. One of them is acting in the interest of the company as a whole, which stems from the Takeover Directive. More significantly, the legal regime for takeovers in the UK makes it clear that the decision on takeover defences belongs to shareholders, not directors, and generally holds that directors cannot use their powers to preclude the majority shareholders' constitutional right to decide whether or not to accept a takeover bid. The target shareholders are therefore given maximum opportunity to decide whether to accept or reject the takeover bid and how to deal with their shares in face of a takeover.

According to the City Code, once the target board is aware of the takeover offer, it is prohibited from taking any action to frustrate the takeover bid without the approval of the shareholders in general meeting.[353] According to Dean, this prohibition has been a central rule of the UK City Code since its inception, and gives target shareholders the ultimate power to determine the success or failure of a hostile bid when balancing the powers between target board and shareholders.[354] This prohibition is based on the common law view that directors' powers should only be used 'for their proper purpose' and this does not include frustrating takeovers.[355] But unlike the proper purpose doctrine, the City Code bans all actions which have the effect of frustrating a takeover offer without shareholder approval. As Seretakis has argued, the NFR makes the purpose of directors irrelevant

---

[353] City Code, r 21.
[354] Janice Dean (n183) 371.
[355] *Hogg v Cramphorn Ltd* [1967] Ch 254.

when considering the validity of the takeover defences.[356] According to an empirical study over a five-year period, undertaken by Deakin and others, litigation is very rarely used by shareholders in the UK and the popularity of poison pills and other takeover defences is far below the level in the USA.[357]

2.2 US's Response

By contrast, the US adopts a dramatically opposite regulatory approach towards a takeover defence to that taken by the UK in the City Code. In the US, the target shareholders do not have as much power to prevent the directors' choice as in the UK. There is an entire body of tactical options for a target board which is seeking to defend itself against a takeover bid. As Miller has argued, the directors of US target companies play a central role in adopting defensive measures – most of which, such as the poison pills, can be implemented without shareholder approval.[358] Through precedents along with the various anti-takeover statutes, a positive increase has been observed in the freedom of directors to adopt takeover defences in response to hostile takeovers.[359] The board of directors in the target company is protected in a way that leaves shareholders little choice in this matter. The broadened power of the target board to resist a hostile takeover seems to be a move toward favouring freer use of takeover defences in the US. In practice, target boards have been granted far more freedom than in the UK to decide whether to accept or reject a takeover bid.

---

[356] Alexandros Seretakis, 'Hostile Takeovers and Defensive Mechanisms in the UK and the US: A Case Against the US Regime' (2012) Social Science Research Network <http://ssrn.com/abstract=1985846> accessed 28 January 2013, 25.
[357] Simon Deakin and others, 'Implicit Contract, Takeovers, and Corporate Governance: in the Shadow of the City Code' in David Campbell and Hugh Collins (eds) *Implicit Dimensions of Contract* (Hart Publishing 2003), 296.
[358] Geoffrey P. Miller, 'Political Structure and Corporate Governance: Some Points of Contrast between the United States and England' (1998) 1 Columbia Business Law Review 51, 51.
[359] Gilson (n346) 495.

However, the board's power to adopt defensive measures is not absolute. Although the target shareholders' ability to gain premiums through takeovers is restricted by the fact that power to respond to takeovers lies with the target company's board of directors, the action taken by the target board in employing defensive measures is subject to the common law fiduciary duties examined by enhanced business judgement rule on a case-by-case basis.[360] In this respect, the target directors are required to demonstrate a certain level of responsibility and good faith towards their shareholders. US courts design a series of tests to make sure that the target board's defensive action is in the best interests of the company and its shareholders, and is reasonable in the light of the threat posed by the takeover bid to corporate policy or effectiveness.[361]

3. Conflict between the Bidders and Target Shareholders

Any system of takeover governance must decide on a policy concerning the potential for coercion which occurs when a person (bidder) attempts, through a tender offer directly to the target shareholders, to acquire shares in the target company, usually with the purpose of taking control of that company.[362] If takeover regulation attempts to protect target shareholders against bidders' coercive actions, there is often a negative impact on the likelihood of the takeovers. The rules, as equal treatment of shareholders and information disclosure are designed to protect shareholders' interests, reduce bidders' gains from acquiring the target and so lessen their incentives to launch a bid.

It is therefore argued that the takeover rules determine how the gains from a takeover are shared between the bidders and target shareholders, and thereby the incentives to make

---

[360] *See e.g.*, *Moran v Household international Inc* 490 A 2d 1059 (Del Ch 1985), 1070.
[361] *See e.g.*, *Unocal Corp v Mesa Petroleum Corp* 493 A 2d 946 (Del 1985).
[362] Armour and Skeel, Jr. (n118) 1745.

and accept a tender offer.[363] The different regulatory responses may be due to different views on the tolerance of shareholder inequality and coercion in hostile takeovers. Considering the extent to which regulation designed to address the coercion and coordination costs of target shareholders has an impact on the incentives for potential bidders to launch a bid offer, as Thompson has suggested, the UK legislator has gone beyond the US to protect target shareholders' interests from hostile takeovers by adopting the MBR.[364]

3.1 UK's Response

In the UK, the City Code eliminates the most severe aspects of shareholder coercion and discrimination by strictly prohibiting partial and two-tier offers. The consideration which the bidder is prepared to pay for control of the target company should be shared equally among shareholders of the same class and proportionately among shareholders of different classes. Furthermore, those who accept an offer and those who sell to the bidder outside the offer process should be equally treated. Thus, if a bidder buys shares in the market during the offer period but at a higher price, it is required to raise the offer price to the level of the market purchase.

Most importantly, that the City Code introduced MBR for fair procedure is for some observers a trademark rule of the Code. It imposes an obligation on a bidder who has obtained control of the target company to make a general offer for all the remaining shares from outstanding target shareholders whose shares have not been purchased, and to pay the same price to all shareholders willing to sell. As Slaughter has argued, this rule is aimed at guaranteeing an exit route for minority shareholders in the case of a change of

[363] Burkart and Panunzi (n82) 739.
[364] Robert B. Thompson, 'Takeover Regulation After the 'Convergence' of Corporate Law' (2002) 24 Sydney Law Review 323, 334.

control, and securing equal treatment of all shareholders in substance.[365] Because of this rule, all bidders attempting to acquire corporate control must have sufficient funds prepared to purchase all the shares of the target company.

3.2 US's Response

In order to achieve a level playing field for all investors, federal legislations governing securities make it clear that any purchase of securities reaching a certain shareholding will trigger an obligation of a prompt and full disclosure of relevant information. The Williams Act is aimed to deal with first-come, first-served tactics, used by bidders seeking to coerce shareholders to tender. Upon a sale of control, the laws provide the target shareholders with an equal opportunity to sell all their shares or on a pro rata basis on substantially the same terms. This right gives minority shareholders an opportunity to partially sell their shares on a pro rata basis with all other prospective sellers.[366]

However, unlike the UK regime, the Williams Act does not go so far as to require a bidder acquiring a controlling stake by means of a block purchase to make a mandatory bid for all the remaining shares so as to give the minority a chance to totally exit the company. The bidders are allowed to purchase a controlling block of shares from a private agreement without making any offer to the remaining shareholders in the target company. As Clark has stated, '[t]he conventional answer given by the courts is that the sale of a control block of stock at such a premium price is not wrong per se'.[367] Therefore, MBR cannot be found in the US federal regulation and there is no support for it in US case laws. In addition, partial bids or two-tier bids are not prohibited in the US, which is

[365] Carla M. Slaughter, 'Rights Offerings, Takeovers and US Shareholders' (2002) 23(2) *Company Lawyer* 42, 53.
[366] William D. Andrew, 'The Stockholder's Right to Equal Opportunity in the Sale of Shares' (1965) 78(3) Harvard Law Review 505, 515.
[367] Robert C. Clark, *Corporate Law* (Little Brown 1986) 478.

the exact opposite of the MBR's philosophy and allows bidders to launch a different subsequent offer to remaining shareholders at a lower price.[368]

4. Explanation of the Divergence

The discussion above has made it clear that the UK and the US have adopted different approaches to the activity of takeovers. The reasons for this divergence, however, are not obvious. In this section, an attempt is made to explain how the differences have arisen.

4.1 Fundamental Principles

A fundamental principle of UK takeover regulation under the City Code and common law is based on the assumption that the possibility of hostile takeovers is an important part of an open and efficient stock market. Thus, when considering the conflict of interest between the target board and shareholders, the UK has been open to hostile takeovers and given priority to shareholder choice and a market for corporate control.[369] The legislators of UK takeover regulation insisted that there should be no interference with the free market; shareholders should be allowed to decide whether to sell their shares. Therefore, the basic spirit of takeover law in the UK is to protect shareholders' interests without disrupting the autonomy of the market for corporate control.[370] Accordingly, the rules governing takeovers are designed to avoid obstacles which would prevent hostile bids and to ensure that the right to decide whether to sell their shares when facing a takeover belongs to shareholders; the board cannot frustrate this right vested in the shareholders.[371]

---

[368] Davies (n202) 177.
[369] Forstinger (n74) 74.
[370] Underhill and Austmann (n48) 87.
[371] Adolf A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (Harcourt, Brace & World 1932) 97.

Because the fundamental principle central to the UK's takeover regulations is fairness and equality among the target shareholders, the City Code governs not only a particular takeover offer, but also pre-offer and post-offer share purchases. In seeking to promote shareholder equality, there are two rules stipulated by the City Code, namely NFR and MBR, serving the purpose of protecting the target shareholders against the bidder's coercion and the target board's exploitation.[372] It is these two rules, as Johnston has pointed out, that provide the sharp contrast with US takeover regulations, by demonstrating a more conservative and traditional British attitude towards shareholders' rights.[373]

In the US, at the federal level, the legislators are only seeking to protect investors, while not inclined to protect the bidders, or the target board. The federal law is neither for nor against takeovers, but was intended to create a level playing field between the target board and bidders by enabling shareholders to make rational decisions based on full and complete information.[374] The Williams Act is regarded as a purely procedural statute focusing on disclosure, with the aim of ensuring equal treatment of all shareholders with respect to information and procedure, so as to prevent an under-priced and coercive sale of shares.[375]

However, at the states level, the design of takeover law is more protective of directors than it is of shareholders' interests with regard to the distribution of corporate powers. It is argued that the theory behind this is the separate personality of the corporation which

---

[372] Underhill and Austmann (n48) 87.
[373] Johnston (n105) 429.
[374] The Williams Act is regarded as a policy of neutrality. *See* William C. Tyson (n237) 278-79.
[375] Harald Baum, 'Takeover Law in the EU and Germany: Comparative Analysis of a Regulatory Model' (2006) 3 University of Tokyo Journal of Law and Politics 60, 63.

has been historically stressed by US law makers.[376] As a separate entity, the board has been given much greater power than in the UK. Thus, in the context of a hostile takeover, the target directors play a major role in the US by being allowed to employ defensive tactics without requiring the shareholder approval. The courts hold that questions regarding the exercise of the corporation's power over its property, or with respect to its rights or obligations, are implicated.[377] As a result, the power of implementing defensive tactics should belong to the directors who exercise their power to manage the business of the company. As Davies has summarised, the US rules are claimed to be less responsive to the conflict of interest between target board and its shareholders, but more responsive to the argument that the power to accept a takeover is regarded in the same way as other essential business decisions reserved for board rather than for the shareholders.[378]

4.2 Effective Lobbying Power

As examined previously, the regulatory framework for the conduct of takeovers in the UK established by the City Code has been developed to reflect the collective opinion of those professionally involved in the field of takeovers as to how fairness to shareholders, appropriate business standards and an orderly framework for takeovers can be achieved.[379] During the post-war period, institutional investment has steadily developed in the UK equity market. According to a report written by Myners, equity ownership has massively shifted from individual investors to institutional investors since the early 1960s, with individual shareholder ownership shrinking from over 50% of the market to under

---

[376] David DeMott, 'Current Issues in Tender Offer Regulation: Lessons from the British' (1983) 58 New York University Law Review 945, 1004.
[377] *Blasius Industries Inc v Atlas Corp*, Civ Action No 9720 (Del Ch July 25, 1988).
[378] Paul L. Davies, 'Shareholder Value, Company Law and Securities Markets Law - A British View' In Klaus J. Hopt and Eddy Wymeersch (eds), *Capital markets and company law* (Oxford University Press 2000) 271.
[379] Johnston (n105) 428.

20%.[380] It is admitted that collective investments administered by specialist fund managers in choosing the best investment plan to some extent reduce the risk to individual investment.[381] However, the primary reason for the rapid emergence of institutional investors is perhaps the tax privileges for institutions. For example, the decision to make pension funds free of capital gains tax led to a huge amount of equity ownership flowing rapidly to institutional investors, because of the fact that contributions to such funds by their beneficiaries are taken out of pre-tax income.[382]

Therefore, by the time the City Code was drafted in 1968, institutional investors had already emerged as a significant power in the British business landscape.[383] In the majority of UK companies, considerable shares are held by institutional investors. The strong presence of institutional investors in the UK required greater corporate governance controls and better protection of their shareholders' interests. Thus, UK corporate governance is significantly influenced by institutional investors representing the interests of shareholders as a class. As Dey has stated, the UK takeover policy is dominated by an industrial strategy and seeks to protect the interests of the shareholders to the maximum.[384]

Consequently, the takeover regulation-making process in the UK was not led by governmental bodies. The British government delegated it to a working group led by the Bank of England. This working group was dominated by representatives of institutional investors and investment banks, with few management representatives and no employee representatives at all. The institutional shareholders have therefore been given an

---

[380] Paul Myners, 'Institutional Investment in the United Kingdom: A Review' (2001) <http://archive.treasury.gov.uk/pdf/2001/myners_report.pdf> accessed 27 November 2012, 27.
[381] *See* Dominic Hobson, *The National Wealth: Who Gets What in Britain* (HarperCollins Business1999) 1035-1042.
[382] Myners (n380) 27.
[383] Armour and Skeel, Jr. (n118) 1771.
[384] Dey (n319) 5.

advantage over the representatives of management in the process of producing takeover rules via the City Code. As Bebchuk and Farrell have stated, UK regulation 'is not imposed from the outside by a detached governmental body but rather by a group that has strong connections to the interested parties' and that group 'gave less weight to managerial interests because of the close connection at least some of them had with the interests of shareholders'.[385] Accordingly the Takeover Panel, regarded as one of the most important arbiters of corporate disputes in the UK, was developed largely in accordance with the wishes of institutional shareholders.[386] Indeed, it is not surprising to find that the requirement of equal treatment and other procedural protections for shareholders provide support for the claim that the City Code rules are imposed by the practitioners' lobby.[387]

Unlike the UK regime, because of the dual system and state competition, the US has failed to produce a national system of regulation governing takeovers to the extent achieved by the City Code. In the context of takeovers, federal laws generally govern the behaviour of the bidding company while the target company is generally subject to corporate law which falls under state jurisdiction and varies from state to state. As Bebchuk and Farrell have argued, there is 'a broad array of inconsistent state laws existing across the United States'.[388] In such cases, to regulate the takeover activities in the US, federal takeover laws tend to be directed at tender offer rules, whereas state laws govern board behaviour.

The position of financial institutions in the US is significantly different from their position in the UK. The amount of equity that financial institutions, such as insurance

---

[385] Lucian A. Bebchuk and Allen Ferrell, 'Federalism and Corporate Law: The Race to Protect Managers from Takeovers' (1999) 99 Columbia Law Review 1168, 1192-93.
[386] John Armour and Henry Hansmann and Reinier Kraakman, 'Agency Problems and Legal Strategies' in John Armour and others (eds), *The Anatomy of Corporate Law A Comparative and Functional Approach* (Oxford University Press 2009) 83.
[387] Johnston (n105) 449.
[388] Bebchuk and Ferrell (n58) 120.

companies and banks, could hold has been largely limited. This is based on the philosophy that the power of financial institutions must be constrained because the American public historically feared that private concentrations of economic power would make the central government too powerful to control.[389] As Roe has observed, the scale of financial institutions in the US was substantially confined by federal and state regulation, so that they are unable to hold a block of shareholdings in a listed company as in the UK.[390]

The inability of the financial institutions to raise sufficient funds arguably promoted an even bigger and more developed securities market in the US in order to compensate for the relatively weak banks.[391] Consequently, there is much more retail investors participation in the US equities market compared to institutional investors. Moreover, as for institutional investors, their ability to influence the development of takeover law was restricted by their greater geographical dispersal in the US. Thus, the weakness of institutional investors did not lead to a law designed to protect shareholders' interests as in the UK.

On the contrary, the target board had more influence in the development of corporate rules in the US. As Bebchuk and Ferell have argued, 'state competition produces a systematic tendency for states to protect incumbent management excessively from takeovers'.[392] Since managers have the power to decide on the state in which to re-incorporate the company, a state seeking to maximise the number of companies that are

---

[389] For details about the financial history in the US, *see* Mark J. Roe, *Strong Manager Week Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1996**).**
[390] Mark J. Roe, 'Political Preconditions to Separating Ownership from Corporate Control' (2000) 53 Stanford Law Review 539, 539-604.
[391] Mark J. Roe, 'Chaos and Evolution in Law and Economics' (1996) 109 Harvard Law Review 641, 645.
[392] Bebchuk and Ferrell (n58) 121.

incorporated there will care a 'great deal about managerial preference'.[393] As a consequence, the states will adopt takeover rules which protect the target company from hostile takeovers so as to attract more companies to incorporate there, or prevent its companies from re-corporation in other states.[394]

In reality, many state laws were passed in response to pressure by particular companies who found themselves the target by potential bidders. These firms petitioned the state legislature to pass an anti-takeover law or amend the current one to make it more difficult for a local company to be taken over. As Bebchuk and Cohen have shown, states that pass anti-takeover laws and offer more protection against takeovers are more likely to attract more companies to be incorporated there.[395] From the management's point of view, a company is more likely to incorporate in a state with satisfactory takeover rules, even if their shareholders' interests are not well considered.[396]

The enormous discretion given to target managers in Delaware is probably the main reason why this state is one of the favourite places for companies to incorporate. As discussed in Chapter 3, the *Interco* case upheld target shareholders' power to decide whether to accept a non-coercive takeover bid,[397] but unfortunately this was short-lived mainly due to the pressure to reincorporate in other states coming from companies already incorporated in Delaware. One year later, the balanced *Interco* ruling was rejected

---

[393] Mark J. Loewenstein, 'Delaware as Demon: Twenty-Five Years after Professor Cary's Polemic' (2000) 71 University of Colorado Law Review 497, 502-08.
[394] Bebchuk and Ferrell (n385) 1173-1174.
[395] Lucian A. Bebchuk and Alma Cohen, 'Firms' Decisions Where to Incorporate' (2003) 46 Journal of Law and Economics 383, 383.
[396] Bebchuk and Ferrell (n58) 124.
[397] *City Capital Associates v Interco* 551 A 2d 787 (Del Ch 1988).

by the Delaware Supreme Court in the *Paramount* case,[398] soon after Wachtell Lipton publicly advised clients to reincorporate outside Delaware if *Interco* remained good law.

4.3 Functional Counterbalance

As examined before, the interests of the UK target companies have been firmly linked to the priorities of its shareholders. Thus, according to Dean, in theory at least, managerial complacency will be prevented by shareholder primacy, along with the emphasis on the strength of institutional investors.[399] Based on this view, UK takeover regulation will not give a free hand to allow the target board to employ defensive takeover measures that might compromise the interests of shareholders.

When facing a takeover threat, the target board is only allowed to manoeuvre in the following three situations: 1) to persuade shareholders to exercise their rights in a particular way, for example, to reject the offer, by providing a detailed statement of the gains and losses to the company in the event of a takeover; 2) to appeal to the competition authorities to raise potential competition concerns to obstruct the bid; 3) to seek other takeover competitors (white knight). As Davies has argued, 'in all three situations the directors of the target are thrown back on their powers of persuasion; in all three cases the final decision on the success of these defensive moves rests with others'.[400] This makes the target board's powers under the circumstance of a hostile takeover in the UK more restrictive than in the US.

From the bidder's perspective, its position is less restrictive, because it is possible to by-pass the incumbent board to directly approach the target shareholders without

---

[398] *Paramount Communications Inc v Times Incorporated* 571 A 2d 1140 (Del 1989), 1153.
[399] Dean (n183) 371.
[400] Davies (n202) 784.

encountering the strong defence, as happens in the US. However, the MBR introduced by the City Code to diminish discriminatory treatment of target shareholders, restricts the bidder who holds over 30% of the target shareholding to launch a general bid to all the remaining target shareholders.

The takeover regulation in the UK is therefore justified as not favouring the target board of directors or bidders, but protecting the interests of shareholders. As Moon has stressed, the City Code 'comes down firmly on the shareholders' side and will impinge on the freedom of boards and persons involved in takeovers and mergers'.[401] In seeking shareholder primacy, both target board and bidder have been restricted and, as a result, the power balance between these two parties has been successfully achieved.

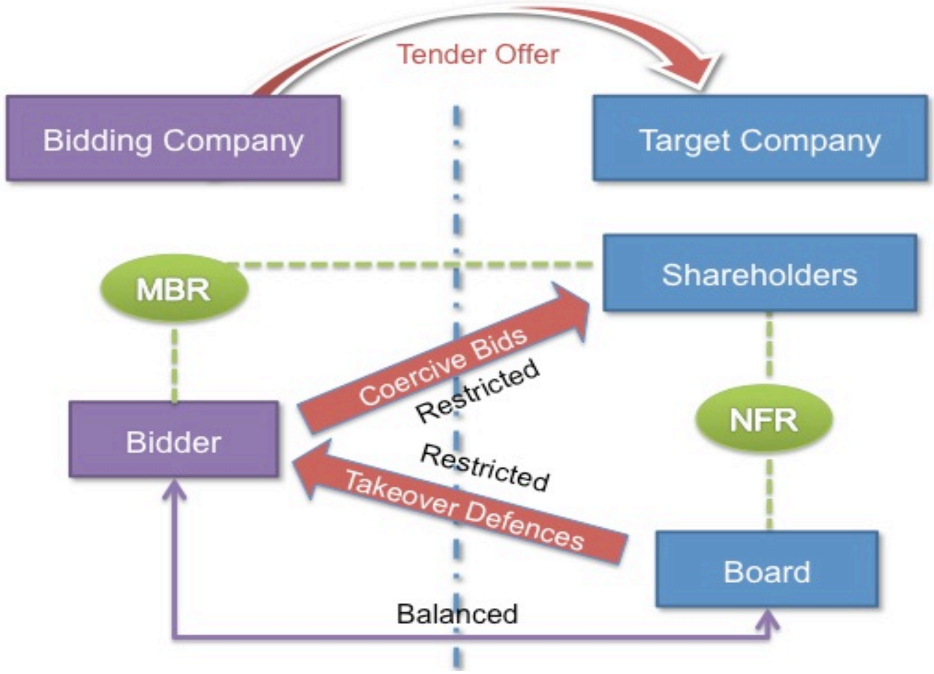
It can be concluded that a functional counterbalance of the effects between MBR and NFR can be found in the UK regime. The MBR has been argued to substantially raise the costs for a potential bidder as it forces the bidder to acquire more shares than he needs to gain control of the target company. This rule may stop certain desired purchases, as the potential purchaser may not have sufficient funds to offer for the whole company. The MBR, therefore, may be doing a favour to the target board to some extent, because it makes takeovers more costly and becomes a takeover defence from the target board's point of view. However, these advantages are offset by the NFR as it restricts the power of the target board to employ any action frustrating the bid.[402] The defensive tactics used by the target board normally substantially raise the costs for the bidder as they make the bid less likely to succeed. It is therefore argued that the NFR stipulated by the City Code potentially keeps the cost of a bid controllable for a potential bidder.[403] Under the system

---

[401] Ronald W. Moon, *Business Mergers and Takeover Bids* (3rd edn, Gee Publishing 1968) 137.
[402] Baum (n375) 61.
[403] Baum (n375) 68.

in the UK, with both MBR and NFR, there is a power balance between target board and bidder in the counterbalance between the high costs for a bidder caused by the MBR on the one hand and the strict NFR for the target board on the other. As Magnuson has observed, these rules together have substantially restricted both bidder and target board's actions during takeover battles.[404]

Figure 4-1 Situation in the UK



In contrast, the Williams Act, one of the most important pieces of securities legislation in US takeover law, is primarily a disclosure statute, passed by Congress because of concern that tender offers were not governed by the disclosure requirements of the federal securities law. It was directed at the activities of companies seeking to pursue hostile deals, with the purpose of protecting target shareholders from secret and coercive takeovers. It is limited solely to governing tender offer procedures, for example by requiring bids to remain open for a certain length of time, and by respective information

[404] Magnuson (n265) 219.

disclosures from both the target board and the bidder regulating the content and timing of communications to the target shareholders. However, unlike the UK's City Code which is concerned with ensuring fairness for shareholders across the entire takeover transaction by setting forth much stricter limitations on the substantive content and nature of the takeover bid, it does not directly address matters concerning the substantive fairness of corporate takeovers or defensive tactics.[405] The Williams Act differs from the City Code in its silence about the target board's role in takeover defences when facing a hostile takeover.

Certain substantive provisions of the Williams Act reduce elements of coercion that disadvantage shareholders in tender offers, by banning first-come first-served offers and requiring the target shareholders to be treated equally. However, it should be kept in mind that partial and two-tier tender offers exist as legitimate takeover measures in the US, as do other sophisticated defensive measures and state anti-takeover laws.[406] The bidder is allowed to launch two-tier offers for less than 100% of the target shares as long as accurate disclosure is made by the bidder. As Gaugh has argued, although the passing of the Williams Act initially slowed the growth of the takeover movement, hostile bidders have tried different ways to 'thwart the requirements of the Williams Act' and to regain the advantage.[407]

In a two-tier bid, the bidders launch a hostile tender offer for the part of the outstanding target shares which is necessary to give them majority control, with an above-market tender offer premium to shareholders who tender into this first tier, shortly thereafter

[405] Thomas Hurst, 'The Regulation of Tender Offers in the United States and the United Kingdom: Self-Regulation Versus Legal Regulation' (1987) 12 North Carolina Journal of International Law and Commercial Regulation 389, 401.
[406] Christian Kirchner and Richard W. Painter, 'European Takeover Law -- Towards a European Modified Business Judgment Rule for Takeover Law' (2000) 1 European Business Organizations Law Review 353, 374.
[407] Gaughan (n30) 13.

merging-out any remaining minority interest that had failed to tender at a lower price. The effect of the two-tier bid is to coerce shareholders into tendering at the first stage rather than run the risk of getting the lower merger-out price.[408] The bidder tells target shareholders in advance of the prices at which shares will be purchased in the merge-out. Even if it offers the same price for the second-stage merger, this amount may only be received much later, possibly in the form of debt securities of uncertain worth, and without interest to cover the intervening period.

As a result, a target shareholder cannot afford to reject the first-stage offer unless he believes that a large enough number of other shareholders will do so to defeat the offer. However, as Coffee has stated, '[t]he heart of the dilemma is that, because no shareholder can rely on what other shareholders will do, they cannot coordinate their actions in order to reject the unsatisfactory offer and negotiate for a higher price'.[409] Bebchuk called this situation the 'prisoner's dilemma'.[410] A shareholder who would reject the offer, as he believes it is inadequate, has no means to communicate with and bind other shareholders. If he chooses to hold out, he will be in a worse position if the second-step merger is at a lower price after other shareholders have tendered and the tender offer was successful. Hence, in a setting where they would be better off from not tendering, it is very unlikely that shareholders who cannot coordinate with other shareholders will reject to tender.[411] As Baumol stated:

---

[408] Louis Lowenstein, 'Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation' (1983) 83 Columbia Law Review 249, 249.
[409] John C. Coffee Jr., 'Partial Justice: Balancing Fairness and Efficiency in the Context of Partial Takeover Offers' (1985) 3 Company and Securities Law Journal 216, 227.
[410] Lucian A. Bebchuk, 'The Case for Facilitating Competing Tender Offers' (1982) 95 Harvard Law Review 1028, 1040.
[411] William J. Carney, 'Shareholder Coordination Costs, Shark Repellents and Takeout Mergers: The Case Against Fiduciary Duties' (1983) American Bar Foundation Research 341, 341.

> The individual investor, knowing that all can gain by the simultaneous exercise of rationality will no more be moved by this consideration than will the small farmer who knows that if he and every other farmer independently cuts his output by fifty percent, all of them will gain. Each, on rational grounds, will be motivated to behave in an "irrational" manner because he knows that others will, for the same reason, have rational ground to do so as well.[412]

Taking poison pills, for example, was invented in the 1980s as a solution to tackle the emergence of the two-tier tender offer used by the bidders to coerce shareholders into tendering their shares at unfair prices. In the case of *Moran*, the Delaware Supreme Court upheld poison pills on the grounds that they can protect the target shareholders against a two-tier coercive offer by assuring that shareholders on the back-end of a tender offer are adequately compensated.[413] Indeed, as Forstinger has observed, the continuing legality of coercive takeovers in the US provides a strong justification for increasing the adoption of defensive tactics by the target board.[414] It can be seen from the waves of hostile takeovers in the late 1970s and early 1980s that numerous states started to permit more and more defensive tactics, as the threat to incumbent management from hostile takeovers became greater and greater. Courts have also increasingly expanded the number of cases under which target boards can use defensive tactics to impede a hostile bid. It is argued that the evolution of the law in Delaware on the use of defensive tactics is a reflection of this trend and has been followed by other states in the US.[415]

Therefore, as Subramanian pointed out, although the US law does not prohibit coercive tender offers such as two-tier tender offers, the problem of compelling shareholders to

---

[412] William J. Baumol, *The Stock Market and Economic Efficiency* (Fordham University Press 1965) 56.
[413] *Moran v Household International Inc* 500 A 2d 1346 (Del 1985).
[414] Forstinger (n74) 84.
[415] Bebchuk and Ferrell (n58) 116.

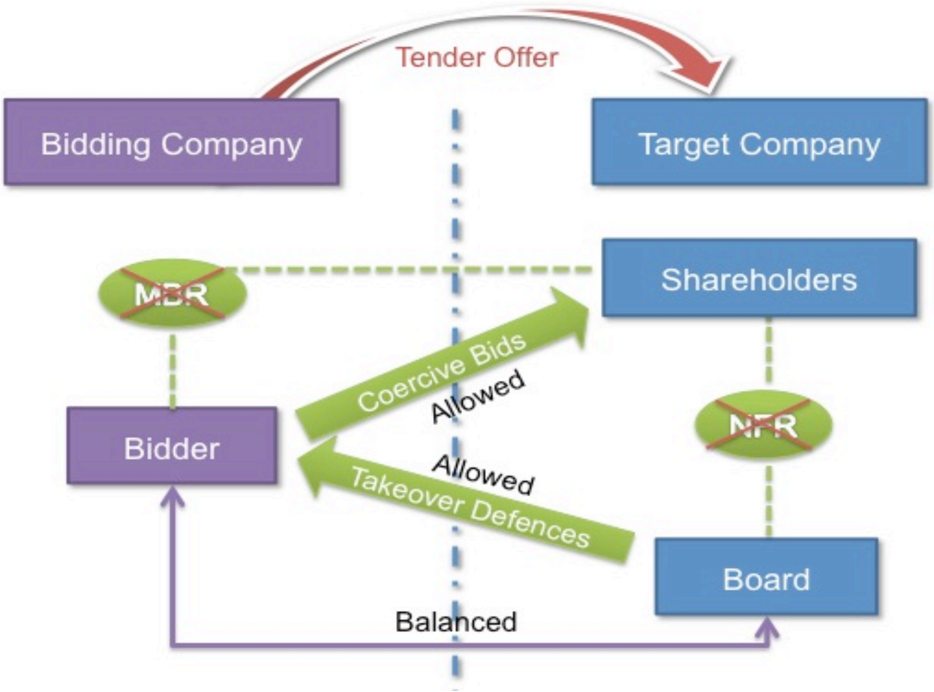
tender even if they do not want to do so has been resolved by providing the target board with the power to employ defensive measures against these coercive offers.[416] In the US, it is the target board that has the power to decide whether a tender offer poses a threat to shareholders and, if so, what takeover defences can reasonably be used in relation to the threat posed, according to the enhanced business judgement rule. As Magnuson has argued, the US takeover regulation 'has given a substantial amount of freedom to both acquiring and target corporations'.[417] Simply, the bidders can make an offer to acquire any number of shares in the target company, and the target board can employ takeover defence against the offer which the bidder has sent directly to the shareholders.

Moreover, empowering directors to a greater extent than in the UK has been regarded as 'a fence to shelter target minority shareholders against undesirable extraction of private benefits by the controllers'.[418] It could be argued that the MBR is not as necessary in the US as in the UK. The shareholders' coordination problems can be solved by the target board's ability to frustrate the takeover bid. In conclusion, the balance between target board and bidder has been equally well achieved in the US because both target board and bidder have been given a free hand to fight in the takeover battle.

---

416 Subramanian (n157) 385.
417 Magnuson (n265) 206.
418 João Marcelo G. Pacheco, 'Bifurcation or Parallel Routes? In Search of US Functional Substitutes for the British Post-Takeover Mandatory Bid Rule' (2006) Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=946208> accessed 6 March 2012, 31.

Figure 4-2 Situation in the US



5. Evaluation of the Different Approaches

Recent theoretical debates in corporate governance have seen a sustained challenge to both UK and US takeover regulations.

5.1 Theoretical Debates

Some scholars have argued that the current regulation of takeovers in the US, where states have the power to restrict hostile takeovers through anti-takeover laws, fails to adequately protect target shareholders, as it does not assume that all shareholders should benefit equally from the corporate control transactions. Bebchuk and Ferrell have argued that the evolution of state takeover regulation does not take into account what shareholders themselves wanted, and therefore leaves them with little choice in the matter.[419] Some further criticise that empowering boards of directors to resist offers in the US is not only self-serving for the board at the cost of shareholders' interests, but also inefficient for the economy as a whole.[420] If shareholders do not want the defences adopted by the board, the only thing they can do is to remove the directors from their positions by running a proxy fight. As Klausner and Daines have found, not many US companies give their shareholders the ability to call a special meeting or to act by written consent.[421] As a result, they have to wait until the shareholders' meeting to exercise their voting rights. Moreover, the difficulty of widespread public shareholders taking collective action makes it even harder for unsatisfied shareholders to remove the defences adopted by the board.

As discussed in Chapter 3, the Delaware cases in the 1990s engaged in a 'pull-you game' of scrutinising directors' actions when they face a takeover bid.[422] It can be argued that 'the dilution of restrictions' on self-interested target boards by Delaware's courts and legislature have resulted in failure to adequately protect shareholders.[423] In other words, these cases might reveal a difficulty in developing clear rules to strike a balance between 'protecting against management's self-interest' and 'allowing legitimate strategic management decision making'.[424] US courts and commentators seem to struggle over the tension between a board's ability to manage and control the company and the shareholders' power to tender their own shares. They generally regard the UK City Code

[419] Bebchuk and Ferrell (n58) 113.
[420] White (n28) 188. *Also see* Frank H. Easterbrook and Daniel R. Fischel, 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) 94 Harvard Law Review1161, 1195.
[421] Robert Daines and Michael Klausner, 'Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs' (2001) 17 Journal of Law, Economics, and Organization 83, 95.
[422] Ventoruzzo (n31) 198.
[423] Stephen B. Presser, 'Thwarting the Killing of the Corporation: Limited Liability, Democracy and Economics' (1992) 87 Northwestern University Law Review 148, 148.
[424] Ventoruzzo (n31) 199.

as a very favourable takeover system because it ensures that shareholders, not directors, retain the right to decide on the success or failure of a takeover bid.[425]

On the other hand, the UK system is not immune to criticism. For instance, Johnston has pointed out that the absolute prohibition on defensive tactics by the target board has had a 'deleterious effect, from an economic perspective, on companies' relationships with key stakeholders, and their employees in particular'.[426] Under the City Code, there is little consideration of employee interests, which may be adversely affected by takeovers.[427] Unlike in the US system, the board is permitted to take account of a range of interests, except for its effect on shareholder interests. In the meantime, there is an argument that the existence of the NFR, which leaves the shareholders' meeting to decide on whether a takeover should proceed, raises another important agency problem, which is between controlling shareholders and minority shareholders.[428] Moreover, as Fischel has stated, the purpose of protecting shareholders under the UK regime often has a detrimental effect on the likelihood of takeovers.[429] It is argued that the MBR's requirement for the bidder to make a general offer may reduce his gains from acquiring the target company and therefore lessen his incentive to launch a bid at the first place.

It should be borne in mind that the above arguments for or against the UK and US approaches do not imply a completely negative judgement on either takeover regulation. It is also true that, no matter how different the takeover approaches are in the UK and US, both systems of regulation have been accepted and work well in the respective countries. Among numerous rules in the takeover regulations, many are universal but some are still

[425] Forstinger (n74) 5.
[426] Johnston (n105) 449.
[427] Johnston (n105) 455.
[428] Marco Ventoruzzo, 'Takeover Regulation as a Wolf in Sheep's Clothing: Taking Armour & Skeel's Thesis to Continental Europe' (2008) 11 University of Pennsylvania Journal of Business Law 135, 138.
[429] Fischel (n39) 13.

controversial. Emerging from this comparison of the UK and US regimes are two controversial rules which distinguish the respective takeover regulations. In the following section, the effect of these two rules is analysed, in order to understand how well their respective takeover regimes work in the UK and US.

5.2 Effect of Two Takeover Rules

It is widely acknowledged that the UK and US have adopted different approaches to hostile takeovers. They are these two rules, MBR and NFR, which clearly expose the divergence between the two systems. These two rules are considered as innovations of the City Code in the UK, adopted by the European Union in its Takeover Directive. They apply to control transactions attempting to address conflicts of interest between the target board and shareholders and between the bidder and target shareholders, resulting from the effect of the allocation of decision making on the success or failure of the takeover offer, and the protection of minority target shareholders against opportunism by the bidder or the controlling shareholders.

In particular, the NFR is intended to limit the use of takeover defences by the target board and constrain opportunistic behaviour. A prohibition on the target board's use of takeover defences without the approval of the target shareholders makes takeover defence less likely to happen, with the effect of raising the number of hostile takeovers. A MBR provides the target minority shareholders with extra protection and the right to exit the company at a fair price. It is argued that providing exit opportunities for minority shareholders allocates more takeover surplus from the bidder to the target shareholders and hence reduces the number of hostile takeovers because bidders have less incentive to make a bid to acquire a poorly performing company and replace its inefficient management.

Therefore, the regulatory choices of these two rules have opposite effect on the efficiency of the market for corporate control. If a takeover regulation that focuses on the conflict of interest between target board and shareholders adopts NFR to restrict managerial decision-making power with respect to the use of takeover defence without shareholder approval, it will improve shareholder protection as it forces directors to satisfy the interests of the shareholders and also promote corporate control by making the takeovers more likely to happen.[430] If a takeover regulation that responds to the conflict of interest between bidder and target shareholders introduces MBR and provides exit opportunities for minority shareholders by requiring a bidder to purchase the remaining shares in the target, then the protection of shareholders, in particular, minority shareholders, is similarly enhanced. However, an efficient market for corporate control is discouraged as the private gains to a bidder, which are often an incentive for a takeover bid, are reduced.

However, in looking at the regulatory effect on the takeover market of adopting both or neither of these two rules, the conclusion can be different. As was found above, the UK adopts both two rules in order to provide extensive protection to shareholders by restricting the interests of both the bidder and the target board. The bidders are required to share the control premium with the minority shareholders and hence raise the cost of launching a bid. This rule therefore has a chilling effect on the takeover market. The target board is prevented from employing takeover defences against the takeover bid and obstacles from the target board are removed for the bidder. Hence, the impact on the takeover market of these two rules is offset.

On the other hand, the US imposes neither of these two rules, giving both bidder and target board room to manoeuvre. From the bidder's perspective, it is allowed to pay a

[430] Goergen and Martynova and Renneboog (n3) 248.

premium above the market price for control and launch a much less favourable term in the subsequent offer. Although this system mitigates the shareholders' free-riding problem in a tender offer and hence stimulates the takeover market, it also forces shareholders to tender even if they believe the bid is inadequate. To solve this problem, the target board is given the discretion to resist the unwanted tender offer (including the coercive offer) by freely employing takeover defences.[431] Without doubt, resistance from the target board will reduce the likelihood of a bidder's success. Hence, it can also be argued that the impact of absence of these two rules on the takeover market is offset.

Table 4-1 Effect of NFR and MBR

Choice of Takeover Rules	Effect on Market for Corporate Control	Effect on Protections of Target Shareholders
Only NFR	Promoted	Shareholders have the right to decide whether to accept the tender offer
Only MBR	Discouraged	Shareholders have the right to share the premium and to exit the company
NFR and MBR	Balanced	Shareholder protection is strengthened
Neither NFR nor MBR	Balanced	Shareholders are coerced to tender but the coercion is reduced by the takeover defences

It is widely accepted that the market for corporate control functions well in both the UK and the US. The effects of a combination of NFR and MBR as well as the absence of these two rules seem to balance their positive and negative impacts on the takeover market and achieve a similar level of corporate control. As Ventoruzzo has pointed out, although the UK and US have adopted different provisions and underlying philosophies

[431] For an extensive discussion of the free-riding problem, *see* Subramanian (n157) 385-91.

in their respective takeover regulation, when measured in terms of their economic effect, these two regimes are closer than at first appears and may have the same function of facilitating the market for corporate control and protecting minority shareholders.[432]

[432] Ventoruzzo (n31) 218.

Chapter 5 Takeover Regime in China

1. Institutional Background

The concept of corporate governance gained official attention in China only in the late 1990s. The improvement of corporate governance has now become a priority of the Chinese government and an important issue in Chinese enterprise reform. It is widely acknowledged that there are two different corporate governance systems around the world: the market-based governance model, which is popular in the UK and US, and the control-based model common in continental Europe. The market-based model has dispersed ownership, independent boards, transparent disclosures and active takeover markets. Conversely, concentrated ownership structures, management-friendly boards, inadequate disclosures and inactive takeover markets are found in the control-based model. Corporate governance in China can best be described as following the control-based model, in which the controlling shareholders have strong control over companies through a concentrated ownership structure.[433]

In the past, there has been little opportunity for the development of a market for corporate control in China, because of the highly concentrated corporate ownership and the non-tradeable nature of state shares of most companies listed on the Chinese stock exchanges. By acknowledging the disciplinary function of hostile takeovers, the Chinese government has been expecting takeovers to play an important role in promoting good corporate governance in Chinese listed companies.[434] Therefore, substantial efforts have been

---

[433] Qiao Liu, 'Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants' (2006) 52(2) CESifo Economic Studies 415, 429; *also see* Jingchen Zhao and Shuangge Wen, 'Promoting Stakeholders: Interests in the Unique Chinese Corporate Governance Model: More Socially Responsible Corporations?' (2010) 21(11) International Company and Commercial Law Review 373.
[434] Wei (n92) 111.

devoted to transforming Chinese state-owned enterprises and the ownership structure of Chinese listed companies in the process of opening up China's markets. As Voβ and Xia have suggested, the development of corporate governance in China cannot be separated from the country's economic reforms.[435] This transformation has led to the development of a takeover market in China, which is regarded as an important external mechanism of corporate governance. Hence, no discussion of the takeover regime in China can be undertaken without understanding the background of this institutional transformation and its influence on corporate governance in China.

1.1 Transformation of State-Owned Enterprises

In 1978 the Chinese government adopted an Economic Reform Policy with the goal of transforming the planned economy into a market economy by introducing market mechanisms into Chinese enterprises. Before this time, Chinese enterprises were wholly owned by the state under the planned economy system, so called state-owned enterprises (SOEs). SOEs were basically factories producing whatever the state instructed them to produce, regardless of market demand.[436] Under such ownership arrangements, there was no existing corporate governance at all. The state was the sole investor and held all property ownership and managerial rights. Hence, political interference could distort and confuse the company's goal of maximising its value. Managers were directly appointed by government authorities and had almost no decision-making power in business operations. More importantly, since there was no connection between production and

---

[435] Stefan Voβ and Yiwen Xia, 'Corporate Governance for Listed Companies in China: An Agenda for the Crisis' (2011) <http://emnet.univie.ac.at/uploads/media/Vo%C3%9F_Xia_01.pdf > accessed 7 July 2012, 4.

[436] Shenshi Mei, *Research on the Structure of Modern Corporate Organ's Power: A Legal Analysis of Corporate Governance* (Publishing House of China University of Political Science and Law 1996) 3.

profitability, state ownership often induced a lack of managerial discipline and incentives to promote technological innovation, which resulted in low efficiency of SOEs.[437]

The inefficiency of SOEs called for major changes in corporate governance and the introduction of modern managerial mechanisms. The Chinese government realised that it was inappropriate to act as a market player and a policy maker at the same time. In order to achieve greater economic efficiencies, it converted SOEs into partially privatised organisations, retaining only strategic levels of control in certain enterprises, such as those involved with national defence and energy.[438] In some sectors, the government gradually reduced its stake and encouraged domestic private capital to become involved; in some sectors, the government opened the market and encouraged international leaders in the field to consolidate the SOEs into large integrated conglomerates. As a result, the Chinese state-controlled system underwent a transformation into one with a mixture of state and private enterprises elements.

Out of concern that the reforms might lead to the loss of state assets, and result in massive unemployment and social unrest, instead of adopting the Russian model represented by a radical privatisation of SOEs, a more cautious and gradual approach was preferred in implementing the reform measures in China. It is noted that SOE reform focused on conferring greater autonomy on the management of SOEs and subjecting them to contractual market incentives and discipline.[439] The goal of reform was to make SOEs responsible for their own gains and losses in the market. It was said, 'SOEs should become legal persons that enjoy full management authority and full responsibility for

---

[437] Fei Lu and Maria Balatbat and Robert Czernkowski, 'The Role of Consideration in China's Split Share Structure Reform' (2008) Social Science Research Network <http://ssrn.com/abstract=1284067> accessed 9 February 2012, 14.
[438] For more information about China's transformation of the system, *see* Ross Garnaut and others, *China's Ownership Transformation* (International Finance Corporate 2005).
[439] Guanghua Yu, 'Chaos Theory and Path Dependence: The Takeover of Listed Companies in China' (2005) 20(2) Banking and Finance Law Review 217.

their own profits and losses'.[440] In October 1984, for the first time the Chinese Communist Party (CCP) publicly announced the ownership of collective enterprises and explicitly ordered the separation of government intervention and enterprise management.

In the 9th Five-year State Plan (1996-2000), the CCP famously announced that the strategic way to restructure the SOEs was to 'grasp the large and let the small go'. And in the 15th National Congress of CCP in 1997, it was formally recognised that private ownership was an important part of the Chinese socialist market economy, although the state was still to keep control of key and strategic sectors, including national security, monopolies, industries providing important public goods and services, and high and new technology industries. It was expected that SOEs would gradually be privatised in other sectors. In 1999, the Chinese government facilitated private ownership on the stock market by stipulating that while the state still maintained control, large and medium-sized SOEs could diversify their ownership structure and be transformed into joint-stock companies, with only a few SOEs remaining wholly state-owned. Non-state controlled enterprises were encouraged to participate in the process of reorganising, reforming and rebuilding SOEs by taking over controlling shares.

The government's continuing efforts to establish a modern enterprise system have led to the privatisation of small SOEs and the corporatisation of large SOEs which were subsequently publicly listed. It should be made clear that the enterprise corporatisation reform underwent a two-stage process. The enterprises were first incorporated into joint-stock companies, and then listed on the stock markets. This reform was intended to separate the state from business management and to allow enterprises to achieve full autonomy; the new shareholders were given the power to monitor management, which

[440] *See* 'The Decision of the Central Committee of the Chinese Communist Party on Several Issues Concerning the Reform of the Economic System' (1984)

encouraged managers to perform well.[441] The state and its agencies gradually reduced their stock participation in the capital market in order to optimise the operational efficiency of the listed SOEs. The SOEs were expected to be more efficient, with management being monitored by an effective board selected for professional expertise rather than through government appointment.[442]

Following the incorporation process, the Chinese government established two national stock exchanges, namely the Shanghai Stock Exchange in December 1990 and the Shenzhen Stock Exchange in December 1991, in order to raise funds for Chinese enterprises and improve corporate governance.[443] As Yu has argued, the establishment of the stock exchanges in China was closely related to the transformation of the SOEs and mainly designed to improve the performance of inefficient SOEs through public listing.[444] By issuing shares to the public through the stock exchanges, listed SOEs would be disciplined by the securities markets into complying with the listing rules of the stock exchanges.[445] More importantly, the external shareholders would play a positive role in monitoring the operation of the enterprises.

The development of a securities market in China inevitably led to the establishment of a new force to regulate corporate activities and promote good corporate governance. A centralised stock market regulatory body, the China Securities Regulatory Commission (CSRC), was created in 1992 as the major regulator of listed companies as well as of the

---

[441] Wai Ho Yenug, 'Non-Tradable Share Reform in China: Marching Towards the Berle and Means Corporation?' (2009) Comparative Research in Law & Political Economy Research Paper No. 48/2009 <http://ssrn.com/abstract=1515957> accessed 25 February 2012, 9.

[442] Gongmeng Chen and Michael Firth and Oliver M. Rui, 'Have China's Enterprise Reforms Led to Improved Efficiency and Profitability?' (2006) 7 Emerging Market Review 82, 86.

[443] The Hong Kong Exchange is another independent stock exchange in China, which is not governed by CSRC and has its own governance rules. Therefore, it is outside the scope of this discussion.

[444] Guanghua Yu, 'The Problem with the Transplantation of Western Law in China' (2004) Social Science Research Network <http://ssrn.com/abstract=1535683> accessed 28 February 2012, 11.

[445] Listing rules provide the conditions under which companies are admitted to the stock exchanges and requirements for their conduct.

securities market. The CSRC is a ministry-level securities regulatory authority under the direct control of the State Council. It was not until 2001 that it was finally given sole responsibility for managing the stock exchanges.[446] It is responsible for carrying out supervision and administration of the securities market and producing regulations relating to the issuance and trade of securities and the operation of the stock exchanges. It has jurisdiction and exclusive power of dispute resolution with respect to the takeover of listed companies.

1.2 Transformation of Shareholding Structure

The Chinese government made it clear that corporatisation must not challenge the dominance of state-owned companies. The state retains ultimate control of the partially privatised SOEs, to maintain an orderly and gradual process of privatisation that will not overwhelm the stock market. When a SOE is listed on a stock market, only a small proportion of its shares are sold to private investors in the Initial Public Offerings (IPO) process. Thus, although the listed companies have nominal autonomy, the state still controls the voting rights because of the peculiar structure of listed companies (owning non-tradeable shares comprising the majority of the share capital).[447] This structure evolved when the state decided to make some SOEs public but to retain control. According to Clarke, with this structure, a large number of corporatised SOEs remain dominated by a single state shareholder that exercises control either through normal channels such as shareholder voting, or through traditional channels such as appointment

[446] For more information on the CSRC see its website at www.csrc.gov.cn/en/homepage/abouten.jsp.
[447] The existence of two classes of A shares which have the same voting and cash flow rights, except that one class is tradeable and the other is not, will be discussed in the following section.

of key personnel.[448] Therefore, highly concentrated state ownership has become a distinctive feature of Chinese listed companies.

1.2.1 Unique Shareholding Structure

In addition to general classifications of common and preferred shares, which conform to Western standards, Chinese listed companies have multiple classes of shares which are distinguished by their ownership, the nationality of their shareholders and the location of the listing. According to Faccio and Lang, split-share structures are common around the world and typically offer different rights to the shareholders.[449] However, the existence of non-tradeable shares seems to be peculiar to China and remains the most distinctive feature of its ownership structure.[450] This study will focus on the regulations with respect to transactions in A shares, which are all tradeable now and can be subject to a tender offer; however, a full picture of the special arrangements in the shareholding structure of Chinese listed companies is presented first.

A shares and B shares

Depending on the nationality of eligible traders and the currency in which the shares are traded, there is a traditional division into two classes, namely A shares and B shares.[451] A shares are denominated and traded in Chinese currency (known as the reminbi or RMB) and are limited to Chinese mainland investors, whilst B shares are designed for foreign investors including those from Taiwan, Hong Kong and Macao. B shares carry the same

---

[448] Donald C. Clarke, 'Corporate Governance in China: An Overview' (2003) 14 China Economic Review 494, 499.
[449] Mara Faccio and Larry H.P. Lang, 'The Ultimate Ownership of Western European Corporations' (2002) 65 Journal of Financial Economics 365, 365.
[450] JiangYu Wang, 'Dancing with Wolves: Regulation and Deregulation of Foreign Investment in China's Stock Market' (2004) 5 Asian-Pacific Law & Policy Journal 1, 14.
[451] In addition to A and B shares, there are classifications by the location of where certain stocks are listed, such as H shares and N shares. H shares are listed on the Hong Kong Stock Exchange and N shares on the New York Stock Exchange. The trading of these shares is mainly subject to local laws rather than Chinese Law.

voting and other relevant rights as A shares. B shares are traded in foreign currency (US dollars for those listed in Shanghai, or Hong Kong dollars for those listed in Shenzhen) according to the exchange rates at the time of the transaction, but the principal and dividends are denominated in RMB.[452] However, it has been suggested that the impact of B shares on the market is limited as they account for only a small proportion of the market in terms of market capitalisation and trading volume, due to lack of interest from the market participants and of the low quality of many companies.[453] By February 2010, only 57 B shares were listed on the Shanghai Stock Exchange and the same number on the Shenzhen Stock Exchange.[454] As Art and Gu have pointed out, the prices of A and B shares for the same listed company can differ, sometimes to a great extent.[455] A shares are generally traded at higher prices than B shares.

The distinction between A and B shares was introduced largely because of the incomplete convertibility of RMB and the government's restricted foreign currency policy.[456] Following the economic reforms, the government has gradually tried to blur the distinction between them. In February 2001, B shares were opened to domestic investors to trade with legally-obtained foreign currency, and in December 2002 A shares became available to foreigners as Qualified Foreign Institutional Investors (QFII).[457] Since then, the A shares and B shares markets have begun to merge, and once the RMB is fully convertible the distinction between A shares and B shares should disappear altogether.

---

452 Shanghai Bacuum Electronic Devices Company Limited was the first Chinese company to issue B shares in November 1991.
453 Huang (n2) 149.
454 Li Guo and Cristiano Rizzi, 'Entering the Chinese Market Through Takeovers - A Glimpse on the Current Legal and Regulatory Regime' (2011) Social Science Research Network <http://ssrn.com/abstract=1879863> accessed 28 February 2012, 5.
455 Robert C. Art and Minkang Gu, 'China Incorporated: First Corporation Law of the People's Republic of China' (1995) 20 Yale Journal of International Law 273, 306.
456 ibid 305.
457 'Temporary Regulations on Foreign Exchange Administration of Domestic Securities Investment by Qualified Foreign Institutional Investor', was jointly promulgated by the CSRC and the People's Bank of China on 5th November 2002. It was replaced by 'Measures on Administration of Domestic Securities Investment of Qualified Foreign Institutional Investors' on 24th August 2006, which was jointly issued by the CSRC, the People's Bank of China and the State Administration of Foreign Exchange (SAFE).

Tradeable shares and non-tradeable shares

More relevant to this research and the complex classification of shares in China is the distinction between tradeable and non-tradeable shares. A shares have been further divided into three sub-sets defined according to the type of shareholder: state shares, legal person shares and public individual shares. Only public individual shares may be freely traded on the stock market, as so-called tradeable shares. The non-tradeable shares are state shares and legal person shares, which are subject to severe trading restrictions and can only be transferred privately to other government agencies, legal entities or foreign investment companies, subject to state approval but not by tender offer. Non-tradeable shareholders enjoy the same cash flow rights and voting rights as holders of public individual shares except for the restriction on public trading. There is an implicit understanding between the state and investors that non-tradeable shares will never be traded in the stock market, in order to prevent any attempt to complete the privatisation process.[458]

State shares are issued to and held by government agencies such as the State-Owned Assets Supervision and Administration Commission (SASAC), or organisations authorised to represent the state in making investments by using state-owned assets and equity interest. On the other hand, legal person shares are owned by state-controlled legal persons such as state-controlled enterprises with at least one non-state shareholder, or domestic institutions ranging from investment banks to non-banking financial institutions. Although these legal entities have a mixed ownership structure with both private and state stakes, they are usually indirectly controlled by central or local government. Hence, these

[458] Andrea Beltratti and Bernardo Bortolotti and Marianna Caccavaio, 'The Stock Market Reaction to the 2005 Non-Tradable Share Reform in China' (2011) ECB Working Paper No. 1339 <http://ssrn.com/abstract=1837318> accessed 11 December 2011, 11.

non-tradeable state shares and legal person shares are ultimately concentrated in the hands of the government, amounting at their peak to about two-thirds of the total shares outstanding in listed companies.[459]

The existence of non-tradeable shares and their concentration in the hands of SOEs or other state-owned asset management agencies is a unique feature of Chinese stock exchanges. The company ownership structure in China was, by international standards, highly concentrated, and the largest shareholder usually had effective control over the firm; individual investors in tradeable shares only possessed a very small proportion of a company's total issued shares.[460] In the IPO process of SOEs, only a small proportion of equity is issued to private investors. In the listed SOEs, the state and parent SOEs still maintain sufficient shareholdings in the form of state shares or legal person shares.

The rationale for the design of non-tradeable shares was to prevent state assets from falling into the hands of individuals and to avoid mishandling or reducing the value of state assets through depreciation or misappropriation.[461] The government attempted to effectively control the transfer of state shares through the design of non-tradeable shares. As Wang has noted, the purpose of this distinction is to control the transferability of the different types of shares and maintain the government's leading role in the economy.[462] In addition, the prohibition on the free transfer of shares made it possible for the government to continue to influence management of the listed companies to achieve political and social goals that did not necessarily improve firms' wealth.[463]

---

459 Song and Meeks (n1) 6.
460 Gongmeng Chen and others, 'Control Transfers, Privatization, and Corporate Performance: Efficiency Gains in China's Listed Companies' (2008) 43 Journal of Financial and Quantitative Analysis 161, 176.
461 Hehong Chen and others, *Study on State-Owned Shares* (China University of Political Science and Law Press 2000) 324.
462 Wang (n450) 15.
463 Chen and Firth and Rui (n422) 89.

1.2.2 Shareholding Structure Reform

Although those non-tradeable shares provided the state or its representatives with effective control over listed companies and prevented uncontrolled sales of SOEs to the private sector, the Chinese government soon recognised the problems caused by the existence of non-tradeable shares. According to Li, illiquidity of the shares became obvious in the eyes of most policy makers.[464] The segmented nature of the shares of listed companies has had a significantly negative effect on the restructuring of SOEs as well as on the market for corporate control. It not only reduced the liquidity of the stock market but also reduced the efficiency of SOEs.

In theory, the owner of the SOEs was the government or the so-called 'people as a whole'. However, the owner in practice was a central or local government organisation. As a collective body, the state played a less effective role as a majority shareholder than it should have done. The motivation of management remained political considerations or the private benefit of government officials rather than shareholder value. A further problem was enforcement against the improper conduct of managers, resulting from the state's dual role of both regulator and controlling shareholder of many listed firms. In particular, a senior company manager might rank higher in the government than an official of the market regulatory body.[465]

This unique divided share structure led to intensive conflict between tradeable and non-tradeable shareholders, and has been recognised as the cause of many corporate governance problems in China.[466] On the one hand, according to Hou and Howell, the non-tradeable shareholders with dominant positions have had an indifferent attitude

---

[464] Jerry Z. Li, *Invest in China - A Practical Legal Guide to Mergers and Acquisitions* (Law Press China 2006) 188.
[465] Donald Clarke (n448) 499.
[466] Huang (n2) 148.

towards share price movements, due to the impossibility of trading their shares and because they could treat themselves preferentially at the expense of other shareholders and employees.[467] On the other hand, the tradeable shareholders have had limited power to affect management decisions with their minority shareholding. Therefore it was not surprising to find that most individual investors in tradeable shares tend to be free riders with few incentives to exercise their voting right or attend shareholders' meeting.[468]

It thus became obvious that the side effects of this shareholding structure were to damage the original purpose of maintaining an orderly enterprise reform. Ironically, they became an obstacle to fulfilling the government's intention for the state to play a less important role in the management of SOEs and to improve SOEs' corporate governance. It can be argued that the high percentage of non-tradeable shares on the market artificially distorted the functioning of the capital market and created inefficiency in corporate governance.[469] As economic and political reforms in China progressed, the government gradually realised that state shares could maintain their value and perhaps even appreciate through transfer on to an open market. Meanwhile, the government began to feel more confident about allowing state shares to be freely traded in the market, as the stock market seemed to be functioning healthily and playing a more important role in the Chinese economy.[470] Hence, a series of reforms were carried out, allowing the controlling shareholders to reduce their voting control by selling off shares to private investors.

---

467 Wenxuan Hou and Sydney Howell, 'Restriction Tightness, Bargaining Power, and the Valuation of Restricted Shares by Conflicting Shareholders in the Split Share Structure Reform' (2006) Social Science Research Network <http://ssrn.com/abstract=1343636> accessed 17 December 2011, 48.
468 For more discussion on shareholders' free riding, *see* Stoyan Tenev and Chunlin Zhang and Loup Brefort, *Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets* (World Bank Publications 2002).
469 Guo and Rizzi (n454) 5.
470 Baoshu Wang and Qinzhi Cui, *The Principles of China's Corporate* (Social Sciences Academic Press 2004) 328-330.

A. State Share Holding Reduction: 2001-2002

In June 2001, the State Share Holding Reduction (known as *Guoyougu Jianchi*) was launched and the Chinese government started to reduce the proportion of state ownership by making non-tradeable shares fully tradeable on the stock exchanges. However, the trading constraints on these non-tradeable shares were terminated without consulting the tradeable shareholders. This measure caused share prices to drop by more than 30%, as investors feared the increased supply of tradeable shares would flood the market and dilute the price of the original tradeable shares.[471] Because of the strong adverse reaction from tradeable shareholders, the government suddenly suspended this process in October 2002, after only four months. This first attempt to make non-tradeable shares freely tradeable on the Chinese stock exchanges was thus considered unsuccessful.[472] These failures, associated with chronic governance problems and lack of confidence in the listed companies, arguably contributed to the four-year bear market in China, during which the market lost about half of its value from its peak in 2001. Taking the Shanghai Stock Exchange for example, the Shanghai Stock Exchange Composite Index (SSECI) plunged from its peak of about 2245 points on 14 June 2001 to a dangerously low level of 998 points on 6 June 2005.[473]

---

[471] *See* Yongbeom Kim and Irene S. M. Ho and Mark St Giles, 'Developing Institutional Investors in People's Republic of China' (2003) World Bank Country Study Paper <www-wds.worldbank.org/.../302480CHA0deve1titutional0investors.pdf > accessed 28 January 2012. In the first attempt, two selected companies sold their state shares to the public. The share price of the two companies fell by about 40% within 15 days of the announcement of the transfer programme.

[472] Michael Firth and Chen Lin and Hong Zou, 'Friend or Foe? The Role of State and Mutual Fund Ownership in the Split Share Structure Reform in China' (2010) 45 Journal of Financial and Quantitative Analysis 685, 687.

[473] *See* Shanghai Stock Exchange <http://www.sse.com.cn/sseportal/en_us/ps/home.shtml> accessed 25 September 2009.

B. Split Share Structure Reform: 2005-2006

Reviewing its previous commitments to improving corporate governance of SOEs, in 2005 the government renewed its effort to reform the shareholding structure. In April of that year, the CRSC introduced a new shareholding structure called the Split Share Structure Reform (known as *Guquan Fenzhi Gaige*) to convert the state and legal person shares into tradeable shares through a new plan entitled 'Notice of the China Securities Regulatory Commission on the Pilot Shareholding Structure Reform of Listed Companies', promulgated on 29th April 2005.

Two official documents were issued to govern the operational procedures of the reform. On 23 August 2005, the CSRC, the SASAC, the Ministry of Finance (MOF), the People's Bank of China (PBC) and the Ministry of Commerce (MOFCOM) jointly issued an important document entitled 'Guidance Notes on the Split Share Structure Reform of Listed Companies' (Guiding Notes). This recognised that the then current shareholder structure had posed a huge problem during China's transition into a market economy, the different disposal of shares having distorted the pricing mechanism of the capital market and restricted the effective allocation of resources. Article 10 of the document made clear that there would be no such differentiation as that between tradeable and non-tradeable shares for new IPOs in the market. Ten days after the issuance of the Guiding Notes*,* the CRSC promulgated 'Administrative Measures on the Split Share Structure Reform of Listed Companies' (Administrative Measures 2005), which set forth in detail the requirements and implementation procedure of the reform.

The process of the reform was gradual. After successful initial experiments on the first and second pilot batches of a small number of firms it had selected in May and June 2005, in August the CSRC publicly announced an extension of the process to all companies traded on the Shanghai and Shenzhen Stock Exchanges and set the end of 2006 as the deadline for every individual listed company to complete the reform by a vote at a shareholders' meeting. To facilitate the reform and stabilise the stock market, in January 2006 the government enacted a new law to facilitate the acquisition of stakes in listed companies by foreign investors.[474] It increased the scope for foreign investors to participate in the Chinese securities market and in the running of listed companies, not only by stipulating that the purchase of A shares was available to a small group of qualified investors (QFII) but also by extending this to all strategic investors who were willing to buy a minimum stake of 10% of the company and hold the shares for more than three years.

Taking previous failures to heart, the new reform adopted a market-based approach rather a government-imposed measure. It decentralised decision making at the company level by allowing tradeable shareholders to freely bargain with non-tradeable shareholders over the method and terms of compensation. The holders of non-tradeable shares were forced to pay compensation to holders of tradeable shares in exchange for the possibility of freely trading their shares in the future. As Quan and Hu have suggested, by turning the non-tradeable shares into tradeable shares, a new and valuable trading privilege was conferred on the non-tradeable shareholders because their shares were purchased at a discount price and then became tradeable.[475] Tradeable shareholders might lose in the short term because the extra supply of tradeable shares in the market might lead to a steep decline in the market price.[476] Therefore, the non-tradeable shareholders needed to give

---

[474] In December 2005, a new regulation called 'Measures for Strategic Investment by Foreign Investors upon Listed Companies' was promulgated by the MOFCOM, the CSRC, the State Taxation Administration (SAT), the State Administration of Industry and Commerce (SAIC) and SAFE; it came into force on 31 Jan 2006.
[475] With regarding to bid price, it will be discussed in detail later this chapter.
[476] Beltratti and Bortolotti and Caccavaio (n458) 20.

consideration to the tradeable shareholders, in exchange for the right to sell their shares in the future.

The compensation plan was to be discussed during the period of trading suspension mutually agreed by the tradeable and non-tradeable shareholders.[477] The trading in shares would restart once the plan was publicly announced.[478] After its announcement, shareholders' meetings could be called at which the compensation plan had to be approved by a majority of two-thirds of the tradeable shareholders.[479] Share trading was also suspended between the announcement of the shareholders' meeting and the final vote.[480] Trading would restart once the compensation was paid out after the final vote.[481] If the proposed compensation plan was not approved by the shareholders' meeting, the non-tradeable shareholders had to propose a new plan and negotiate with the tradeable shareholders again.[482] The compensation plans took various forms such as cash, warrants and stock splits, in most cases involving the non-tradeable shareholders giving shares to the tradeable shareholders.

Moreover, a suspension of trading for a 12-month lock-up period for the non-tradeable shareholders was imposed to prevent a potentially dramatic stock price fluctuation caused by the sudden massive supply of shares on the market.[483] It is argued that this 12-month lock-up period set up for the non-tradeable shareholders was a key feature of the 2005 reform; it alleviated concern among public investors about dilution effect from the

---

[477] Administrative Measures 2005, art 9.
[478] Administrative Measures 2005, art 11.
[479] Administrative Measures 2005, art 16.
[480] Administrative Measures 2005, art 12.
[481] Administrative Measures 2005, art 17.
[482] For an extended description of this process, *see* Kai Li and others, 'Privatization and Risk Sharing: Evidence from the Split Share Structure Reform in China' (2010) Social Science Research Network <http://ssrn.com/abstract=1677178> accessed 25 March 2012.
[483] Administrative Measures 2005, art 27(1).

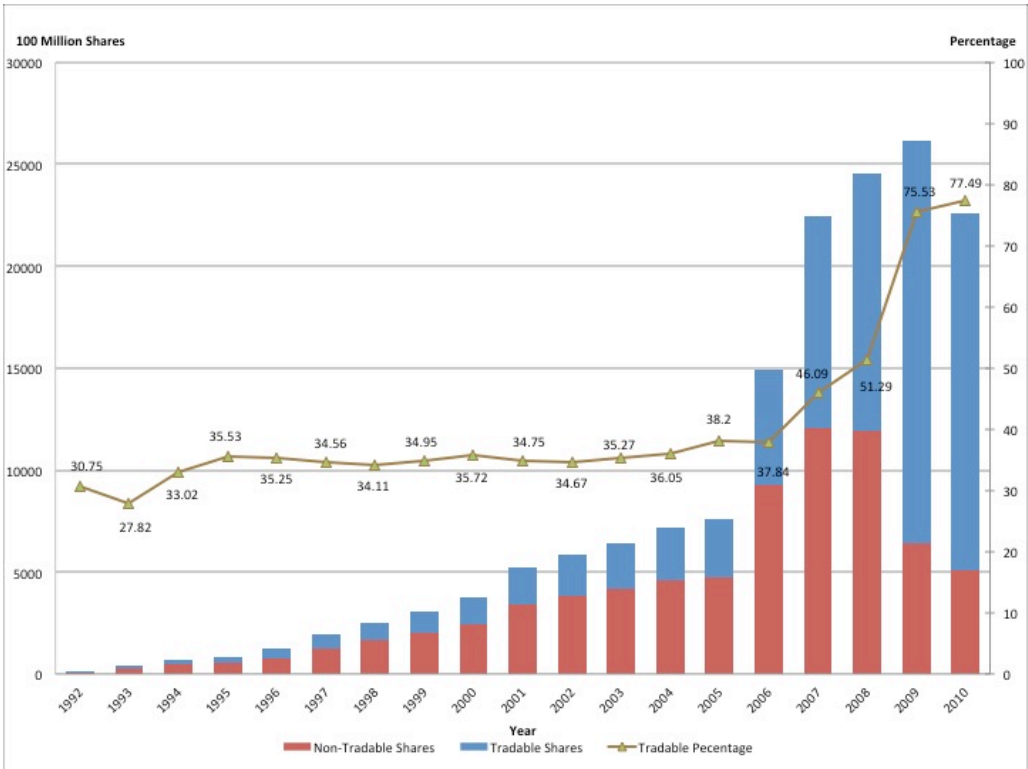
conversion of the non-tradeable shares into tradeable shares.[484] Furthermore, a holder of non-tradeable shares with more than 5% of the total shares of the listed company was further prohibited from trading on the stock exchange market more than 5% of the company's total shares over 12 months (more than 10% over 24 months) after the expiry of the lock-up period.[485] As a result, after the compensation had been paid, all trading constraints would be in force for three years.

Unlike the market reaction to the State Share Holding Reduction in 2001, the Split Share Structure Reform of 2005 proceeded successfully, with positive reaction from the market. By the end of the announced deadline in 2006, the reform had largely been implemented, with the vast majority of non-tradeable shares being converted into tradeable shares. As a result of the reform, the Chinese stock market assumed a different landscape. In 1992, tradeable shares accounted for 30.75% of all the shares in terms of volume. By the end of 2007, 1,254 firms, whose total market value accounted for over 97% of China's stock market capitalisation, had implemented the reform, and by the end of the following year only 31 out of more than 1,500 listed companies remained to do so.[486] Eventually, all the non-tradeable shares were set free from the suspension of trading and obtained full liquidity in the market.

---

[484] Beltratti and Bortolotti and Caccavaio (n458) 11.
[485] Administrative Measures 2005, art 27(2).
[486] See the official website of the Shanghai Stock Exchange <http://www.sse.com.cn/...(Market Review)> accessed 18 June 2010); *also see* the official website of the Shenzhen Stock Exchange <http://www.szse.cn/…(Market Review)> accessed 18 June 2010.

Figure 5-1 Shareholding Structure in China from 1992-2010



Source: Calculations based on the data collected from official websites of Shanghai and Shenzhen Stock Exchanges

1.2.3 Impact on Takeover Market in China

Before the shareholding structure reform, the distinction between tradeable and non-tradeable shares meant that the former could be acquired by tender offer, whereas the latter could only be purchased by agreement. Since Chinese listed companies were under highly concentrated ownership at that time, in order to successfully gain control of a listed company, it was normal to purchase the non-tradeable shares by private agreement in a friendly manner. The acquirer negotiated with the controlling shareholder and entered into a share transfer agreement with that shareholder to purchase the non-tradeable shares, so as to gain a sufficient percentage of shares in the target listed company. There are three reasons that explain why this method became the primary technique to gain control of a listed company.

First, under the split share structure, about two-thirds of the Chinese stock market at its peak was composed of non-tradeable shares. It can be seen from Figure 5-1 that non-tradeable shares comprised nearly 62% of all firms' outstanding shares in 2005. Moreover, as one survey found out, in 88% of all listed companies non-tradeable shares accounted for at least 50% of their outstanding shares in the same year.[487] It was virtually impossible to take over a company without purchasing some of those non-tradeable shares. Second, it was preferable for a purchaser to obtain a controlling block of non-tradeable shares, for security and in order to save time, even though the purchase of non-tradeable shares required governmental approval. Third, as mentioned above, the price of non-tradeable shares was inherently much lower than that of tradeable shares in the same company, because of the segregated equity structure. The non-tradeable shares could be transferred at prices linked to the book value, which was typically lower that the market value. In China, even a poorly performing company might have an unusually high share price by Western standards,[488] so a buyer could obtain a controlling status by dealing more cheaply from the state owner than by open-market purchase.

Consequently, as Cha has observed, it was not surprising to find that there was a very limited number of takeovers, particularly hostile takeovers, by offer in China before the split share structure reform.[489] The first hostile takeover by open-market purchase took place in 1993 when Shenzhen Baoan Group, a legal person company listed on the

---

[487] Nan Jia and Jing Shi and Yongxiang Wang, 'Value Creation and Value Capture in Corporate Governance: Using the Value-Based Approach to Analyze an Ownership Reform of China's Listed Firms' (2012) Marshall School of Business Working Paper <http://ssrn.com/abstract=2171355> accessed 17 July 2012, 5.
[488] Wang (n450) 12.
[489] Ming Cha, 'Analysis on the Features of Two Cases of Tender Offer' *China Securities News* (Beijing, 23 April 2003) 5.

Shenzhen Stock Exchange, secretly acquired the publicly traded shares of Shanghai YanZhong Industry Co Ltd, a listed company on the Shanghai Stock Exchange and secured a holding of 17.07% when combined with the stakes held by two affiliated companies, Baoan Huayuang and Shenzhen Ronggang. Although Shanghai YanZhong protested against this takeover, it was held valid by the CSRC confirming that the takeover was a market behaviour. But Shenzhen Baoan Group was fined because of the breach of takeover disclosure rules and would only be allowed to complete its acquisition after a certain period of time.[490] There was no occurrence of takeovers of listed companies by an offer in the period 1997-2002. In 2003, the first takeover by offer was published by Nanjing Iron & Steel Co Ltd, a Nanjing-based iron and steel maker, to acquire 29.05% of outstanding shares in Nanjing Iron & Steel Joint Stock Co Ltd, which was listed on the Shanghai Stock Exchange. This first tender offer stirred up China's securities market and initiated a brand new involvement option for the takeover participants.

After the 2005 shareholding structure reform, it was expected that this situation would change. At least in theory, takeovers by offer would become a more feasible investment option than in the previous situation. Once the former non-tradeable shares had eventually been turned into shares tradeable on the open market, the problem of the segregated equity structure and the different prices for different shares would disappear. When all non-tradeable shares could be freely traded on the stock exchanges on expiry of the statutory lock-up periods, it was argued that the pace of the ongoing SOEs reform would accelerate.[491] The scope of the capital markets would expand to develop a widely

---

[490] For more information, see China Securities Regulatory Commission Official Bulletin on 25 October 1993.
[491] Chen and Firth and Rui (n442) 87.

dispersed pattern of share ownership,[492] and takeover activities would pick up, improving the overall efficiency of the Chinese economy.[493]

However, it should be borne in mind that the official objective of the shareholding structure reform was to eliminate non-tradeable shares and facilitate a long-term stable stock exchanges. The reform aimed at solving the technical problem regarding the future listing and trading of non-tradeable shares, rather than reducing state ownership. There was no suggestion that the state would raise funds by trading state shares on the capital market. This echoes what Chairman Shang of the CSRC said in June 2005: 'Making all shares tradeable does not mean selling out all shares'.[494] Any transfer of the state's shares in listed companies are subject to decisions by the SASAC.[495] The Securities Law also provides that when the takeover of a listed company involves shares held by an investment organisation of the state, the matter shall be subject to approval by the relevant department in charge in accordance with the regulations of the State Council.[496] As Mattlin has argued, Chinese government still retains tight control of its shares in Chinese listed companies.[497]

1.3 Concentrated Ownership of Chinese Listed Companies

Indeed, in China, the number of companies which have a controlling shareholder is very high, and on average the controlling shareholder holds a high percentage of the outstanding voting shares. As has Zhang argues, the concentration of ownership of

---

492 Clarke (n448) 499.
493 Li (n464) 191.
494 'China to Include H Shares in Stock Reform Plan' *Financial Times* (London, 27 June 2005).
495 Interim Measures for the Administration of State-owned Shareholders' Transfer of Their Shares of Listed Company, art 7.
496 Securities Law, art 94.
497 Mikael Mattlin, 'The Chinese Government's New Approach to Ownership and Financial Control of Strategic State-Owned Enterprises' (2007) BOFIT Discussion Papers No. 10/2007 <http://ssrn.com/abstract=1001617> accessed 19 March 2012, 15-16.

Chinese listed companies can be regarded as particularly high when compared with the widely dispersed ownership of the UK and US, where a proactive market of corporate control continues to function well.[498] The topic of concentrated ownership in China has attracted enormous attention, and it is undeniable that many criticisms have been made of this ownership structure. However, it should be kept in mind that any discussion of the corporate ownership structure in a particular country should be based on careful consideration of its evolution and its goals for the future.

According to statistical data provided by empirical researchers, both capital structure and corporate ownership in listed companies have undergone significant changes following the Chinese economic reforms of the last 30 years. As shown in the study by Liu et al, the largest shareholder ownership declined from approximately 45% in 2000, to 40% in 2005 and about 36% in 2010.[499] In the statistics collected from the CSMAR database, shown in Table 5-1, the declining trend in the largest and second largest shareholder ownership from 2004 to 2012 is clearly visible.[500] Moreover, Figure 5-2 shows that the average gap between the first and second largest shareholders decreased from about 32% in 2004 to 26% in 2012. However, there was very little change in the overall percentage of largest and second largest shareholdings from 2006 to 2012. The single largest shareholder averaged 36% of shares in all listed companies, while the second largest typically owns around 9% of shares.

---

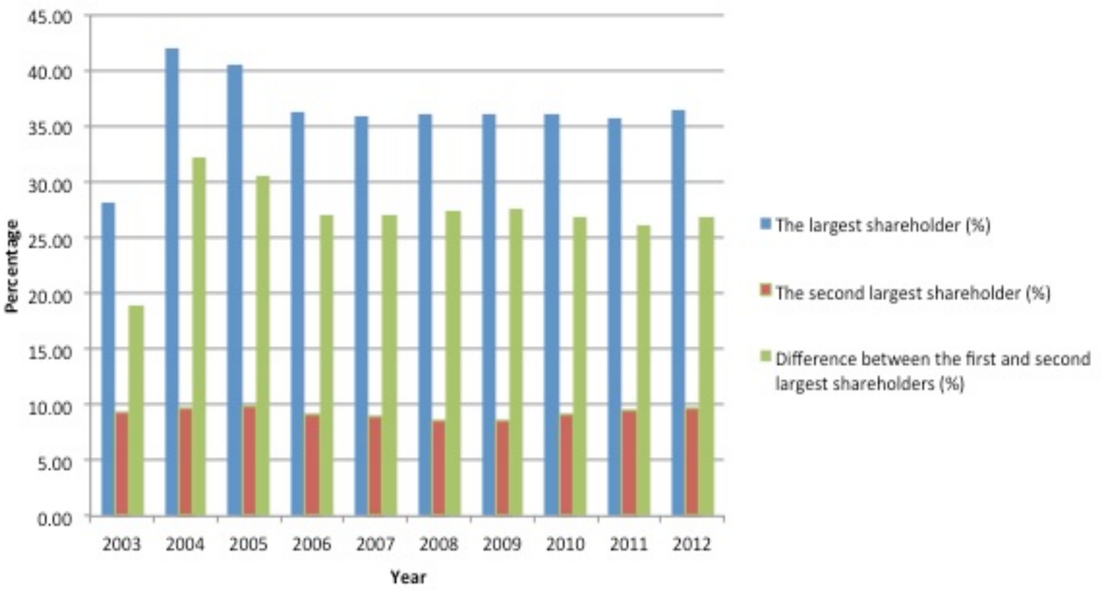
[498] Lin Zhang, 'Hostile Takeovers in China: Comparative Corporate Governance and Institutional Changes' (2012) Social Science Research Network <http://ssrn.com/abstract=2107689> accessed 18 January 2013, 8.
[499] Chunyan Liu and Konari Uchida and Yufeng Yang, 'Controlling Shareholder, Split-Share Structure Reform and Cash Dividend Payments in China' (2012) Financial Markets & Corporate Governance Conference <http://ssrn.com/abstract=1898549> accessed 18 January 2013, 9.
[500] The largest shareholder is the average percentage of shares owned by the largest owner in each listed company.

Table 5-1 The Largest and Second Largest Shareholder Ownership from 2004-2012

Year	Largest Shareholder	Second Largest Shareholder
2004	41.99%	9.74%
2005	40.47%	9.80%
2006	36.27%	9.19%
2007	35.86%	8.88%
2008	36.09%	8.65%
2009	36.16%	8.62%
2010	36.18%	9.20%
2011	35.71%	9.50%
2012	36.54%	9.64%

Source: Calculations based on CSMAR Database.

Figure 5-2 The Difference between the Largest and Second Largest Shareholders from 2004-2012



Source: CSMAR Database

According to data collected by Deng from 1,571 Chinese listed companies in 2008, 20.8% of the sample companies reported their largest shareholder as having more than 50% shareholding, 64.9% as from 20% to 50%, and 14.3% as less than 20%.[501] In 2002, Lin had undertaken a similar analysis on the ownership structure of 1,059 Chinese listed companies and found out that the three ratios were 40%, 52.6% and 7.4% respectively.[502] It can be seen that the number of listed companies with a controlling shareholder holding more than half of the shares dropped from 40% in 2002 to 20.8% in 2008; the figure for holdings of 20-50% showed an increase from 52.6% to 64.9%. Voβ and Xia undertook a similar comparison and found that the percentage of listed companies with the largest shareholder holding more than 50% shares significantly decreased from 33% in March 2005 to 19% in Feb 2007.[503] From these statistics, it is clear that there is a dramatic decline in the number of listed companies with a single shareholders having absolute control, although the number of companies with a controlling shareholder having actual control over the listed company is steadily growing.

Based on these data, it can be argued that the ownership structure of Chinese listed companies has become wider. As mentioned previously, in accordance with Administrative Measures 2005, non-tradeable shareholders were required to pay compensation to tradeable shareholders in exchange for converting their shares into tradeable ones. It was observed that the majority of non-tradeable shareholders offered free bonus shares as compensation.[504] This issue of free bonus shares relatively reduced

---

501 Hui Deng, 'Constraining the Majority Shareholders under the Concentrated Ownership Structures of the CDLCs: An Opportunity for the Transformation along with the Equity-division Reform' (2008) 6 Legal Science 145, 146.
502 Lefen Lin, *Research on the Ownership Concentration of the Chinese Listed Company* (Economy and Management Publisher 2005) 217.
503 Voβ and Xia (n435) 12.
504 Bernardo Bortolotti and Andrea Beltratti, 'The Nontradable Share Reform in the Chinese Stock Market' (2006) FEEM Working Paper No 131.06 <http://ssrn.com/abstract=944412> accessed 17 January 2013, 112.

the percentage ownership of controlling shareholders. In this respect, it can be argued that the split share structure reform contributed to this change.

However, it cannot be denied that concentrated ownership remains at a relatively high level, as the state still accounts for a high percentage of ownership in most listed companies.[505] According to Zhao, in China 'listed company' normally means listed SOE; and the largest shareholder normally refers to the state, which has controlling shareholdings in listed companies.[506] As empirical studies have indicated, 81.6% of Chinese companies are directly or indirectly controlled by the state [507] and 80% of companies' largest shareholder is the state.[508]

Looking at two types of listed companies in China, state-owned and privately-held, the type with the state as a major or controlling shareholder has declined. In 2001, 82% of all companies were under the ultimate control of the state, but the figure dropped to 71% in 2005, 60% in 2007 and 21% in 2010.[509] However, it is not true that there has been a fundamental shift from state ownership to non-state private control. According to Allen and Shen, in June 2010, the largest ten SOEs accounted for 39.5% of the total market capitalization of Shanghai Stock Exchange.[510] Although the number of privately controlled companies has grown over recent years, SOEs still dominate the trading on the Chinese capital market.[511] Regardless of the controlling shareholder's nature, state-owner

---

505 Voβ and Xia (n435) 17.
506 Jingchen Zhao, 'A More Efficient Derivative Action System in China: Challenges and Opportunities through Corporate Governance Theory' (2013) Northern Ireland Legal Quarterly (forthcoming), 37.
507 Voβ and Xia (n435) 14.
508 Neng Liang and Michael Useem, 'Corporate Governance in China' in Institute of Directors (ed), *The Handbook of International Corporate Governance* (Kogan Page 2009) 169.
509 *See* Martin J. Conyon and Lerong He, 'Executive Compensation and Corporate Governance in China' (2011) <http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1005&context=ics> accessed 20 March 2013, 20; Benjamin L. Liebman and Curtis J. Milhaupt, 'Reputational Sanctions in China's Securities Markets' (2008) 108 Columbia Law Review 929, 938.
510 William T. Allen and Han Shen, 'Assessing China's Top-Down Securities Markets' (2010) New York University School of Law, Public Law Research Paper No 10-70 <http://ssrn.com/abstract=1648336> accessed 20 March 2013, 8.
511 Mariana Pargendler, 'State Ownership and Corporate Governance' (2012) 80 Fordham Law Review 2917, 2943.

or not, it is safe to conclude that although the largest shareholders' holding and accordingly ownership concentration, has been in relative decline, the existence of a largest shareholder still dominates the Chinese listed companies, and concentrated corporate ownership has not changed significantly over the last few years.

1.3.1 Path Dependent Theory

The above facts imply that after all the outstanding non-tradeable shares were allowed to freely trade on the stock markets, the concentrated ownership of the listed company has been dispersed only to a slight degree.[512] Controlling shareholders still retain their power, and the concentrated ownership structure is still a distinct feature of Chinese corporate governance.[513] The controlling situation of the state in listed companies still persists. In order to explain why this is so, it is worth considering path dependence theory. In other words, as part of corporate governance within one nation's economic and social system, the development of the ownership structure has its source in path dependence.

According to Hathaway's definition, path dependence means some phenomena are influenced in a specific way by historical events.[514] Roe's winding road theory is also a good way to explain what path dependence is: today's road is determined by what path was taken in the past. The existence of today's winding road, which diverges from the potential straight road, is influenced by the early fur trader's decision to avoid the wolves'

---

[512] Zhang (n498) 1.
[513] Mary Comerford Cooper, 'New Thinking in Financial Market Regulation: Dismantling the "Split Share Structure" of Chinese Listed Companies' (2008) 13 Journal of Chinese Political Science 53, 63.
[514] Oona A. Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 Iowa Law Review 101, 103.

den.[515] Similarly, the concentrated ownership structure in China is path dependent as a result of historical accidents and China's economic and political reforms.

As Bebchuk and Roe have argued, differences in ownership structure between different countries persist even if their economies have developed towards a similar form.[516] They emphasise the direct effect of the initial ownership on the subsequent ownership structure.[517] The Chinese government introduced market mechanisms to improve SOEs' performance on the one hand, and retain substantial state ownership in the listed companies on the other.[518] The SOEs have been given the opportunity of accessing external finance through being listed on the stock exchange, and thus have to accept market supervision and implement good corporate governance. However, the persistence of a high proportion of state ownership can be an obstacle to Chinese listed companies, that prevents them from operating as efficiently as expected.

A dispersed shareholding structure has been adopted by more and more jurisdictions and functions well. With the integration of global financial markets, in the long term, concentrated corporate ownership should move towards dispersed ownership, by introducing a corporate governance strategy of dispersed control. However, it should be emphasised that this will be a naturally evolving process, and any sudden actions to change it will have detrimental effects.[519] Despite the inefficiency caused by concentrated ownership, the structure might persist because of the current underdeveloped Chinese securities market and weak shareholder protection, which cannot afford an immediate

---

515 Roe (n391) 643.
516 Lucian Arye Bebchuk and Mark J. Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52 Stanford Law Review 127, 129.
517 Bebchuk and Roe (n516) 139.
518 Yuwa Wei, 'China's Capital Market and Corporate Governance: The Promotion of the External Governance Mechanism' (2007) 4 Macquarie Journal of Business Law 325, 341.
519 Berndt (n67) 61.

radical change. As Roe has argued, each path dependent ownership system has costs, and the costs of change might outweigh the benefits.[520]

Bebchuk and Roe further suggested a concept of 'rent seeking', a source of path dependence, to explain why one country developed a certain ownership structure in the first place, eventually leading to an inefficient ownership structure. They have argued that those who have a controlling position in companies may exert pressure to enact a law to prevent changes which might improve corporate efficiency, but which would reduce the private benefits they receive through exercising their controlling power.[521] That is, 'rent-protection' consideration which enable controllers to extract large private benefits might lead to the persistence of concentrated ownership.[522] It can be argued that the development of a corporate governance structure is path dependent on the existing controlling parties who adopt rules to protect their private interests.

As Liu has observed, in China almost every corporate governance practice is rooted more or less in rent-seeking incentives of a politician or a businessman connected to a politician.[523] Although Chinese enterprise reform has attempted to diversify the SOEs ownership structure and improve efficiency, in most companies there is a single dominant shareholder whose controlling shareholding provides power and influence over the company's operation. It is hard to separate business and politics.[524] In China, nearly every aspect of corporate governance and the stock market is heavily regulated by the government authorities, from central to local levels. The state's continuing control over

---

[520] Roe (n391) 650.
[521] Bebchuk and Roe (n516) 142.
[522] *See* Lucian Arye Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' (1999) National Bureau of Economic Research Working Paper No. 7203 < http://www.law.harvard.edu/faculty/bebchuk/pdfs/nber7203.99.pdf > accessed 25 February 2013.
[523] Liu (n433) 427.
[524] ibid.

most aspects of the Chinese economy is path dependent and therefore leads corporate ownership along the path of concentration.[525]

Since the late 1970s, the Chinese government has made enormous efforts to transform the economy from a centrally planned system to a more market-oriented one. Although a series of reforms were implemented to increase autonomy for SOEs, introduce private businesses and develop stock market, the state continues to be a dominant player in the Chinese economy.[526] Wang has suggested that the concentrated ownership structure of state-controlled listed companies cannot be substantially dispersed, simply because the Chinese government is unlikely to give up control of these companies, at least in the short term.[527] According to the path dependence theory, which suggests continuing systematic persistence, it is predicted that the concentration of the capital structure of the current Chinese equity market, which includes the state as a majority shareholder, is likely to continue for a long time.

1.3.2 Impact on Takeover Market in China

In accordance with China's Securities Law, there are two methods of takeover of a listed company: takeover by offer (tender offer) and takeover by agreement.[528] As described above, the tender offer is widely used in countries with dispersed ownership of listed companies, like the UK and US. However, this is not true of China, where firms with widely held shareholders are unusual. The majority of listed companies in China are still under the control of the state or quasi-state controlling shareholders. This has significant

---

[525] Wei Cai, 'Path Dependence and Concentration of Ownership and Control of Companies Listed in China' (2009) 20(8) International Company and Commercial Law Review 281, 284.
[526] Conyon and He (n509) 2.
[527] Ting Wang, 'No Substantive Selling-out of Previously Non-tradable Shares of Centrally State-controlled Listed Companies' (2008) China Securities Journal A01, A01.
[528] Securities Law, art 85.

implications for Chinese corporate governance in general, and for the takeovers market in particular. This pattern of ownership and control means that the main agency problem in Chinese corporate governance is not between target directors and shareholders, but between controlling shareholders and minority shareholders.

It is, therefore, nearly impossible for an acquirer to accumulate control through purchasing shares on any stock exchange. As Zhang has clearly pointed out, the almost total absence of takeover by offer results in the non-existence of an active hostile takeover market in China.[529] To acquire a sufficient percentage of shareholding in a target listed company, the acquirer must instead negotiate the purchase plan with the controlling shareholder in the target company and enter into a share transfer agreement with that shareholder. Takeover by agreement is therefore still the preferred method in China.

The numbers in Table 5-2 shows that the vast majority of takeovers in China from 2005-2010 have been completed by agreement. The takeover by offer is still not the most frequently used takeover approach in China. The reason why I collected the data starting from 2005 is because that before the shareholding structure reform in 2005, the distinction between tradeable and non-tradeable shares and the high percentage of non-tradeable shares in the Chinese listed companies made the takeovers by offer a very rare phenomenon in the Chinese takeover market. After the 2005 shareholding structure reform, it was expected that this situation would change and takeovers by offer, at least in theory, would become a more feasible investment option than in the previous situation.

[529] Zhang (n498) 7.

Table 5-2 Takeovers of Chinese Listed Companies by Agreement and by Offer from 2005-2011

Year	Takeover by Agreement		Takeover by Offer	
	Announced	Succeeded	Announced	Succeeded
2005	332	193	0	0
2006	430	148	9	1
2007	388	192	0	0
2008	163	62	1	1
2009	1154	548	4	1
2010	1526	558	4	3
2011	1648	660	1	0
2012	1829	529	3	1

Source: Chinese Enterprises Merges and Acquisitions Year Book[530] and CSMAR Database

From the above table, it is not surprising to see the remarkably less number of takeovers by offer against the takeovers by agreement of Chinese listed companies. The under-development of hostile takeovers persisted due to the concentrated ownership of Chinese listed companies. However, it cannot be denied that the Chinese government's continuing efforts to transform the SOEs have far-reaching implications for takeover activities. With the completion of split share structure reform, listed SOEs should have become independent enterprises with relatively diverse ownership structures. Although a single or several large shareholders with substantial blocks of shares still retain control of Chinese listed companies, change is seen in that the rest of the shares can be widely dispersed. In order to take over a company with controlling shareholders, a bidder may obtain a block

[530] Jinxin Zhang, *Chinese Enterprises Merges and Acquisitions Year Book* (Chinese Economic Publishing 2005-2012).

of shares through a friendly sale agreement with incumbent controlling shareholders, or by accumulating a substantial block of previously dispersed shares more or less against the desire of the incumbent controlling shareholders. Although a private negotiation to purchase controlling shares will remain a common method of gaining corporate control for some time to come, hostile takeovers can be a valid and workable option for consideration, and it is expected that more and more Chinese listed companies will become vulnerable to hostile takeovers and thus subject to relevant takeover regulations.

2. Overview of China's Takeover Regime

As noted above, until the shareholding structure reform, China was insulated from the market for corporate control. Takeover activity has recently become more common and is gradually being recognised as an important feature of the Chinese corporate landscape.[531] China has attempted to create a clearer roadmap for the takeover players, and over the last two decades has developed a coherent and stable regulatory framework for takeover transactions, particularly for those looking at listed companies in the Chinese securities market. The Chinese government has issued a series of takeover regulations stipulating the conditions and legal procedures for takeovers to protect shareholders' interests and impose a fiduciary duty on directors to avoid their abuse of power at the cost of the shareholders. As Guo and Rizzi have argued, China's takeover regime has been greatly enhanced in terms of transparency and operational feasibility, which will undoubtedly increase the opportunity of permissible takeover transactions.[532]

It is widely acknowledged that China belongs to the family of continental law countries, also called civil law jurisdictions, where statutes are the main source of law and

[531] Hill (n58) 9.
[532] Guo and Rizzi (n454) 20.

precedents have no binding power. In China, the word 'law' generally has a relatively wide meaning, depending largely on the context. Chinese law is divided into three tiers at the central level. National laws are ranked at the top, promulgated by the national legislature, the National People's Congress (NPC) or its Standing Committee. The middle tier comprises administrative regulations issued by the State Council, and the last tier is composed of departmental rules announced by various functional departments under the State Council, such as ministries, commissions and agencies.

It is worth noting that although most laws governing takeover transactions in China are departmental rules enacted and issued by the competent functional departments under the State Council, these departmental rules must be formulated in accordance with the relevant national laws promulgated by the NPC or its Standing Committee. As Li has stressed, the national basic law serves as the fundamental legal basis for all administrative regulations and departmental rules.[533] Discussion of the major takeover-related national laws, administrative regulations and departmental rules follows.

2.1 Shaping the Takeover Framework -- Company Law and Securities Law

The Chinese takeover regime has experienced a step-by-step evolution, along with the development of the economy and capital market, starting with a law on Industrial Enterprises Owned by the Whole People[534] to a Company Law[535] and a Securities Law[536]. A year before the Company Law was adopted in 1993, the State Economic Restructuring Commission issued 'Opinions on the Standardization of Joint Stock Companies' to

---

533 Li (n464) 25.
534 This Law was adopted at the first Session of the 7th National People's Congress and promulgated by Order No.3 of the President of the PRC on 13 April 1988.
535 The Company Law of the People's Republic of China was promulgated by the standing Committee of the Eighth National People's Congress on 29 December 1993, amended on 25 December 1999, 28 August 2004 and 27 October 2005.
536 The Securities Law of the People's Republic China was promulgated by the standing Committee of the Ninth National People's Congress on 29 December 1998, amended on 28 August 2004 and 27 October 2005.

facilitate the conversion of SOEs to joint stock companies. In 1993, the State Council also promulgated the 'Tentative Regulation on the Administration of the Issuing and Trading of Shares' (Tentative Regulation 1993) which was the first influential regulation containing takeover provisions, and which created the early takeover regime in China.[537] With the new Company Law and Securities Law which came into force in 2006, these two pieces of legislation have contributed to shaping the legal framework governing takeovers of listed companies in China.

The Company Law was amended in 2005 and the new version took effect on 1 January 2006. The New Company Law, which replaces the Old Company Law enacted in 1993, is a complete revision of the old law; some 90% of its provisions were not covered by the old law.[538] Although there are no provisions directly relevant to takeover transactions, there are several important terms which may be used frequently during a takeover transaction.

- There are two types of company under the Company Law: the limited liability company (*youxian zeren gongsi*) and the joint stock limited company (*gufen youxian gongsi*).[539] The former is regarded as a private company closely held by a much smaller and connected group of investors, while the latter has widely held shares and can be listed on a stock exchange as a listed company.[540] Although joint stock limited companies do not have to be listed on a stock exchange, all listed companies in China take this form in accordance with both the Company Law and the Securities Law.

---

[537] The Tentative Regulation on the Administration of the Issuing and Trading of Shares was promulgated by the State Council on 22 April 1993.
[538] Steven M. Dickinson, 'Introduction to the New Company Law of the People's Republic of China' (2007) 16 Pacific Rim Law & Policy Journal 1, 1.
[539] Company Law, art 2.
[540] Zhao (n506) 12.

- 'Controlling shareholder' refers to a shareholder whose capital contribution amounts to 50% or more of the total capital of a limited liability company, or whose shares exceed 50% of the total equity shares of a joint stock limited company, or whose capital contribution or proportion of shares is less than 50% but according to his capital contribution, or the shareholding he enjoys a voting right which is large enough to have a significant impact upon resolutions of the shareholder's meeting.[541]
- '*De facto* controller' refers to anyone who is not a shareholder but is able to hold actual control of the acts of the company by means of investment relations, agreements or any other arrangement.[542]
- 'Connect relationship' refers to the relationship between the controlling shareholder, the *de facto* controller, director, supervisor, or senior manager of a company and the enterprise directly or indirectly controlled thereby, and any other relationship that may lead to the assignment of any interests of the company.[543]

The Securities Law is the basic law regulating the issuance and trading of shares on the stock exchanges in China, protecting the lawful rights and interests of investors. It has introduced a new takeover regime by including a whole section (Chapter 4) which specifically regulates takeovers of listed companies. This chapter stipulates general requirements that an acquirer must meet when conducting the takeover, including basic forms of takeover, disclosure, and condition for mandatory bid rule. However, according to Huang, the Securities Law only provides general requirements for takeovers and establishes a broad framework that seems to be incapable of meeting the need to regulate

[541] Company Law, art 217(2).
[542] Company Law, art 217(3).
[543] Company Law, art 217(4).

takeovers.[544] In short, the Securities Law does not contain a comprehensive set of rules to regulate takeovers of listed companies. As a result, in order to establish a sound takeover regime in China, many other departmental rules and administrative regulations which are more specific and detailed for the purpose of implementation have been adopted.[545] Most of these were issued by the watchdog of the stock market, the CSRC. The rules with regard to takeovers of listed companies will be discussed in more detail.

2.2 Forming the New Regime for Takeover of Listed Company – Takeover Measures 2002 and 2006

In 2002, Chinese legislators issued regulations specifically governing takeovers of listed companies for the first time. They are the 'Measures for Regulating Takeovers of Listed Companies' (Takeover Measures 2002)[546] and the 'Measures for Regulating Information Disclosure of the Changes in Shareholdings of Listed Companies，[547] issued by the CSRC to 'close the legislative loophole'.[548] These two regulations contain detailed provisions with respect to takeover activities and fill most of the legal gaps in the previous regulations. They have substantially improved the efficacy of the takeover law and are expected to promote the 'sustained and healthy' development of takeover activities.[549] However, due to the SOEs' dominant status in the capital market, the development of a takeover market has been slow and few takeover cases have been initiated since the promulgation of these two laws.

---

[544] Huang (n543) 153.
[545] Li (n464) 33.
[546] Measures for Regulating Takeovers of Listed Companies was promulgated by the CSRC on 28 September 2002, effective on 1 December 2002 and repealed on 1 September 2006.
[547] Measures for Regulating Information Disclosure of the Changes in Shareholdings of Listed Companies was promulgated by the CSRC on 28 September 2002, effective on 1 December 2002 and repealed on 1 September 2006.
[548] Chao Xi, 'Foreign Solutions for Local Problems? The Use of US-style Fiduciary Duties to Regulate Agreed Takeovers in China' (2008) 6(4) Journal of Chinese Economic and Business Studies 407, 412.
[549] Xiao Zhang, 'New Rules to Encourage M&A' *China Daily* (Beijing, 9 Oct 2002), 2.

Led by the objectives of improving the efficiency of SOEs and promoting an active takeover market to facilitate the reallocation of productive resources, in 2006 the CSRC promulgated a new regulation governing takeovers, the 'Measures for Regulating Takeovers of Listed Companies' (Takeover Measures 2006)[550] to replace the two laws issued in 2002. The Explanatory Memorandum to the Takeover Measures 2006 stated that the takeover law revision was to suit the new environment, whereby the national economy was facing strategic restructuring and the shareholding structure of listed companies was undergoing a radical transformation.[551] Indeed, the Takeover Measures 2006 came into force at a time when the six-year transition period of China's WTO membership was about to lapse and Chinese capital market was being transformed under the ongoing shareholding structure reform.

The Takeover Measures 2006 have provided China with a comprehensive legal framework for takeovers of Chinese listed companies and a sound basis for the development of takeover activities.[552] As Cai has suggested, it was not until 2006 that a well-established takeover regime governing the takeover of listed companies was set up to help restructure the national economy and optimise the allocation of resources.[553] It is argued that the rules under the new Takeover Measures make the takeover framework more concrete and easier to apply, with the effect of simplifying takeover processes, cutting down costs and boosting transactional efficiency.[554] These new measures not only represent the continuous commitment of the Chinese government to develop a

[550] Measures for Regulating Takeovers of Listed Companies was promulgated by the CSRC on 31 July 2006, effective on 1 September 2006.
[551] Explanatory Memorandum, para 1. *See* CSRC's website <http://www.csrc.org.cn/n575667/n642011/2050045.html> accessed18 October 2009.
[552] Guo and Rizzi (n454) 9.
[553] Wei Cai, 'The Mandatory Bid Rule in China' (2011) 12 European Business Organization Law Review 653, 656.
[554] Huang (n543) 153-154.

modernised regulatory takeover market but also, to some extent, bring China's takeover law more closely into line with those of other more developed countries.

The Takeover Measures 2006 have made a number of important substantial changes to fill the gaps in the Takeover Measures 2002, such as permission for partial bids, more methods of payment and more efficient systems of information disclosure. The measures were developed in accordance with relevant takeover provisions of the Company Law, the Securities Law and several other administrative regulations and departmental rules. Those provisions, which were previously spread through numerous regulations, have been unified under a single piece of legislation. This has significantly expanded the takeover provisions of Chapter 4 in the Securities Law, and thus covered a wide range of possible situations in various takeover transactions. The focus here is on the Takeover Measures 2006, with a brief introduction to the relevant provisions of Chapter 4 of the Securities Law to Chinese takeover regulations. The discussion of the Takeover Measures 2006 centres on the substantial changes it made to the new takeover regime in China.

In order to ensure that the takeover activities of listed companies are well regulated, a special internal committee known as the Takeover Committee was established by the CSRC. It is composed of professionals and experts in the takeover area to provide consultancy opinions about takeover regulation at the request of the functional department of the CSRC.[555] The opinions are mainly about whether or not the takeover for a listed company is constitutional, whether or not there is any circumstance under which a listed company may not be taken over, and other relevant matters.[556] It should be noted that the Takeover Committee, unlike the case in the UK, was not established as an

---

[555] Takeover Measures 2006, art 10.
[556] Takeover Measures 2006, art 10.

independent body, but was established under the jurisdiction of the CSRC, leaving the CSRC as the ultimate enforcement agent to make the final decision.

As discussed previously, takeover by agreement will still be the main method to gain control of a listed company for the foreseeable future in China. However, following the shareholding structure reform of 2005, a more diverse shareholding structure for Chinese listed companies has begun to emerge, resulting in an increasing number of takeovers by offer to acquire shares in the listed company. The commitment of Chinese policy makers to a functional takeover regulation is the response to this trend. The Takeover Measures 2006 set up a new takeover regime which puts a clear emphasis on takeovers by 'tender offer' and introduces a whole chapter on how to conduct a tender offer. When discussing the tender offer rules, it is presupposed that the target company has a widely distributed shareholding structure and that its shares are freely transferable without takeover barriers. This is central to an understanding of the tender offer process and illustrates the fundamental conflict between target management and shareholders.[557]

3. Shareholder Protection Rules

In line with the principles of openness, fairness and equality set out in the Takeover Measures 2006,[558] there is a set of provisions in Chapters 2 and 3 of the Measures on how the takeover of listed companies should be conducted. Without any doubt, the protection of equal opportunities for shareholders is a central part of these provisions.

[557] Burkart and Panunzi (n82) 740.
[558] Takeover Measures 2006, art 3.

3.1 Sufficient Information to the Market

It is generally recognised that an investor is required to make an adequate and timely disclosure of his interests in a listed target company, to provide the market with an early warning of possible takeovers. Accordingly, the Takeover Measures 2006 enacted a series of provisions requiring information, sufficient for the target shareholders to make an informed decision, to be available.

3.1.1 Disclosure of Substantial Shareholdings

Information disclosure about the ownership of listed companies, also called disclosure of substantial shareholdings, can be found in the takeover laws of most jurisdictions, including the UK and US. In China, the CSRC has promulgated the disclosure rules under Chapter 2 of the Takeover Measures 2006, in accordance with Article 86 of the Securities Law, by requiring acquirers to disclose certain information when they increase their stake in the company. The Measures provide detailed rules to implement Article 86 of the Securities Law.

According to Article 86 of the Securities Law, when an investor increases his shareholding in a listed company to 5%, by open-market purchase or private agreement, a disclosure is required. The investor must disclose his position by submitting a written report to the CSRC and the stock exchange, and notify the listed company and the public, within three business days from the date when such shareholding arises. During this period of time, the investor is prohibited from purchasing or selling shares of the listed company until the market is informed.[559] Furthermore, if the subsequent shareholding increases or decreases to reach 5%, this must be disclosed each time in the same manner;

[559] Securities Law, art 86.

the investor is not allowed to trade the relevant shares within the disclosure period or within two days thereafter.[560] As a result, the investor must stop his purchase and fulfil the disclosure obligation when his shareholding in the target company reaches 5%, 10%, 15%, 20%, 25% and 30%. When the 30% threshold is triggered, a MBR will apply. (This rule will be discussed in detail below.)

3.1.2 Tender Offer Report

In addition, under Article 28 of the Takeover Measures 2006, the CSRC requires a bidder to disclose certain information before an offer on the takeover of a listed company is actually launched. The information needing to be fully disclosed is stipulated in Article 29; it includes all the information vital for target shareholders to make a decision, and other items required by the CSRC, such as the purpose of the takeover, the number of shares to be acquired, the period open for the takeover bid, the offer price and the payment arrangements. Bidders intending or required by law to launch an offer must submit a tender offer report to the CSRC.

This report will ultimately serve as the basis on which the CSRC decides whether to allow the bidder to launch the offer, as prescribed by the Takeover Measures 2006. The bidder may announce its offer only if the CSRC has 'expressed no objection' within 15 days of submission of the report.[561] During this period, the CSRC will notify the bidder if it finds that the report does not comply with the provisions of the relevant laws and administrative regulations, or presents a threat to national security or the public interest.[562] Article 41 further requires that if there is a significant change in the basic facts disclosed in the tender offer report, the bidder should submit another written report to the

[560] Securities Law, art 86.
[561] Takeover Measures 2006, art 28.
[562] Takeover Measures 2006, art 28.

CSRC and make an announcement within two working days of the occurrence of the significant change.

3.2 Equal Treatment of Shareholders

As in the UK and US, there is a set of rules in the Takeover Measures 2006 to ensure that all shareholders are treated equally in the process of takeovers. Under Article 37, the offer shall be kept open for no less than thirty days and no more than sixty days after the offer is launched (except where there is a contested offer) to avoid shareholders making a hasty decision. It further provides that during the acceptance period prescribed in the offer, the purchaser cannot cancel the offer. If the purchaser wants to change the terms of the offer, the approval of the CSRC is required[563] and variation cannot occur within the fifteen days prior to the expiration of the bid unless the offer is contested.[564] In addition, the target shareholders can withdraw their acceptance up to three days before the expiration of the bid.[565] During the acceptance period, the bidder is also prohibited from purchasing or selling any shares in the target company through any means or under other terms not specified in its offer.[566]

3.2.1 Bid Prices and Methods of Payment

Previously, under the Takeover Measures 2002, the offer prices for non-tradeable and tradeable shares had to be set differently. Holders of tradeable shares usually purchased the company's shares at a much higher price than holders of non-tradeable shares.[567] The

---

563 Takeover Measures 2006, art 39.
564 Takeover Measures 2006, art 40.
565 Takeover Measures 2006, art 42.
566 Takeover Measures 2006, art 38.
567 *See* Xianying Quan and Bin Hu, 'A Legal Analysis of the Shareholding Structure Reform' (2006) Annual Report on China's Financial Law 380, 383-86. Historically, when SOEs become listed, the non-tradeable shares were converted into the shares of a listed company based on the Net Asset Value. The CSRC required that one RMB of net assets

offer price for non-tradeable shares was determined with reference to the most recent audited book net asset value per share of the target company, while tradeable shares were bought and sold on the stock exchange with a premium to the net asset value.[568] The reason for these regulations was to try to avoid any loss in value of state-owned assets during the takeover period. However, if shares did not trade at their market value, this could distort the takeover market if market value exceeded book value; the existing owners of tradeable shares would lose out because new buyers of non-tradeable shares would effectively obtain their shares at a discount. In the case of Hengtong Investment Ltd's acquisition of Shanghai Lingguang Ltd in 2004, the transfer price of non-tradeable shares was 4.3 RMB while the individual shares traded on the stock exchange were around 13 RMB.[569]

In light of the 2005 shareholding structure reform, the Takeover Measures 2006 adopted a uniform rule for price setting by requiring that the proposed price for the shares could not be lower than the highest price paid by the bidder for the target company's shares in the six months preceding the date on which the bidder published the tender offer report.[570] This would actually raise the offer price of what were originally non-tradeable shares converted into tradeable ones, as on average market value consistently and significantly exceeded book value on the Chinese stock market.

Moreover, the Takeover Measures 2006 extended the consideration that could be offered in the takeover of a listed company from the previous cash only to securities (shares or debentures), a combination of cash and securities, or any other lawful method, and the

---

should be converted into at least a 0.65 shares, which means that not-tradeable shares cost less than 1.54 RMB (1/0.64) per share, while the price for tradeable shares was based on the market price.

[568] Takeover Measures 2002, art 34.

[569] Chen Gong and others, *Principles and Cases of Corporate Mergers and Acquisitions* (Renmin University Press 1996) 63-8.

[570] Takeover Measures 2006, art 35.

financial advisor responsible for this transaction should claim that the purchaser had the financial ability to make the offer.[571] However, it should be noted that the payment had to be made in cash if the purchaser launched a general offer with the purpose of delisting a listed company,[572] or launched a general offer because the CSRC had rejected his application for waiver; also, if the consideration was paid in legally transferable securities, the acquirer should provide the target shareholders with the opportunity to choose cash instead of securities.[573]

3.2.2 General Offer and Partial Offer

A general offer is an offer made to all shareholders of the listed target company for all the shares, while a partial offer is defined as an offer made to all target shareholders for less than the whole of the target listed company's issued shares. Under the Takeover Measures 2002, the takeover bid had to be a full bid. In 2005, with a view to providing potential acquirers with greater flexibility and reducing the costs associated with takeover transactions, the Securities Law introduced the concept of the partial bid.[574] According to Huang, the partial offer serves an economic function by benefiting bidders, because it allows a bidder to obtain corporate control with a considerably smaller funds than would be the case with a general offer.[575] The adoption of partial offers also confirms the Chinese government's ongoing commitment to accelerating the control shifts and promoting a more active takeover market to solve the corporate governance problems.

---

[571] Takeover Measures 2006, art 36.
[572] According to the listing rules, there are a number of requirements on a company to be listed, one of which is that the publicly held shares in a company must account for more than 25% of all outstanding shares, and if the total amount of the issued capital of the company exceeds RMB 400 million, then the publicly held shares must be more than 10%. *See* Securities Law, art 50.
[573] Takeover Measures 2006, art 27.
[574] Security Law, art 88.
[575] Huang (n543) 167

In conformity with the Securities Law, the Takeover Measures 2006 set out detailed provisions on how to conduct a partial takeover by stipulating that if an investor was voluntarily to acquire the shares of a listed company by means of an offer, it could issue to all shareholders of the target company an offer to acquire all of the shares held by them or an offer to acquire only some of the shares held by them.[576] This means that bidders are allowed to choose between a general or partial offer as a strategy to acquire a listed company. It is further required that if a bidder receives acceptances for a greater number of shares than specified in the offer of the partial bid, each acceptance should be redeemed on a pro rata basis.[577]

In order to avoid abuse, the Takeover Measures 2006 requires that in any event, if a purchaser acquires the shares of a listed company by means of a partial offer, the proportion of shares that are planned to be purchased shall be more than 5% of the issued shares of the target listed company.[578] This requirement is to prevent the use of partial bids to commit market manipulation or insider trading, because the threshold of 5% relates to the significant information disclosure obligation.[579]

3.2.3 Mandatory Bid Rule

The MBR which is central to the City Code in the UK has also been adopted in China, although it does not exist in the US. The MBR requires a bidder who acquires a large block of target shares to make a general offer for all shares of the target company.

Under Article 88 of the Securities Law, it stipulates:

---

[576] Takeover Measures 2006, art 23.
[577] Takeover Measures 2006, art 43.
[578] Takeover Measures 2006, art 43.
[579] Explanatory Memorandum, para 3(6).

> Through securities trading at a stock exchange, an investor holds or holds with any other person by means of agreement or any other arrangement 30% of the shares issued by a listed company and if the purchase is continued, he shall issue a tender offer to all the shareholders of the said listed company to purchase all of or part of the shares of the listed company.

The CSRC set up more detailed provisions to implement the MBR in the Takeover Measures 2006. No matter whether the takeover is conducted by means of offer or agreement, all the methods of acquiring more than 30% of the shares in a target listed company may trigger the MBR. However, under the context of takeover by agreement, the obligation to launch a mandatory bid can be waived under certain circumstances subject to CSRC approval. Article 96 of the Securities Law gives the CSRC discretion to decide when and how to exempt a bidder from the MBR. The Takeover Measures 2006 restate that if, by means of agreement, the 30% threshold is reached, any further acquisition must be made by general or partial tender offer unless an exemption is obtained from the CSRC.[580]

Article 47 of the Takeover Measures 2006 deals with the MBR in the case of takeover by agreement in two separation situations. If acquisitions result in holding 30% of the target company's issued shares and the acquirer continues to acquire shares, it should put a general offer or partial offer to all the shareholders of the target company, unless an exemption is obtained from the CSRC. If an acquirer who intends to acquire more than 30% of the target company's shares by agreement shall acquire the portion that exceeds 30% by way of an offer, unless an exemption is issued by the CSRC. If the acquirer fails to obtain the exemption but intends to execute the takeover agreement or the acquirer

[580] Takeover Measures 2006, art 47.

does not apply for an exemption, a general offer must be made before implementation of the takeover agreement.[581]

Pursuant to the Takeover Measures 2006, exemption is normally granted upon grounds mainly related to the following circumstances: the transfer will not cause a change in the de facto controlling person of the listed company; the listed company faces great financial difficulties, the rescue plan proposed by the acquirer has been approved by the company's shareholders, and the acquirer undertakes not to transfer the shares for a minimum three-year period; a private placement of shares with the acquirer causes his or her shareholding to exceed 30% of the company's issued share, the acquirer promises not to transfer the shares for a three-year period and the shareholders support the exemption application.[582]

The CSRC sets up two ways of applying for exemption. Other than the normal process where the matter is complicated (the decision should be rendered within 20 days of receiving the application)[583], the Takeover Measures 2006 provide a simple procedure to allow quicker processing (the CSRC must render a decision within five days of application) where crossing the 30% threshold appears to be technically caused by non-takeover activities such as repurchase of shares, inheritance, underwriting arrangements and other circumstances deemed by the CSRC as necessary.[584] If the bidder fails to be granted the simple procedure, it should either reapply for exemption through normal procedure or fulfil the mandatory bid obligation.

Furthermore, in accordance with the Takeover Measures 2006, the MBR also applies to indirect takeovers, which refers to the situation where although an investor does not itself

---

[581] Takeover Measures 2006, art 47.
[582] Takeover Measures 2006, art 62.
[583] Takeover Measures 2006, art 62.
[584] Takeover Measures 2006, art 63.

take over a listed company by directly acquiring its shares, it gains the control by other means, such as private agreement, investment relationship or any other arrangement.[585] For instance, an investor can indirectly take over a target company by acquiring control of a controlling shareholder of the target company. In addition, the concept of control is clarified by defining that an investor controls a listed company if he has more than a 50% shareholding, can exercise 30% of voting rights, or otherwise has the capacity to determine the election of more than half of the directors or the outcome of decisions of a shareholders' meeting.[586]

4. Directors' Duties and Takeover Defences

When facing a hostile takeover, the target board is more likely to employ a takeover defence against the unwanted bid regardless of whether the offer is beneficial to the shareholders. As a result, nearly all the takeover regulations impose duties on the directors to avoid the abuse of their power at the cost of shareholders' interests. With regard to the controversial issue raised between the UK and US takeover laws, namely, whether the power to accept or reject a takeover bid is in hands of shareholders or directors, the Chinese legislation has adopted rules similar to those of the UK's City Code.

4.1 Directors' Fiduciary Duties

In spite of the fact that China does not belong to the common law system, Chinese legislators did codify and adopt the fiduciary duty, an important notion from Western countries, not only in company law but also in securities law, bankruptcy law and other related measures. The general fiduciary duty of directors is stipulated in Article 148 of the

---

[585] Takeover Measures 2006, art 56. The Takeover Measures 2006 adds a new chapter V to specifically regulate indirect takeovers.
[586] Takeover Measures 2006, art 84.

Company Law by stating that the directors shall bear the obligations of loyalty and diligence to the company. The specific actions which are prohibited against duty of loyalty are set forth in Article 149(1) - (8) of the Company Law.

In the context of takeovers, Article 8 of the Takeover Measures 2006 also contains fiduciary standards that govern the behaviour of the target board by requiring that the directors, supervisors and senior managers of the target company have to meet their duties of loyalty and diligence to the company and shall treat fairly all the acquirers who intend to take over the company.[587] It further requires that the target board's adoption of any decisions and measures with regard to takeovers should be beneficial to the interests of the company and its shareholders. In particular, there are three actions which are clearly prohibited: posing any improper obstacles to the attempted takeovers by abuse of power; providing any forms of financial aid to the acquirers by using the resources of the target company; and damaging the lawful rights and interests of the target company and its shareholders.

4.2 Directors' Role in Takeover Defences

Pursuant to the Takeover Measures 2002, the takeover defences used by the target board may not damage the legal rights and interests of the target company and its shareholders. After a public announcement of intention to take over a target company, Article 33 specifically prohibited the target directors from taking six commonly used defensive actions, such as issuing new shares and convertible bonds, buying back its own shares, or amending the company's articles of association, under any circumstance.[588] This

[587] Takeover Measures 2006, art 8.
[588] Takeover Measures 2002, art 33.

provision had been strongly criticised as both over-inclusive and under-inclusive.[589] It cannot be right to simply conclude that the six listed defences would damage the interests of the target company and its shareholders in any circumstance. It left no room to assess whether employed defences were appropriate in specific circumstances. On the other hand, it was even harder to argue that, other than these six listed defences, the directors could be allowed to use any defence when facing a hostile takeover. As Huang has argued, the legislator's intention to prohibit the target board from abusing takeover defences cannot be fulfilled because it is still able to employ other non-prohibited defensive measures to deter the proposed offer.[590]

In response to this rigid provision, the Takeover Measures 2006 made some significant changes by stipulating that, after the bidders announce the offer and until the offer expires or is completed, the target company may only continuously engage in normal business operations and implement the resolutions made by the shareholders' meeting. Specifically, without the approval of the shareholders' meeting, the target company's directors are not permitted to take measures such as disposing of the company's assets, making outward investment or changing the main business activities, providing guarantees or loans, to make a significant impact on the assets, liabilities, rights and interests or business outcome of the company.[591] Also, no director of the target company is allowed to resign during the course of the takeover offer.[592]

Moreover, the law does not require the target board to be passive towards shareholders when facing a takeover bid. Article 32 of Takeover Measures 2006 requires that the target board shall take the following actions when facing a takeover bid: making investigation

[589] Huang (n2) 170.
[590] Huang (n2) 177.
[591] Takeover Measures 2006, art 33.
[592] Takeover Measures 2006, art 34.

into the capacity, credit status and purpose of takeover of the acquirer, analysing the conditions for tender offer, bringing forward advice on whether or not the shareholders should accept the offer, and employing an independent financial consultant to issue a professional opinion. If the acquirer makes any major changes to the conditions of his offer, the target board should accordingly give its supplementary opinions within three working days.[593]

Although the Takeover Measures 2006 prohibit the target board from using any defensive measures without the shareholder approval during the period of takeover offer, there is no provision governing the defences intended to impede the takeover bid in advance. Theoretically speaking, these pre-bid defences, such as poison pill, staggered board, gold parachute and voting rights restrictions, can be added to a listed company's articles of association. The only condition is that they are approved by the shareholders' meeting, because only the shareholders have the right to amend the articles of association under the Company Law. However, even before being presented to a shareholders' meeting for approval, some of the defences are not allowed under the Company Law regime.

A dual-class share structure with different voting rights attached to each class may not be used as a takeover defence under the Company Law because Article 104 provides that a shareholder shall have one voting right for each share he holds. With regard to the structure of the board, Articles 46 and 109 of the Company Law provide that the terms of the board of directors shall be provided in the articles of association, but each term shall not exceed three years. Under the Company Law, there is no provision governing the staggered structure of the board. To conform with the 2005 new Company Law, the CSRC issued amended 'Guidance for the Articles of Association of Listed Companies'

[593] Takeover Measures 2006, art 32.

(the 2006 Guidance) on 16th of March 2006. Article 96 of the 2006 Guidance provides that a director's term starts on the date when he takes up the position and ends on the date when the term of the current board of directors expires.[594] It implies that different expiry dates for the current board of directors are not allowed, and the entire board of directors will be re-elected at the same shareholders' meeting after its term expires. The staggered board, therefore, is not legally accepted as a takeover defence in the Chinese context. In the meantime, Article 96 of Guidelines also prohibits the removal of a director by a shareholders' meeting for no cause before expiry of the term of the current board. The bidder, therefore, who obtains sufficient shareholding to amend the articles of association, still has to wait to the end of the board's term to elect new directors and gain control of the target board.

It is argued that after the amended Company Law took effect in 2006, preloading anti-takeover provisions can be more feasible, as it gives more autonomy to the articles of association.[595] However, pre-bid defences are still not common in practice, and the validity of some of them is still in question. As Guo and Rizzi have explained, the reason why the validity of pre-offer defences has not yet been challenged in court is largely because the hostile takeover is still a fairly rare phenomenon in China.[596] In a famous takeover case in 2005, the leading portal operator Sina Corp has employed a poison pill to fight off a potential hostile takeover by a leading internet game operator Shanda Interactive Entertainment Ltd, by announcing that new shares would be issued to shareholders at half price in the event of anyone holding more than 10% of its shares by an acquisition. In addition, Sina established a staggered board over a three-year term. It

---

[594] All Chinese listed companies are required by the CSRC to adopt all the provisions of the Guidelines for the Articles of Association of Listed Companies into its articles of association.
[595] Guo and Rizzi (n454) 16.
[596] ibid 17.

will be interesting to see whether Shanda will challenge the legitimacy of the staggered board set up by Sina and how the court will rule on it. However, Shanda did not take any legal action against Sina's defensive measures, but sell out all its shareholding in Sina to three buyers from 2006 to 2007.

Chapter 6 Promotion of Takeovers and Non-Frustration Rule

1. Literature Review – who decides to accept or reject a takeover bid?

Over recent decades, takeovers have unarguably been one of corporate activities which have caught widespread public attention. An important aspect of takeovers is the so-called takeover defences which are employed by target directors to resist a takeover bid. Takeover defences, on the one hand, protect undervalued target companies from being controlled by an opportunistic bidder, and on the other hand prevent target shareholders from tendering their shares to obtain a premium. Most of the doctrinal and scholarly debates focus on the division of power between target directors and target shareholders in deciding whether to accept or reject an offer from a hostile bidder. Bainbridge posed the question that lies at the heart of corporate takeover jurisprudence: who ultimately has the right to allow a takeover to proceed? Is it the board, which monitors the daily business of the company, or the shareholders who actually own the company?[597]

As in the case of mergers or asset sales, the board will be approached first to discuss the possibility of a takeover. If the board rejects a proposed merger or asset sale, the shareholders will not be invited to, nor entitled to, make decisions.[598] However, the situation in the hostile takeover context is more complicated. In contrast to mergers, it is achieved by making a tender offer directly to the shareholders of the target company, and thus bypasses the incumbent management's approval.[599] In addition to the MBR, which was adopted by the UK's City Code to provide further protection for shareholders, the

---

[597] Stephen M. Bainbridge, 'Director Primacy in Corporate Takeovers: Primary Reflections' (2002) 55 Stanford Law Review 791, 792.
[598] Jennifer J. Johnson and Mary Siegel, 'Corporate Mergers: Redefining the Role of Target Directors' (1987) 136 University of Pennsylvania Law Review 315, 315.
[599] Roberta Romano, 'Competition for Corporate Charters and the Lesson of Takeover Statutes' (1993) 61 Fordham Law Review 843, 844.

extent to which the target boards can adopt defensive measures in the face of a hostile takeover is regarded as another significant distinction between the UK and US takeover law.[600]

It has been argued by Ribstein that the regulation of board defences against a takeover bid involves a 'sensitive balance' between restricting takeover defences to encourage 'a viable market for corporation control as a constraint on agency costs' and 'giv[ing] the board ultimate say on a takeover for legitimate ends'.[601] As argued above, following the development of defensive tactics in the 1970s, the board's discretion was extended to the tender offers. This development prompted wide-ranging debate over takeover defences amongst scholars, practitioners and businessmen in the1980s.

Some commentators were in favour of prohibiting defensive tactics employed by a target board without the consent of its shareholders, so that the target shareholders would be the ones who had the right to decide whether to accept the bid.[602] Other commentators favoured allowing directors to use defensive tactics to impede an unwanted takeover. They argued that the target board should at least be given some scope to slow down a hostile bid.[603] In this section, the literature on the arguments concerning this long-standing debate are reviewed and the different schools are described in more detail.

---

[600] MBR will be discussed in detail in the next Chapter.
[601] Ribstein (n209) 183.
[602] *See e.g.,* Manne (n84); Easterbrook and Fischel (n420); Easterbrook and Fischel (n40); Gilson (n87); Gilson (n347); Alan Schwartz, 'Search Theory and the Tender Offer' (1986) 2 Journal of Law, Economics, and Organization 229; Ronald J. Gilson and Alan Schwartz, 'Sales and Elections as Methods for Transferring Corporate Control' (2001) 2 Theoretical Inquiries Law 783; Bebchuk (n668); Lowenstein (n408).
[603] *See e.g.*, Martin Lipton, 'Takeover Bids in the Target Boardroom' (1979) 35 Business Lawyer 101; John C. Coffee Jr., 'Regulating the Market for Corporate Control: A Critical Assessment of the Takeover's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145; Martin Lipton, 'Pills, Polls, and Professors Redux' (2002) 69 University of Chicago Law Review1037.

1.1 Two Schools of Thought

The publishing of *Takeover Bids in the Target's Boardroom* by Lipton in 1979 instigated an intense debate on who should enjoy the ultimate authority to decide whether or not the company would be sold at a premium over market price. Shareholder primacy and director primacy are both the subject of strong arguments.

1.1.1 Shareholder Primacy

There is a large body of literature which opposes empowering target directors to resist takeovers by adopting defensive tactics, and proposes rules to constrain target company directors' actions when confronted by a tender offer.[604] This school of thought, supporting 'shareholder primacy', has assumed that tender offers are beneficial to the shareholders and should be encouraged. They believe that maximisation of shareholder wealth is the central criterion for evaluating the appropriateness of adoption of defensive measures by the target company. Shareholder primacy contends not only that 'shareholders are the principals on whose behalf corporate governance is organized', but also that 'shareholders do (and should) exercise ultimate control of the corporate enterprise'.[605]

According to Easterbrook and Fischel, takeover defences against tender offers reduce the gains to the shareholders and increase the agency costs, hence causing a general reduction in social welfare.[606] Gordon also believes that giving target company directors unlimited power to reject a hostile bid is highly undesirable because 'the potential for a hostile control transaction not only exposes management directly to the capital market but also it energizes and backstops other forms of managerial monitoring…'[607] Therefore, it is for

---

[604] *See e.g.*, Easterbrook and Fischel (n420); Jeffrery N. Gordon, 'Just Say Never?' Poison Pills, Deadhand Pills, And Shareholder-Adopted Bylaws: An Essay For Warren Buffett' (1997) 19(2) Cardozo Law Review 511; Kershaw (n181).
[605] Bainbridge (n597).
[606] Easterbrook and Fischel (n420) 1161-1204.
[607] Gordon (n604) 518.

shareholders to have the final word on how to dispose of a tender offer to the company. The UK takeover rules have always been inclined to this theory, giving the shareholders opportunity to decide on the merits of the takeover bid.

1.1.2 Director Primacy

The current US policy of 'director primacy', supported by many corporate scholars, allows directors to use defensive measures by positing that the decision whether or not to accept a tender offer is primarily for the board of directors.[608] Lipton, for example, in his classic essay, left the target company's board of directors with wide discretion when responding to a hostile tender offer, subject only to judicial review under the modest restraints of the business judgement rule, arguing that granting directors in the target company ultimate power to decide whether or not to sell the firm was beneficial for the company and its shareholders in the long term.[609]

Supporters of director primacy agreed with Lipton that it is short sighted to impose a prohibition on directors from employing defensive measures and allowing shareholders to sell whenever a substantial premium is available, as depriving boards of the ability to reject a hostile takeover would encourage management to focus on short-term performance rather than on potentially more profitable performance under a long-term strategy. Therefore, directors should have the power to use defensive tactics to resist the offer if they can justify that the company could be sold in the future for a higher price, or that the future market value of the company plus the interim dividends would mean a greater value to the shareholders than the present offer price.[610] It was believed that the

---

[608] *See* Bainbridge (n597) 803 and Davies (n378) 271.
[609] Lipton (n603) 109.
[610] ibid.

board of the target company was 'more appropriate than its shareholders to make the decision on a hostile bid and its potential change of business strategy'.[611]

1.2 Debate about Corporate Models

Different views on the nature and purpose of the corporation may explain the ongoing debate over who should have primacy to decide whether to accept or reject the tender offer.

1.2.1 Property Model

The property model suggests that the corporation is the property of shareholders, who hire directors to act as agents on their behalf to monitor the company's business. Shareholders themselves must be permitted to accept or reject a tender offer as the purpose of the corporation is the maximisation of their wealth.[612] As Easterbrook and Fischel have pointed out, shareholders are the 'sole residual claimants' in the company, entitled to the profit left over after the firm's contractual obligations have been met.[613] Apart from the directors' intention to keep their positions at the shareholders' expense, allowing the target board to freely employ defence against takeovers deprives shareholders of the fundamental rights attached to their investment in the company, and possibly of significant financial gains from tendering their shares.[614]

Thus, when faced with a hostile bid, shareholders, as the ultimate owners of the company, should have an opportunity to express their opinion on whether to sell their shares at a premium above the current market price, or to keep faith with the incumbent management by rejecting the offer. However, it is not within the directors' capacity to

---

[611] Davies (n378) 283.
[612] Allen (n89) 261-266.
[613] Easterbrook and Fischel (n40) 36.
[614] John H. Farrar, 'Business Judgment and Defensive Tactics in Hostile Takeover Bids' in John H. Farrar (ed), *Takeovers, Institutional Investors, and the Modernization of Corporate Laws* (Oxford University Press1993) 380.

make decisions as agents of the shareholders, as it is argued that the board is hired to run the business but not to make ownership decisions.[615] In response, Bebchuk has submitted that the directors should only have the power to seek out a better offer with greater value in the interests of shareholders, or to warn the shareholders that there will be an immediate loss if they tender their shares.[616]

1.2.2 Entity Model

The entity model holds the contrary opinion, viewing the corporation as a societal institution whose purpose is broader than simply maximising the shareholders' wealth. Scholars favouring the entity model see directors' decision making as fundamental, asserting that they must be permitted to employ defences on the shareholders' behalf, because creating value solely for shareholders in takeovers can be at the expense of other constituencies, particularly employees and creditors.[617] It is believed that corporate wealth is generated not solely for shareholders but also for these other constituencies. According to Gulati et al, as an economic term, the corporation is defined as 'an unique vehicle by which large groups of individuals, each offering a different factor of production, privately order their relationships so as to collectively produce marketable goods or services'.[618] That is, the company is a legal entity representing a complex set of contractual relationships.[619] As a result, shareholders do not own the company, as the company in fact is not something that is capable of being owned by anybody.

---

[615] John C. Coffee Jr. and Louis Lowenstein and Susan Rose-Ackerman, *Knights, Raiders, and Targets: the Impact of the Hostile Takeover* (Oxford University Press1988) 54.
[616] Bebchuk (n410) 1028-1030. *Also see*, Ronald J. Gilson and Reinier Kraakman, 'Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?' (1989) 44 Business Lawyer 247, 247.
[617] *See e.g*., Morey W McDaniel, 'Bondholders and Corporate Governance' (1986) 41 Business Lawyer 413; Andrei Shleifer and Lawrence H. Summers, 'Breach of Trust in Hostile Takeovers' in Alan J. Auerbach (ed), *Corporate Takeovers: Causes and Consequences* (University of Chicago Press1998); William W. Bratton, 'Corporate Debt Relationships: Legal Theory in a Time of Restructuring' (1989) Duke Law Journal 92.
[618] G. Mitu Gulati and William A. Klein and Eric M. Zolt, 'Connected Contracts' (2000) 47 UCLA Law Review 887.
[619] Eugene F. Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of Political Economy 288, 290.

This school of thought believes that corporate success cannot be achieved without decades of investment from all the constituencies, including employees, creditors and communities. They are important to the efficient functioning of the corporation and thus their interests are entitled to be considered by boards of directors. The incentives for them to make a contribution to the company will be significantly reduced if their contributions are likely to be expropriated unfairly when the shareholders sell the company at a premium.[620] As Lipton has stated, allowing shareholders to decide whether or not a company should be sold 'would have a fundamental impact on the way in which corporations operate'.[621]

The entity model proposes that directors, serving as a mediating body, are acting as faithful trustees who can balance the interests of all parties according to the company's overall interests and generate the most benefit for all concerned.[622] In the face of a hostile takeover, it is wise to let the directors make decisions based on consideration of the interests of the constituencies. As Davies has argued, the protection of the position of the incumbent management is regarded as 'a proxy for the protection of non-shareholder interests affected by the takeover'.[623] It is therefore suggested that the directors, having a duty not only to the shareholders but also to other constituencies, should exercise an independent power and need not bend to the demands of the shareholders as long as the directors believe that the corporation's best interests are served.[624]

---

[620] Raghuram G. Rajan and Luigi Zingales, 'Power in A Theory of the Firm' (1998) 113 Quarterly Journal of Economics 397, 392.
[621] Lipton (n603) 110.
[622] Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia Law Review 248, 291.
[623] Paul L. Davies, 'Shareholder Value', 284.
[624] Martin Lipton, 'Corporate Governance in the Age of Finance Corporatism' (1987) 136 University of Pennsylvania Law Review 1.

1.3 Debate about Directors' Role

Even among those who advocate curtailment of the target directors' power to use defensive measures, there are divergent views on the role directors should play when faced with a hostile bid. In allowing target shareholders to decide whether to accept or reject a hostile takeover, it is contended that the target board could just be passive or could actively launch an auction in response to a hostile bid.

1.3.1 Passive Role

This view not only opposes the adoption of takeover defences by the directors, but also advocates a purely passive role for target company directors when confronted by a hostile takeover; the use of any forms of defence hinders shareholder wealth maximisation.[625] Easterbrook and Fischel have supported the passive role by stating that 'any strategy designed to prevent tender offers reduces welfare' because 'shareholders lose whatever premium market value the bidder offered or would have offered, but for the resistance or the prospect of resistance.'[626]

The basic rationale for this view is that allowing directors to auction the company will have the effect of discouraging takeovers and will reduce the benefits from takeovers in the long term. The bidders who generally initiate the tender offer have substantial search costs in identifying targets. As Easterbrook and Fischel have argued, 'if there is no first bidder there will be no later bidders and no tender premium'.[627] Forcing bidders to compete in an auction will make subsequent bidders take a free ride on the first bidder's search efforts and diminish their gain from the takeover, because no bidder is willing to

---

[625] *See e.g.*, Frank H. Easterbrook and Daniel R. Fischel, (n420); Frank H. Easterbrook and Daniel R. Fischel, 'Auctions and Sunk Costs in Tender Offer' (1982) 35 Stanford Law Review 1; Frank H. Easterbrook and Daniel R. Fischel, 'Corporate Control Transactions' (1982) 91 Yale Law Journal 698.
[626] Easterbrook and Fischel (n420) 1194-95.
[627] ibid 1179.

acquire a target company by paying a price almost as high as the shares would be worth under the best management.[628]

Consequently, instigating an auction will reduce the bidders' incentive to search for poorly managed targets and engage in takeover transactions, because the process of monitoring and bidding becomes less profitable.[629] The decreased probability that a hostile takeover will be made, thus increases agency costs and reduces social welfare in general.[630] It is also suggested that 'the whole process of defending takeovers even to pursue a higher premium is socially wasteful, including the amount the target directors spend in adopting defensive tactics and the amount the bidders spend to overcome the resistance'.[631] The supporters of this view simply prefer to let the initial bidders buy the target company at the premium they intend to pay and avoid competition with other subsequent bidders.

1.3.2 Auctioneering Role

This view similarly prohibits the power of the target directors to use takeover defences, except to the extent that competing bidding is achieved. It rejects a totally passive role for directors and favours a rule of auctioneering by allowing the directors to take action to trigger a competitive bid and increase the premium paid to the target shareholders.[632] The basic rationale for this view is based on the assumption that the bidder's offer price is inadequate compared to the 'true' value of the company, and the target directors believe that they are likely to obtain a higher offer for its shareholders in the future.[633] As a result,

---

[628] Easterbrook and Fischel (n40) 174.
[629] Schwartz (n602) 231.
[630] David P. Baron, 'Tender Offers and Management Resistance' (1983) 38(2) Journal of Finance 331, 332.
[631] Easterbrook and Fischel (n40) 1175.
[632] *See* Bebchuk (n410); Lucian Arye Bebchuk, 'The Case for Facilitating Competing Tender Offers: A Reply and Extension' (1982) 35 Stanford Law Review 23; Gilson (n87); Ronald J. Gilson, 'Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense' (1982) 35 Stanford Law Review 51.
[633] Baron (n630) 331.

if the target board is allowed to find a white knight to enter a competing bid, target shareholders will have an opportunity to receive a price as close to the true value of their shares as possible. Without the possibility of an auction, although shareholders have a common goal in pursuing the highest price to trade their shares, they do not have the mechanism to carry this out.

Supporters of this rule also believe that auctioneering by the target board to seek a competing bidder can solve the problem of coercion associated with two-tier bids.[634] If a target board is able to seek a white knight to enter a bidding competition, the initial bidder cannot easily acquire a blocking position in the target company by threatening the shareholders with the plan of a subsequent squeeze-out merger. As Bebchuk has argued, by instigating the competition, each bidder will be forced to offer a premium reflecting his best capacity to use the target company's resources, which is closest to the real value of the target shares.[635] As a result, the target shareholders will have an opportunity to receive a higher price for their shares without being coerced into tendering, even if they think the offer price is inadequate.

The advocates of the auctioneering rule acknowledge the risk that the initial bidder will lose the takeover to a higher bidder if the initial bidder is outbid, but assert that they can still obtain some gains by purchasing a substantial amount of shares in the target company prior to announcing its takeover intentions, and simply tendering their pre-offer purchases of the target company's shares to their competitor or to the market at a profit.[636] According to Gilson, 'the possible welfare losses from reduced incentives to make the

---

[634] Aniano Luzung, 'Should Directors be allowed to Use Takeover Defensive Measures (1993) 12 University of Tasmania Law Review 75, 82.
[635] Bebchuk (n410) 1039-41, 1044-46.
[636] Bebchuk (n410) 1035.

initial offer are offset by the efficiency gains that are realised when the target is allocated to the investor that values it most highly'.[637]

1.4 Empirical Studes

Takeover bids have been known to affect the value of the target company before and after the bid is completed, whether it is successful or not. Many empirical studies have been carried out to assess the effects of takeovers themselves and of takeover defences on the wealth of target shareholders.

1.4.1 Expected returns to target shareholders from takeovers

A few empirical researchers have suggested that target shareholders do obtain significantly positive returns from a successful takeover bid.[638] In the US, Jensen and Ruback reviewed 13 studies that looked at returns after takeovers were announced and reported an average excess return of 30% to target shareholders in successful tender offers from 1958-1981; Jarrell and Poulson found 28.9% from 1963-1986; Andrade, Mitchell and Stafford suggested 23.3% from 1973-1998.[639] In the UK, Franks and Harris found 25.8% from 1955-1985; Limmack suggested 33% from 1977-1986; and George and Renneboog 29.3% from 1993-2000.[640]

---

[637] Gilson (n87) 871.

[638] *See e.g.*, Peter Dodd, 'Merger Proposals, Management Discretion and Stockholder Wealth' (1980) 8 Journal of Financial Economics 105; Peter Dodd and Richard Ruback, 'Tender Offers and Stockholder Returns: An Empirical Analysis' (1977) 5 Journal of Financial Economics 351.

[639] Michael C. Jensen and Richard Ruback, 'The Market for Corporate Control: the Scientific Evidence' (1983) 11 Journal of Financial Economics 5, 10; Gregg A. Jarrell and Annette B. Poulsen, 'The Returns to Acquiring Firms in Tender Offers: Evidence from Three Decades' (1989) 18(3) Journal of the Financial Management Association 12, 16; Gregor Andrade and Mark Mitchell and Erik Stafford, 'New Evidence and Perspectives on Mergers' (2001) 15(2) Journal of Economic Perspectives 103,110.

[640] Julian R. Franks and Robert S. Harris, 'Shareholder Wealth Effects of Corporate Takeovers: The U.K. Experience 1955-1985' (1989) 23 Journal of Financial Economics 225, 232-3; Robin L. Limmack, 'Corporate Mergers and Shareholder Wealth Effects' (1991) 21 Accountant and Business Research 239, 245; Marc Goergen and Luc Renneboog, 'Shareholders Wealth Effects of European Domestic and Cross –Border Takeover Bids' (2004) 10 European Financial Management 9, 23.

Empirical research, though far from conclusive, also suggests that takeover defences which are not subject to shareholder approval are more likely to be harmful to shareholder wealth than those which require shareholder approval. Indeed, this view that takeover defences reduce the wealth of target shareholders has gained support from legal scholars.[641] A study by Bebchuk et al, which is frequently cited, analysed a five-year sample of hostile takeover bids and found the defences adopted by target boards made hostile bids significantly less likely to succeed; the average returns of target company shareholders in the nine months following a hostile bid were reduced by 8-10% compared with the returns to shareholders in target companies without these defences.[642] Easterbrook and Jarrell examined the evidence from financial economics and concluded that successful takeover defences deprived target shareholders of appreciation gains of 15% to 52% of the value of target shares.[643]

Mikkelson and Partch found evidence that corporate turnover significantly declined from 33% in frequent hostile takeover periods to 17% in times of infrequent hostile takeovers. Even more important, the decline in the turnover rate was significantly more notable in poorly performing firms.[644] Research by Jarrell et al concluded that the returns to shareholders from takeover transactions greatly outweighed the costs to other constituencies.[645] From the other perspective, Bradley, Desai and Kim examined 112 unsuccessful tender offers between 1963 and 1980 and reported that cumulative abnormal returns were lower for targets that remained independent than for those that were later

[641] *See e.g*., Lucian Arye Bebchuk, 'The Case Against Board Veto in Corporate Takeovers' (2002) 69 University of Chicago Law Review 973; John C. Coates IV and Guhan Subramanian, 'A Buy-Side Mode of Lockups: Theory and Evidence' (2000) 53 Stanford Law Review 307; Robert B. Thompson and D. Gordon Smith, 'Toward A New Theory of the Shareholder Role: 'Sacred Space' in Corporate Takeovers' (2001) 80 Texas Law Review 261.
[642] Bebchuk and Coates IV and Subramanian (n52) 887.
[643] Frank H. Easterbrook and Gregg A. Jarrell, 'Do Targets Gain from Defeating Tender Offers' (1984) 59 New York University Law Review 277, 292.
[644] Wayne H. Mikkelson and M. Megan Partch, 'The Decline of Takeovers and Disciplinary Managerial Turnover'(1977) 44 Journal of Financial Economics 205, 205-207.
[645] Gregg A. Jarrell and James A. Brickley and Jeffiry M. Netter, 'The Market for Corporate Control: The Empirical Evidence Since 1980' (1988) 2 Journal of Economic Perspectives 49, 54-58.

sold.[646] The empirical evidence provided by Subramanian also showed that takeover defences do not necessarily lead to higher premiums, considering the costs and asymmetric information in hostile bids.[647]

1.4.2 Expected returns to target shareholders from takeover defence

In favouring the argument that takeovers may not create value for shareholders, a number of empirical studies have examined the economic benefits to target shareholders as a result of the defeat of a takeover bid. Using a sample of 36 hostile takeover targets from 1973 to 1979, Lipton found that the shares of more than 50% of the target companies which defeated hostile takeovers had a higher market price than the offer price after the successful defence.[648] Bradley's and Dodd and Ruback's studies indicated that the target shareholders earned positive returns in those cases in which a tender offer was unsuccessful.[649] Berkovitch and Khanna found that certain defensive strategies, such as crown jewel sales, lock-up options or litigation, which make the target company undesirable for bidders, do improve the target company shareholder's wealth.[650] Although it is often argued that the target board may use takeover defences to extract protection or compensation for themselves by deterring a proposed takeover, Coates's studies indicated that these defences significantly increased the premium the target shareholders received in the event that the takeovers were completed successfully.[651]

---

[646] Michael Bradley and Anand Desai and E.Han Kim, 'The Rationale behind Interfirm Tender Offers: Information or Synergy?'(1983) 11 Journal of Financial Economics 183, 183-206.
[647] Guhan Subramanian, 'Bargaining in the Shadow of Takeover Defenses' (2003) 113 Yale Law Journal 621, 634.
[648] Lipton (n603) 101.
[649] *See* Michael Bradley, 'Interfirm Tender Offers and the Market for Corporate Control' (1980) 53 Journal of Business 345; Dodd and Ruback (n638).
[650] Elazar Berkovitch and Naveen Khanna, 'How Target Shareholders Benefit from Value-Reducing Defensive Strategies in Takeovers' (1990) 45 Journal of Finance 137.
[651] John C. Coates IV, 'Empirical Evidence on Structural Takeover Defenses: Where Do We Stand?' (2000) 54 University of Miami Law Review 783. *Also see* Robert Comment and G. William Schwert, 'Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures' (1995) 39 Journal of Financial Economics 3.

1.4.3 Concluding Remarks

Shareholder primacy generally contends that shareholders are the principals on whose behalf corporate governance is organised, and that they exercise ultimate control of the corporation.[652] The property model argues that shareholders are the owners of the corporations and that maximising shareholder wealth is the best way to maximise the value of the firm as a whole. Thus, managers should be passive and let shareholders decide whether to tender. In the director primacy model, the board of directors is not a mere agent of the shareholders, and centralised decision making is regarded as an essential attribute of efficient corporate governance.[653] Entity modellers also take the view that the company is serving not only the interests of shareholders but also of the company's constituencies, including employees, suppliers, creditors, customers, and even the interests of the local community. Thus, it is claimed that the target board of directors and not the shareholders should have the power to make the final decision on a takeover bid.

The contestants in this debate were unable to reach any middle ground, not only because of ideological differences between the two sides of the arguments, but also because of generally satisfactory results achieved by both the City Code in the UK and the current Delaware laws in the US.[654] The UK has adopted a notable approach to regulating takeovers, favouring shareholder primacy. In the US, shareholder primacy has been far more successful in theoretical debates than in actual practice, and the Delaware courts hold that the company is under the control of its directors.

---

[652] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439.
[653] Stephen M. Bainbridge, *Corporate Law and Economics* (Foundation Press 2002) 199.
[654] William T. Allen and Jack B. Jacobs and Leo E. Strine, Jr., 'The Great Takeover Debate: A Meditation o Bridging the Conceptual Divide' (2002) 69 University of Chicago Law Review 1067, 1067.

Looking at the vast amount of empirical investigation, there is ample evidence to indicate the positive and negative effects of takeover defences on shareholders' returns. This empirical data has been used by each individual school of thought to support its own side of the debate. On the one hand, curtailment of directors' ability to resist a takeover bid would have an adverse effect on long-term development of the company and therefore damage the economy. On the other hand, allowing directors to employ defensive tactics could have a detrimental effect on managerial entrenchment and destruction of shareholder value. It is difficult to conclude which result is more convincing than the other.

It can be argued that these empirical studies have failed to resolve the problem of whether the takeover regulations should curtail directors' ability to resist takeover bids by employing defensive tactics without consulting the shareholders. As Coates has stated, '[n]ot a single strong finding has been confirmed in other studies. Little or no consensus exists on why [takeover defences] are adopted or what effects they have'.[655] However, the dividing line between placing the decision for the success or failure of a takeover bid in the hands of the target managers or the shareholders seems to be a major fault-line in the design of takeover regulations.[656] It is entirely the legislator's choice to meet its own legislative purpose, in the face of the enormous amount of academic literature trying to convince legislators one way or the other.

2. Responses to the Arguments

Before assessing the appropriateness of the Chinese approach to takeover defences, it is necessary to respond to the arguments summarised in the literature review and answer the

[655] John C. Coates IV, 'Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence' (2000) 79 Texas Law Review 271, 317.
[656] Davies and Hopt (n5) 269.

question of whether a target board should be allowed to employ takeover defences without the shareholders' consent.

2.1 Takeovers as a Corporate Governance Mechanism

When deciding whether or not to allow a target board to freely use takeover defences, an important issue needing to be clarified is whether the hostile takeover is good or bad in general, and what are the functions it serves in terms of corporate governance. Takeovers, especially hostile takeovers, have long been 'interpreted as the critical corporate governance mechanism … without which managerial discretion cannot be effectively controlled'.[657] An efficient takeover market enhances corporate governance in two ways, summarised by Amour and Skeel as the 'direct' and 'indirect' benefits of hostile takeovers.[658]

Firstly, hostile takeovers are regarded as a mechanism to improve the allocation of social resources for the benefit of society as a whole, by ensuring that these resources are operated by the most capable person and thus maximise economic returns.[659] A successful bidder can improve the target company's performance by bringing better management after the bid is completed. Thus, corporate control is transferred to those who are capable of managing the assets of the target more efficiently and profitably. As Burkart and Panunzi have argued, when the incumbent management loses its comparative advantage in running the company, takeovers 'remove the inefficient managers against their will and exploit synergies between firms'.[660]

---

[657] Andrei Shleifer and Robert W. Vishny, 'A Survey of Corporate Governance' (1997) 52 Journal of Finance 737, 756.
[658] Amour and Skeel, Jr. (n118) 1734.
[659] Michael C. Jensen, 'Takeovers: Their Causes and Consequences' (1988) 2 Journal of Economic Perspectives 21, 23.
[660] Burkart and Panunzi (n82) 744.

Secondly, hostile takeovers are viewed as a disciplinary mechanism for incumbent management by giving them a stronger incentive to perform well and focus on returns to shareholders. Under the threat that the company will be acquired and that the managers will lose their jobs, target management is forced to manage the company more efficiently and thus create more value for its shareholders. As Manne has noted, the threat of a potential takeover disciplines management to serve the interests of shareholders in order to keep both their 'power and protection commensurate with their interest in corporate affairs'.[661] In other words, a company will be run in a manner closer to that of a successful bidder and will do as much as possible in order to reduce the chance of being taken over by outsiders. As a result, shareholders in general benefit from takeovers even if their company never becomes the subject of a takeover bid.[662]

2.2 Consideration of Interests of Stakeholders

Those who support abandoning the exclusive consideration of shareholders' interests and giving equal consideration to a wide range of interests of other constituencies, criticise placing the decision on takeover offers with the target shareholders and not giving substantial recognition to the interests of other stakeholders.[663]

It may be true that the fair treatment of other constituencies is instrumentally important in creating company wealth and that their interests need to be considered in a company's business plan, but it cannot be justified that establishment of the business is only to benefit other constituencies. Other constituencies should expect to be protected through contract with the corporation and specific aspects of statutory law, such as workplace safety, unemployment insurance and fraudulent conveyance law. Given such contractual

---

[661] Manne (n84) 124.
[662] Easterbrook and Fischel (n420) 1194.
[663] *See e.g.*, Charles R. T. O'Kelley and Robert B Thompson, *Corporations and other Business Associations: Selected Statutes, Rules and Forms* (Aspen 1998) 345-348.

and statutory protection, the main goal of the company is to operate to create a profit and maximise the returns for the owners of the company's equity, the shareholders.

From the potential equity investors' point of view, if they do not have the assurance that their interests will be given priority, less capital is likely to be invested in the markets. Consequently, in the long term, it is arguable that 'the social costs occasioned by the reduced incentives for investment would far outweigh any social costs incurred by other constituencies affected by takeovers.[664] As Roe has argued, 'if the company is operated based on a belief that shareholders are the only residual beneficiary, other constituencies will be overall better off and their fairness will be maximized, otherwise leaving too much discretion to management so as to protection stakeholder interests might in the end maximize neither shareholder, nor stakeholder but only management their own'.[665]

2.3 Target Board's Situation in Takeovers

It is argued that the rules of fiduciary duties and especially the duty of loyalty effectively restrict directors' ability to use their authority in their own interests. However, when a company is subject to a hostile takeover, the situation is totally different. The target board is exposed to a significant conflict of interest, loss of their jobs and the accompanying private benefits that they enjoy from their positions, against maximising the value of the company for its shareholders. Target boards may therefore have strong incentives to frustrate bids. As Strout has pointed out, the temptation which directors face is 'harder to control through classic loyalty rules' because it is not to 'steal from their firms', but to 'neglect shareholders' interests in order to keep their own jobs'.[666] Indeed, Clark has

[664] Allen and Jacobs and Strine, Jr. (n654) 1090.
[665] Mark J. Roe, 'The Shareholder Wealth Maximization Norm and Industrial Organization" (2001) 149 University of Pennsylvania Law Review 2063, 2065.
[666] Lynn A. Stout, 'Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right' (2004) 40 Business Lawyer 1435, 1453.

explained this extremely difficult situation which directors face when their company is the target of a takeover bid:

> we could well conclude that in no other context is the conflict of interest as serious as in the takeover situation. Often the managers' jobs are at stake. The temptation to find that what is best for oneself is also best for the corporation and shareholders (for example, to assert that company's stock is "undervalued" and that shareholders will eventually do better if the pending offer fails), the temptation to spend corporate resources extravagantly in the attempt to fend offer the raider (it's always easier to spend other people's money), and the temptation to sacrifice the shareholders' interests (as by paying exorbitant amounts of greenmail) must be overwhelming. No human being can be expected to resist such temptations. Nor does it matter much if a majority of directors are outside directors. They still have a social bond with the inside directors and officers, not with the diffuse public shareholders, and they may care about the status and perquisites that go along with being a director.[667]

Likewise, even if a hostile bid is the result of poor management in the target company, the use of takeover defences would enable the directors to retain control or at least to extract a favourable deal for themselves.[668] Similarly, it is argued that no matter how attractive the price offered by the bidder, for the same reasons, the target board will usually reject the offer and justify their actions on all sorts of high-sounding grounds.[669] Therefore, when facing a hostile takeover, if the target board is given power to employ defensive measures, it would be more likely to judge the offer based on the likelihood of keeping

---

[667] Clark (n367) 588.
[668] Bebchuk (n641) 993.
[669] Coffee Jr. and Lowenstein and Rose-Ackerman (n615) 54.

their positions in the target company, than on the best interests of the company and its shareholders.

Although supporters of takeover defences argue that target shareholders will obtain a higher offer price in the end if the target board is free to employ defensive tactics when confronted with a hostile takeover, there is no evidence to show that if the target board is given the power to fend off a takeover bid which they do not want, they will use this power to raise the premium for shareholders rather than to extract private benefits. As Hartzell et al reported, in takeover transactions the board may negotiate a lower premium for their shareholders if they receive private benefits in the takeovers.[670] Thus, the agency costs in a takeover situation are unlikely to be exceeded by any positive benefits to the takeover premium which may result from takeover defences.

Moreover, those who support the US approach (director primacy) claim that the board is in a better position than its shareholders to make a decision on a hostile bid, as they are well trained professionals. It is argued that the board has been delegated the authority to manage the business of the company and thus has better information than shareholders about the target's business and the bidder's prospects for the company. The response to a takeover bid for the target company is therefore regarded as part of ordinary business decision making, which belongs to directors.

This is not, however, persuasive. The decision on a takeover bid which is directly presented to the shareholders is not as a normal business decision allocated to the board to run the company. It is an investment decision for shareholders to make, on whether or not to sell their shares in a particular company. This decision affects core shareholder rights,

[670] Jay C. Hartzell and Eli Ofek and David Yermack, 'What's In It For Me? CEOs Whose Firms Are Acquired' (2004) 17 Review of Financial Studies 37, 43. *Also see* Julie M. Wulf, 'Internal Capital Markets and Firm-Level Compensation Incentives for Division Managers' (2002) 20 (2) Journal of Labor Economics S219.

the right of voting one's shares. Although the board may be more competent in making ordinary business decisions, it has no advantage over the shareholders in deciding this issue. As Davies has stated, shareholders may be just as expert in taking this kind of decision as directors.[671] Thus, allowing the board to make the decision on the shareholders' behalf is not appropriate. Shareholders should be sufficiently well informed to make their own decision based on their own investment judgment.

Furthermore, in the face of a hostile takeover offer, shareholders may make cross-purpose decisions on whether or not to sell their shares. As Weiss has pointed out, in response to a takeover bid there inevitably exists a conflict of interest between shareholders who are willing to sell their shares in order to capture the immediate premium and shareholders who plan to keep their shares in the company, either through loyalty to current management or belief in the company's long-term economic performance.[672] These two groups of shareholders present different attitudes toward the board's interference. For the shareholders who wish to tender, any resistance from the target board is unwelcome, while those who intend to retain their shareholdings in the target company will be in favour of takeover defences. Hence, it is inappropriate to let the board decide on the shareholders' behalf. The correct way is to leave shareholders to decide whether to sell their shares, without the board's interference.

2.4 Regulatory Choice on Power Allocation

Shareholders, as the primary recipients of an offer, should have the right to determine the outcome of the proposed offer. Whether or not the target directors' act for proper purpose or in good faith or for the best interest of the company in their long-term strategies is

---

[671] Davies (n378) 294.
[672] Melvyn I. Weiss, 'Tender Offers and Management Responsibility' (1978) 23 New York Law School Law Review 445, 452.

irrelevant: shareholders should have the opportunity to tender their shares to bidders who offer a premium for the transfer of control. The power to accept or reject a takeover bid should be in the hands of shareholders not only because they are the holders of the rights to residual profits and assets of the company, but also because they bear a higher risk than any other party engaged in the business.[673]

Moreover, in promoting the active market for corporate control, the bidders should also be free to put offers to the shareholders without resistance from the target board. As Davies and Hopt have noted, the takeover regulation must provide not only exit rules for shareholders but also entry rules for bidders.[674] If takeovers are beneficial to both shareholders and society in general, any measure designed to prevent bidders from launching a bid is undesirable as it reduces welfare.[675] Similarly, Kershaw has argued that takeover defences should be prohibited as they can deter 'efficient combinations that generate synergies and reduce the cost of production'.[676]

When facing a takeover bid, the target board has to be neutral and does not have the right to obstruct the bid by 'making acts of extraordinary administration just to create obstacles'.[677] If the decision were left to the target directors, their interest in keeping their own jobs and retaining the benefits associated with control would more likely outweigh their duty to act in the best interests of the shareholders.[678] This would not only decrease management's incentive to maximise the interests of shareholders but also prohibit shareholders from trading their shares freely.

[673] Report of the high Level Group of Company Law Experts on Issues Related to Takeover Bids (2002), 21.
[674] Davies and Hopt (n5) 234.
[675] Easterbrook and Fischel (n40) 173.
[676] Kershaw (n182) 267.
[677] Guo and Rizzi (n454) 16.
[678] Amour and Skeel, Jr. (n118) 13.

In order to prevent directors from using their power for self-serving purposes, the safe solution is to give the final decision on whether to accept or reject a takeover bid to shareholders themselves. This ensures a well-functioning system of corporate governance and an active market for corporate control which reduces the possibility of target board acting out of self-interest, and facilitates the replacement of inefficient or incompetent management.[679] Therefore, it can be concluded that the legal rules, in one respect, should restrict the target board's ability to resist a takeover bid in order to self-interestedly entrench itself; in another, they should allow the board to act as a negotiator and possibly auctioneer to get a higher premium for shareholders.

Allowing the target board to put the target company up for auction is argued to be beneficial to the shareholders as it increases their wealth.[680] Davies and Hopt have also suggested that this event seems unproblematic as it does not constrain the shareholders' choices but enlarges them.[681] Although the shareholders have a right to accept or reject a takeover bid, the target board should be allowed to search for a white knight for the shareholders. The target company will be allocated to the bidder who is best able to use the target assets efficiently.[682] Bidders who are willing to pay for the shift in control will gain the most added value and synergy from the takeover bids. As Gilson has argued, 'allocating resources among competing claimants by price is desirable because it places resources with the most efficient users'.[683] The target company will therefore ultimately gain from the bidding competition by being acquired by the bidder who values the company most highly.

---

[679] Liu (n199) 5.
[680] Mucciarelli (n209) 416.
[681] Davies and Hopt (n5) 237.
[682] Bebchuk (n410) 1028.
[683] Gilson (n632) 64.

3. Chinese Approach Comparing with the UK and US's

As mentioned previously, a hostile takeover raises a conflict of interest between the incumbent controllers of the target and its shareholders. In the UK and US, this is between the target directors and shareholders. When a takeover bid is imminent, these two countries apply totally different rules to address this conflict of interest.

In the US, the target management is given greater flexibility to act against potentially undesired bids by using takeover defences. The main weight of the ruling is on the general fiduciary duties owed by the target board to the shareholders as defined in Delaware case law.[684] Delaware courts apply an enhanced judicial scrutiny to target directors' actions in responding to a hostile takeover offer.[685] However, criticism of the US principle that the target board enjoys the freedom to deploy takeover defences without shareholders' consent continues. In a recent case, *Air Productions and Chemicals, Inc. v Airgas, Inc., in re Airgas Inc. Shareholder Litigation*,[686] the court confirmed that the target board's use of a poison pill in combination with a staggered board to thwart a tender offer was valid. Given the effect which the *Airgas* case may have on hostile takeovers, institutional investors, proxy advisors and shareholder representatives, seeking to achieve a healthier allocation of power between the target board and the shareholders in a hostile takeover offer, strongly suggested a court-controlled expiry date for poison pills when used in conjunction with a staggered board to fend off the tender offer.[687] They recognised the unfairness of the situation where a tender offer fails only because of the

---

[684] Dennis J. Block and Nancy E. Barton and Stephen A. Radin, *The Business Judgment Rule – Fiduciary Duties of Corporate Directors and Officers* (Clifton 1987) 85.
[685] *See Unocal Corp v Mesa Petroleum Corp* 493 A. 2d 946 (Del 1985).
[686] *Air Productions and Chemicals Inc v Airgas Inc, in re Airgas Inc Shareholder Litigation* Delaware Chancery Court, February 15, 2011 - CA Nos 5249 - CC and 5256 - CC, 16 A. 3d 48 (Del Ch 2011).
[687] *See* Bernd Delahaye (n307).

defensive tactics used by the board, even though a majority of target shareholders want to tender. However, the US has not gone as far as the UK in adopting NFR.

In the UK, the City Code imposes NFR to prevent the board of directors from taking any actions that may frustrate a potential bid without the approval of its shareholders, giving complete power as to the acceptance of a bid to the target shareholders. Johnston has argues that the NFR introduced by the City Code to restrict boards' power to employ defences is extremely important.[688] General Principle 3 of the City Code requires the board of the target company to 'act in the interests of the company as a whole and not deny the shareholders the opportunity to decide on the merits of the bid'. During the offer period, the City Code also requires the target board to avoid taking any action to frustrate the bid or deny shareholders the opportunity to decide on the merits of the bid[689] and to communicate their opinion on the offer to their shareholders.[690]

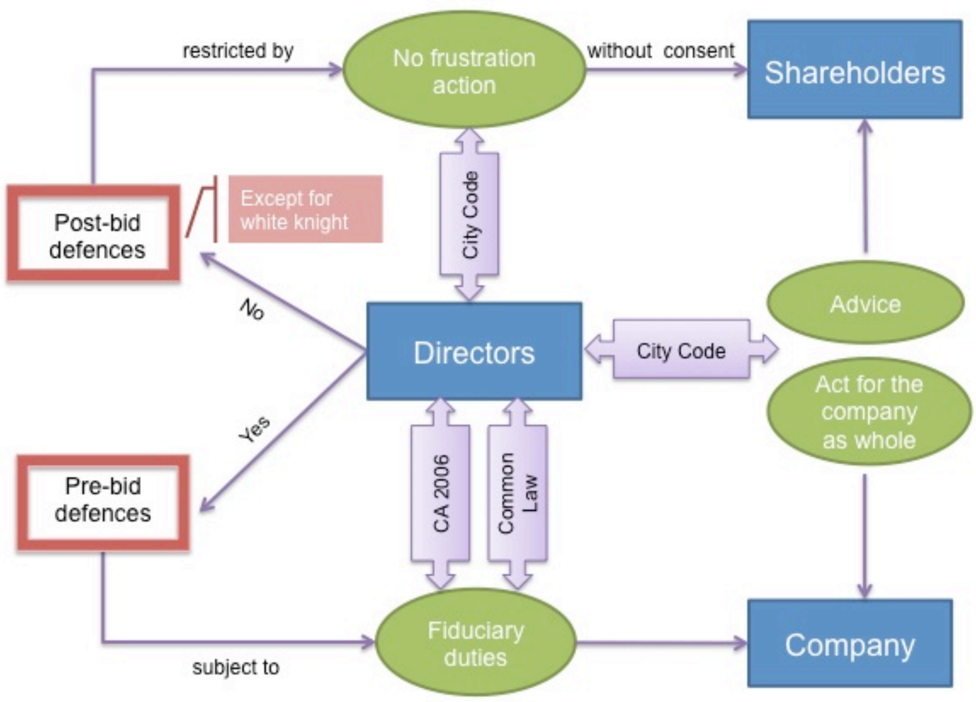
As a result, in the UK post-bid defences are forbidden without shareholder approval when a takeover bid is imminent. In using pre-bid defences, the target board is not governed by the City Code, but directors are still subject to their fiduciary duties in the common law and codified duties in the CA 2006. Moreover, the City Code insists it is the duty of the board to provide shareholders with sufficient and accurate information relating to the takeover bid and to offer advice. Imposing this duty on directors ensures that shareholders are able to make a properly informed decision on the offer for their shares.

Moreover, although the target board is prohibited from defending the company against a takeover bid without shareholder approval, it is allowed to seek a competing bid, a white knight, without authorisation from the general meeting of shareholders. In the US, when

688 Johnston (n105) 443.
689 City Code, r 21.
690 City Code, General Principle 2, r 25.

the target directors intend to sell to a white knight, the Delaware Supreme Court held that the directors' duty is no longer the preservation of the independence of the company but the maximisation of the company's value.[691] In such a situation, both the UK and US require that the directors should not favour one bidder over the others but must maintain a level playing field for all bidders by treating them equally.

Figure 6-1 Directors' Role in the UK



In China, the problem of corporate governance is particularly serious due to the lack of efficient supervision of management.[692] Hence, as the former Chairman of the CSRC, Xiaochuan Zhou, commented on the development of the new Chinese takeover regime, 'through takeovers and restructurings, China's capital market will play an active role in better integrating the nation into the world economy and ensuring smoother economic

691 *Revlon Inc v MacAndres & Forbes Holdings Inc* 506 A 2d 173 (Del 1986), 182.
692 Junhai Liu, 'Prospect for China's Corporate Law Reform after the Entry into WTO' in Baoshu Wang and others (eds), *Corporate Law Reform for A Global Competitive Economy* (Social Science Academic Press 2003) 270.

transition and structural adjustment'.[693] In China, theoretically speaking, a regime like the City Code is therefore preferable as it prohibits the target board from using takeover defences to deter the tender offer without shareholder approval. In reality, the Chinese legislators have followed UK experience rather than the Delaware takeover regime on the target directors' role when facing a hostile takeover.

In order to promote the market for corporate control, the Takeover Measures 2006 also restrict the target board's ability to use defences without the shareholder approval. Chinese legislators clearly recognised that empowering board of directors to resist offers interferes with the market discipline of corporate governance which is being promoted by the government. Through an active market for corporate control, Chinese companies are expected to be managed more efficiently because of the threat of hostile takeovers. As Yu has stressed, restricting directors' ability to use takeover defences has a satisfactory outcome in general, and sends out a positive signal in the sense of achieving the primary goal of improving the efficiency of a large number of state-owned listed companies.[694] Moreover, as in the UK's approach, Chinese takeover law does not impose a passive role on the target board, which should make a recommendation to shareholders on whether to accept the offer and hire financial consultants to give an expert opinion.[695] Moreover, the law does not prohibit directors from seeking a white knight to enter a competing bid to enlarge the shareholders' choice.

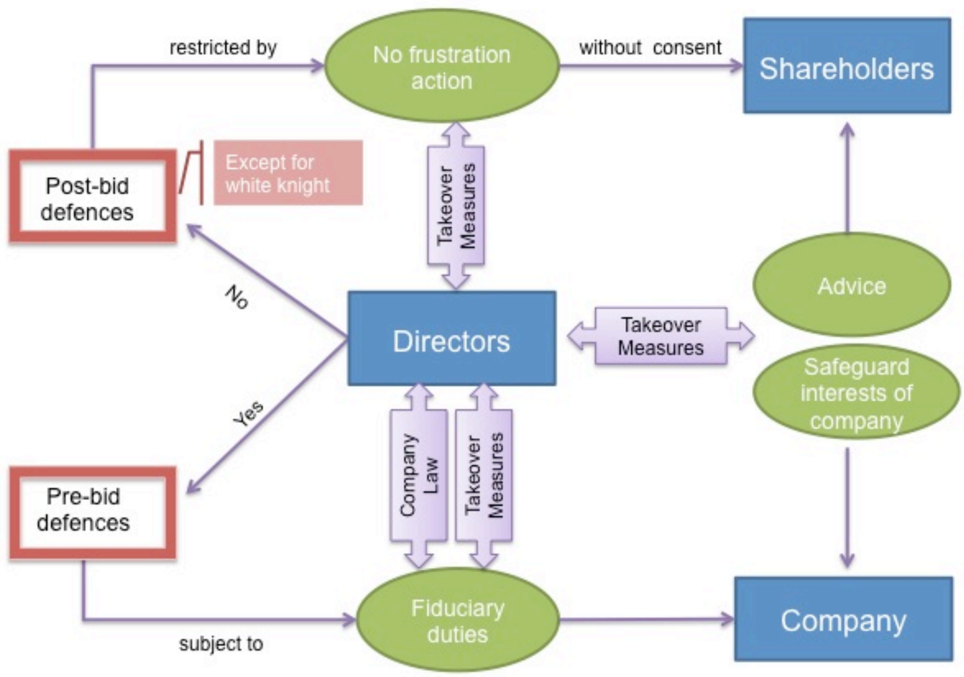
At the same time, the Chinese approach mandates Delaware-like fiduciary duties of directors in the context of takeover. Although directors in the UK are also subject to fiduciary duties, the more restricted NFR means that they are rarely enforced. However,

---

[693] Xiao Zhang, 'New Rules to encourage M&As' *China Daily* (Beijing, 9 October 2002) 2.
[694] Guanghua Yu, 'Takeovers in china: The Case Against Uniformity in Corporate Governance' (2005) 34 Common Law World Review 169, 189.
[695] Takeover Measures 2006, art 32.

the Chinese legislators have explicitly written the fiduciary duties of directors not only into the Company Law but also into the takeover rules. This provides that when facing a takeover bid, the board of a target company have to meet their duties of loyalty and diligence to the company and make sure that decisions and defensive measures are beneficial to the interests of the target company and its shareholders. If there is a bid competition, the target board is not allowed to favour one bidder over others and must treat fairly all the acquirers who intend to take over the company.[696]

Figure 6-2 Directors' Role in China



[696] Takeover Measures 2006, art 8.

Chapter 7 Protection of Shareholders and Mandatory Bid Rule

1. Costs of Shareholder Protection Rules

In addition to the promotion of an active takeover market, ensuring fairness and justice for shareholders is a main goal of takeover regulation. Thus, the rules designed to protect the interests of shareholders and ensure equal treatment of minority shareholders are easy to justify and widely accepted in the majority of countries' takeover regulations. Nearly the whole process of the tender offer is governed by rules intended to protect the equal opportunity of shareholders, which is mainly achieved by requiring adequate information disclosure and specifying certain tender offer rules.[697] Similar shareholder protection rules can be found in the takeover law in the UK, US and China.

These rules include, for example, that the takeover bid should be made to all holders of the same type of shares; if the number of shares that bidders offer to purchase is less than the number of shares for which the offer is accepted, the shares should be bought on a pro rata basis; the offer should be open for a certain length of time and offerors should not be allowed to withdraw their takeover offer during the offer period; shareholders should have the right to withdraw their acceptance if they change their mind during the offer period; and shareholders are entitled to have access to adequate information to make informed decisions on whether to tender or not. All the above rules are designed to ensure that target shareholders are not coerced into a tender offer which they think is inadequate. Rules such as requiring a bid to be made to all the shareholders in the target company on a pro rata basis, and kept open for a certain period of time, significantly reduce the possibility that the target shareholders are tendering simply because of their concern that

[697] Richard W. Jennings and Harold March and John C. Coffee, *Securities Regulation: Cases and Materials* (Foundation Press 1992) 652.

other shareholders will tender before them and they will be left as a minority in the acquired company.[698]

However, it needs to be stressed that all the rules designed to protect shareholders' interests have costs. They may have the effect of facilitating potential competing takeover offers and even effectively deterring takeovers that otherwise would have been launched.[699] As Huang has argued, 'the objective of shareholder protection, however, may conflict with the economic objectives of efficiency in resource allocation to the extent that the rule would render the hostile takeover more difficult and thus diminish the contestability of takeovers'.[700] A good example to illustrate this cost is the rule requiring the bid to be open for a certain period of time, which may give a potential competitor time to enter a competing bid. As Romano has remarked, 'any regulation that delays the consummation of a hostile [even a friendly] bid … increases the likelihood of an auction by providing time for another bidder to enter the fray, upon the target's solicitation or otherwise'.[701]

1.1 Information Disclosure Rules

In order to protect the interests of target shareholders, the takeover regulations of almost all jurisdictions require bidders to disclose to the market information about any substantial holdings above a certain size in the target company, in order to help target shareholders make a well-informed investment judgement and reduce the gains from low and steady 'creeping control' purchased in the open market, without alerting market

---

[698] Kirchner and Painter (n406) 374.
[699] *See, e.g.,* Justin Mannolini, 'Convergence or Divergence: Is there a Role for the Eggleston Principles in a Global M&A Environment?' (2002) 24 Sydney Law Review 336.
[700] Huang (n543) 166.
[701] Roberta Romano, 'A Guide to Take-overs: Theory, Evidence and Regulation' in Klaus J. Hopt and Eddy Wymeersch (eds.), *European Takeovers: Law and Practice* (Butterworths Law 1992) 28.

participants or other potential bidders.[702] One of the leading supporters of disclosure rules has argued that requiring the disclosure of material information to shareholders, such as the purpose of holding shares and the future plans of the offeror, is necessary because public investors are to stand on 'equal footing' with the acquiring person in assessing the future of the company and the value of its shares.[703]

The information disclosure rules, which have attracted a wide range of practical and academic attention, show a similar concern. It is noted that imposing a disclosure duty on bidders does not recognise their research costs, and increases both the cost and the risk of takeovers by lowering the bidder's expected return. This may make the initial bid less profitable and thus greatly reduce bidders' incentives to make a takeover bid in the first instance.[704] Specifically, these rules impose a heavy obstacle to hostile takeovers through the purchase of shares via the stock exchanges after every change of 5% in shareholdings. The disclosed information may prematurely inform the market and give a potential competitor advance warning that a particular target company is undervalued and an offer for it is likely to be forthcoming. More importantly, subsequent bidders may take advantage of the information produced and disclosed by a first bidder. Furthermore, it may induce public investors to buy shares in the particular target company and hence boost the target share price. As Black has observed, 'the competitive character of the takeover market washes away all gains for the bidder once it loses the benefit of secrecy'.[705]

---

[702] Jonathan R. Macey and Jeffry M. Netter, 'Regulation 13 D and the Regulation Process' (1987) Washington University Law Quarterly 131, 132.
[703] Fischel (n39) 10.
[704] Manuel F. Cohen, 'A Note on Takeover Bids and Corporate Purchases of Stock' (1966) 22 Business Lawyer 149, 153. *Also see* Daniel R. Fischel (n39) 13.
[705] Bernard S. Black, 'Bidder Overpayment in Takeovers' (1989) 41 Stanford Law Review 597, 614.

By requiring the bidders to disclose information, the threshold of substantial shareholdings and the time for disclosure have a significant influence on the contestability of the takeover.[706] The lower the threshold, the more protection the target shareholders will obtain; however, the likelihood of a takeover bid being made will be less. Generally speaking, the bidder needs to accumulate a certain number of shares before initiating a takeover bid. If the takeover rules require the bidders to disclose their holdings in the target company too early, the market could react to raise the share price, and hence the takeover bid would turn out to be more costly for bidders.[707] As Liu and Pißler have pointed out, 'it is very likely that after the first announcement the share price rises to a level that makes the bidder's endeavour to further increase his holdings in the target virtually impossible'.[708] Therefore, when choosing an appropriate disclosure threshold, a regulator faces a trade-off between the promotion of corporate control and the protection of shareholders.[709] In China, the 1993 Tentative Regulation on the Administration of the Issuing and Trading of Shares requires a substantial shareholder to disclose a change in its holding of at least 2% of the outstanding shares.[710] In order to reduce its effect on the takeovers, this threshold was raised to 5% in the Securities Law of 2005.

When discussing takeover regulation, although we cannot ignore the above costs associated with the shareholder protection rules, there seems to be general consensus on the need for extensive disclosure information by bidders, and to address shareholders' coordination difficulties through equal treatment rules.[711] Thus, it is not surprising to find

---

[706] Gilson and Black (n42) 898.
[707] Guido A. Ferrarini, 'Share Ownership, Takeover Law and the Contestability of Corporate Control' (2000) Social Science Research Network <http://ssrn.com/abstract=265429> accessed 29 September 2012, 23.
[708] Junhai Liu and Knut Benjamin Pißler, 'Corporate Governance of Business Organizations in the People's Republic of China: The Legal Framework After the Revision of the Company Law in 2005' (2010) Social Science Research Network <http://ssrn.com/abstract=1695888> accessed 29 September 2012, 34.
[709] Huang (n543) 163.
[710] Tentative Regulation 1993, art 47.
[711] Davies and Hopt (n5) 273.

that the shareholder protection rules occupy a central part of all takeover regulation. It is common to see rules requiring the disclosure of information for the benefit of the target shareholders and equal treatment of the shareholders, especially minority shareholders. Although these rules have an adverse effect on the market for corporate control, it is true that shareholders do need to be well protected and will be better off with a regulated bidding procedure and information disclosure.[712]

1.2 Regulatory Response in China

As noted in Chapter 6, hostile takeovers play an important role in realising the wealth generated by exploiting synergies between the acquiring and the target company, as well as by disciplining target management to act in the best interests of its shareholders. Chinese legislators intend to maximise the desirable effect of hostile takeovers and ensure the efficient allocation of productive resources and management monitoring by regulating the takeover activities. Meanwhile, shareholder protection cannot be ignored. It is also crucial to the development of the Chinese takeover market.[713] The takeover regulation in China provide a safeguard for target shareholders, ensuring sufficient information to consider the tender offer and equal opportunity to participate. In recent years, the CSRC has been primarily concerned with protecting the rights of individuals and less sophisticated investors, trying to ensure that individual investors receive fair, full and accurate disclosures of potential transactions, for them to make informed decisions.

For this reason, China intends to ensure a well-functioning market for corporate control and to protect shareholders' interests at the same time. As the CSRC clearly stipulates in Article 1 of the 2006 Takeover Measures, according to Company Law, Securities Law

[712] Bebchuk (n632) 45-46.
[713] Huang (n543) 147.

and other laws and relevant administrative regulations, this measure was enacted in order to standardise the takeover activities of listed companies, stimulate the optimisation of the resource allocation on the stock market, protect the lawful rights and interests of investors, and safeguard the normal order of the stock market. Hence, the discussion of the appropriateness of Chinese takeover regulation in this chapter will concentrate on the balance between these two fundamental objectives of takeover regulation: promotion of an active takeover market and protection of shareholders. The focus will be on whether the current takeover regulation has solved the policy dilemmas between these two principles, within China's own political and economic environment.

2. Mandatory Bid Rule

The equality rules designed to provide protection to shareholders seem to be recognised in all jurisdictions. However, there is no universal acceptance of rules to implement the equality principle between those in control and those left as minority shareholders, by providing the right of exit for the minority shareholders. Whether or not to require the acquirer to make a general offer to the remaining shareholders once it has acquired sufficient shares to obtain control of the target becomes one of the most controversial expressions of the equality principle.[714]

This rule, the MBR, which requires the bidder to make a tender offer to all the outstanding shares when a specified controlling threshold is met, was introduced by the UK's City Code and later spread to many other countries and regions. China's takeover law also adopts the MBR in order to ensure equality of treatment of minority shareholders. However, the US is not one of these countries, and there is no such consensus in the US's

---

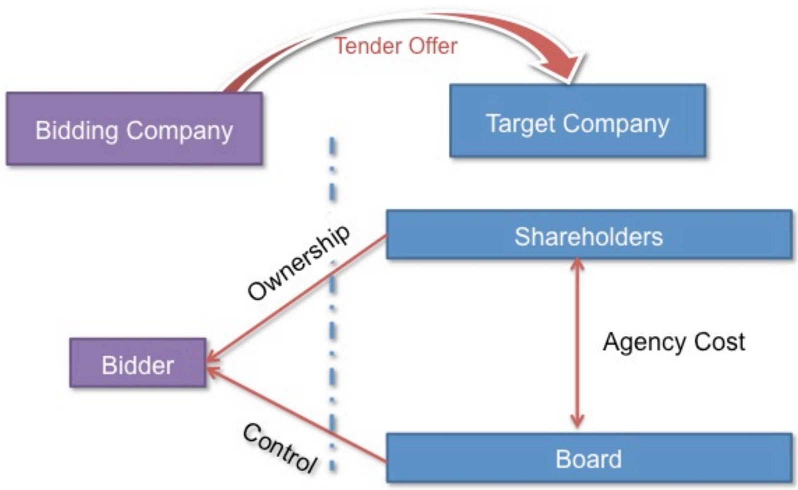
[714] Davies and Hopt (n5) 252.

takeover law. Two-tier offers, which violate the principle of MBR, do not violate the provisions of the Williams Act in the US.[715]

2.1 Rationale for MBR

When considering the applicability of the MBR, whether or not there is a controlling shareholder in the target company is a crucial issue. Where there are no controlling shareholders in the target company, the control of the company is passed from the hands of the target board to the bidder, despite that the ownership of control is transferred from target shareholders to the bidder. As Davies and Hopt have suggested, ‘there is a disjunction between the parties to the dealing which bring about the transfer of control (acquirer and target shareholders) and the parties to the control shift itself (acquirer and target board)’.[716] Therefore, the main agency problem is between the target board and the target shareholders. The fundamental concern that takeover regulation needs to address is management’s opportunism at the cost of shareholders.

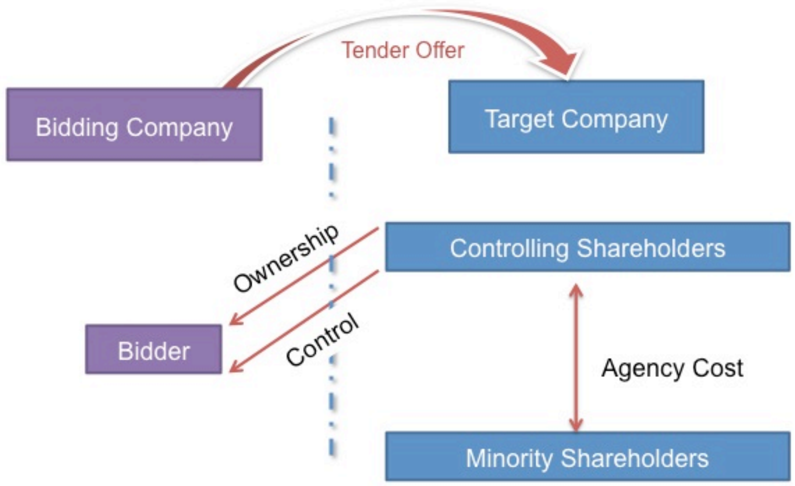
Figure 7-1 Companies without Controlling Shareholders



[715] Davies and Hopt (n5) 157-91.
[716] ibid 228.

On the other hand, where there is an existing controlling block of shares held by one or a small number of shareholders in the target company, the successful corporate control shift is not from the target board, but from those controlling shareholders to the bidder who intends to obtain control. In this situation, agency problems occur between controlling shareholders and non-controlling shareholders. The main problem that takeover law tends to address is how to protect non-controlling (minority) shareholders' interests against controlling shareholders' opportunism.[717]

Figure 7-2 Companies with Controlling Shareholders



When there are controlling shareholders in the target company, the bidder is more likely to come to a purchase agreement with them at a premium price and then decide whether or on what terms to make a subsequent offer to the non-controlling shareholders. The controlling shareholders may sell control of the company to a bidder who will be less respectful of the interests of non-controlling shareholders in exchange for a high selling price. The takeover regulation seeks to address this problem by adopting MBR to require

[717] Lucian A. Bebchuk and Assaf Hamdani, 'The Elusive Quest for Global Governance Standards' (2009) 157 University of Pennsylvania Law Review 1263, 1267.

bidders to extend the same terms of purchase to the non-controlling shareholders in the target company.[718] MBR can be justified on the following three bases.

Firstly, since the shift of control usually involves a premium over the market price paid to the incumbent controller, it is argued that the remaining shareholders should have the opportunity to share the premium which the bidder is paying for receiving control. This controlling premium is referred to as the difference between the market price for an individual share and the price of a share that includes controlling benefit in the target company.[719] In the absence of an obligation to make a mandatory bid, controlling shareholders who own a higher percentage of shares in the target company can sell their block shareholding outside the market at any price that a bidder is willing to pay for the control shift, without involving minority shareholders in the deal. Hence, the sale of a block to transfer control can take place whenever it is mutually beneficial for the bidder and the controlling shareholders.[720] The rationale behind the MBR is to provide equal treatment to minority shareholders by effectively preventing creeping transfer of control and ensuring that all shareholders share equally in the control of the premium.

Secondly, when control of a company passes to a new controller, it is argued that the remaining shareholders should have the opportunity to sell their shares at the highest price paid by the new controller. When the incumbent controlling shareholders sell control of the company for a high premium, to a bidder who will loot the target company by expropriating the private benefits of corporate control, the minority shareholders will be locked in the looted company.[721] They will then be forced to deal with the new

---

[718] Davies and Hopt (n5) 229.

[719] Joseph A. McCahery and others, *The Economics of the Proposed European Takeover Directive* (Centre for European Policy Studies 2003) 15.

[720] Berglöf and Burkart (n32) 196.

[721] For a more comprehensive description of the private benefits of control, *see* Ronald J. Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 Harvard Law Review

controlling shareholder who is intent on looting the company, only to find their shares have declined in value. In this respect, the MBR is set to deal with the conflict between new controlling shareholders and minority shareholders after the completion of the control shift. In the event of an undesirable change of control by the controlling shareholder, it provides the minority shareholders with an opportunity to exit the company at a fair price and with equal treatment of all shareholders in substance.[722]

Finally, the minority shareholders need extra protection when a bidder launches a tender offer in a coercive way by stating that he will make a lower offer once he has obtained control of the company.[723] In the absence of MBR, the minority shareholders may be under pressure to make the choice of tendering their shares during the control acquisition process, because if they do not tender their shares to bidders, they will lose the immediate benefit of the offer and have to take a lower price for their shares after the deal is sealed. In this way, the bidders can coerce the target shareholders to tender at a price even below what they consider its value.[724] Under these circumstances, MBR is used to remove pressure to tender from the non-controlling shareholders. In addition, where the bid is value-increasing, it can be argued that providing non-accepting shareholders with an exit right is not necessary because the value of minority shareholders' shares will be higher after the control shift than before. However, as Burkhart and Panuzi has argued, the non-controlling shareholders' interest may not be guaranteed in a value-increasing company,

---

1641; Robert M. Heller, 'Have the Controlling Shareholders Breached Their Fiduciary Duties to the Minority in Transferring Control Shares' <http://www.hellerlaw.com/controlling-shareholder-breach.html> accessed 2 October 2012.

[722] Johnston (n105) 446.

[723] Burkhart and Panunzi (n82) 749.

[724] Magnuson (n265) 212.

as there is still a risk that the new controller may attempt to exploit the private benefits of control at the expense of their interest.[725]

2.2 Adverse Effect of MBR

Some scholars observed that even though the MBR could provide more protection for shareholders by ensuring that the control premium is shared by all shareholders, and that minority shareholders have a right to exit the company, the rule almost inevitably increases the cost of acquiring the control of target companies and consequently may reduce the number of takeover bids by making the target company more expensive to acquire.[726] As Burkart and Panunzi have pointed out, 'the mandatory bid rule never simultaneously secures a bid premium and provides effective protection'.[727]

The MBR not only makes bidders pay more in terms of the takeover offer price, but also makes them buy a greater number of shares than they intended.[728] Bidders are required to purchase not only the number of shares sufficient to obtain control of the target, but also an additional amount of shares at a price which can exceed the market price. As a result, the MBR may fend off potential takeover bidders from the takeover market and weaken the disciplinary function of the market for corporate control. This is because of the requirement of a general offer for all the outstanding shares in the target company, intended to provide shareholders with the exit opportunity at an attractive price; this is something they rarely have, but it may put a bid in a situation where the bidders are

[725] Burkhart and Panunzi (n82) 749.
[726] *See e.g.*, Lucian Arye Bebchuk, 'Efficient and Inefficient Sales of Corporate Control' (1994) 109 Quarterly Journal of Economics 957,174; Burkart and Panunzi (n28) 257; Berglöf and Burkart (n32); Roberta Romano, 'A Guide to Takeovers: Theory, Evidence, and Regulation, Takeover Regulation' (1992) 9 Yale Journal on Regulation 119, 120; Georgios Psaroudakis, 'The Mandatory Bid and Company Law in Europe' (2010) 7(4) European company and Financial Review 550, 561.
[727] Burkart and Panunzi (n28) 734.
[728] Ventoruzzo (n31) 18.

discouraged by the burden of the MBR and give up the intention of purchasing corporate control in the first place.[729]

From the perspective of controlling shareholders, they will be reluctant to sell their block by being required to share the control premium with the non-controlling shareholders when the MBR is triggered, because the greater takeover cost forces the bidder to lower the consideration in the offer for obtaining control shift.[730] The controlling shareholders have to give up some control premium to share with other shareholders when the threshold is triggered. Hence, even if the control transfer will improve the efficiency and create value for the target company, it is unlikely to happen due to the controlling shareholders' resistance to the sale. Similarly, non-controlling shareholders are also worse off because of the lower offer price. As McCahery and Vermeulen have observed,

> Under the assumption that the blockholder has access to private benefits of control, the majority shareholder enjoys a disproportionately large segment of the company's stand alone value to transfer control, the incumbent blockholder will demand compensation for the loss of private benefits. If all shareholders must be treated alike, the blockholder's share will be proportionate to the value in the takeover. For the incumbent controlling shareholder, the proportionate value of takeover can be less than the disproportionate share of the stand-alone firm value.[731]

Although the costs of the MBR exist for companies with dispersed holdings of shares, where the bidder can build up a controlling block by acquiring shares from dispersed non-

---

[729] Davies and Hopt (n5) 253.
[730] Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press 2009) 258.
[731] Joseph A. McCahery and Erik P. M. Vermeulen, 'Does the Takeover Bids Directive Need Revision?' (2010) TILEC Discussion Paper No 2010-006 < http://ssrn.com/abstract=1547861> accessed 21 September 2012, 8.

controlling shareholders, they are particularly high in the target company with controlling shareholders.[732] In the latter case, a bidder not only needs to pay for the private benefits of control to purchase the controlling block from the controlling shareholders, but also needs to extend it to the remaining shareholders. Therefore, the MBR, requiring that the subsequent general offer be made to the remaining shareholders at the same price paid outside the market or prior to the bid, makes the cost of control shift much higher than purchase of the controlling block. As Coffee has noted, 'if private benefits of control are high, the disincentive effect of a MBR will be significant'.[733]

From the bidder's perspective, an MBR can act similarly to a takeover defence in which the target management gains an advantage because they can be protected from removal in the target company.[734] As Ventoruzzo has noted, 'in systems where controlling shareholders possess, on average, a threshold of shares over 30%, the compulsory tender offer might represent something akin to a statutory defensive measure'.[735] All in all, an MBR that provides equal treatment for minority shareholders reduces the private benefits of control that a bidder expects from the takeover transaction. This discourages bidders from launching a takeover bid, which means there will be fewer takeover bids and therefore fewer changes in corporate control.[736] Consequently, the MBR is detrimental to takeover opportunities and causes corporate control to remain in the hands of inefficient controlling shareholders. As Bebchuk has argued, in companies with controlling

[732] Davies and Hopt (n5) 254.
[733] Coffee (603) 1282-1289.
[734] Luca Enriques, 'The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation' (2004) 4 European Company and Financial Law Review 440, 448-9.
[735] Ventoruzzo, (n24) 214.
[736] Johnston (n105) 452.

shareholders, the MBR eliminates unfair treatment to non-controlling shareholders at the cost of reducing more efficient control transfer.[737]

2.3 Modification of MBR

As the triggering threshold and the bid price set in the rule could greatly influence the practical outcome of the rule, it is argued that the costs of MBR can be reduced by increasing the threshold above which the bidder has to make a mandatory offer, or by lowering the price in the tender offer below the highest price paid for any of the shares previously accumulated.[738] For instance, Swiss law permits shareholders, by provisions in the company's constitution, to raise the triggering percentage from one third (the default setting) to up to 49%, and requires only that the offer should be at not less than the market price when the mandatory offer is made, or at 75% of the highest price paid for the shares by the acquirer over the previous 12 months.[739] Extending the list of exceptions to the rule is also one way to reduce the costs associated with the MBR.

The legislators in China have also recognised the costs of adopting MBR and have tried to modify it to mitigate its disincentive effect in various ways. For example, the Provisional Regulations for the Administration of Stock Issuance and Transaction (Provisional Regulations), which was promulgated in 1993, provides that the bid price is the greater of either the highest price paid by the offeror in the twelve months preceding disclosure of the bid, or the average market price during a thirty-day trading period prior to the bid.[740] The Takeovers Measures 2006 try to reduce the bid price by stipulating that it must be not less than the highest price that the bidder has paid for the shares during the

---

737 *See e.g.*, Lucian A. Bebchuk (n726) 957.
738 Paul Davies, 'The Notion of Equality in European Takeover Regulation' in Jennifer Payne (ed) *Takeovers in English and German Law* (Hart Publishing 2002) 28.
739 Loi sur les bourses (Switzerland), arts 32(4), 22(2) and 32(1).
740 Provisional Regulations, art 48.

six months preceding the date of the bid.[741] Moreover, in accordance with the Takeover Measure 2002, the bidder has to launch a general offer if his shareholding reaches the threshold. In order to reduce the cost of applying the mandatory bid with a general offer, the Takeover Measures 2006 permit the acquirer to launch a partial bid for shares of the target company once the threshold is reached.

3. Evaluation MBR's Effect in China

When considering the appropriateness of the imported English-style MBR, it should be remembered that the effect of MBR cannot be assessed separately from the local economic situation and capital market development. The commitment of the legislators in China to modify the MBR has to some extent indicated its negative effect on the Chinese takeover market. The arguments supporting the imposition of MBR may make more sense in theory than in practice in the Chinese context.

3.1 Costs Outweigh the Benefits

In the UK, where MBR was invented, the shareholding structure of listed companies is very wide, with no takeover barriers and the free transfer of shares and their voting rights. The control threshold is defined as 30% in the City Code, in the belief that acquiring interests in shares carrying 30% or more of the voting rights of a target company will enable the bidder to obtain effective control, irrespective of whether such interest or interests give actual control. This implies that a bidder can acquire up to 29.9% of the target company's voting rights by private negotiation or partial offer, without any intervention from the Takeover Panel and without triggering a mandatory bid obligation

[741] Takeover Measures 2006, art 35.

under Rule 9 of the City Code, because it is assumed that that these activities do not involve a shift of corporate control.

The dispersed shareholding structure with no single large shareholder who can exercise influential control over the company means that the control of most of the listed companies can be transferred without triggering a mandatory bid. As Cheffins has pointed out, acquisition of control outside the market resulting in a private shift of control is less likely to happen in a system of widespread ownership.[742] MBR only becomes necessary in exceptional circumstances, where the controlling shareholder is particularly strong and there is a risk that controlling interests might be transferred outside the market. In this context, it can be argued that MBR is intended less to protect minority shareholders from any change in control, and more to deal with changes in control by the action of a large blockholder.[743] The dispersed structure in the UK may contribute to explaining why the MBR is completely accepted throughout the UK and has worked well and fairly. As Lee has argued, there is no evidence that the MBR potentially inhibits the likelihood of hostile takeovers in the UK.[744]

However, unlike the situation in the UK, under the concentrated ownership structure in China, most listed companies have a controlling shareholder who probably holds more shares than the triggering threshold of MBR. According to the data collected from the CSMAR database, the single largest shareholder often owns more than 50% of the company's shares. The corporate ownership in China is thus in sharp contrast to the UK

---

[742] Brian R. Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan via Toronto' (1999) 10 Duke Journal of Comparative & International Law 5, 16.
[743] McCahery J and Vermeulen E (n731) 10.
[744] Lee (n156) 199.

and US, with their dispersed shareholding structures and low concentrations, and where it is rare for investors to hold more than 10% of shares in the listed company.[745]

Table 7-1 Listed Companies with the Largest Shareholder Ownership over 30%

Year	Listed Company	Over 30%	Percentage
2004	1258	817	64.94%
2005	1256	788	62.74%
2006	1322	761	57.56%
2007	1413	825	58.39%
2008	1464	872	59.56%
2009	1600	944	59.00%
2010	1924	1143	59.41%
2011	2124	1249	58.80%

Source: CSMAR Database

As Yu has observed, similar legal rules adopted in different countries may lead to different adaption and outcomes.[746] In the Chinese situation, the practical effect of MBR is such that it is more likely that whoever intends to obtain control must have sufficient funds to buy all the outstanding shares in order to obtain control over a Chinese listed company, whether in a friendly or a hostile way. MBR is therefore acting more like a potentially powerful weapon for incumbent management to resist a hostile bid.[747]

[745] Martin J. Conyon and Lerong He, 'Executive Compensation and Corporate Governance in China' (2011) <http://digitalcommons.ilr.cornell.edu/ics> accessed 2 Oct 2012, 20.
[746] Yu (n694) 170.
[747] Ventoruzzo (n31) 19.

It is widely acknowledged that there are significant numbers of inefficient SOEs in China. The Chinese government has viewed takeover activity as a key driver to accelerate the privatisation process and to reduce agency costs of SOEs. It intends to make SOEs more efficient and better able to compete with international entities operating in China, through the takeover market.[748] However, China's current takeover regulation adopting MBR to empowering the minority to share the control premium not only fail to protect shareholders' interests as a whole in the long term, but also undermine the discipline function of the takeover market.[749] The costs of adopting the MBR therefore outweigh its benefits.[750] As a result, it is far from clear that the MBR is still effective in China.

Firstly, the MBR requires the bidder to offer non-controlling shareholders the same per share price as he paid the existing controlling shareholder for the controlling block. In such case, a control shift only takes place when the bidder has sufficient capital to pay the control premium to the minority shareholders. Leveraging and borrowing between private companies is prohibited under Chinese law,[751] and it is usually difficult for private companies to obtain funds from financial institutions. This is because in China, the financial institutions are more willing to finance SOE projects, as the SOEs are believed to have stronger repayment capability and, more importantly, the government will bail them out if they are in financial difficulties.[752] As a result, private companies are less likely to obtain sufficient capital to buy all the remaining shares required by the MBR. Consequently, the existence of MBR makes takeovers by private companies nearly impossible in China.

---

748 Liang Yue and Shanghang Lv, 'Upgrade SOE's Operation Efficiency through Improving Internal Control' (2010) 11 Finance and Accounting 35, 35.
749 Charlie Xiao-Chuan Weng, 'Lifting the Veil of Words: An Analysis of the Efficacy of Chinese Takeover Laws and the Road to the Harmonious Society' (2011) 24 Columbia Journal of Asian Law 1, 49.
750 Chao Xi, *Corporate Governance and Legal Reform in China* (Wildy Simmonds and Hill 2009) 63.
751 *See* Zhin Chen, 'Private Firm Looking for New Ways to Finance the Takeover' (2010) 4 China Technology and Economy of Private Firms 72.
752 *See* Xiaojing Wu, 'The Legality Issue of Finance Contract between Private Firms' (2007) 23 People Justice 27.

Secondly, there has been a wide gap between MBR and its operation in practice. The need for an active takeover market to facilitate SOEs reform has forced the CSRC to grant exemptions, otherwise the high cost of applying the MBR would largely reduce incentives for potential bidders to take over Chinese listed companies.[753] As a result, the market regulator, the CSRC, has been given broad discretion to waive the MBR on a case-by-case basis. It is argued that the exemption not only amplifies the CSRC's regulatory and administrative power, but also, more importantly, it significantly reduces the applicability of the MBR in practice.[754] As Hill has discovered, the frequent exercise of waiver power by the CSRC effectively 'subvert[s] the operation of the mandatory bid rule altogether'.[755] An extreme case presented by Li is that the CSRC had granted exemption from the MBR to all takeovers by private agreement, 121 in total, by the end of 2000.[756]

In the past, the CSRC frequently gave exemptions to allow takeovers to go ahead without making a bid to all target shareholders, as the rule put too much burden on bidders, especially when the transfer of control triggering the threshold was state-owned shares. An exemption from MBR became much more difficult to obtain after the Takeover Measures 2006 came into force; these are more restrictive than the Takeover Measures 2002 in terms of the grounds for exemption. Nevertheless, this is not because the MBR now makes more sense in China, but probably because the costs of MBR have become much lower by allowing partial bids in the Takeover Measures 2006 so that the over-wide exemptions to the MBR in the Takeover Measures 2002 can be narrowed down within a reasonable range.

---

753 Guanghua Yu, 'Using Western Law to Improve China's State-owned Enterprises of Takeovers and Securities Fraud' (2004) 39 Valparaiso University Law Review 339, 350.
754 Weng (n749) 17.
755 Hill (n58) 9.
756 *See* Bingan Li, 'A Discussion of the Exemption from the Mandatory Bid Rule' (2003) 18(6) Legal Forum 50.

However, the Takeover Measures 2006 add a catch-all provision, providing that the CSRC has the power to exempt the MBR in other circumstances deemed by the CSRC as necessary to development and change in the securities market and protect the lawful rights and interests of investors. As Yu has argued, this catch-all provision largely makes the MBR irrelevant in China.[757] Moreover, it is argued that the waivers of the MBR issued by the CSRC could largely distort the takeover market because they can potentially be used to discriminate against certain market participants and provide others with favourable treatment.[758]

All in all, the MBR intended to protect minority shareholders by ensuring a share in the control premium and providing an exit opportunity, is argued to have the opposite effect in the Chinese takeover market. Even if the bidder successfully obtains control of the target company, what is left for him is only synergy gains as the control premium is significantly diluted by the MBR.[759] Although the MBR increases the compensation to minority shareholders in the case of a successful takeover, more importantly it reduces the likelihood of a takeover. As Weng has observed, the reality is that there are fewer takeovers taking place in China, 'caused partially, if not completely, by the mandatory bid rule'.[760] Adoption of the MBR is argued to effectively hinder the trade in controlling blocks, the dominant form for control shifts in China under its concentrated shareholding structure.[761] Armour et al have expressed a similar concern by noting that a full

---

[757] Guanghua Yu (n694) 189.
[758] *See* Wayne Chen and James Weng, 'The Art of Investment: Tactics for Acquiring PRC Listed Companies' (2007) China Law & Practice < http://www.chinalawandpractice.com/Article/1690357/The-Art-of-Investment-Tactics-for-Acquiring-PRC-Listed-Companies.html?Print=true> accessed 18 July 2012.
[759] Weng (n749) 49.
[760] ibid 47.
[761] Erik Berglöf and Mike C. Burkart (n32) 175.

mandatory bid can 'stifle takeovers in countries where there are controlling shareholders'.[762]

3.2 Partial Bid Particularly Dilutes Benefits

Under the current concentrated corporate ownership structure in China, the MBR requirement of a general offer largely impedes the growth of the takeover market. A question faced by the Chinese legislators is to what extent MBR, which is intended to provide better protection to minority shareholders, will actually hinder rather than promote takeovers. As a result, aiming at ensuring an active takeover market to enhance the competitive ability of Chinese listed companies, legislators abandoned the original spirit of MBR by allowing minority shareholders to share only part of the control premiums, and curtailing their right to exit. The new approach introduced in Takeover Measures 2006 allows bidders to launch a partial bid once the threshold has been triggered, by stipulating that a bidder who has obtained a 30% shareholding in a listed company, shall make an offer to all shareholders of the listed company for a complete or partial acquisition of shares of the listed company.[763] In the case that more shares are tendered than the bidder has offered to buy, the shares tendered must be purchased on a pro rata basis.[764]

The reason why UK's MBR is argued to go beyond US's equal opportunity rule in protecting target minority shareholders is that it requires an acquirer, who obtains control of the target company, to offer to buy all the remaining shares from outstanding shareholders. Mandatory bids on all the outstanding shares are designed to reduce the risk that a controlling shareholder will sell his shares at a premium outside the market, leaving

[762] Armour and Jacobs and Milhaupt (n132) 274.
[763] Takeover Measures 2006, art 24.
[764] Takeover Measures 2006, art 56.

remaining shareholders in the target company unable to sell their shares at a reasonable price. In other words, only an offer for all the outstanding shares ensures the protection of all the minority shareholders by providing for exit for every shareholder who does not agree with the takeover, without the need for pro rata acquisitions.[765]

The extent of the protection for shareholders which MBR can provide is determined by the threshold at which the general bid must be launched and the price that must be paid; however, it is never determined by whether to allow a partial bid.[766] The original spirit of an MBR is to require a bidder to offer all minority shareholders an exit opportunity on terms no less favourable than those offered to the controlling shareholders for their block of shares. Given that the mandatory bid offer is not for all the outstanding shares, the exit opportunity is not granted to all shareholders, because some are still left in a minority status in the company controlled by the new controller, without the opportunity of sharing the premium. As Pacheco has argued, if on acquiring control a purchaser is only required to offer to buy part of the shares of the target on a pro rata basis, then MBR does not provide the minority shareholders with the total exit that is expected.[767]

The key difference between a mandatory bid and a partial bid is that, in the case of a mandatory bid, the controlling shareholder has to sell all his shares, so all other shareholders must have the same opportunity; whereas in the event of a partial bid, all shareholders are treated equally and will have the chance to sell a certain percentage of their shareholdings. As Davies and Hopt have pointed out, in order to give the minority the option to exit the company, the MBR should be accompanied by a prohibition on partial bids, even if there is a pro rata acceptance rule to make sure all minority

---

[765] Marco Ventoruzzo (n31) 35.
[766] Marco Ventoruzzo (n31) 34.
[767] Pacheco (n418) 23.

shareholders are treated equally.[768] A mandatory partial bid for a minimum of 5% of the outstanding shares, stipulated in the Takeover Measures 2006, is not a real MBR as it violates the spirit of MBR to ensure the protection of all shareholders and thus greatly dilutes its original effect on the protection of minority shareholders.

[768] Davies and Hopt (n5) 253.

Chapter 8 Recommendations for Chinese Takeover Law Reform

1. Answering the Research Questions

The UK and US, the first countries to introduce explicit takeover regulations, in 1968, have chosen significantly different regulatory regimes in responding to the conflicts of interest between the target board and target shareholders and between the bidder and target shareholders. This is in spite of the fact that both countries have widely spread shareholdings in their public companies and a similarly developed securities market.

It was found that the central issue in the UK's takeover regulation is fairness among the target shareholders. The directors do not have power to employ any defensive measure to thwart an unwanted takeover bid unless the shareholders approve it and the bidder has to extend the offer to the remaining shareholders once obtaining 30% of shares in the target company. In the US, however, takeover law is designed to be more protective of managers than shareholders, but at the same time gives bidders more flexibility to launch a bid. Although the target directors owe fiduciary duties to the company, which prohibit them from improperly using their power, they have the ultimate say on adoption of defensive measures in the face of a takeover offer.

In China, unlike the UK and US, the conflict of interest is chiefly between controlling shareholders and minority shareholders, because of the country's highly concentrated shareholding structure. The Chinese takeover regulation is designed to maximise shareholders' interests by facilitating beneficial takeovers and to minimise the risk of potential abuse of shareholders' interests by other parties, including the target board, the bidders and the target controlling shareholders. The Takeover Measures 2006 promulgated by the CSRC, associated with the Company Law and the Securities Law, have completed China's takeover regime and established a sound legal environment for the conduct of takeover transactions.

There are, however, two notably divergent rules concerning takeovers in the UK's City Code, namely NFR and MBR, which answer crucial questions which are at the centre of the debate: whether the board is allowed to employ takeover defences without shareholder approval, and whether the bidders have to launch a general bid on reaching a certain threshold. When discussing the pros and cons of the Chinese takeover regime, it was found that China has followed the UK model by adopting both NFR, to restrict a board's ability to employ takeover defences; and MBR, to provide minority shareholders with an exit option in the event of a change of control.

In allocating powers between directors and shareholders responding to takeover measures, the NFR is clearly supported so that shareholders can make decisions about their shares in the target company. The target board is prohibited from taking any action that would frustrate a takeover bid, without shareholder approval. If the directors can simply apply takeover defences without the shareholders' consent, it is not only self-serving for the board at the cost of shareholders' wealth, but also inefficient for the economy as a whole. Consequently, if shareholders want to be sure that frustration actions are employed in their interests, takeover defences must be subject to their approval.

As noted above, Chinese legislators have adopted a similar regulatory response to takeover defences as the UK's. This recognises shareholder decision making in relation to a takeover bid; as a general rule, the target directors are also entitled to make certain decisions and take defensive measures in response to a takeover bid, such as searching for a competing bidder without shareholder approval. Nevertheless, the target board has to perform the fiduciary duties owed to their company. The Takeover Measures 2006 takes an ex ante approach like the City Code's, addressing the conflict interest between the target board and shareholders by prohibiting the board from adopting any takeover defence without shareholders' approval.

It needs to be mentioned that under the current system of Chinese capital market where the key agency problem is between controlling majority and minority shareholders, the Takeover Measures 2006 keep silent on this problem. Although defensive measures against a takeover bid cannot be taken unless the board is explicitly authorised by a resolution of the shareholders' meeting, the controlling shareholders and the actual controlling party might easily receive such approval at the meeting without the participation of minority shareholders. Therefore, having the shareholders' meeting decide on the applicability of defensive actions might not be an effective method for non-controlling shareholders.

However, it has to be stressed that the agency problem between controlling and minority shareholders is not an acceptable argument to refute shareholder primacy. Requiring the shareholders' consent to employ takeover defences should be a fundamental principle of the takeover regulation. The decision on takeover defence should not be left to the directors to decide, without the participation of the shareholders. Requiring the shareholders to confirm whether to launch a defensive measure at least provides a possible legal route for the shareholders to obtain a preliminary injunction to prohibit takeover defences without their consent.[769] Ventoruzzo has further argued that the NFR increases the transparency of the adoption of frustration actions and gives non-controlling shareholders the opportunity to discuss the defences at the meeting and to obtain further

[769] Ventoruzzo (n31) 20.

information from the directors.[770] Therefore, what the Chinese legislators need to do is to make current takeover rules governing takeover defences more specific, in the meantime paying more attention to minority shareholder protection.

With regard to the MBR, because the current Chinese shareholding structure is characterised by controlling shareholdings, it is suggested that the costs of MBR outweigh its benefits. It has been shown that when there is a controlling shareholder in the target company, the MBR makes it more costly to acquire control of the target. From this perspective, the takeover bid succeeds only if the bidder is willing and has the ability to extend the control premium to all the remaining shareholders in the target company. As a result, this rule allocates more surplus to the minority shareholders so that it becomes less attractive to the bidders to acquire control in the target company. Accordingly, this reduces the likelihood that the shareholders will receive a takeover premium.

Although empirical evidence demonstrates that takeovers maximise the value of the target company and enhance managerial accountability by the threat of replacing inefficient management, takeovers rarely happen in China's capital market. As Weng has suggested, one of reasons is that 'Chinese takeover laws have a chilling effect towards potential corporate raiders'.[771] In particular, the MBR seems to suit the British enterprise landscape, although this is not the case in China in the current economic situation. The MBR is ill-suited and makes hostile takeovers in China even more unlikely. Any modification of the English-style MBR clearly implies that strictly following the original would not be efficient in the Chinese takeover environment.[772]

---

[770] Ventoruzzo (n31) 20.
[771] Weng (n749) 1.
[772] Yu (n444) 12.

2. Recommendations on NFR

2.1 Modifying Article 33 of Takeover Measures 2006

Allowing target shareholders to decide the outcome of a takeover bid by imposing NFR is a rational regulatory choice by Chinese legislators. However, to bring them into line with the original model in the UK's City Code, the provisions stipulating a rule similar to the NFR in the Takeover Measures 2006 need to be sharpened up and unambiguous. Rule 21 of City Code on restrictions on frustrating action prohibits a target board from taking any 'frustrating actions' rather than 'defensive actions' without the approval of the shareholders' general meeting once an offer is imminent.[773] It explicitly forbids the issue of retained shares and options, the sale or acquisition of assets of a material amount, and the stipulation of contracts other than in the ordinary course of business. Moreover, it should be kept in mind that the list of forbidden actions named in Rule 21 is not exhaustive, as the City Code forbids any actions taken by the target board with the effect of frustrating a takeover bid, regardless of what form they take.

Similarly, the Chinese approach forbids those actions which 'may make a significant impact on the assets, liabilities, interests or business results of the company'.[774] However, it is hard to argue that all the actions that may have a significant impact on the assets, liabilities, interests or business results of the company, will necessarily have the effect of frustrating a takeover bid in any situation. They are still open to different interpretations. Furthermore, Article 8 of Takeover Measures 2006 prohibits target directors from obstructing a takeover offer by abusing their power to pursue their own interest at the cost of shareholders'. This can be interpreted as the target board still being allowed to launch

[773] City Code, r 21.
[774] Takeover Measures 2006, art 33.

anti-takeover measures as long as they act within their powers and in the interests of the target shareholders.

It is crucial to underline that the provisions of the current Takeover Measure 2006 with regard to takeover defences is less effective than the UK's NFR, which requires the board to obtain the consent of shareholders before any actions which might frustrate the takeover. In order to affirm the shareholder-oriented approach, any action with the effect of thwarting a takeover bidder, irrespective of its form and the target board's incentives, should be explicitly forbidden by the law. The Takeover Measures 2006, aiming to protect the lawful rights and interests of the target shareholders, should be as precise as the City Code in specifying that all defensive measures which may result in any takeover offer being frustrated must be approved by shareholders at the general meeting.

2.2 Clarifying Directors' Fiduciary Duties

The Chinese regulatory response to the takeover defence is a combination of the UK and Delaware approaches; it prohibits directors from employing takeover defences during the offer period, at the same time imposing on directors their fiduciary duties throughout the whole of their term. This approach rules out the possibility of post-bid defensive measures employed by the target board to frustrate an unwanted bid, without the shareholders' consent. Imposing fiduciary duties on the directors during the offer period is therefore not very useful, as the directors' ability to use takeover defences is completely restricted by the NFR.

However, the Chinese Company Law and Securities Law do not make any explicit rulings on the legitimacy of pre-bid defences used by the target board, nor is there any provision in the Takeover Measures 2006 governing the using of defensive tactics by the directors of a potential target company before the takeover is imminent. In prohibiting the target board from adopting takeover defences in advance, in order to pursue their private interests at the expense of the shareholders, the concept of directors' fiduciary duties becomes relevant. Directors are only subject to the fiduciary duties owed to the company when they choose anti-takeover mechanisms to entrench themselves prior to a takeover bid.

Article 148 of the Company Law for the first time in China's corporate law expressly stipulates directors' fiduciary duties in an Anglo-American way. It recognises that the directors' fiduciary duties have two aspects: duties of loyalty and of diligence. In the takeover of listed Chinese companies, the Takeover Measures 2006 also promulgate these two fiduciary obligations of the target board of directors. According to Article 8, when considering takeover defences, the target board owes duties of loyalty and diligence to the company and must make sure that any defensive tactics are beneficial to the target company and shareholders; the board must not abuse its powers by presenting an inappropriate obstacle to the attempted takeover. However, those path-dependent elements mentioned in Chapter 5, as well as the civil law system rooted in China, inevitably imply a winding road in the importation of common law fiduciary duties into Chinese jurisdiction. The incompleteness and ambiguity of the provisions is a priority for the legal reformist to deal with.

In particular, the duty of loyalty requires that directors do not engage in actions which may damage the company and other shareholders' interests, and exercise their rights in good faith and with a good manner. The specific prohibitions against duty of loyalty set forth in Article 149(1)-(8) of the Company Law end with the catch-all provision 'other actions in breach of the duty of loyalty to the company'. However, surprisingly, the Company Law refers to the existence of a duty of diligence, but contains no further provision with respect to it. This incompleteness makes the duty of diligence particularly hard to apply. Identification of breach of this duty is nearly impossible in the statutory law system, where the statute is the only legal source for the court to make the judgment.[775]

Specifically, in the context of takeovers, although the Takeover Measures 2006 stipulate the general fiduciary duties of the target board, simply following the Company Law is considered over-abstract and misleading in practice.[776] It prohibits the target board from placing an inappropriate obstacle in the way of a takeover bid, as an abuse of its powers. The provision is particularly confusing as it restricts the board's defensive actions on two counts, placing an inappropriate obstacle and abusing its powers. Accordingly, it is unclear whether it is acceptable for the board to place an inappropriate obstacle to the takeovers as long as the board uses its power properly; or acceptable to use an appropriate obstacle even though abusing its power. Moreover, the absence of explanation of 'inappropriate obstacle' makes its application even harder.

Without doubt, the Company Law should be more specific on the duty of diligence and provide a standard for its application and for identifying breaches. The Takeover Measures 2006 should be clear and unambiguous in how to apply the fiduciary duties and add more guidance in the context of a target board adopting anti-takeover measures before the takeover bid is imminent. Much has been written on how to make the imported fiduciary duties more workable in China,[777] and a fuller examination of fiduciary duties is outside the scope of this research. The issue most relevant to this research is that under

---

[775] Rebecca Lee, 'Fiduciary Duty without Equity: "Fiduciary Duties" of Directors under the Revised Company Law of the PRC' (2007) 47 Virginia Journal of International Law 897, 901.
[776] Weng (749) 68.
[777] For a more comprehensive analysis of fiduciary duties in China, *see* Nicholas C. Howson, 'The Doctrine that Dared Not Speak its Name: Anglo-American Fiduciary Duties in China's 2005 Company Law and Case Law Intimations of Prior Convergence' in Hideki Kanda and Kon-Sik Kim and Curtis Milhaupt (eds), *Transforming Corporate Governance in East Asia* (Routledge 2008) 193-254; Chao Xi (n548).

the current Chinese Company Law, as stated in Chapter 5, most pre-offer defensive measures are not within the scope of the target board's ability but down to the decision of the shareholders' meeting. Therefore, the main problem faced by the drafters of Chinese takeover law is not how to restrict a target board's opportunistic behaviour prior to the declaration of tender offers, but the conflict of interest between controlling shareholders and minority shareholders.

Pursuant to the Company Law, the target board does not have the right to adopt any pre-bid defences in the articles of association, without the shareholders' consent. Any amendment to a company's articles of association must be approved by the shareholders' meeting.[778] The board only has the power to initiate a proposal on those issues which have a significant impact on the interests of the company and its shareholders, and then call for a shareholders' meeting to consider them.[779] Unlike the situation in the US, gaining control of a Chinese company's board of directors does not necessarily mean the potential acquirer will obtain immediate control of the target company.[780] As such, the main agency problem that takeover regulation needs to address is to seek effective protection of minority shareholders by prohibiting controlling shareholders from manipulating the resolution on adoption or removal of takeover defences, no matter whether they are pre- or post-bid, at the minority shareholders' expense.

2.3 Enhancing the Protection of Minority Shareholders

Under Articles 101(3) and 103 of the Company Law, shareholders separately or aggregately holding 10% or more of a company's shares can call a special shareholders'

---

[778] Company Law, arts 44 and 104.
[779] Company Law, art 105 and Securities Law arts 13 and 14.
[780] Liu Fang, 'Takeover Defences under PRC Law (Part II)' (2006) <http://www.chinalawandpractice.com/Article/1692096/Channel/9939/Takeover-Defences-under-PRC-Law-Part-II.html> accessed 2 February 2013.

meeting; those separately or aggregately holding 3% or more of the shares can put forward a proposal to the shareholders' meeting for consideration. In the takeover scenario, the majority shareholders, therefore, may call a special shareholders' meeting independently to adopt takeover defences; in the meantime, the minority shareholders also have the opportunity to propose takeover defences for approval by the meeting. Accordingly, both controlling and minority shareholders are in the same position in terms of initiating a takeover defence to be approved at the shareholders' meeting. The main conflict of interest arises over the way in which the resolution at the shareholders' meeting is decided. In this respect, the voting system plays a vital role.

In accordance with Article 104 of the Company Law, the resolution on issues including amendment of articles of association, increasing or reducing the registered capital, merger, and division, dissolution and change of the company form, should be passed by shareholders representing two-thirds or more of the voting rights of the shareholders present at the meeting. The issues articulated in this provision cover almost all the measures which can be used to thwart a takeover bid. In order to better resolve this inherent conflict between controlling and non-controlling shareholders, the takeover law should stipulate in a more explicit and effective way the requirement for a two-thirds supermajority of shareholders voting at the shareholders' meeting on the takeover-frustrating actions articulated in Article 33 of Takeover Measures 2006, and on the defensive measures that existed prior to the takeover bid. Under this system, the controlling shareholders cannot find any regulatory gap to adopt or remove a takeover defence without minority shareholder participation.

Moreover, it is important to make a controlling shareholder liable for a resolution passed at the shareholders' meeting. This problem can be solved by imposing the fiduciary duties of the controlling shareholders to the minority shareholders, similar to those of directors and prohibiting controlling shareholders from misusing their power to harm the non-controlling shareholders' interests. The non-controlling shareholders would therefore have the right to challenge the resolution before the court in light of the controlling shareholders' abusive behaviour and significant damage caused to their interests. In terms of takeover defences, when controlling shareholders breach their fiduciary duty by employing the defences at the cost of minority shareholders, the minority shareholders could bring a suit to withdraw the defences and compensate the company and themselves for any loss it may have suffered. The regulatory advice on imposing fiduciary duties on the controlling shareholders will be provided later.

3. Recommendations on MBR

As discussed above, in a system with controlling shareholders, the agency problems and inherent conflict of interest is not between directors and dispersed shareholders, but rather between incumbent controlling shareholders, who attempt to extract private benefits from the target company, and non-controlling shareholders, who prefer equal treatment and a value-increasing bid. The takeover regulation seeks to address this problem either by requiring bidders to extend the same terms of purchase to the non-controlling shareholders in the target company or by prohibiting the existing controlling shareholders from exploiting their private benefits at the expense of non-controlling shareholders, whether they are incumbent controlling shareholders selling their block or the new controlling shareholders who obtain control after the bid.[781]

[781] Davies and Hopt (n5) 229.

In particular, a duty could be imposed either on the acquirer of the controlling block to make a general offer to purchase the non-controlling shares at the same price as that paid for the control shift; or on the seller (incumbent controlling shareholders) to share the control premium with the non-selling minority shareholder and on the new controller (new controlling shareholders) not to harm existing minority shareholders' interests after the completion of the takeover.[782] The difference between these two approaches is that the former not only requires sharing the control premium with the minority shareholders, but also provides them with an exit right by requiring the bidder to extend the same premium to all the remaining minority shareholders in the target company. It is legislator' job to make a regulatory choice on either imposing MBR to provide minority shareholders with an exit opportunity at the time of control shift, or imposing controller's duties to protect the minority shareholders against unfair treatment.

3.1 Abolishing Imported MBR

With the development of globalisation, it is common to see one legal system borrow successful rules from other legal systems in order to create legal certainty and meet the needs of international legal harmonisation, especially in the business area. The same is true for China, which has been constantly learning from other systems in attempting to establish a sound legal framework. Its legislating process of new takeover regulations is also based on a study of foreign experience, with the aim of enhancing its market economy by attracting more foreign investments.

With regard to the motivation for imitation, they are not inclusive. Some legislatures imitating other legal systems are simply motivated by saving time and cost, rather than by

[782] ibid 258.

pursuit of the best quality.[783] In some extreme cases, the only reason for adopting a foreign model is that many other countries, particularly Western countries, have adopted these rules. Using a solution which has already been proved to work abroad may add to the prestige of that country, no matter whether it is workable in its own practice.[784] Of course, it cannot be denied that some countries are more or less compelled to follow the particular legal system of other countries. No matter what the exact reason for imitating a foreign law, it is certain that the foreign rules may have a different impact on the legal system of the borrowing country.[785]

There is always a potential risk that foreign legal institutions may be adopted wholesale from foreign experience, without adjustment to local circumstances. In an even worse scenario, when the policy makers borrow rules from a foreign legal system, they do not know how to apply them appropriately. Therefore, it is important to note that borrowing foreign legal solutions cannot be a simply copy, but a 'careful survey of similar foreign institutions' and 'a reasonable transportation of those which may be retained, according to local conditions'.[786] Likewise, Reitz has argued that significant modification will be required when one legal system transplants others because each legal system is regarded as 'an at least partially unique legal system'.[787]

Any legislation must be enacted to meet the needs of the people for whom it is made, as it is closely connected with the social, economic and political context in which it operates. In a similar vein, any adoption of transplanted legal rules in a foreign country is also subject to the local background. As Mann and Milhaupt have pointed out, the roles which

---

[783] Smits (n19) 495.
[784] Developing countries' introduction of a human rights charter into their constitutions is a good example.
[785] *See* Daniel Berkowitz and Katharina Pistor and Jean-Francois Richard, 'The Transplant Effect' (2003) 51 American Journal of Criminal Law 163.
[786] Denis Tallon, 'Comparative Law: Expanding Horizons' (1969) 10 Journal of the Society of Public Teachers of Law 265, 266.
[787] John C. Reitz (n25) 625.

legal reformists play are not only to transplant foreign law, but more importantly, to improve the understanding of the outcome of transplanted rules as determined by 'cognitive biases, political ideologies and historical accidents'.[788] Hence, the first step of transplantation is to understand how the rules arrived in their own countries and to recognise that the foreign rules may not function as well as expected after the transplant.

It is argued that different ownership and corporate governance structures need different rules even if the aim of legislators in all countries is to enhance efficiency.[789] Accordingly, Goerge et al have pointed out that similar rules applied in different types of corporate governance may not have the same effect, but rather an undesirable one.[790] Good law does not always ensure a good effect in a different environment. It may be true that the MBR, which was adopted effectively in the UK, would not necessarily produce the desired result in China.[791] Without careful consideration of the unique shareholding structure in Chinese listed companies, the costs associated with trying to adopt the MBR could be particularly high.[792]

Through a properly regulated takeover market, Chinese legislators intend to achieve an active market for corporate control and at the same time sufficient protection for shareholders. In order to improve the corporate governance of Chinese listed companies, protection of minority shareholders' interests is a priority of Chinese takeover law. In the Takeover Measures 2006, a set of equal treatment rules has been laid down to protect the interests of minority shareholders. For example, under the information disclosure rules,

---

788 Ronald J. Mann and Curtis J. Milhaupt, 'Forward: Path Dependence and Comparative Corporate Governance' (1996) 74 Washington University Law Quarterly 317, 323.
789 Berndt (n67) 7.
790 Marc Goergen and Marina Martynova and Luc Renneboog, 'Corporate Governance Convergence: Evidence from Takeover Regulation Reforms' (2005) ECGI - Law Working Paper No 33/2005 <http://ssrn.com/abstract=709023> accessed 19 August 2012, 29.
791 Wei (n92) 115.
792 Xi (n548) 417.

the bidders are required to disclose the comprehensive information in a tender offer report to all the target shareholders.[793]

However, these two goals may be in conflict. As already observed, the shareholder protection rules increase the gains of target shareholders, but diminish the bidder's expected private benefits, resulting in a less active market for corporate control. Therefore, it is important to find a regulatory balance between these two goals. The regulation attempting to protect shareholder interests, such as substantial information disclosure rules and shareholders' equal treatment rules, inevitably has some adverse effect on the development of the takeovers. However, there is no compelling reason to change them because they are widely accepted by most jurisdictions and are also necessary under the Chinese takeover law.

However, a takeover rule like MBR that is intended to protect minorities in a system with a widespread ownership structure has the opposite effect on the takeover market in a country with controlling shareholders, like China. The political goal of maintaining control of the SOEs, and the concentrated ownership of Chinese listed companies, have completely changed the rationale of adopting MBR and made it irrelevant in practice.[794] It cannot be denied that the Chinese government will significantly reduce its ownership in state-owned listed companies for economic purposes. Nevertheless, this will be a long and gradual process, because of path dependence. In the foreseeable future, what is certain is that the adoption of MBR cannot satisfactorily achieve the goal of improving efficiency of Chinese state-owned listed companies through an active takeover market. It cannot prevent the controllers from extracting private interests for themselves, but instead

---

[793] Takeover Measures 2006, art 28.
[794] Yu (n444) 14.

diminishes the positive effect of the market for corporate control in replacing or disciplining inefficient management and improving corporate governance.[795]

The costs of adopting MBR in China obviously outweigh the benefits. In recognising the disincentive effects of the MBR, its abolition is vital to the development of the market for corporate control, thus improving the corporate governance of Chinese listed companies. Therefore, in China, where the business environment is not like that of the City Code in the UK, considering its high costs and undesirable effects on the Chinese takeover market, the MBR is obviously not the solution and should be abolished. In addition, fiduciary duties on the controlling shareholders need to be imposed to ensure the protection of minority shareholders' interests.

3.2 Imposing Fiduciary Duties on Controlling Shareholders

It is widely acknowledged that companies with highly concentrated ownership are generally under the control of controlling shareholders instead of professional managers, because the directors are usually nominated and appointed by the controlling shareholders and such directors always act in the interests of these shareholders. Through the proximity of the controlling shareholders and the board of directors, it is not hard to understand the controlling shareholders' incentives and potential to expropriate gain from the minority shareholders.[796] In China, as Cai has suggested, the largest shareholder in the listed company is capable of controlling the board of directors with more power than that allocated according to his pro rata shareholding.[797]

---

[795] Karl Hofstetter, 'One Size Does Not Fit All: Corporate Governance for 'Controlled Companies'' (2005) Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=802705> accessed 28 October 2012, 35-36.
[796] Porta and Lopez-de-Silanes and Shleifer (n65) 511.
[797] Cai (n525) 286.

There is a consensus that target controlling shareholders must be prevented from using the takeover as a vehicle to damage the interest of the target company or its minority shareholders. If their actions are likely to cause damage to the company and loss to the shareholders, they should be prohibited and penalised. To prevent abuse of the lawful rights of minority shareholders by the controlling shareholders, rules to protect minority shareholders should be laid down in the general corporate law, imposing penalties on the controlling shareholders for any losses engaged by them.[798]

Since this is not unique to the takeover scenario, but a common issue that corporate law should face within many contexts; it is not possible to rely on MBR to protect the minority shareholders against controllers' abuse all the time.[799] As Davies and Hopt have remarked, for this purpose, 'the mandatory bid rule constitutes a pre-emptive strike at majority oppression of minority shareholders and proceeds on the basis that general corporate law is not adequate to police the behaviour of controllers'.[800] Therefore, in the absence of MBR, especially in the context of hostile takeovers, takeover regulation should generate more detailed rules with regard to fiduciary duties on controlling shareholders to protect the target company and minority shareholders' lawful rights and interests.

Fiduciary duty is a well-established common law principle, under which directors owe duties to shareholders and the company. The concept of fiduciary duties of directors has been imported into Article 148 of Chinese Company Law. However, whether controlling shareholders owes fiduciary duties to the company or to other shareholders remains

---

[798] Eddy Wymeersch, 'The Mandatory Bid: A Critical Review' in Klaus J. Hopt and Eddy Wymeersch (eds), *European Takeovers – Law and Practice* (Butterworths 1992) 357.
[799] Yu (n444) 10. *Also see* Jesper Lau Hansen, 'The Mandatory Bid Rule: The Rise to Prominence of a Misconception' (2003) 45 Scandinavian Studies in Law 173, 183.
[800] Davies and Hopt (n5) 253.

controversial. In the UK, no fiduciary duty is imposed on controlling shareholders toward non-controlling shareholders. However, the case law in some US states has recognised that controlling shareholders do owe fiduciary duties to the company and other shareholders, and has imposed an obligation on the controlling seller whenever the controllers obtain a control premium with the potential of prejudicing the non-controlling shareholders.[801] The controlling shareholders are thus unable to exercise their power to transfer the control of the company for their own private benefit without sharing the same benefit with the minority. According to Pacheco, imposing fiduciary duties on controlling shareholders in the US provides substantially wider protection to minority shareholders, by 'constraining the ongoing and operational extraction of private benefits by the controllers', than does imposing an obligation on the acquirer to share the control premium in the UK.[802]

In the case of *Gerdes v Reynolds*, the court held that the controlling shareholders should compensate the non-selling shareholders for foreseeable harm caused by the sale of control.[803] Given that the sale of control can be argued as a corporate asset belonging to all shareholders, the controlling seller is required to share the premium proportionally with the non-controlling shareholders.[804] Nevertheless, it should be noted that the controlling shareholders are not required to share the premium obtained from a transfer of control in every case,[805] only when it can be demonstrated that they acted in bad faith and unfairly prejudiced the minority shareholders. In the recent case *In re Synthes, Inc.*

---

[801] *See, e.g.*, *Ivanhoe Partners v Newmont Mining Corp* 535 A 2d 1334 (Del 1987); *Donahue v Rodd Electrotype Co of New England* 367 Mass 578, 328 NE 2d 505 (1975); *Linge v Ralston Purina Co* 293 NW 2d 191 (Iowa Sup Ct 1980); *Citron v Fairchild Camera & Instrument Corp* 569 A 2d 53 (Del 1989) and *Kahn v Lynch Communication System Inc* 638 A 2d 1110 (Del 1994). *Also see*, Harry G. Henn and John R. Alexander, *Laws of Corporations and Other Business Enterprises* (3rd edn, West Group 1983) 653-61; Lynn A. Stout, 'On the Export of US-Style Corporate Fiduciary Duties to Other Cultures: Can A Transplant Take?' in John Gillespie and Pip Nicholson (eds) *Asia Socialism and Law Change: the Dynamics of Vietnamese Renewal and Chinese Reform* (Asia Pacific Press 2005) 46-47.
[802] Pacheco (n418) 30.
[803] *Gerdes v Reynolds* 28 NY S 2d 622 (1941).
[804] *Perlman v Feldmann* 219 F 2d 173 (2d Cir 1955); *Brown v Halbert* 76 Cal Rptr 781 (1969).
[805] William M. Fletcher, *Cyclopedia of the Law of Private Corporations* (Callaghan 1980), 5811.

Shareholders Litigation, the Delaware Court of Chancery reaffirmed that the controlling shareholders were in breach of their duty of loyalty to the minority shareholders only if they derived a 'personal financial benefit to the exclusion of, and detriment to, the minority stockholders'.[806] The Delaware court imposed fiduciary duties on controlling shareholders to ensure that they do not abuse their controlling power for their private interests at the expense of the minority shareholders. But as clarified in *Synthes*, the Delaware law does not go further to require the controlling shareholder to 'subrogate his own interests so that the minority shareholders can get the deal that they want.'[807]

General fiduciary duties of controlling shareholders cannot be found in either the Chinese Company Law or the Securities Law. What can be found are Articles 20 and 21 in the Company Law, which look most relevant. According to Article 20, all shareholders of a company shall exercise their rights in light of laws and shall not abuse their shareholders' rights to harm the interests of the company or of other shareholders. Where any of the shareholders of a company causes any loss to the company or to other shareholders by abusing the shareholder's rights, it shall be subject to compensation liability in accordance with the law. Under Article 21 of the Company Law, a duty is imposed on the controlling shareholders and de facto controller not to use their connected relationship to harm the company's interests and thereby cause the company to suffer losses, or they shall be subject to compensation liability.

Although Article 20 imposes duties on shareholders to other shareholders in the company, the explicit duties of controlling shareholders cannot be found in this provision. Article 21 stipulates the principles that controlling shareholders must follow, but it does not clearly provide that the controlling shareholders owe fiduciary duties to the other shareholders,

---

[806] *In re Synthes Inc Shareholders Litigation* No. 6452 2012 WL 3641014 (Del Ch August 17, 2012), 1.
[807] ibid, 13.

only preventing controlling shareholders from damaging the company's interests. It only applies to the circumstance under which controlling shareholders harm the company's interests by taking advantage of its connection relationship. As a result, a fiduciary relationship between the controlling shareholders and non-controlling shareholders has not been established at the national law level in China.

Pursuant to Article 7 of the Takeover Measures 2006, it stipulates that no controlling shareholder or de facto controller of a target company may abuse the shareholder's rights thereof to damage the lawful rights and interests of the target company or any other shareholders. If this damage occurs, the said controlling shareholders or de facto controller should eliminate the damages before the transfer of the control of the target company; otherwise, it shall use incomes from the transfer of the relevant shares to eliminate all the damages, and shall provide sufficient performance guarantee or arrangement for the damages that have not been eliminated, and obtain the approval from the shareholders' meeting of the target company according to the articles of association.

It is the 2006 Takeover Measures, which is at a lower legal level, that stipulates controlling shareholders' duties to other shareholders by prohibiting abuse of their shareholders' rights. Since the main source of law is statutes, and case law is not the legal source in China, the legislation needs to be specific and accurate. Unfortunately, the operation of controllers' duties is currently outside the framework of national law. Therefore, the borrowed US principle of controlling shareholders' fiduciary duties should be expressly written into Chinese national law; otherwise, the duties on the controlling shareholders may not have enforceable power before the court. According to Weng, any legislative default or gap is unacceptable as it will cause serious application problems and will sometimes lead to judiciary corruption.[808] Chinese Company Law must be clear and unambiguous in imposing controllers' fiduciary duties to the company and other shareholders.

Moreover, although Article 7 of the Takeover Measures 2006 stipulates the duties that controlling shareholders owe to the company and others shareholders by prohibiting the controlling shareholders from abusing their power, it does not clearly introduce the concept of fiduciary duty as does Article 8 for directors' fiduciary duties; this latter stipulates that the directors owe a 'fiduciary duty and an obligation of due diligence to the company'. As Xi has observed, detailed rules governing the fiduciary duties on controlling shareholders are apparently absent in China.[809] Article 7 only prohibits controlling shareholders from abusing their shareholders' right, to harm the interests of the company and other shareholders. This provision only stipulates an abstract statement of the principle.

Hence, the Takeover Measures 2006 need to make clear that the controlling shareholders owe a fiduciary duty to the company and the other shareholders by requiring them to act in good faith; and to provide guidance to the controlling shareholders about how to apply the substance of the duties they owe. In addition, in the sale of control of a company, the Takeover Measures 2006 also need to require the controlling shareholders to compensate the minority shareholders if they breach their fiduciary duties and cause them foreseeable damage. Such damage includes selling to an asset stripper who, to their knowledge, intends to harm the company; diverting business opportunities to their own benefit and

[808] Charlie Xiao-Chun Weng, 'Assessing the Applicability of the Business Judgment Rule and "Defensive" Business Judgment Rule in Chinese Judiciary: A Perspective on Takeover Dispute Adjudications' (2010) 34 Fordham International Law Journal 124, 134.
[809] Xi (n548) 413.

excluding minority shareholders; and other similar misconduct resulting in exploitation of the minority shareholders' status in the company.

Furthermore, after introducing the provisions for statutory derivative actions into the Company Law in 2005, it is now clear that shareholders are entitled to bring actions in court against directors and senior managers of a listed company for breach of their duties (including fiduciary duties), even though the loss caused is to the company as a whole rather than to the shareholders directly.[810] According to Article 152 of the Company Law, if the board of directors or senior executives breach their duties by violating the law, administrative regulations or articles of association, then shareholders who have held 1% or more of the total shares in the company for at least 180 days consecutively can initiate a lawsuit with a people's court after exhausting internal remedies.

Regarding the possibility of derivative suits against controlling shareholders when they breach their fiduciary duties, the answer is unclear under the current takeover regulations in China. In accordance with Article 152 of the Company Law, shareholders could initiate a derivative action in the case of the legal rights and interests of a company damaged 'by others' and experiencing losses. Chinese scholars are of the opinion that 'others' in this provision includes controlling shareholders and de facto controlling parties who owe fiduciary duties to the company.[811] The minority shareholders should have the right to bring a legal claim against those who not only manage the company but also control it, for a remedy against the controller's abuse. Hence, the Company Law should make it clear that in the event of any damage to the legal interest of the company by controlling shareholders and de facto controlling parties, the other shareholders can file a lawsuit

---

[810] Weng (n808) 129.
[811] Junhai Liu, *Institutional Innovations of New Corporate Law: Legislative and Judicial Controversies* (Law Press China 2006) 255-256.

with a people's court and advocate the compensation for damages caused by their misconduct on the company's behalf.

Article 152 also gives shareholders a different standing to initiate the derivative action against directors and others. Directors can be sued if they cause loss to the company by violating laws, administrative regulations or the articles of association during the course of performing their duties,[812] while 'others' can be sued if they violate the lawful rights and interests of the company and cause loss. In China, as stated repeatedly above, the main agency problem is between the controlling shareholders and minority shareholders, not between managers and shareholders (as in the UK and US); no good reason has been found for making this difference between directors and controlling shareholders. The minority shareholders should be allowed to trigger the derivative suit against the controlling shareholder not only under the same conditions and procedures but also under the same standing as derivative suits against directors and senior managers.[813]

Last but not least, as controlling shareholders owe fiduciary duties not only to the company but also to the minority shareholders, the remedy for the minority shareholders against the controlling shareholders for damages should not only be in the form of a derivative suit in the company's name, but also be brought by the minority shareholders directly as individuals or as a group of injured shareholders. Thus, in the event of any losses to minority shareholders themselves, the Company Law should allow minority shareholders to pursue remedies against controlling shareholders if they can prove controlling shareholders' misconduct; under Article 153, the Company Law gives shareholders a direct right to file a lawsuit in the people's court against directors or senior

---

[812] Company Law, art 150.

[813] For more comprehensive discussions on derivative suits in China, *see* Donald C. Clarke and Nicholas C. Howson, 'Pathway to Minority Shareholder Protection: Derivative Actions in the People's Republic of China' (2011) Social Science Research Network <http://ssrn.com/abstract=1968732> accessed on 17 February 2013.

managers if they damage the interests of shareholders by violating any law, administrative regulation or the articles of association.

4. Concluding Remarks

Instead of following either the UK or the US model, this research suggests that Chinese legislators assemble a combination of the pro-takeover elements of both regimes. On the one hand this means following the British NFR, to make sure the decision-making power on the fate of the takeover bid is allocated to target shareholders. On the other hand, it means imposing fiduciary duties on controlling shareholders similar to those developed in the US, and by abandoning the British MBR to remove its negative effect on the development of the takeover market in China.

Although having NFR alone without MBR may not look convincing at first sight, it seems an appropriate path that would suit the current development of the Chinese takeover market. The protection of minority shareholders can be achieved by imposing a fiduciary duty on controlling shareholders to act in the best interests of all shareholders. Indeed, there is no system which aims at promoting a takeover market by imposing an NFR on the target board and at the same time gives the bidder maximum freedom to structure its bid without considering the shareholders' interests. In protecting target shareholders, the bidder's coercive behaviour can be largely restricted by the information disclosure rules and shareholder equal treatment rules. The drafters of Chinese takeover regulation need to consider the shareholders' interests, although the demands of minority shareholders to share the control premium should not prevail over concerns about curtailing the operation of a market for corporate control in China.

Of course, as all shares of Chinese listed companies are now freely tradeable, the current shareholding structures of Chinese listed companies are undergoing some strategic changes. Although it is unlikely that controlling shareholders, including state shareholders, will sell all their shares in the listed company and leave the equity market fully fluid in the near future, it may be that aggressive Chinese economic reform will influence the capital structure of Chinese equity market and increase the number of listed companies with a more widespread ownership structure, although not on a scale comparable to the UK and US situation in the foreseeable future. Once the state elects to reduce control of most publicly listed companies, and there are a large number of listed companies not under the control of large single shareholders, this study should be reviewed to assess whether the imposition of MBR is appropriate in the changed Chinese enterprise landscape. All in all, there is never an end to regulatory effort to seek the most suitable takeover regime in order to achieve the optimal outcome.

Bibliography

Alcock A, 'The Regulation of Takeovers' (2001) 5 Journal of International Financial Markets 163

-- and Birds J and Gale S, *Companies Act 2006: The New Law* (Jordans 2007)

Allen W, 'Our Schizophrenic Conception of the Business Corporation' (1992) 14 Cardozo Law Review 261

-- and Jacobs J and Strine, Jr. L, 'The Great Takeover Debate: A Meditation o Bridging the Conceptual Divide' (2002) 69 University of Chicago Law Review 1067

-- and Shen H, 'Assessing China's Top-Down Securities Markets' (2010) New York University School of Law, Public Law Research Paper No 10-70 <http://ssrn.com/abstract=1648336> accessed 20 March 2013

Andrade G and Mitchell M and Erik Stafford, 'New Evidence and Perspectives on Mergers' (2001) 15(2) Journal of Economic Perspectives 103

Andrew W, 'The Stockholder's Right to Equal Opportunity in the Sale of Shares' (1965) 78(3) Harvard Law Review 505

Aranow E and Einhorn H and Berlstein G, *Development in Tender Offers for Corporate Control: An Updating of a Prior Treatise on the Practical and Legal Problems Involved in Tender Offers* (Columbia University Press 1977)

Armour J, 'Enforcement Strategies in UK Corporate Governance: A Roadmap and Empirical Assessment' in John Armour and Jennifer Payne (eds), *Rationality in Company Law: Essays in Honour of DD Prentice* (Hart Publishing 2009)

-- and Hansmann H and Kraakman R, 'What Is Corporate Law' in John Armour and others (eds), *The Anatomy of Corporate Law A Comparative and Functional Approach* (Oxford University Press 2004)

-- and Hansmann H and Kraakman R, 'Agency Problems and Legal Strategies' in John Armour and others (eds), *The Anatomy of Corporate Law A Comparative and Functional Approach* (Oxford University Press 2009)

-- and Jacobs J and Milhaupt C, 'The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework' (2011) 52 Harvard International Law Journal 221

-- and Skeel Jr. D, 'Who Writes the Rules for Hostile Takeovers, and Why? The Peculiar Divergence of US and UK Takeover Regulation' (2007) 95 Georgetown Law Journal 1727

Art R and Gu M, 'China Incorporated: First Corporation Law of the People's Republic of China' (1995) 20 Yale Journal of International Law 273

Bai C and others, ‘Corporate Governance and Firm Valuations in China’ (2002) <http://ssrn.com/abstract=361660> accessed 9 May 2013

Bainbridge S, ‘Director Primacy in Corporate Takeovers: Primary Reflections’ (2002) 55 Stanford Law Review 791

-- *Mergers and Acquisitions* (2nd edn, Foundation Press 2008)

Baron D, ‘Tender Offers and Management Resistance’ (1983) 38(2) Journal of Finance 331

Baum H, ‘Takeover Law in the EU and Germany: Comparative Analysis of a Regulatory Model’ (2006) 3 University of Tokyo Journal of Law and Politics 60

Baumol W, *The Stock Market and Economic Efficiency* (Fordham University Press 1965)

Bebchuk L, ‘The Case for Facilitating Competing Tender Offers’ (1982) 95 Harvard Law Review 1028

-- ‘The Case for Facilitating Competing Tender Offers: A Reply and Extension’ (1982) 35 Stanford Law Review 23

-- ‘The Pressure to Tender: An Analysis and a Proposed Remedy’ (1987) 12 Delaware Journal of Corporate Law 911

-- ‘Efficient and Inefficient Sales of Corporate Control’ (1994) 109 Quarterly Journal of Economics 957

-- ‘A Rent-Protection Theory of Corporate Ownership and Control’ (1999) National Bureau of Economic Research Working Paper No 7203 <http://www.law.harvard.edu/faculty/bebchuk/pdfs/nber7203.99.pdf > accessed 25 February 2013

-- ‘The Case Against Board Veto in Corporate Takeovers’ (2002) 69 University of Chicago Law Review 973

-- and Coates IV J and Subramanian G, ‘The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy’ (2002) 54 Stanford Law Review 885

-- and Cohen A, ‘Firms’ Decisions Where to Incorporate’ (2003) 46 Journal of Law and Economics 383

-- and Ferrell A, ‘Federalism and Corporate Law: The Race to Protect Managers from Takeovers’ (1999) 99 Columbia Law Review 1168

-- and Ferrell A, ‘A New Approach to Takeover Law and Regulatory Competition’ (2001) 87 Virginia Law Review 111

-- and Hamdani A, ‘The Elusive Quest for Global Governance Standards’ (2009) 157 University of Pennsylvania Law Review 1263

-- and Roe M, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) 52 Stanford Law Review 127

Beltratti A and Bortolotti B and Caccavaio M, 'The Stock Market Reaction to the 2005 Non-Tradable Share Reform in China' (2011) ECB Working Paper No 1339 <http://ssrn.com/abstract=1837318> accessed 11 December 2011

Berglöf E and Burkart M, 'European Takeover Regulation' (2003) 36 Economic Policy 171

Berkovitch E and Khanna N, 'How Target Shareholders Benefit from Value-Reducing Defensive Strategies in Takeovers' (1990) 45 Journal of Finance 137

Berkowitz D and Pistor K and Richard J, 'The Transplant Effect' (2003) 51 American Journal of Criminal Law 163

Berle A, 'Corporation Powers as Powers in Trust' (1931) 44 Harvard Law Review 1049

-- and Means G, *The Modern Corporation and Private Property* (Harcourt, Brace & World 1932)

Markus Berndt, 'Global Differences in Corporate Governance Systems Theory and Implications For Reforms' (2000) Harvard Law and Economics Discussion Paper No 303 <http://www.law.harvard.edu/programs/olin_center/papers/pdf/303.pdf> accessed 31 March 2013

Bittlingmayer G, 'The Market for Corporate Control (including Takeovers)' (1998) <http://ssrn.com/abstract=81808> accessed 16 July 2011

Black B, 'Bidder Overpayment in Takeovers' (1989) 41 Stanford Law Review 597

Blair M and Stout L, 'A Team Production Theory of Corporate Law' (1999) 85 Virginia Law Review 248

Block D and Barton N and Radin S, *The Business Judgment Rule – Fiduciary Duties of Corporate Directors and Officers* (Clifton 1987)

Bortolotti B and Beltratti A, 'The Nontradable Share Reform in the Chinese Stock Market' (2006) FEEM Working Paper No 131 06 <http://ssrn.com/abstract=944412> accessed 17 January 2013

Bradley M, 'Interfirm Tender Offers and the Market for Corporate Control' (1980) 53 Journal of Business 345

Bradley M and Desai A and Kim E, 'The Rationale behind Interfirm Tender Offers: Information or Synergy?'(1983) 11 Journal of Financial Economics 183

Bratton W, 'Corporate Debt Relationships: Legal Theory in a Time of Restructuring' (1989) Duke Law Journal 92

Brudney V and Chirelstein M, 'Fair Shares in Corporate Mergers and Takeovers' (1974) 88 Harvard Law Review 297

Bull G and Vice A, *Bid for Power* (3rd edn, Elek Books 1961)

Burkart M and Panunzi F, 'Mandatory Bids, Squeeze-Outs and Similar Transactions' in Guido Ferrarini and others (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004)

Cai W, 'Path Dependence and Concentration of Ownership and Control of Companies Listed in China' (2009) 20(8) International Company and Commercial Law Review 281

-- 'The Mandatory Bid Rule in China' (2011) 12 European Business Organization Law Review 653

Carney W, 'Shareholder Coordination Costs, Shark Repellents and Takeout Mergers: The Case Against Fiduciary Duties' (1983) American Bar Foundation Research 341

-- *Mergers and Acquisitions: Cases and Materials* (Foundation Press 2007)

-- and Silverstein L, 'The Illusory Protections of the Poison Pill' (2003) 79 Notre Dame Law Review 179

Chandler III W, 'Hostile M&A and the Poison Pill in Japan: A Judicial Perspective' (2004) Columbia Business Law Review 45

Chase O, 'Legal Processes and National Culture' (1997) 5 Cardozo Journal of International and Comparative Law 1

Cheffins B, 'Current Trends in Corporate Governance: Going from London to Milan via Toronto' (1999) 10 Duke Journal of Comparative & International Law 5

-- *Corporate Ownership and Control British Business Transformed* (Oxford University Press 2009)

Chen G and Firth M and Rui O, 'Have China's Enterprise Reforms Led to Improved Efficiency and Profitability?' (2006) 7 Emerging Market Review 82

-- and others, 'Control Transfers, Privatization, and Corporate Performance: Efficiency Gains in China's Listed Companies' (2008) 43 Journal of Financial and Quantitative Analysis 161

Chodosh H, 'Comparing Comparisons: In Search of Methodology' (1999) 84 Iowa Law Review 1025

Choi Y, 'The Choice of Organizational Form: The Case of Post-Merger Managerial Incentive Structure' (1993) 22 Financial Management 69

Church J and Edwards AB, 'Comparative Law/Comparative Method' in Hosten (ed), *Introduction to South African Law and Legal Theory* (Butterworths 1995)

Clark R, *Corporate Law* (Little, Brown 1986)

Clarke B, 'Directors' Duties During an Offer Period—Lessons from the Cadbury PLC Takeover' (2011) UCD Working Papers in Law, Criminology and Socio-Legal Studies Research Paper No 44/2011 <http://ssrn.com/abstract=1759953> accessed 8 March 2012

Clarke D, 'Corporate Governance in China: An Overview' (2003) 14 China Economic Review 494

-- and Howson N, 'Pathway to Minority Shareholder Protection: Derivative Actions in the People's Republic of China' (2011) Social Science Research Network <http://ssrn.com/abstract=1968732> accessed on 17 February 2013

Coates IV J, 'Measuring the Domain of Mediating Hierarchy: How Contestable are US Public Corporations?' (1999) 24 Journal of Corporate Law 837

-- 'Empirical Evidence on Structural Takeover Defenses: Where Do We Stand?' (2000) 54 University of Miami Law Review 783

-- 'Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence' (2000) 79 Texas Law Review 271

-- 'The Contestability of Corporate Control: A Critique of the Scientific Evidence on Takeover Defenses' (2000) 79 Texas Law Review 271

-- and Subramanian G, 'A Buy-Side Mode of Lockups: Theory and Evidence' (2000) 53 Stanford Law Review 307

Coffee Jr. J, 'Regulating the Market for Corporate Control: A Critical Assessment of the Takeover's Role in Corporate Governance' (1984) 84 Columbia Law Review 1145

-- 'Partial Justice: Balancing Fairness and Efficiency in the Context of Partial Takeover Offers' (1985) 3 Company and Securities Law Journal 216

-- and Lowenstein L and Rose-Ackerman S, *Knights, Raiders, and Targets: the Impact of the Hostile Takeover* (Oxford University Press1988)

Cohen M, 'A Note on Takeover Bids and Corporate Purchases of Stock' (1966) 22 Business Lawyer 149

Comment R and Schwert G, 'Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures' (1995) 39 Journal of Financial Economics 3

Conyon M and He L, 'Executive Compensation and Corporate Governance in China' (2011) <http://digitalcommons.ilr.cornell.edu/ics> accessed 2 Oct 2012

Cooper M, 'New Thinking in Financial Market Regulation: Dismantling the "Split Share Structure" of Chinese Listed Companies' (2008) 13 Journal of Chinese Political Science 53

Cox J and Hazen T, *Cox & Hazen on Corporations* (2nd edn, Aspen Publishers 2003)

Cranston R, 'The Rise and Rise of the Hostile Takeover' in Klaus J. Hopt and Eddy Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths Tolley 1992)

Daines R and Klausner M, 'Do IPO Charters Maximize Firm Value? Antitakeover Protection in IPOs' (2001) 17 Journal of Law, Economics, and Organization 83

Davey P, *Defenses Against Unnegotiated Cash Tender Offer* (Conference Board 1977)

Davies P, 'The Regulation of Defensive Tactics in the United Kingdom and the United States' in Klaus J. Hopt and Eddy Wymeersch (eds), *European Takeovers: Law and Practice* (Butterworths Tolley 1992)

-- 'Shareholder Value, Company Law and Securities Markets Law - A British View' In Klaus J. Hopt and Eddy Wymeersch (eds), *Capital markets and company law* (Oxford University Press 2000)

-- 'The Notion of Equality in European Takeover Regulation' in Jennifer Payne (ed) *Takeovers in English and German Law* (Hart Publishing 2002)

-- *Gower and Davies' Principle of Modern Company Law* (Sweet & Maxwell 2003)

-- and Hopt K, 'Control Transactions' in John Armour and others (eds), *The Anatomy of Corporate Law: a Comparative and Functional Approach* (Oxford University Press 2004)

-- and Schuster E and Van de Walle de Ghelcke E, 'The Takeover Directive as a Protectionist Tool?' in Ulf Bernitz and Wolf-Georg Ringe (eds) *Company Law and Economic Protectionism: New Challenges to European Integration* (Oxford University Press 2010)

Dawson S and Pence R and Stone D, 'Poison Pill Defensive Measures' (1987) 42 Business Lawyer 423

Deakin S and others, 'Implicit Contracts, Takeovers and Corporate Governance: in the Shadow of the City Code' (2002) ESRC Centre for Business Research, University of Cambridge Working Paper 254 < http://www.cbr.cam.ac.uk/pdf/WP254.pdf> accessed 17 July 2012

Dean J, 'Directors' Duties in Response to Hostile Takeover Bid' (2003) 14(12) International Company and Commercial Law Review 370

Delahaye B, 'Still Alive: Poison Pills and Staggered Boards As Hostile Takeover Defences – the Battle for Airgas' (2012) International Company and Commercial Law Review 211

DeMott D, 'Current Issues in Tender Offer Regulation: Lessons from the British' (1983) 58 New York University Law Review 945

Demsetz H and Lehn K, 'The Structure of Corporate Ownership: Causes and Consequences' (1985) 93 Journal of Political Economy 1155

DePamphilis D, *Mergers, Acquisitions, and Other Restructuring Activities: An Integrated Approach to Process, Tools, Cases, and Solutions* (4th edn, Academic Press 2008)

Dey J, 'Efficiency of Takeover Defence Regulations A Critical Analysis of the Takeover Defence Regimes in Delaware and the UK' (2009) Social Science Research Network <http://ssrn.com/abstract=1369542> accessed 2 January 2011

Dickinson S, 'Introduction to the New Company Law of the People's Republic of China' (2007) 16 Pacific Rim Law & Policy Journal 1

Dodd P 'Merger Proposals, Management Discretion and Stockholder Wealth' (1980) 8 Journal of Financial Economics 105

-- and Ruback R, 'Tender Offers and Stockholder Returns: An Empirical Analysis' (1977) 5 Journal of Financial Economics 351

Easterbrook F, 'Manger's Discretion and Investors' Welfare: Theories and Evidence' (1984) 9 Delaware Journal of Corporate Law 54

-- and Fischel D, 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) 94 Harvard Law Review1161

-- and Fischel D, 'Auctions and Sunk Costs in Tender Offer' (1982) 35 Stanford Law Review 1

-- and Fischel D, 'Corporate Control Transactions' (1982) 91 Yale Law Journal 698

-- and Fischel D, *The Economic Structure of Corporate Law* (Harvard University Press 1996)

-- and Jarrell G, 'Do Targets Gain from Defeating Tender Offers' (1984) 59 New York University Law Review 277

Eckbo B, 'Bidding Strategies and Takeover Premiums: A Review' (2009) 15 Journal of Corporate Finance149

Enriques L, 'The Mandatory Bid Rule in the Takeover Directive: Harmonization Without Foundation' (2004) 4 European Company and Financial Law Review 440

Faccio M and Lang L, 'The Ultimate Ownership of Western European Corporations' (2002) 65 Journal of Financial Economics 365

Fama E, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of Political Economy 288

Fang L, ‘Takeover Defences under PRC Law (Part II)’ (2006) <http://www.chinalawandpractice.com/Article/1692096/Channel/9939/Takeover-Defences-under-PRC-Law-Part-II.html> accessed 2 February 2013

Farrar J, ‘Business Judgment and Defensive Tactics in Hostile Takeover Bids’ in John H. Farrar (ed), *Takeovers, Institutional Investors, and the Modernization of Corporate Laws* (Oxford University Press1993)

Ferrarini G, ‘Share Ownership, Takeover Law and the Contestability of Corporate Control’ (2000) Social Science Research Network <http://ssrn.com/abstract=265429> accessed 29 September 2012Feinman J, *Law 101: Everything You Need to Know about the American Legal System* (Oxford University Press 2006)

-- and Miller G, ‘A Simple Theory of Takeover Regulation in the United States and Europe’ (2009) Cornell International Law Journal 301

Firth M and Lin C and Zou H, ‘Friend or Foe? The Role of State and Mutual Fund Ownership in the Split Share Structure Reform in China’ (2010) 45 Journal of Financial and Quantitative Analysis 685

Fischel D ‘Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offer’ (1978) 57 Texas Law Review 1

Fletcher W, *Cyclopedia of the Law of Private Corporations* (Callaghan 1980)

Forstinger C, *Takeover Law in the EU and the USA: A Comparative Analysis* (Kluwer Law International 2002)

Garcia F, ‘Protecting Nonshareholder Interests in the Market for Corporate Control: A Role for State Takeover Statutes’ (1990) 23 University of Michigan Journal of Law Reform 507

Garnaut R and others, *China’s Ownership Transformation* (International Finance Corporate 2005)

Gaughan P, *Mergers What Can Go Wrong and How to Prevent It* (John Wiley & Sons 2004)

-- *Mergers, Acquisitions, and Corporate Restructurings* (John Wiley & Sons 2007)

Gearing M, ‘Provisions Application to All Offers, Partial Offers and Redemption or Purchase by A Company of Its Own Securities’ in Maurice Button (ed), *A Practitioner’s Guide to The City Code on Takeovers and Mergers 2008/2009* (City & Financial Publishing 2008)

Gilson R, ‘A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers’ (1981) 33 Stanford Law Review 819

-- ‘Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense’ (1982) 35 Stanford Law Review 51

-- 'Unocal Fifteen Year Later (And What We Can Do About It)' (2001) 26 Delaware Journal of Corporate Law 491

-- 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 Harvard Law Review 1641

-- and Black B, *The Law and Finance of Corporate Acquisitions* (2nd edn, Foundation Press 1995)

-- and Kraakman R, 'Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?' (1989) 44 Business Lawyer 247

-- and Schwartz A, 'Sales and Elections as Methods for Transferring Corporate Control' (2001) 2 Theoretical Inquiries Law 783

Goergen M and Martynova M and Renneboog L, 'Corporate Governance Convergence: Evidence from Takeover Regulation Reforms in Europe' (2005) 21 Oxford Review of Economic Policy 243

Gong C and others, *Principles and Cases of Corporate Mergers and Acquisitions* (Renmin University Press 1996)

Gordley J, 'Comparative Legal Research: Its Function in the Development of Harmonized Law' (1995) 43(4) American Journal of Comparative Law 555

Gordon J, 'Just Say Never?' Poison Pills, Deadhand Pills, And Shareholder-Adopted Bylaws: An Essay For Warren Buffett' (1997) 19(2) Cardozo Law Review 511

-- and Nixon H, 'The Outer Boundaries of the Poison Pill in US Takeovers' (1989) 4(3) Journal of International Business and Law 142

Gower L, 'Corporate Control: The Battle for the Berkeley' (1955) 68 Harvard Law Review 1176

Gulati G and Klein W and Zolt E, 'Connected Contracts' (2000) 47 UCLA Law Review 887

Guo L and Rizzi C, 'Entering the Chinese Market Through Takeovers - A Glimpse on the Current Legal and Regulatory Regime' (2011) Social Science Research Network <http://ssrn.com/abstract=1879863> accessed 28 February 2012

Hadjinestoros M, 'Exploitation of Business Opportunities: How the UK Courts Ensure that Directors Remain Loyal to Their Companies' (2008) 19(2) International Company and Commercial Law Review 70

Hansen J, 'The Mandatory Bid Rule: The Rise to Prominence of a Misconception' (2003) 45 Scandinavian Studies in Law 173

Hansmann H and Kraakman R, 'The End of History for Corporate Law' (2001) 89 Georgetown Law Journal 439

Hartzell J and Ofek E and Yermack D, 'What's In It For Me? CEOs Whose Firms Are Acquired' (2004) 17 Review of Financial Studies 37

Hathaway O, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 Iowa Law Review 101

Hayes III S and Taussig R, 'Tactics of Cash Takeover Bids' (1967) 45 Harvard Business Review 135

Heller R, 'Have the Controlling Shareholders Breached Their Fiduciary Duties to the Minority in Transferring Control Shares' <http://www.hellerlaw.com/controlling-shareholder-breach.html> accessed 2 October 2012

Henn H and Alexander J, *Laws of Corporations and Other Business Enterprises* (3rd edn, West Group 1983)

Herzel L and Shepro R, 'Ups and Downs of US Takeover Defense' (1988) 9 Company Law 84

Hill J, 'Corporate Scandals Across the Globe: Regulating the Role of the Director' in Guido Ferrarini and others (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004)

-- 'Takeover, Poison Pills and Protectionism in Comparative Corporate Governance' (2010) Working Paper No. 168/2010 <http://ssrn.com/abstract=1704745> accessed 17 February 2013

Hingley R, 'The Takeover Panel' in Maurice Button (ed), *A Practitioner's Guide to The City Code on Takeovers and Mergers 2008/2009* (City and Financial Publishing 2008)

Hobson D, *The National Wealth: Who Gets What in Britain* (HarperCollins Business1999)

Hofstetter K, 'One Size Does Not Fit All: Corporate Governance for 'Controlled Companies'' (2005) Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=802705> accessed 28 October 2012

Hopt K, 'Common Principles of Corporate Governance in Europe?' in Joseph A. McCahery and others (eds), *Corporate Governance Regimes: Convergence and Diversity* (Oxford University Press 2002)

-- 'Comparative Company Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press 2006)

Hou W and Howell S, 'Restriction Tightness, Bargaining Power, and the Valuation of Restricted Shares by Conflicting Shareholders in the Split Share Structure Reform' (2006) Social Science Research Network <http://ssrn.com/abstract=1343636> accessed 17 December 2011

Howson N 'The Doctrine that Dared Not Speak its Name: Anglo-American Fiduciary Duties in China's 2005 Company Law and Case Law Intimations of Prior Convergence' in Hideki Kanda and Kon-Sik Kim and Curtis Milhaupt (eds), *Transforming Corporate Governance in East Asia* (Routledge 2008)

Huang H, 'China's Takeover Law: a Comparative Analysis and Proposals for Reform' (2005) 30 Delaware Journal of Corporate Law 145

-- 'The New Takeover Regulation in China: Evolution and Enhancement' (2008) 42(1) International Lawyer 153

Hurst T, 'The Regulation of Tender Offers in the United States and the United Kingdom: Self-Regulation Versus Legal Regulation' (1987) 12 North Carolina Journal of International Law and Commercial Regulation 389

Jarrell G and Brickley J and Netter J, 'The Market for Corporate Control: The Empirical Evidence Since 1980' (1988) 2 Journal of Economic Perspectives 49

-- and Poulsen A, 'The Returns to Acquiring Firms in Tender Offers: Evidence from Three Decades' (1989) 18(3) Journal of the Financial Management Association 12

Jenkinson T and Mayer C, *Hostile Takeovers: Defence, Attack and Corporate Governance* (McGraw-Hill Book 1994)

Jensen M, 'Takeovers: Their Causes and Consequences' (1988) 2 Journal of Economic Perspectives 21

-- and Ruback R, 'The Market for Corporate Control: the Scientific Evidence' (1983) 11 Journal of Financial Economics 5

Jia N and Shi J and Wang Y, 'Value Creation and Value Capture in Corporate Governance: Using the Value-Based Approach to Analyze an Ownership Reform of China's Listed Firms' (2012) Marshall School of Business Working Paper <http://ssrn.com/abstract=2171355> accessed 17 July 2012

Johnson J and Siegel M, 'Corporate Mergers: Redefining the Role of Target Directors' (1987) 136 University of Pennsylvania Law Review 315

Johnston A, *The City Takeover Code* (Oxford University Press1980)

-- 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 Cambridge law Journal 422

Julian R. Franks and Harris R, 'Shareholder Wealth Effects of Corporate Takeovers: The U.K. Experience 1955-1985' (1989) 23 Journal of Financial Economics 225

Kamba W, 'Comparative law: A Theoretical Framework' (1974) 23 International and Comparative law Quarterly 485

Kenyon-Slade S, *Mergers and Takeovers in the US and UK* (Oxford University Press 2004)

Kershaw D, 'The Illusion of Importance: Reconsidering the UK's Takeover Defence Prohibition' (2007) 56(2) International & Comparative Law Quarterly 267

Kim Y and Ho I and Giles M, 'Developing Institutional Investors in People's Republic of China' (2003) World Bank Country Study Paper <www-wds.worldbank.org/.../302480CHA0deve1titutional0investors.pdf > accessed 28 January 2012

Kirchner C and Painter R, 'European Takeover Law -- Towards a European Modified Business Judgment Rule for Takeover Law' (2000) 1 European Business Organizations Law Review 353

Kraakman R and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press 2009)

Kummer D and Hoffmeister J, 'Valuation Consequences of Cash Tender Offers' (1978) 33 Journal of Finance 505

Lamb D, 'United States of America: Directors' Duties under Delaware Takeover Law' (1994) 15(9) Company Law 283

Lee R, 'Fiduciary Duty without Equity: "Fiduciary Duties" of Directors under the Revised Company Law of the PRC' (2007) 47 Virginia Journal of International Law 897

Lee T, 'Takeovers – The United Kingdom Experience' in John H. Farrar (ed), *Takeovers, Institutional Investors, and the Modernization of Corporate Laws* (Oxford University Press 1993)

Li K and others, 'Privatization and Risk Sharing: Evidence from the Split Share Structure Reform in China' (2010) Social Science Research Network <http://ssrn.com/abstract=1677178> accessed 25 March 2012

Liang N and Useem M, 'Corporate Governance in China' in Institute of Directors (ed), *The Handbook of International Corporate Governance* (Kogan Page 2009)

Liebman B and Milhaupt C, 'Reputational Sanctions in China's Securities Markets' (2008) 108 Columbia Law Review 929

Limmack R, 'Corporate Mergers and Shareholder Wealth Effects' (1991) 21 Accountant and Business Research 239

Lipton M, 'Takeover Bids in the Target Boardroom' (1979) 35 Business Lawyer 101

-- 'Corporate Governance in the Age of Finance Corporatism' (1987) 136 University of Pennsylvania Law Review 1

-- 'Pills, Polls, and Professions Redux' (2002) 69 University of Chicago Law Review 1037

Liu C and Uchida K and Yang Y, 'Controlling Shareholder, Split-Share Structure Reform and Cash Dividend Payments in China' (2012) Financial Markets & Corporate Governance Conference <http://ssrn.com/abstract=1898549> accessed 18 January 2013

Liu H, 'The Non-Frustration Rule of the UK City Code on Takeover and Mergers and Related Agency Problems: What are the Implications for the EC Takeover Directive?' (2011) 17 Columbia Journal of European Law 5

Liu J and Pißler K, 'Corporate Governance of Business Organizations in the People's Republic of China: The Legal Framework After the Revision of the Company Law in 2005' (2010) Social Science Research Network <http://ssrn.com/abstract=1695888> accessed 29 September 2012

Liu Q, 'Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants' (2006) 52(2) CESifo Economic Studies 415

Loewenstein M, 'Delaware as Demon: Twenty-Five Years after Professor Cary's Polemic' (2000) 71 University of Colorado Law Review 497

Lowenstein L, 'Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation' (1983) 83 Columbia Law Review 249

Lowry J, 'Poison Pills in U.S. Corporations – a Re-examination' (1992) Journal of Business Law 337

Lu F and Balatbat M and Czernkowski R, 'The Role of Consideration in China's Split Share Structure Reform' (2008) <http://ssrn.com/abstract=1284067> accessed 9 February 2012

Luzung A, 'Should Directors be allowed to Use Takeover Defensive Measures (1993) 12 University of Tasmania Law Review 75

Macey J and Netter J, 'Regulation 13 D and the Regulation Process' (1987) Washington University Law Quarterly 131

Magnuson W, 'Takeover Regulation in the United States and Europe: An Institutional Approach' (2009) 21 Pace International Law Review 205

Mann R and Milhaupt C, 'Forward: Path Dependence and Comparative Corporate Governance' (1996) 74 Washington University Law Quarterly 317

Manne H, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political Economy 110

Mannolini J, 'Convergence or Divergence: Is there a Role for the Eggleston Principles in a Global M&A Environment?' (2002) 24 Sydney Law Review 336

Martin J. Conyon and Lerong He, 'Executive Compensation and Corporate Governance in China' (2011)

<http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1005&context=ics> accessed 20 March 2013

Mattlin M, 'The Chinese Government's New Approach to Ownership and Financial Control of Strategic State-Owned Enterprises' (2007) BOFIT Discussion Papers No 10/2007 <http://ssrn.com/abstract=1001617> accessed 19 March 2012

McCabe M and Nowak M, 'The Independent Director on the Board of Company Directors' (2008) 23 Managerial Auditing Journal 545

McCahery J and others, 'The Economics of the Proposed European Takeover Directive' in Ferrarini Guido and others (eds), *Reforming Company and Takeover Law in Europe* (Oxford University Press 2004)

-- and Vermeulen E, 'Does the Takeover Bids Directive Need Revision?' (2010) TILEC Discussion Paper No 2010-006 < http://ssrn.com/abstract=1547861> accessed 21 September 2012

McDaniel M, 'Bondholders and Corporate Governance' (1986) 41 Business Lawyer 413

Mikkelson W and Partch M, 'The Decline of Takeovers and Disciplinary Managerial Turnover' (1977) 44 Journal of Financial Economics 205

Miller G, 'Political Structure and Corporate Governance: Some Points of Contrast between the United States and England' (1998) 1 Columbia Business Law Review 51

-- 'Special Symposium Issue: Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England' (1998) Columbia Business Law Review 51

Moon R, *Business Mergers and Takeover Bids* (3rd edn, Gee Publishing 1968)

Mucciarelli F, 'White Knights and Black Knights - Does the Search for Competitive Bids Always Benefit the Shareholders of 'Target' Companies?' (2006) 3(4) European Company and Financial Law Review 408

Muir D and Schipani C, 'New Standards of Director Loyalty and Care in the Post-Enron Era: Are Some Shareholders More Equal Than Others' (2005) 8 Legislation and Public Policy 279

Mukwiri J, 'Implementing the Takeover Directive in the UK' (DPhil thesis, University of Leicester 2008)

-- 'The Myth of Tactical Litigation in UK Takeovers' (2008) 8 Journal of Corporate Law Studies 373

Myners P, 'Institutional Investment in the United Kingdom: A Review' (2001) <http://archive.treasury.gov.uk/pdf/2001/myners_report.pdf> accessed 27 November 2012

Nuttall R, 'An Empirical Analysis of the Effects of the Threat of Takeover on UK Company Performance' (1999) Nuffield College, University of Oxford, Working Paper No 5 < http://ssrn.com/abstract=155561 > accessed 12 July 2011

O'Kelley C and Thompson R, *Corporations and other Business Associations: Selected Statutes, Rules and Forms* (Aspen 1998)

-- and Thompson R, *Corporations and Other Business Associations: Cases and Materials* (5th edn, APSEN 2006)

Ogowewo T, 'Tactical Litigation in Takeover Contests' (2007) Journal of Business Law 589

Olson B, *Publicly Traded Corporations: Governance & Regulation* (Thompson/West 2004)

Pacheco J 'Bifurcation or Parallel Routes*?* In Search of US Functional Substitutes for the British Post-Takeover Mandatory Bid Rule' (2006) Social Science Research Network <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=946208> accessed 6 March 2012

Pargendler M, 'State Ownership and Corporate Governance' (2012) 80 Fordham Law Review 2917

Parkinson J, *Corporate Power and Responsibility* (Clarendon Press 1993)

Pennington R, 'Takeover Bids in the UK' (1969) 17 American Journal of Comparative Law 159

Porta R and Lopez-de-Silanes F and Shleifer A, 'Corporate Ownership around the World' (1999) 54 Journal of Finance 471

Prentice R and Langmore J, 'Hostile Tender Offers and the "Nancy Reagan Defense": May Target Boards "Just Say No"? Should They Be Allowed To?' (1990) 15 Delaware Journal of Corporate Law 377

Presser S, 'Thwarting the Killing of the Corporation: Limited Liability, Democracy and Economics' (1992) 87 Northwestern University Law Review 148

Psaroudakis G, 'The Mandatory Bid and Company Law in Europe' (2010) 7(4) European company and Financial Review 550

Pudge D, 'Conduct During the Offer; Timing and Revision; and Restrictions Following Offers' in Maurice Button (ed), *A Practitioner's Guide to The City Code on Takeovers and Mergers 2008/2009* (City and Financial Publishing 2008)

Rainer J, *Introduction to Comparative Law* (Manz 2010)

Rajan R and Zingales L, 'Power in A Theory of the Firm' (1998) 113 Quarterly Journal of Economics 397

Reitz J, 'How to Do Comparative Law' (1998) 46(4) American Journal of Comparative Law 617

Ribstein L, 'Why Corporations?'(2004) 1 Berkeley Business Law Journal 183

Richard W. Jennings and Harold March and John C. Coffee, *Securities Regulation: Cases and Materials* (Foundation Press 1992)

Roberts R, 'Regulatory Responses to the Rise of the Market for Corporate Control in Britain in the 1950s' (1992) 34 Business History 183

Roe M, 'Chaos and Evolution in Law and Economics' (1996) 109 Harvard Law Review 641

-- *Strong Manager Week Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1996)

-- 'Political Preconditions to Separating Ownership from Corporate Control' (2000) 53 Stanford Law Review 539

-- 'The Shareholder Wealth Maximization Norm and Industrial Organization" (2001) 149 University of Pennsylvania Law Review 2063

Romano R, 'A Guide to Take-overs: Theory, Evidence and Regulation' in Klaus J. Hopt and Eddy Wymeersch (eds.), *European Takeovers: Law and Practice* (Butterworths Law 1992)

-- 'Competition for Corporate Charters and the Lesson of Takeover Statutes' (1993) 61 Fordham Law Review 843

Sacco R, 'Legal Formants: A Dynamic Approach to Comparative Law (Installment I of II)' (1991) 39 American Journal of Comparative Law 1

-- 'One Hundred Years of Comparative Law' (2001) 75 Tulane Law Review 1159

Schlesinger R, 'The Role of the "Basic Course" in the Teaching of Foreign and Comparative law' (1971) 19 American Journal of Comparative Law 616

Schwartz A, 'Search Theory and the Tender Offer' (1986) 2 Journal of Law, Economics, and Organization 229

Scott T, 'The Comparative Method of Legal Research' <http://web.up.ac.za/sitefiles/file/47/J%20Scott%20-%20Comparative%20research%20perspectives%20_Private%20law_.pdf > accessed 15 April 2013

Seretakis A, 'Hostile Takeovers and Defensive Mechanisms in the UK and the US: A Case Against the US Regime' (2012) Social Science Research Network <http://ssrn.com/abstract=1985846> accessed 28 January 2013

Shleifer A and Summers L, ‘Breach of Trust in Hostile Takeovers’ in Alan J. Auerbach (ed), *Corporate Takeovers: Causes and Consequences* (University of Chicago Press1998)

-- and Vishny R, ‘A Survey of Corporate Governance’ (1997) 52 Journal of Finance 737

Slaughter C, ‘Rights Offerings, Takeovers and US Shareholders’ (2002) 23(2) *Company Lawyer* 42

Smith A, *An Inquiry into the Nature and Causes of the Wealth of Nations* (Random House 1776)

Smith G, ‘Poison Pill Forum: The Revival of Interco’ (2010) Conglomerate <http://www.theconglomerate.org/2010/09/poison-pill-forum-the-revival-of-interco.html> accessed 3 April 2013

Smith K, ‘How Companies Use Shareholder Rights Plans (Poison Pills) to Fight Hostile Takeover’ <http://www.moneycrashers.com/poison-pills-fight-hostile-takeovers/> accessed 10 April 2012

Smits J, ‘Comparative Law and its Influence on National Legal Systems’ in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (Oxford University Press 2006)

Song G and Meeks G, ‘The Convergence of the Chinese and Western Takeover Markets’ (2009) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1505947> accessed 31 March 2010

Stephen M. Bainbridge, *Corporate Law and Economics* (Foundation Press 2002)

Stout L, ‘Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May Be Right’ (2004) 40 Business Lawyer 1435

-- ‘On the Export of US-Style Corporate Fiduciary Duties to Other Cultures: Can A Transplant Take?’ in John Gillespie and Pip Nicholson (eds) *Asia Socialism and Law Change: the Dynamics of Vietnamese Renewal and Chinese Reform* (Asia Pacific Press 2005)

Subramanian G, ‘A New Takeover Defense Mechanism: Using an Equal Treatment Agreement as an Alternative to the Poison Pill’ (1998) 23 Delaware Journal of Corporation Law 375

-- ‘Bargaining in the Shadow of Takeover Defenses’ (2003) 113 Yale Law Journal 621

Tallon D, ‘Comparative Law: Expanding Horizons’ (1969) 10 Journal of the Society of Public Teachers of Law 265

Tenev S and Zhang C and Brefort L, *Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets* (World Bank Publications 2002)

Thompson R, 'Takeover Regulation After the 'Convergence' of Corporate Law' (2002) 24 Sydney Law Review 323

-- and Smith D, 'Toward A New Theory of the Shareholder Role: 'Sacred Space' in Corporate Takeovers' (2001) 80 Texas Law Review 261

Tyson W, 'The Proper Relationship Between Federal and State Law in the Regulation of Tender Offers' (1990) 66 Notre Dame Law Review 241

Underhill W and Austmann A, 'Defence Tactics' in Jennifer Payne (ed), *Takeover in English and German Law* (Hart Publishing 2002)

Ventoruzzo M, 'Europe's Thirteenth Directive and U.S. Takeover Regulation: Regulatory Means and Political and Economic Ends' (2006) 41 Texas International Law Journal 171

-- 'The Thirteenth Directive and the Contrasts Between European and U.S. Takeover Regulation: Different (Regulatory) Means, Not so Different (Political and Economic) Ends?' (2006) Bocconi Legal Studies Research Paper No 06-07 <http://ssrn.com/abstract=819764> accessed 21 July 2011

-- 'Takeover Regulation as a Wolf in Sheep's Clothing: Taking Armour & Skeel's Thesis to Continental Europe' (2008) 11 University of Pennsylvania Journal of Business Law 135

Voβ S and Xia Y, 'Corporate Governance for Listed Companies in China: An Agenda for the Crisis' (2011) <http://emnet.univie.ac.at/uploads/media/Vo%C3%9F_Xia_01.pdf > accessed 7 July 2012

Wang J, 'Dancing with Wolves: Regulation and Deregulation of Foreign Investment in China's Stock Market' (2004) 5 Asian-Pacific Law & Policy Journal 1

Watson A, *Legal Transplants: An Approach to Comparative Law* (2nd edn, University of Georgia Press 1993)

Wei Y, 'China's Capital Market and Corporate Governance: The Promotion of the External Governance Mechanism' (2007) 4 Macquarie Journal of Business Law 325

-- 'Maximising the External Governance Function of the Securities Market: A Chinese Experience' (2008) International Company and Commercial Law Review 111

Weiss M, 'Tender Offers and Management Responsibility' (1978) 23 New York Law School Law Review 445

Weng C, 'Assessing the Applicability of the Business Judgment Rule and "Defensive" Business Judgment Rule in Chinese Judiciary: A Perspective on Takeover Dispute Adjudications' (2010) 34 Fordham International Law Journal 124

-- 'Lifting the Veil of Words: An Analysis of the Efficacy of Chinese Takeover Laws and the Road to the Harmonious Society' (2011) 24 Columbia Journal of Asian Law 1

Weston J and Mitchell M and Mulherin J, *Takeovers, Restructuring and Corporate Governance* (Pearson Prentice Hall 2004)

White B, 'Conflicts in the Regulation of Hostile Business Takeovers in the United States and the European Union' (2003) 9 Ius Gentium 161

Wulf J, 'Internal Capital Markets and Firm-Level Compensation Incentives for Division Managers" (2002) 20 (2) Journal of Labor Economics S219

Wymeersch E, 'The Mandatory Bid: A Critical Review' in Klaus J. Hopt and Eddy Wymeersch (eds), *European Takeovers – Law and Practice* (Butterworths 1992)

Xi C, 'Foreign Solutions for Local Problems? The Use of US-style Fiduciary Duties to Regulate Agreed Takeovers in China' (2008) 6(4) Journal of Chinese Economic and Business Studies 407

-- *Corporate Governance and Legal Reform in China* (Wildy Simmonds and Hill 2009) 63

Yenug W, 'Non-Tradable Share Reform in China: Marching Towards the Berle and Means Corporation?' (2009) Comparative Research in Law & Political Economy Research Paper No 48/2009 <http://ssrn.com/abstract=1515957> accessed 25 February 2012

Yu G, 'The Problem with the Transplantation of Western Law in China' (2004) Social Science Research Network <http://ssrn.com/abstract=1535683> accessed 28 February 2012

-- 'Using Western Law to Improve China's State-owned Enterprises of Takeovers and Securities Fraud' (2004) 39 Valparaiso University Law Review 339

-- 'Chaos Theory and Path Dependence: The Takeover of Listed Companies in China' (2005) 20(2) Banking and Finance Law Review 217

-- 'Takeovers in china: The Case Against Uniformity in Corporate Governance' (2005) 34 Common Law World Review 169

Yue L and Lv S, 'Upgrade SOE's Operation Efficiency through Improving Internal Control' (2010) 11 Finance and Accounting 35

Zhang L, 'Hostile Takeovers in China: Comparative Corporate Governance and Institutional Changes' (2012) Social Science Research Network <http://ssrn.com/abstract=2107689> accessed 18 January 2013

Zhang X, 'New Rules to encourage M&As' *China Daily* (Beijing, 9 October 2002)

Zhao J, 'A More Efficient Derivative Action System in China: Challenges and Opportunities through Corporate Governance Theory' (2013) Northern Ireland Legal Quarterly (forthcoming)

-- and Wen S, 'Promoting Stakeholders: Interests in the Unique Chinese Corporate Governance Model: More Socially Responsible Corporations?' (2010) 21(11) International Company and Commercial Law Review 373

Chinese Materials

Cha M, 'Analysis on the Features of Two Cases of Tender Offer' *China Securities News* (Beijing, 23 April 2003)

Chen H and others*, Study on State-Owned Shares* (China University of Political Science and Law Press 2000)

Chen W and Weng J, 'The Art of Investment: Tactics for Acquiring PRC Listed Companies' (2007) China Law & Practice <http://www.chinalawandpractice.com/Article/1690357/The-Art-of-Investment-Tactics-for-Acquiring-PRC-Listed-Companies.html?Print=true> accessed 18 July 2012

Chen Z, 'Private Firm Looking for New Ways to Finance the Takeover' (2010) 4 China Technology and Economy of Private Firms 72

Deng H, 'Constraining the Majority Shareholders under the Concentrated Ownership Structures of the CDLCs: An Opportunity for the Transformation along with the Equity-division Reform' (2008) 6 Legal Science 145

Li J, *Invest in China - A Practical Legal Guide to Mergers and Acquisitions* (Law Press China 2006) 188

Li B, 'A Discussion of the Exemption from the Mandatory Bid Rule' (2003) 18(6) Legal Forum 50

Lin L, *Research on the Ownership Concentration of the Chinese Listed Company* (Economy and Management Publisher 2005)

Lin Z and Liu L and Zhang X, 'The Development of Corporate Governance in China' (2007) Company Lawyer 195

Liu J, 'Prospect for China's Corporate Law Reform after the Entry into WTO' in Baoshu Wang and others (eds), *Corporate Law Reform for A Global Competitive Economy* (Social Science Academic Press 2003)

-- *Institutional Innovations of New Corporate Law: Legislative and Judicial Controversies* (Law Press China 2006)

Mei S, *Research on the Structure of Modern Corporate Organ's Power: A Legal Analysis of Corporate Governance* (Publishing House of China University of Political Science and Law 1996)

Quan X and Hu B, 'A Legal Analysis of the Shareholding Structure Reform' (2006) Annual Report on China's Financial Law 380

Wang B and Cui Q, *The Principles of China's Corporate* (Social Sciences Academic Press 2004)

Wang T, 'No Substantive Selling-out of Previously Non-tradable Shares of Centrally State-controlled Listed Companies' (2008) China Securities Journal A01

Wu X, 'The Legality Issue of Finance Contract between Private Firms' (2007) 23 People Justice 27

Zhang J, *Chinese Enterprises Merges and Acquisitions Year Book* (Chinese Economic Publishing 2005-2012)