ACTIVIST INVESTORS AND UNDER-ENFORCED FIDUCIARY DUTIES: A REFLECTION ON CHINA'S TAKEOVER REGULATION IN THE AFTERMATH OF THE BAONENG/VANKE TAKEOVER

Xingxing Li[*†]

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* Xingxing Li is an Associate Professor of Law at Jinan University. She also acts as external legal advisor to the Standing Committee of the Guangdong Provincial People's Congress. Before joining the academia, she practiced law at Clifford Chance LLP as Senior Associate. She holds J.S.D. and LL.M. degrees from The University of Chicago, and LL.M. and LL.B. degrees from Tsinghua University.

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ABSTRACT

This article draws on the controversial 2015–2017 hostile takeover attempt of Vanke by Baoneng. Vanke is a listed company and one of China's largest real estate developers. Baoneng is a Chinese real estate and insurance conglomerate. The takeover ended abruptly due to unexpected regulatory interventions, unveiling many deep-rooted corporate governance issues common to Chinese listed companies. These issues remain unresolved and deserve academic inquiry.

This article argues that shareholders may be harmed by China's existing securities regulations, which have several deficiencies that facilitate incumbent management abuse of corporate power. For example, a fallacy in the stock trading rules makes it possible for corporate insiders to suspend stock trading at will, typically as a hostile takeover defense. More importantly, this article empirically finds that the fiduciary duties of directors and officers in listed companies are under-enforced in Chinese courtrooms. China's idiosyncratic features prevent it from realizing the social efficiency of takeover regulation, including curbing management misbehaviors.

Judicial enforcement of director and officer fiduciary duties has a long way to go before the Chinese market for corporate control turns optimally vigorous. This article makes a normative argument that China's policymakers should restructure takeover regulation so that activist investors can effectively compete with incumbent management in the Chinese market for corporate control. The argument for a policy shift is bolstered by the fact that Chinese takeover bidders face more legal and extra-legal obstacles than their United States counterparts. Ultimately, this approach may help to achieve the desired neutrality between activist investors and incumbent management, thus improving listed companies' corporate governance.

I. INTRODUCTION

Few hostile takeovers have attracted as much attention as Baoneng's failed hostile takeover of Vanke. The story made headlines largely because of its business implications: Yao Zhenhua, the de facto controller of Baoneng and an inconspicuous player in the real estate sector, attempted to take control of Vanke, one of China's largest listed property conglomerates. For the financial industry, this drama is a classic example of how debt financing is made possible in a country like China, where leveraged buyouts are discouraged as a matter of policy.

For legal academics, this high-profile hostile takeover is an extreme example of the fallacies in the corporate governance of Chinese listed companies. In a case of instant irony, Vanke, a firm that once took pride in its sophisticated corporate governance, employed various defense tactics to Baoneng's hostile bid. These tactics also brought Vanke directors and officers to the brink of breaching their fiduciary duties.

Academic inquiries into the Baoneng/Vanke takeover are worthwhile, especially considering the regulatory and political interventions involved in the case that may have dictated the verdicts on Baoneng and Vanke. The value of academic criticisms may not be immediately apparent, but they may provide useful perspectives on improving China's legal infrastructure for corporate governance in the future.

This article builds upon the Baoneng/Vanke case and provides in-depth legal analyses and criticisms of the deficiencies in the Chinese takeover laws and regulations that enabled the Vanke insiders to take advantage of minority shareholders. This article finds that, instead of remaining neutral between the acquirers and the incumbent management, Chinese regulators are generally biased in favor of the incumbent management. Moreover, the legal and extra-legal obstacles faced by activist investors explain why China's takeover market is essentially nonexistent compared to more sophisticated markets, such as those in the United States.

Further, this article argues that a preferential policy toward incumbent management is detrimental to enhancing corporate governance in Chinese listed companies. Moreover, fiduciary duties are under-enforced by China's judiciary, which further aggravates the problem. To offset inherent impediments to acquirers, China's policy-makers should make it easier, not harder, for activist investors to succeed in hostile takeovers. Part II of this article sets the stage by detailing the Baoneng/Vanke takeover and breaking down the emerging legal issues throughout the takeover campaign's evolution. Part III examines the regulatory defects in the suspension of stock trading. Part VI discusses the deficiencies in Chinese disclosure rules, which are

required of listed companies in the event of a takeover. Part V provides an empirical study of the enforcement of directors' fiduciary duties in Chinese listed companies. Part V also explains why the judiciary is destined to play a limited role in helping to improve listed companies' corporate governance. Part VI draws on the broader policy background relevant to takeovers and reflects on the general policy choices in takeover laws and regulations. Part VII concludes.

II. WHEN ACTIVIST INVESTORS MEET THE HANDICAPPED TAKEOVER REGIME

A. Baoneng/Vanke Takeover: Its Rise and Demise

China Vanke Co., Ltd. (Vanke) is one of China's largest property developers and is dually listed on the Shenzhen Stock Exchange (SZSE) and the Stock Exchange of Hong Kong (HKEX).[1] Historically, Vanke was proud of its sophisticated corporate governance structure and, prior to 2015, its ownership was well-dispersed.[2] China Resources National Corporation (China Resources) is a state-owned conglomerate and was Vanke's largest shareholder at the end of 2014, holding 14.91% of its outstanding shares.[3]

Wang Shi, founder and long-time chairman of Vanke, carefully crafted Vanke's dispersed shareholder structure, handpicking China Resources to become Vanke's largest shareholder.[4] On the one hand, choosing China Resources provided Vanke with the endorsement that comes with a state-owned enterprise (SOE) shareholder. SOEs in China, as opposed to private domestic companies, tend to receive preferable treatments in terms of access to bank loans and favorable policies, and they generally enjoy higher prestige in the Chinese economy.[5] On the other hand, creating a dispersed ownership framework ensured that no

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1. For an introduction to Vanke, *see China Vanke*, VANKE, https://www.vanke.us/about/china-vanke (last visited Apr. 8, 2019). Vanke's SZSE stock code is 000002. *Vanke-A*, SHENZEN STOCK EXCHANGE, http://www.szse.cn/English/application/search/index.html?keyword=000002 (last visited Apr. 8, 2019) (China). Vanke's HKEX stock code is 2202. *China Vanke Co., Ltd.-H Shares (2202)*, H.K. STOCK EXCHANGE, https://www.hkex.com.hk/Market-Data/Securities-Prices/Equities/Equities-Quote?sym=2202&sc_lang=en (last visited Apr. 8, 2019) (H.K.).

2. *See generally* VANKE, ANNUAL REPORT 2014 162 (2014), http://www3.hkexnews.hk/listedco/listconews/SEHK/2015/0424/LTN20150424688.pdf (H.K.) (listing Vanke's top ten shareholders).

3. *Id.* at 162–63. China Resources has a number of subsidiaries listed on the HKEX.

4. *See generally* Summer Zhen, *The Battle for Vanke: Wang Shi's Own Fight*, S. CHINA MORNING POST (June 17, 2016, 7:59 PM), https://www.scmp.com/business/article/1976943/battle-vanke-wang-shis-own-fight (describing Wang Shi's friendly relationship with China Resources and his reliance on a dispersed ownership structure before the Baoneng/Vanke battle).

5. *See, e.g.*, Robert Cull & Lixin Colin Xu, *Who Gets Credit? The Behavior of Bureaucrats and State Banks in Allocating Credit to Chinese State-owned Enterprises*, 71 J. DEV. ECON. 533 (2003) (describing how SOEs' have easy access to bank loans).

single majority shareholder would dominate the boardroom, which provided Wang Shi with more leeway to maneuver Vanke.[6]

Over the years, "professional managers" became a growing presence at Vanke.[7] Yet management did not appear to hold a substantial portion of Vanke shares. According to its public disclosure in August 2016, Vanke's insider holdings amounted to 0.2% of its outstanding shares.[8] However, Vanke set up a "business partnership" plan on the side, under which its directors, officers, supervisors, and other key employees held an equity interest in Vanke.[9]

These business partners did not hold their equity interests in Vanke directly,[10] which would otherwise subject Vanke insiders to disclosure obligations under Chinese securities regulations.[11] Instead, Vanke's business partners made use of "stock holding vehicles"—special purpose vehicles defined as "classified collective asset management plans."[12] The two stock holding vehicles in question, "Guosen Jinpeng"[13] and "De Ying,"[14] were products of securities companies. Vanke's insiders invested in these trust units, leaving their specific individual stakes

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6. *See generally* Zhen, *supra* note 5 (describing that Wang Shi was aware of the benefits of dispersed ownership for management).

7. *See* Thomas Hout & David Michael, *A Chinese Approach to Management*, 92 HARV. BUS. REV. 103 (2014) (explaining the development of Vanke's professional management system).

8. VANKE, INTERIM REPORT 201685 (2016), http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0928/LTN20160928624.pdf (H.K.) (listing directors, supervisors, and senior management holdings).

9. The business partner stock holding vehicles were established in May 2014. A total of 1,320 employees became the first business partners. *See* VANKE, ANNUAL REPORT 2014, *supra* note 3, at 8, 66–67.

10. Vanke business partners invested in a limited partnership, named Shenzhen Ying'an Financial Consultancy Enterprise (Ying'an Partnership), through which the business partners gradually increased their holdings of Vanke's A-shares. *See* VANKE, ANNUAL REPORT 2014, *supra* note 3, at 67 ("Since 28 May 2014, Ying'an Partnership has increased its holding of Vanke's A-shares through Securities Company's Asset Management Program . . . several times. As of 27 January 2015, The Securities Company's Asset Mangement Program product Ying'an Partnership purchased held . . . 4.48%" of the Group's total shares.).

11. *See generally* Hui Huang, *The Regulation of Insider Trading in China: A Critcal Review and Proposals for Reform*, 17 AUSTL. J. CORP. L. 281 (2005) (describing Chinese securities laws and insider trading).

12. VANKE, ANNUAL REPORT 2014, *supra* note 3, at 158.

13. *See id.* (listing the third largest shareholder, "Guosen Securities – Industrial and Commercial Bank of China – Guosen Jinpeng No. 1 Classified Collective Asset Management Plan," (Guosen Jinpeng) with 3.30% ownership).

14. *See* VANKE, ANNUAL REPORT 2015 191–92 (2016), http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0428/LTN20160428027.pdf (H.K.) (listing the seventh largest shareholder, "CMS Wealth – CMB – De Ying No. 1 Specialised Asset Management Plan" (De Ying), with 2.98% ownership and disclosing Guosen Jinpeng's updated holdings as 4.14%). The existence of De Ying as the stock holding vehicle was not disclosed until Vanke's 2015 Annual Report. *Id.*

undisclosed to the public.[15] In turn, these stock holding vehicles made equity investments in Vanke on the open market.[16]

As of December 2015, Vanke insiders held 7.79% of Vanke's outstanding shares via the two stock holding vehicles, which starkly contrasted the publicly-disclosed collective shareholdings of less than 1%.[17] Anecdotal evidence suggests that the insiders deliberately depressed the stock prices of Vanke in order to facilitate its acquisition of Vanke shares at a low price below its value over time.[18]

Reminiscent of hostile takeovers in developed securities markets, two key elements for an active hostile takeover were therefore present in Vanke's case:[19] (1) a dispersed shareholding structure,[20] and (2) a depressed share price relative to the corporation's intrinsic value.[21] More than one raider eyed Vanke as the hostile takeover battle evolved, including: Shenzhen Baoneng Investment Group, Ltd. (Baoneng), whose business lines crossed over real estate and insurance; Anbang Life Insurance Co., Ltd. (Anbang Insurance), a highly acquisitive insurer; and Evergrande Real Estate Group (Evergrande), the Hong Kong-listed property corporation and one of China's largest homebuilders.[22]

Yao Zhenhua, founder of Baoneng, was well aware that Vanke's stock was significantly undervalued.[23] He started to accumulate shares on the open market, utilizing a number of channels, including universal life insurance products and asset management plans.[24] On July 10, 2015,

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15. *See* VANKE, ANNUAL REPORT 2014, *supra* note 3, at 67, 159 (Only the aggregate number of shares held in these stock holding vehicles was disclosed; no breakdown on individual insiders' interests was made available.).

16. *See id.* at 67.

17. Zhiwen Wang, *Jinpeng, Deying Ziguan Jihua yu Wanke Guanxi Chengmi* (金鹏、德盈资管计划与万科关系成谜) [*The Mysterious Relationship Between Jinpeng and De Ying Asset Management Plans*], JINGJI CANKAO BAO (经济参考报) [ECON. INFO. DAILY] (July 22, 2016), http://jjckb.xinhuanet.com/2016-07/22/c_135531641.htm (China).

18. *Id.*

19. John Armour et al., *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*, 52 HARV. INT'L L.J. 219, 240–41 (2011) (suggesting that the combination of three elements—dispersed ownership structure, depressed share values, and a United States takeover regime—presage an active takeover market).

20. *Id.* at 221.

21. John C. Coffee, Jr., *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1162, 1170 (1984).

22. *See, e.g.*, Joyce Ho, *Fighting a Hostile Takeover is Taking its Toll on China Vanke*, NIKKEI ASIAN REV. (Sept. 1, 2016), https://asia.nikkei.com/Business/Fighting-a-hostile-takeover-is-taking-its-toll-on-China-Vanke2 (discussing Anbang Insurance and Evergrande's involvement in China's most-watched takeover battle).

23. Laura He, *Vanke's Corporate Battle Signals Opportunities in Big Property Blue-Chips*, S. CHINA MORNING POST (Mar. 23, 2016, 1:56 PM), https://www.scmp.com/business/companies/article/1929408/vankes-corporate-battle-signals-opportunities-big-property-blue (quoting economist Chen Zhenzhi that "Baoneng started the battle because they believe Vanke was undervalued").

24. *See* VANKE, *Announcement Regarding the Unusual Movements in the Trading of A-Shares*, HKEXNEWS.HK (July 5, 2016),

Zhenhua acquired 5% of shares in Vanke through Foresea Life Insurance, a subsidiary of Baoneng, triggering the disclosure requirement.[25] By July 24, 2015, Baoneng disclosed that its shareholding percentage in Vanke had increased to 10%,[26] and by August 26, 2015, to 15.04%.[27] As of November 2015, Baoneng surpassed China Resources as Vanke's largest shareholder.[28]

In its takeover defense, Vanke management used a combination of tactics, including soliciting political support and regulatory intervention.[29] In the process, China Resources' stance diverged from that of Vanke management.[30] After becoming Vanke's largest shareholder, Baoneng, the hostile acquirer, proposed to remove ten out of the eleven Vanke directors on the Board and two Vanke supervisors from their posts during a special shareholders' meeting.[31] However, before the takeover battle fully unfolded, state regulators intervened and stopped Baoneng from proceeding further in the acquisition.[32] Liu Shiyu, then chairman of the China Securities Regulatory Commission (CSRC), denounced activist investors such as Baoneng as "barbarians,"[33] a term notably used in Bryan Burrough and John Helyar's best-selling

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http://www3.hkexnews.hk/listedco/listconews/sehk/2016/0705/ltn201607051563.pdf (H.K.) (discussing how Baoneng mainly used two vehicles under its control to make the acquisition—Shenzhen Jushenghua Co., Ltd. (Jushenghua) and Foresea Life Insurance Co., Ltd (Foresea Life Insurance), a subsidiary of Jushenghua).

25. VANKE, *Short-Form Disclosure*, CNINFO (July 10, 2015), http://www.cninfo.com.cn/finalpage/2015-07-11/1201276697.PDF (China) (filed with H.K. Stock Exchange); *see also Baoneng to Acquire Vanke or End: Process Review and Enlightenment*, BAZYD (May 28, 2018), http://bazyd.com/baoneng-to-acquire-vanke-or-end-process-review-and-enlightenment/ (China) (noting that Baoneng acquired 5% of Vanke's total share capital by July 2015).

26. VANKE, *Short-Form Disclosure*, *supra* note 26; *see also Baoneng to Acquire Vanke or End*, *supra* note 26 (noting that Baoneng acquired 10% of Vanke's total share capital by July 2015).

27. VANKE, *Short-Form Disclosure*, *supra* note 26; *see also Baoneng to Acquire Vanke or End*, *supra* note 26 (noting that Baoneng acquired more than 15% of Vanke shares and became Vanke's largest shareholder by August 2015).

28. Zhen, *supra* note 5 (discussing Baoneng increasing its stake in Vanke to 24.26%).

29. *See infra* Part II.B for a discussion of Vanke's takeover defenses.

30. *Id.*

31. *See* VANKE, *Requisition of Extraordinary General Meeting by Shareholders Proposed Removal of Directors and Supervisors*, HKEXNEWS.HK (June 26, 2016) http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0626/LTN20160626029.pdf (H.K.).

32. *See* Michelle Price & Clare Jim, *China Vanke Tussle Is Big Test for New Securities Regulator*, REUTERS (July 25, 2016), https://www.reuters.com/article/us-china-vanke-regulator/china-vanke-tussle-is-big-test-for-new-securities-regulator-idUSKCN10514D (describing the visible hands of the regulators, especially the CSRC).

33. Liu Shiyu, *Zai Zhongguo Zhengquan Touzi Jijin Ye Xierhui Di Er Jie Huiyuan Daibiao Dahui Shang de Zhici* (在中国证券投资基金业协会第二届会员代表大会上的致辞) [*Speech on the Second Meeting of Representatives of the China Securities Investment Funds Association*], CHINA SEC. REG. COMM'N (Dec. 3, 2016), http://www.csrc.gov.cn/pub/newsite/zjhjs/ldbz/liushiyu/lsyjhyhd/201612/t20161203_307137.html (China). Liu Shiyu took office after his predecessor Xiao Gang stepped down amid the stock market crash in 2015 and was succeeded by a new chairman Yi Huiman as of 2019. *Id.*

book *Barbarians at the Gate*.[34] Liu Shiyu accused certain activist investors of engaging in leveraged takeovers using money from illegal sources.[35]

It was unusual for Liu Shiyu, as head of China's securities regulator, to comment on the legality of Baoneng's source of funding. Indeed, it was the China Insurance Regulatory Commission (CIRC)[36] that had jurisdiction over the regulation of Baoneng's insurance arm.[37] The CSRC's unconventional condemnation of Baoneng prior to the CIRC voicing an opinion foreshadowed Baoneng's ultimate defeat. The market's suspicion was that Liu Shiyu's commentary across the regulatory divide indicated that he was conveying nuanced messages from China's top leadership.[38]

Shortly after the CSRC's unusual move, the CIRC followed suit and imposed a series of administrative sanctions on Baoneng. This included the suspension of Foresea Life Insurance, a subsidiary of Baoneng, from continuing to engage in the universal life insurance business.[39] This, in effect, cut off Baoneng's source of funding for any further acquisition efforts; Foresea Life Insurance's launch of universal life insurance products played a pivotal role in raising funds for Baoneng to deploy in the takeover.[40] The CIRC also banned Yao Zhenhua from engaging in insurance related business.[41] The intervention of securities and

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34. *See generally* BRYAN BURROUGH & JOHN HELYAR, BARBARIANS AT THE GATE—THE FALL OF RJR NABISCO (HarperCollins 2009).

35. *See* Liu, *supra* note 34.

36. Shu Zhang, *China to Merge Regulators, Create New Ministries in Biggest Overhaul in Years*, REUTERS (Mar. 12, 2018, 7:02 PM), https://www.reuters.com/article/us-china-parliament/china-to-merge-regulators-create-new-ministries-in-biggest-overhaul-in-years-idUSKCN1GP003. The CIRC has subsequently merged into China's banking regulator, the CBRC, and is now called the China Banking and Insurance Regulatory Commission (CBIRC). *Id.*

37. For an explanation of the CIRC's jurisdiction over the insurance industry, *see* Margaret M. Pearson, *Governing the Chinese Economy: Regulatory Reform in the Service of the State*, 67 PUB. ADMIN. REV. 718, 721, 723, 725–26 (2007).

38. *See* Wang Xiangwei, *Why "Barbarian" Insurers Have Forced Beijing to Intervene*, S. CHINA MORNING POST (Dec. 10, 2016, 4:34 PM) https://www.scmp.com/week-asia/opinion/article/2053390/why-barbarian-insurers-have-forced-beijing-intervene (noting that the Baoneng/Vanke takeover "prompted the central leadership to take decisive action to protect well-run companies" by siding with Vanke management).

39. *Id.* (describing how Foresea Life Insurance could no longer sell universal life insurance products, the proceeds from which were used to finance Baoneng's leveraged takeover); *see also* Barry Naughton, *The Regulatory Storm: A Surprising Turn in Financial Policy*, 53 CHINA LEADERSHIP MONITOR 1, 6 (2017), https://www.hoover.org/sites/default/files/research/docs/clm53bn.pdf (indicating that "Liu's willingness to indulge in such overheated vocabulary clearly indicated that something had changed in the attitude of top policy-makers, emboldening the regulator to go on the offensive.").

40. Naughton, *supra* note 40, at 7 (showing the sale of universal life insurance products provided Baoneng with needed financing).

41. *China Regulator Bans Foresea Chief from Insurance Business for 10 Years*, REUTERS (Feb. 24, 2017, 3:33 AM), https://www.reuters.com/article/us-china-insurance-foresealife/china-regulator-bans-foresea-chief-from-insurance-business-for-10-years-idUSKBN1630XZ.

insurance regulators signaled a regulatory veto over Baoneng's hostile takeover.[42]

Because the regulators sided with Vanke management, Baoneng was forced to back off the takeover.[43] Baoneng announced that it would only become a financial investor in Vanke, not a raider.[44] Vanke management introduced state-backed Shenzhen Metro Group Co., Ltd. (Shenzhen Metro) as a white knight, with China Resources selling its entire stake in Vanke to Shenzhen Metro and ceasing to be a shareholder.[45] Baoneng began the process of quietly phasing out of Vanke, gradually selling its interests on the securities market.[46] This landmark case in China's takeover market then came to an abrupt end due to the influence of political forces.[47]

B. The Unorthodox Antitakeover Tactics and Their Legal Controversies

With raider knocking at the door, Vanke management and directors fought back using several controversial defense tactics. These tactics were unconventional compared to those commonly used in sophisticated markets.[48] Below are a few representative defense tactics that Vanke employed against Baoneng.

1. Public Condemnation

Aware of Baoneng's threat to the management-friendly dispersed shareholding structure, Wang Shi openly denounced the newcomer shareholder as not "creditworthy enough" to be a Vanke shareholder.[49] Such a comment is unusual from an acclaimed public company on a sophisticated securities market. As a takeover defense, Vanke's chairman expressly discriminated against a shareholder on the basis

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42. Naughton, *supra* note 40, at 6–7.

43. Yang Qiaoling, Lin Jinbing & Fran Wang, *Baoneng Backs Off from Fight Over Vanke's Control*, CAIXIN (Jan. 14, 2017, 6:45 PM), https://www.caixinglobal.com/2017-01-14/101044053.html.

44. *Id.*

45. Summer Zhen & Sandy Li, *China Resources to Sell Its 15% Stake in Vanke to Shenzhen Metro*, S. CHINA MORNING POST (Jan. 12, 2017, 3:30 PM), https://www.scmp.com/business/article/2061548/vanke-trading-suspended-report-suggests-lead-shareholder-china-resources.

46. Qu Hui & Han Wei, *Corporate Raider Baoneng Dumps More Vanke Shares*, CAIXIN (May 22, 2018, 5:02 AM), https://www.caixinglobal.com/2018-05-22/corporate-raider-baoneng-dumps-more-vanke-shares-101253855.html (noting that by the end of May 2018, Baoneng had reduced its shareholding in Vanke to 22% and that Baoneng's exit process is ongoing).

47. *See generally* Naughton, *supra* note 40.

48. *See infra* Part III.

49. *See* Shuli Ren, *China Vanke: Barbarians at the Gate, Sell at Record High*, BARRON'S, https://www.barrons/articles/china-vanke-soars-to-record-on-corporate-control-swap-for-coli-says-morgan-stanley-1450407045 (last updated Dec. 18, 2015, 12:08 AM); *see also* Zhen, *supra* note 5.

that it was a non-SOE.[50] The hidden message was that management should handpick its preferred shareholders, which defies the general corporate governance principle that a board of directors should act in the best interests of the company, and thus its shareholders.[51]

2. Prolonged Trading Halt

To delay Baoneng from making further moves, Vanke suspended all trading of its shares on the Hong Kong Stock Exchange.[52] According to Vanke, the trading halt was due to a contemplated major restructuring.[53] This reason, however, turned out to be fictitious: at the time of the trading suspension, Vanke did not have a concrete partner with which it had contemplated a deal.[54] After the trading suspension, Vanke management sought an ally that could overtake Baoneng as its new largest shareholder. Three months later, Vanke announced it was entering into a Memorandum of Understanding (MOU) with Shenzhen Metro.[55]

The trading suspension lasted for an unusually long time in order to thwart Baoneng's acquisition plan.[56] Six months lapsed before Vanke fully lifted the suspension on trading of its stocks.[57] Immediately prior

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50. Wang Shi's consistent siding with SOEs such as China Resources and Shenzhen Metro as his handpicked Vanke shareholders implies his inclination to favor SOEs over non-SOEs like Baoneng. *See generally* Tianyu Zhang, *The Battle of Ownership in Chinese Enterprises: Vanke*, CUHK BUS. SCH. (July 11, 2017), https://cbk.bschool.cuhk.edu.hk/the-battle-of-ownership-in-chinese-enterprises-the-case-of-vanke (H.K.).

51. *See, e.g.*, REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 97–99, 161–63 (Oxford University Press, 3rd ed. 2017).

52. VANKE, *Suspension of Trading in Relation to Material Asset Restructuring*, HKEXNEWS.HK (Dec. 20, 2015), http://www3.hkexnews.hk/listedco/listconews/SEHK/2015/1220/LTN20151220029.PDF (H.K.). The commencement date of the trading suspension was December 18, 2015. *Id.* The suspension applied to both Vanke's A and H shares. *See id.* The trading suspension of the A-shares market lasted for six months, while that of the H-shares market had a significantly shorter duration. *See China Vanke's A-Shares Plunge 10% After Six-Month Suspension*, BLOOMBERG (July 3, 2016, 8:58 PM), https://www.bloomberg.com/news/articles/2016-07-04/china-vanke-s-a-shares-plunge-10-after-six-month-suspension.

53. VANKE, *Suspension of Trading*, *supra* note 53.

54. *Vanke Suspends Trading After Chair Opposes Shareholder's Leveraged Buying*, China Daily, http://www.chinadaily.com.cn/business/2015-12/18/content_22745567.htm (last updated Dec. 18, 2015, 5:30 PM) (China).

55. VANKE, *Announcement Regarding the Progress of Material Asset Restructuring and Trading Suspension*, HKEXNEWS.HK (Mar. 24, 2016), http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0324/LTN20160324821.pdf (H.K.).

56. *See* Peggy Sito, *China Vanke Says Its Shenzhen Shares to Remain Suspended for Another Two Months*, S. CHINA MORNING POST (Jan. 15, 2016, 8:59 PM), https://www.scmp.com/business/article/1901717/china-vanke-says-its-shenzhen-shares-remain-suspended-another-two-months (analyzing the impacts of a continued share suspension on Baoneng). The trading halt hampered Baoneng's pace of hostile takeover, including its plan to replace Vanke's directors and management. *Id.*

57. Peggy Sito, *China Vanke H Shares Down 12.66 Per Cent After Trading Resumes*, S. CHINA MORNING POST (Jan. 6, 2016, 9:23 AM), https://www.scmp.com/business/article/1898246/china-

to the suspension, Baoneng had acquired 23.52% of Vanke, while Anbang Insurance had purchased another 7.01%.[58] Although the trading halt did not affect Baoneng's acquisition of the first 23.52% shares in Vanke, it did impede Baoneng from gaining further control over Vanke stock, directors, and management. When trading resumed, the raiders had been effectively defeated.[59] The legal controversy involves whether Vanke made a misrepresentation by announcing a planned major reorganization as its reason for the trading halt, which may have been moot at the time of the announcement.[60] It is also unclear whether the practice was compliant with the SSE trading rules.[61] Even assuming no trading rules were broken, the occurrence begs the question whether the practice constituted an illegal antitakeover tactic.

These legal questions remain unanswered after the Baoneng/Vanke takeover campaign. From a business standpoint, prolonged trading suspension, a phenomenon unique to China, proves to be an effective tactic to fend off activist investors. Protracted suspensions negatively impact the financing strategies that activist investors use. This is because activist investors such as Baoneng use as much leverage as possible, causing the costs of financing to weigh heavily on them.[62] Moreover, as the takeover campaign drags on, the activist investors become increasingly vulnerable to market volatility. Indeed, the takeover's momentum waned as the Chinese securities market crashed in mid-2016 and pessimism penetrated the market.

3. Introduction of White Knight through Questionable Internal Approval Procedure

As Vanke's management became increasingly aggressive in the Baoneng/Vanke battle, even China Resources grew dissatisfied with its misbehavior.[63] When Vanke's management tried to bring Shenzhen

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vanke-h-shares-down-1266-cent-after-trading-resumes. Vanke's trading suspension lasted from December 18, 2015 until June 18, 2016. *Id.*

58. *See* Yang Qiaoling & Leng Cheng, *After Failing to Take Over, Baoneng Starts Selling Vanke Stake*, CAIXIN (Apr. 18, 2018, 7:30 PM), https://www.caixinglobal.com/2018-04-18/after-failing-to-take-over-baoneng-starts-selling-vanke-stake-101236220.html.

59. *See id.*

60. For China's rules on securities misrepresentations, *see* Yanguo Yuan, *Civil Liability for Misrepresentation in the Securities Market: A Comparative Study of China, Taiwan and U.S.*, CITY U. OF HONG KONG (July 15, 2013), http://lbms03.cityu.edu.hk/theses/c_ftt/phd-slw-b46908559f.pdf (H.K.).

61. *Id.*

62. In the case of Baoneng, the leverage did not take the form of usual bank loans. Instead, Baoneng used heavy leverage in its asset management plans. *See supra* Part II.A.

63. Zheng Yangpeng & Xie Yu, *China Resources Underlines Opposition to Vanke's White-knight Sell-off*, S. CHINA MORNING POST (June 20, 2016, 9:51 PM), https://www.scmp.com/business/companies/article/1978169/china-resources-underlines-opposition-vankes-white-knight-sell; *see also* Summer Zhen, *China Vanke Files Lawsuit to Invalidate Ownership Rights of Majority Shareholder Baoneng*, S. CHINA MORNING POST (Feb. 7, 2017, 9:43 PM),

Metro in as a white knight in March 2016, they failed to submit the Vanke-Shenzhen Metro Cooperation MOU to the Board of China Resources, a major shareholder.[64] Vanke management claimed the MOU did not have to be approved by the Board because it was not a legally binding agreement.[65] Similar to other legal regimes, an MOU is not necessarily legally binding in China,[66] but the gist of the question is beyond its legal effect. In accordance with Vanke's articles of association, its Board has the authority to draft plans for material acquisitions,[67] and to decide on the sale and purchase of assets within its ascribed authority.[68] Vanke management contended there was plenty of room for interpretation in the term "plan for material restructuring." However, the execution of an MOU to issue new shares as consideration for three parcels of land priced at over $6 billion could not fit into even a liberal definition of the term.[69] As a result, China Resources openly voiced objection against Vanke management, claiming that its information disclosure process was non-compliant.[70]

Subsequently, when Vanke management finally put a definitive agreement on the table for the Board's approval, the directors appointed by China Resources voted against the deal.[71] But because China Resources was not a controlling shareholder and the directors appointed by it did not form the majority of the Board, it was unable to veto the deal at that level.[72] It is worth noting that despite China

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https://www.scmp.com/business/article/2068854/china-vanke-files-lawsuit-invalidate-ownership-rights-majority-shareholder (discussing China Resources' opposition to Vanke introducing Shenzhen Metro as a new shareholder).

64. Peggy Sito, *Vanke Defends Handling of Its Proposed Deal with Shenzen Metro*, S. CHINA MORNING POST (Mar. 18, 2017, 9:05 PM), https://www.scmp.com/property/hong-kong-china/article/1927084/vanke-defends-handling-its-proposed-deal-shenzhen-metro.

65. *Id.*

66. Dan Harris, *The China MOU (Memorandum of Understanding)*, HARRIS BRICKEN: CHINA L. BLOG (Dec. 28, 2012), https://www.chinalawblog.com/2012/12/the-china-mou-memorandum-of-understanding-use-them-at-your-peril.html.

67. *A+H Articles of Association of China Vanke Co., Ltd.* art. 137(7), H.K. STOCK EXCHANGE (2014), http://www3.hkexnews.hk/listedco/listconews/SEHK/2014/0624/LTN20140624398.pdf (H.K).

68. *Id.* art. 137(8), 141.

69. In accordance with Vanke's Announcement Regarding the Progress of Material Asset Restructuring and Trading Suspension, Vanke contemplated to acquire a special purpose vehicle as subsidiary of Shenzhen Metro. VANKE, *Announcement Regarding Progress*, *supra* note 56. The special purpose vehicle held the three parcels of land valued between RMB 40 billion (approximately USD $6.2 billion) and RMB 60 billion (approximately USD $9.2 billion). As consideration, Vanke proposed to issue new shares to Shenzhen Metro at a steep discount compared to Vanke's average trading price during the relevant period. *See* Sandy Li, *China Vanke to Issue Shares to Shenzhen Metro Group in Possible 45.6 Billion Yuan Deal*, S. CHINA MORNING POST (June 18, 2016, 12:07 P.M.), https://www.scmp.com/business/companies/article/1977005/china-vanke-issue-shares-shenzhen-metro-group-possible-456.

70. *See* Zheng & Xie, *supra* note 64.

71. VANKE, *Board Resolutions*, CNINFO (June 18, 2016), http://www.cninfo.com.cn/finalpage/2016-06-18/1202374893.PDF (China).

72. *See generally id.*

Resources' allegation that Vanke management infringed its shareholders' rights,[73] it never brought the dispute before a Chinese court. The case vividly displays the negligible role Chinese courts play in enforcing corporate fiduciaries' duties.[74]

4. Biased Independent Directors

While the independent directors did not play an unbiased role amid the tensions between Vanke's bidders, shareholders, and incumbent management, they ultimately determined the fate of the Shenzhen Metro deal. With the directors of China Resources and those of the Vanke management split on their votes, the votes of independent directors became decisive.[75] As China Resources challenged the validity of the Board's approval of the Shenzhen Metro deal, Vanke's independent director Hua Sheng repeatedly published articles siding with the Vanke management and criticizing China Resources as a shareholder.[76] Another independent director, Zhang Liping, claimed a conflict of interest and abstained from voting.[77]

It was the decision of Mr. Zhang to abstain from voting that gave rise to the controversy over the validity of the Board resolution.[78] To qualify as an independent director for a public corporation, a director must be independent of controlling shareholders, insiders, and the corporation's executive management team.[79] When an independent director does not meet the independence requirement, he or she should resign from office, rather than simply abstain from voting.[80] But the independent director chose to abstain from voting because at least one-third of the board members have to be independent directors as

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73. *See* Zheng & Xie, *supra* note 64.

74. *See infra* Part V.A.

75. VANKE, *Board Resolutions*, *supra* note 72.

76. Hua Sheng, *Hua Sheng Xiangjie Wanke Dongshihiu: Wo Weisheme Bu Zhichi Da Gudong* (华生详解万科董事会：我为什么不支持大股东) [*Hua Sheng on Vanke Board of Directors: Why I Don't Support the Opinions of the Large Shareholder*], SHANGHAI ZHENGQUAN BAO (上海证券报) [SHANGHAI SEC. NEWS] (June 24, 2016), http://news.cnstock.com/news,yw-201606-3824777.htm?page=3 (China).

77. Emma Dong, *For Vanke, Shenzhen Metro Deal Is 'Life or Death' Matter*, BLOOMBERG (June 23, 2016), https://www.bloombergquint.com/china/for-vanke-saving-shenzhen-metro-deal-is-life-or-death-matter.

78. *Cf.* Liping Zhang, *Vanke: The Battle of Five Armies*, GLASS LEWIS (June 30, 2016), http://www.glasslewis.com/vanke-the-battle-of-five-armies/.

79. Shangshi Gongsi Duli Dongshi Lu Zhi Zhiyin (上市公司独立董事履职指引) [Guidelines for the Performance of Duties by Independent Directors of Listed Companies] (promulgated by China Listed Co. Ass'n, Sept. 12, 2014, effective Sept. 12, 2014) at art. 4, http://en.pkulaw.cn/Print/Print.aspx?Lib=law&Cgid=233969&Id=19384&SearchKeyword=&SearchCKeyword=&paycode=&LookType= (China).

80. *Id.*

required by CSRC in order to pass valid board resolutions.[81] Had Mr. Zhang resigned, the composition of the Board would no longer be in compliance with the mandatory requirement, rendering any board resolution invalid. In this regard, Mr. Zhang's choice helped push through the board resolutions desired by Vanke's incumbent management.[82]

The biased behavior of independent directors in the Baoneng/Vanke case exemplifies the longtime concern that independent directors are not really independent. In theory, independent directors should be a much-needed check against management misbehavior. It is also expected that a board composition of inside, independent, and affiliated directors helps to bring different skill sets and expertise to the Board.[83] But there are plenty of challenges to the conventional wisdom. Sanjai Bhagat and Bernard Black, for example, found that there is no empirical evidence supporting the claim that greater board independence correlates with better corporate performance, indicating that independent directors might not be the good monitors that the legislators have hoped for.[84] The possible explanation for the inverse correlation is the trade-off between independence and incentive. Unlike independent directors, inside directors have conflicts of interest yet have more financial ties the firm.[85] In essence, the greater stock ownership of inside directors leads them to care more about the firm's performance.[86]

Despite the academic criticisms over the biased behavior of independent directors in the Baoneng/Vanke takeover,[87] no administrative sanction or judicial action was ever levied against the independent directors.[88] This is problematic because the lack of action conflicts with the governance goals of Chinese public corporations,

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81. Guanyu Zai Shangshi Gongsi Jianli Duli Dongshi Zhidu de Zhidao Yijian (关于在上市公司建立独立董事制度的指导意见) [Directive Opinion on the Establishment of the Independent Director Scheme in Listed Companies] (promulgated by China Sec. Reg. Comm'n, Aug. 16, 2001, effective Aug. 16, 2001), Zheng Jian Fa, 2001, No. 102, at art. 1(3) (China).

82. *See* Zhang, *supra* note 79.

83. Barry D. Baysinger & Henry N. Butler, *Corporate Governance and the Board of Directors: Performance Effects of Changes in Board Composition*, 1 J.L. ECON. & ORG. 101, 110–11 (1985).

84. Sanjai Bhagat & Bernard Black, *The Non-Correlation Between Board Independence and Long-Term Firm Performance*, 27 J. CORP. L. 231, 263 (2002).

85. *Id.* at 263–65.

86. *Id.*

87. *See, e.g.*, Zhang, *supra* note 79.

88. VANKE, *Announcement Regarding Investors Online Meeting on 2016 Annual Results*, HKEXNEWS.HK (Mar. 26, 2017) http://www3.hkexnews.hk/listedco/listconews/SEHK/2017/0326/LTN20170326043.pdf (H.K). As of March 2017, after the Baoneng-Vanke takeover battle waned, the two independent directors at the center of controversy, Zhang Liping and Hua Sheng, remained on the board. *Id.*

namely that "corporate boards need directors who are not merely independent, but who are *accountable* as well."[89]

In the case of China, the concern over the independence of independent directors is widespread. Empirical findings by multiple Chinese scholars reveal skepticism about the value of independent directors. Chinese outside directors rarely disagree with incumbent management, an indication of the general alliance of independent directors and management. One Chinese study found that outside directors oppose management proposals in only 4% of board resolutions.[90] This finding is consistent with the general proposition that employing independent directors is not necessarily an effective mechanism.

5. Advance Disclosure of Takeover-related Information

As Vanke management grappled with Baoneng and China Resources, Anbang Insurance and Evergrande joined in to further muddy the water. Anbang Insurance acquired 5% of Vanke on the A-shares market in December 2015 and revealed an ambition to acquire further shares.[91] Meanwhile, Evergrande purchased 4.68% of Vanke on the A-shares market by August 2016.[92] Vanke management fended off these raiders by means of unorthodox tactics.

Even before Evergrande was required by law to disclose its shareholding, Vanke may have exposed Evergrande's move to the public. Evergrande purchased 2% of interest in Vanke, well below the 5% threshold that would trigger the disclosure requirement,[93] but a media outlet, citing an anonymous source, reported Evergrande's shareholding.[94] Some suspect that Vanke intentionally leaked the non-

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89. Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 865 (1991).

90. Kangtao Ye et al., *Duli Dongshi de Duli Xing: Jiyu Dongshihui Toupiao de Zhengju* (独立董事的独立性：基于董事会投票的证据) [*The Independence of Independent Directors: Evidence from Board Voting Behavior*], 1 JINGJI YANJIU (经济研究) [ECON. RES. J.] 126, 126 (2011) (China), English abstract available at http://www.paper.edu.cn/scholar/showpdf/NUT2cN1lOTA0eQxeQh.

91. *See* Ho, *supra* note 23.

92. CHINA EVERGRANDE GROUP, DISCLOSABLE TRANSACTION—ACQUISITION OF SHARES IN CHINA VANKE CO., LTD. (Aug. 4, 2016). For Evergrande's subsequent further acquisition up to 6.82% of Vanke shares, *see* VANKE, *Announcement Regarding China Evergrande's Further Acquisition of Vanke A-Shares*, HKEXNEWS.HK (Aug. 16, 2016) http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0816/LTN20160816169.pdf (H.K.).

93. Shangshi Gongsi Shougou Guanli Banfa (2014 Nian Xiuding) (上市公司收购管理办法 (2014 年修订)) [Measures for the Administration of the Acquisition of Listed Companies (Revised in 2014)] (promulgated by China Sec. Reg. Comm'n, May 17, 2006, effective May 17, 2006, amended 2014) CHINA SEC. REG. COMM'N, at art. 13 [hereinafter Takeover Measures], http://www.csrc.gov.cn/pub/newsite/ssgsjgb/ssbssgsjgfgzc/jgfg/201505/t20150508_276474.html (China).

94. *Guanyu Dui Wanke Qiye Gufen Youxian Gongsi de Guanzhu* (关于对万科企业股份有限公司的关注函) [*Letter of Inquiry Regarding China Vanke Co., Ltd.*], SHENZEN STOCK EXCHANGE (Aug. 5, 2016) https://www.szse.cn/UpFiles/fxklwxhj/CDD00000239615.PDF (China).

public information to the media to hinder further action on Evergrande's part.[95] The information drove up Vanke's stock price, thereby increasing the cost of any further acquisitions by Evergrande.[96] The disclosure of listed companies on unofficial platforms ahead of the official public disclosure caused concern among Chinese regulators.[97]

In response to this suspected scheme, the Shenzen Stock Exchange issued a letter to Vanke and inquired whether it was actually Vanke that leaked the information.[98] The inquiry centered on the bookkeeping and internal review procedure of Vanke's shareholders list.[99] In response, Vanke denied that its shareholders list activity was incompatible with the bookkeeping rules and regulations.[100]

It is difficult, if not impossible, for the Shenzhen Stock Exchange to confirm or rebut Vanke's response. While a general denial alone would not ease the suspicions rampant in the market, the Shenzhen Stock Exchange failed to initiate further investigation into the information leak.[101] In China, a letter of inquiry contains questions raised by the stock exchange for a specific listed company.[102] Therefore, the issuance of a letter of inquiry is an indication that the stock exchange is scrutinizing a listed company's compliance matters.[103] Yet, the letter in itself is a toothless tiger, as a misrepresentation of the listed company in its response hardly triggers the regulator's investigation or even administrative sanctions.[104]

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95. *Id.*

96. *See* Ho, *supra* note 23 (noting that Vanke's shares immediately soared following the news release).

97. *See Letter of Inquiry Regarding Vanke*, *supra* note 95.

98. *See id.*

99. *Id.*

100. VANKE, "Guanyu Dui Wanke Quye Gufen Youxian Gongsi de Guanzhu Han" de Huifu (《关于对万科企业股份有限公司的关注函》的回复) [*Reply to the "Letter of Inquiry Regarding China Vanke Co., Ltd."*], CNINFO (Aug. 9, 2016) http://www.cninfo.com.cn/finalpage/2016-08-10/1202552786.PDF (China).

101. By contrast, the SSE took regulatory measures against Evergrande for trading in Vanke shares. *See* Yifan Xie, *Shenzhen Stock Exchange Warns China Evergrande About Stock Trading*, WALL ST. J. (Nov. 11, 2016), https://www.wsj.com/articles/shenzhen-stock-exchange-warns-china-evergrande-about-stock-trading-1478894137.

102. *See* Benjamin L. Liebman & Curtis J. Milhaupt, *Reputational Sanctions in China's Securities Market*, 108 COLUM. L. REV. 929, 947–48 (2008) (reviewing the legal effects of oversight letters issued by Chinese stock exchanges). Chinese stock exchanges routinely issue oversight letters including letters of inquiry to listed companies in their daily supervision of listed companies. For a reservoir of the inquiry letters sent by the SSE, *see Wen Xun Hanjian* (问询函件) [*Inquiry Letter*], SHENZHEN STOCK EXCHANGE http://www.szse.cn/disclosure/supervision/inquire/index.html (China).

103. *See generally* Liebman & Milhaupt, *supra* note 103.

104. For example, the SSE stresses the absolute number of letters of inquiry issued on an annual basis (e.g., more than 990 in 2016 for listed companies' annual reports) but does not disclose its follow-up actions against misrepresentations in the listed companies' replies. *See Press Release*, SHENZHEN STOCK EXCHANGE (July 7, 2017) http://www.szse.cn/main/aboutus/bsdt_left/xwfbh/39773659.shtml (China).

The problem associated with the regulator's failure to investigate or prosecute underscores the inevitable capacity constraints on public enforcement. As with other public enforcement agencies, stock exchanges are resource constrained. Compared to rampant management misbehavior, the exchanges are severely understaffed. It is unrealistic to expect stock exchanges to investigate a substantial portion of the abnormal activities on the securities market, even if they are determined to deter misbehavior and noncompliance with government regulations.[105] The listed corporations, in turn, choose their marginal level of harmful activities based on their understanding of the marginal deterrence level of regulatory sanctions, which is only nominal in China.[106] Because the probability of detection by the public enforcers of securities law is low and sanctions are limited, deterrence is also low. This may explain the widespread management misbehavior of listed corporations on China's securities market.[107]

6. Poison Pill or White Knight?

As the takeover battle continued, friction between China Resources, the longtime management-friendly shareholder, and Vanke management intensified. During the attempted hostile takeover of Vanke, China Resources refused to substantially increase its ownership of Vanke shares to outweigh Baoneng's at Vanke request.[108] China Resources also expressed concern that an issue of new shares to a white knight sought by Vanke management would dilute its interest in Vanke.[109] Vanke management teamed up with a different partner—a desirable new shareholder—after being turned down by China Resources. In June 2016, Vanke announced that it contemplated a private offering to Shenzhen Metro, a state-owned company under the control of Shenzhen Municipality through the Shenzhen division of state-owned Assets Supervision and Administration Commission (SASAC), China's government agency designated as a holding entity of

105. The allocation of enforcement resources is a classical theme in the economics of enforcement. *See generally* A. Mitchell Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. OF ECON. LITERATURE 45, 64 (2000). One of the classic questions in the study of the economics of public enforcement is how to best allocate society's enforcement resources in its apprehension of violators. *Id.*

106. For modeling on the choice of public enforcement over level of activities, *see id.* at 58–60.

107. *See, e.g.*, Carlos Noronha, Yun Zeng & Gerald Vinten, *Earnings Management in China: An Exploratory Study*, 23 MANAGERIAL AUDITING J. 367, 367 (2008) (explaining that managers of Chinese listed companies' have a general incentive to manage or manipulate corporate earnings); Chunxin Jia et al., *Fraud, Enforcement Action, and the Role of Corporate Governance: Evidence from China*, 90 J. BUS. ETHICS 561, 562–63 (2009) (describing the widespread fraudulent activity in Chinese securities market).

108. *Supra* Part II.B.3. Ultimately, China Resources exited Vanke by selling its 15% stake to Shenzhen Metro. Zhen & Li, *supra* note 46.

109. *Supra* note 65 and accompanying text.

state-owned assets.[110] The choice of shareholder reinforced Wang Shi's repeated statement that he wanted a state-owned company, and not a domestic company, to be Vanke's largest shareholder.[111]

While Vanke claimed Shenzhen Metro as its white knight, the issue of whether the private offering was a de facto poison pill is an open question. As consideration for Shenzhen Metro's subscription of shares in Vanke's private offering, Shenzhen Metro proposed a sale of three plots of land to Vanke.[112] The price for the asset sale reflected a significant premium over the cost at which Shenzhen Metro acquired the land in the first place.[113] When the Shenzhen Government injected the land into Shenzhen Metro as its capital contribution only a few years earlier, the aggregate valuation was RMB 23.59 billion.[114] By contrast, the valuation for the same assets doubled when sold to Vanke, soaring to RMB 45.61 billion.[115]

Regulators felt uneasy about the high premium on these assets. The Shenzhen Stock Exchange issued a letter of inquiry probing, among other things, the reason for the increase in asset valuation.[116] Vanke, in its response, maintained that injecting the land into Vanke at a high premium relative to the same land's valuation only a few years ago was reasonable.[117] According to Vanke, the purchase price reflected the fair market value of the land in compliance with applicable accounting standards.[118]

To be sure, an overvaluation of assets in Vanke's purchase of assets from Shenzhen Metro in consideration for new shares in Vanke does not necessarily imply fraud. Whether the price was unreasonably high is a commercial question and may fall into the ambit of business judgment, duly exercised by Vanke's directors. However, the suspicion lingers: Vanke management was so eager to invite Shenzhen Metro to overtake China Resources and Baoneng as Vanke's largest shareholder that it was willing to pay a premium that could jeopardize the interests of existing shareholders. Existing shareholders' equity interests and earnings per

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110. VANKE, *Major Transaction in Relation to the Acquisition of Qianhai International by Way of Issuance of Shares*, HKEXNEWS.HK (June 17, 2016) [hereinafter *Vanke-Shenzhen Metro Deal Proposal*], http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0619/LTN20160619039.pdf (H.K.).

111. Zhang, *supra* note 51.

112. *Vanke-Shenzhen Metro Deal Proposal*, *supra* note 111.

113. *Id.*

114. VANKE, *Reply from China Vanke Co., Ltd. in Relation to Letter of Inquiry Regarding the Restructuring of China Vanke Co., Ltd. (Permission Type Restructuring Inquiry Letter [2016] No. 39) from the Shenzhen Stock Exchange*, HKEXNEWS.HK (July 4, 2016), http://www3.hkexnews.hk/listedco/listconews/SEHK/2016/0704/LTN20160704007.pdf (H.K.).

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.*

share may become unduly diluted when a new shareholder is issued shares at a grossly low price.[119] It could have been an actionable transaction, and the Vanke directors' decision could have been tested against the fiduciary duties they owed. However, neither Baoneng, China Resources, nor any other minority shareholder, challenged the appraisal price in the courtroom.[120]

Vanke is among China's most creditworthy listed corporations and enjoys low debt financing costs that are readily made available by financial institutions.[121] The fact that Vanke forwent a debt transaction, opting instead for an equity deal, is puzzling unless viewed as an attempt to expel raiders. The choice also casts doubt on whether the deal was necessary or in the best interests of shareholders. Given that Vanke, one of the country's largest real property developers,[122] has a reservoir of high-quality land, what was the real motivation behind its straying away from its usual, cheaper practice to structure a debt transaction in its acquisition of land? Moreover, even assuming an equity deal is acceptable, why structure it as an issuance of new shares—with the immediate effect of dilution—and not an all-cash one when Vanke had a solid cash flow? Last but not least, in the proposed equity transaction, was it a reasonable and prudent business judgment to agree with the appraisal that the value of the land had doubled in only a few years? All these unanswered questions raise suspicions about the fairness of the price and the prudence of the Vanke directors.

Even ruling out the possibility of fraud, it is worth inquiring whether the directors of Vanke violated the business judgment rule by engaging in grossly imprudent conduct. Unfortunately, there is little Chinese law on point; however, the United States case *Cole v. National Cash Credit Ass'n* may likewise be a useful reference.[123] In *Cole*, the shareholder claimed an undervaluation of the company's assets and an overvaluation of the assets of the merger partner.[124] The court recognized that grossly imprudent conduct of a director is not exempt from the business judgment rule.[125] In a similar vein, Vanke directors

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119. *See generally* Richard Kolodny & Diane Rizzuto Suhler, *Changes in Capital Structure, New Equity Issues, and Scale Effects*, 8 J. FIN. RES. 127 (1985) (explaining the correlation between issuing new shares and shareholders' negative returns); Paul Asquith & David W. Mullins Jr, *Equity Issues and Offering Dilution*, 15 J. FIN. ECON. 61 (1986) (explaining the effect of share issuance on stock prices).

120. *See* discussion *infra* Part V.A.

121. VANKE, ANNUAL REPORT 2016 31 (2017), http://www3.hkexnews.hk/listedco/listconews/SEHK/2017/0418/LTN201704181069.pdf (H.K.) (mentioning Vanke's low financing cost).

122. *See China Vanke*, *supra* note 2.

123. Cole v. Nat'l Cash Credit Ass'n, 156 A. 183, 183 (Del. Ch. 1931).

124. *Id.* at 187.

125. *Id.* at 188 ("[M]ere inadequacy of price will not reveal fraud. The inadequacy must be so gross as to lead the court to conclude that it was due not to an honest error of judgment but rather to bad faith, or to a reckless indifference to the rights of others interested.").

and officers should not be easily exculpated from the claim that their actions were grossly imprudent.

III. PROLONGED TRADING SUSPENSIONS: A DEFENSE TACTIC INSUFFICIENTLY ADDRESSED BY REGULATORS

Besides the legal controversies, one notable phenomenon in the Baoneng/Vanke takeover is that Vanke management used unorthodox means to fend off acquirers that are beyond the scope of permissible defensive tactics under China's takeover law.[126] The phenomenon highlights one salient feature unique to China's takeover market: corporate directors and officers have more tools in their toolbox (extra-legal tactics)[127] than their Western counterparts to guard against activist investors.[128] A number of these extra-legal tactics are novel to sophisticated financial markets. This section discusses one of the tactics, namely, invoking trading suspensions at will.

The use of extra-legal tactics underscores the idiosyncratic features of different securities markets, despite the internationalization of stock markets and the cross listing of firms. Successful takeovers are rare in China's securities market where the playing field heavily tilts in favor of incumbent management.[129] This phenomenon analogizes to the enigma of how no market for hostile takeovers has developed in certain Asian securities markets even when dispersed shareholder ownership, depressed share values, and a regulatory framework modeled after the United Kingdom or the United States are all present.[130] China, like

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126. *See* Hui Huang, *China's Takeover Law: A Comparative Analysis and Proposals for Reform*, 30 DEL. J. CORP. L. 145, 172–77 (2005) [hereinafter Huang, *China's Takeover Law*] (addressing Chinese regulations on takeover defenses and associated problems); *see also* Yi Zhang, *China Takeover Guide* 1, 9–10, IBANET.ORG, https://www.ibanet.org/Document/Default.aspx?DocumentUid=3115E456-2094-45BF-B9B9-23B49D045561 (last visited March 29, 2019) (discussing Chinese law on takeover defenses); Jennifer G. Hill, *Takeovers, Poison Pills and Protectionism in Comparative Corporate Governance* 9–11 (ECGI Working Paper Series in Law, Paper No. 168, 2010), https://ecgi.global/sites/default/files/working_papers/documents/SSRN-id1704745.pdf (highlighting the drastic contrast between China's takeover law and its operation in practice). *See generally* Hui Huang, *The New Takeover Regulation in China: Evolution and Enhancement*, 42 INT'L L. 153, 158–167 (2008) (providing a subsequent update on the rules governing takeover defenses).

127. Extra-legal tactics is the term used in this article to refer to the methods Chinese corporate directors and officers utilize that are prohibited by Western corporations.

128. *See* discussion *infra* Part IV.A. *Compare* Wei Cai, *Hostile Takeovers and Takeover Defences in China*, 42 H.K. L.J. 901, 901–02 (2012) (discussing the pervasive adoption of anti-takeover provisions in Chinese listed firms' articles despite these provisions' questionable legitimacy throughout the article) *and* Zhang, *supra* note 127 (explaining the general tendency of Chinese laws and regulations to be silent about controversial takeover defenses).

129. *See infra* Graph One.

130. For the explanation on why there is an absence of an active market for takeovers in Japan, *see generally* Dan W. Puchniak & Masafumi Nakahigashi, *The Enigma of Hostile Takeovers in Japan: Bidder Beware*, 15 BERKELEY BUS. L.J. 4, 4 (2018) (discussing how this absence is due to local Japanese factors such as the control of boards by lifetime employees which are under-noticed by Western scholars).

Japan,[131] has a takeover regime that is not easily comparable to the United States hostile takeover regimes, even though their laws and regulations have increasingly assumed United States features. The process of adapting to the Western legal framework for corporate governance, as well as the convergence of Chinese securities market regulation to a sophisticated capital market, make the statutes and regulations more complicated than they appear.[132]

A. Abuse of Trading Suspensions

Vanke's tactic to invoke a prolonged trading suspension[133] was modeled after the longtime practices adopted by a herd of listed companies during China's stock market crash in the summer of 2015.[134] In 2015, the bubbles in China's Growth Enterprise Market (GEM market) and Small and Medium Enterprise Market (SME market) burst shortly after speculative activities pushed the indexes to an extremely unreasonable level; GEM and SME markets' average PE ratios peaked at as high as 100 plus.[135] As large shareholders in GEM and SME companies typically mortgaged their shares in exchange for debt financing, a sharply plummeting stock price meant that their leverages would be forced to close out.[136] To avoid this fate, these shareholders almost

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131. Puchniak & Nakahigashi, *supra* note 131, at 22–25 (noting both that Japan's mandatory bidding rule, presumably modeled after the UK City Code, allows a bidder to take control of a target listed company without having to trigger the mandatory bidding requirement; and the rule's resemblence to the United States model).

132. For a comparative study of Chinese listed companies' corporate governance, *see generally* Iain MacNeil, *Adaptation and Convergence in Corporate Governance: The Case of Chinese Listed Companies*, 2 J. CORP. L. STUD. 289 (2002).

133. *See supra* Part II.B.2.

134. *See generally* Jennifer Huang et al., *Discretionary Stock Trading Suspension*, SUMMER INSTITUTE OF FINANCE CONFERENCE (unpublished working paper) (July 2018), http://www.cafr-sif.com/2018/2018selected/Discretionary%20Stock%20Trading%20Suspension.pdf (summarizing the widespread trading suspension in the 2015 stock market crash); *see also* Kenneth Rapoza, *China's Trading Suspensions Explained*, FORBES (July 15, 2015, 2:00 PM), https://www.forbes.com/sites/kenrapoza/2015/07/15/chinas-trading-suspensions-explained/#6387d56d2710.

135. *Cf. The Causes and Consequences of China's Market Crash*, ECONOMIST (Aug. 24, 2015), https://www.economist.com/news/business-and-finance/21662092-china-sneezing-rest-world-rightly-nervous-causes-and-consequences-chinas.

136. *See* Jin Sheng, *The A-share Bailout and the Role of China's Securities Watchdog in Regulating a Policy-driven Market*, THE POLITICAL ECONOMY OF FINANCIAL REGULATION 479–509 (Emilios Avgouleas & David C. Donald eds., 2019) (discussing former Chief Consultant to the CSRC, Anthony Neoh's comments on the lessons to be learned from the 2015 stock market turbulence); *see also* Gabriel Wildau & Yizhen Jia, *China Share Pledges Soar as Founders Seek New Borrowing Tools*, FIN. TIMES (Dec. 26, 2017), https://www.ft.com/content/881bae58-e3c9-11e7-97e2-916d4fbac0da (noting that share pledging by controlling shareholders is commonplace and on the rise in China). The share pledge problem was aggravated by the use of leverage financing made available by shadow-banking financial institutions. *See* Jiangze Bian et al., *Leverage-Induced Fire Sales and Stock Market Crashes* 1, 10–12 (Mar. 2018), https://fnce.wharton.upenn.edu/wp-content/uploads/2018/03/Shue_UpdateLeverage_induced_fire_sales_20180309_18A.pdf (using shadow-financed margin accounts).

unanimously adopted the tactic of suspending trading of the public companies over which they had control.[137] In this way, the market prices appeared as the last ones shown on the tapes prior to the suspension, even though the liquidity of the stocks had dried out.[138]

There were a few serious problems underlying this idiosyncratic feature of China's securities market. For one thing, the suspension period tended to be overly lengthy. It could be as long as ten months, as exemplified in the case of Huaxin International (002018).[139] More importantly, the threshold to apply for a trading suspension was low. A public company could become qualified for the trading suspension by simply tossing out an announcement that it envisioned certain material matters, without having to provide any particulars about such "material matters."[140] A common tactic to further extend the trading suspension period upon its expiry was to subsequently furnish a different reason, such that another trading halt is triggered and the clock stops ticking again.[141]

What was worse, a number of these contemplated material transactions failed to materialize when the public companies resumed

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137. The fact that a substantial proportion of controlling shareholders in Chinese listed companies mortgage their shares as security for their bank loans or other debt financings is also a reason why they engage in propping activities. For a discussion about controlling shareholders' propping behavior in China, *see* Qianwei Ying & Liang Wang, *Propping by Controlling Shareholders, Wealth Transfer and Firm Performance: Evidence from Chinese Listed Companies*, 6 CHINA J. ACCT. RES. 133 (2013).

138. It could be argued that the trading halt also benefited Baoneng inadvertently in that the pre-suspension price helped Baoneng avoid its margin calls. But Vanke's stock price was on the rise amid the takeover battle prior to the trading halt, rendering it unlikely to trigger any margin calls on the shares owned by Baoneng. Furthermore, as Vanke intentionally initiated the trading suspension aimed at halting Baoneng's pace in the takeover, it was unlikely that the defense ended up benefiting Baoneng contrary to Vanke's intention.

139. Anhui Huaxin International Holding Co. Ltd. (Huaxin International, SME stock code 002018) announced its trading suspension by reason of contemplating certain material matters. It subsequently extended the suspension upon the expiry of the initial suspension period by furnishing another reason that it underwent certain material asset reorganizations. The restructuring, as it turned out, failed to substantiate in the end. HUAXIN INTERNATIONAL, *Guanyu Chouhua Zhongda Shixiang de Tingpai Gonggao* (关于筹划重大事项的停牌公告) [*Announcement Regarding the Trading Suspension Because of Contemplated Material Matters*], CNINFO (June 16, 2015) [hereinafter *Trading Suspension Announcement*], http://www.cninfo.com.cn/finalpage/2015-06-16/1201154330.PDF (China); HUAXIN INTERNATIONAL, *Si Guanyu Gongsi Zhongda Zichan Chongzu Shixiang de Jinzhan Ji Fupai Gonggao* (关于公司重大资产重组事项的进展及复牌公告) [*Announcement Regarding the Progress on the Corporation's Material Asset Reorganization and the Resume of Trading*], CNINFO (Apr. 15, 2016), http://www.cninfo.com.cn/finalpage/2016-04-15/1202181721.PDF (China).

140. *Trading Suspension Announcement*, *supra* note 140 (no specific reason for trading suspension was provided except the vaguely worded "material matters").

141. HUAXIN INTERNATIONAL, *Guanyu Pilu Zhongda Zichan Chongzu Baogao Shu Ji Gongsi Gupiao Jixu Tingpai de Gonggao* (关于披露重大资产重组报告书暨公司股票继续停牌的公告) [*Announcement Regarding the Disclosure of Material Asset Reorganization and the Continuation of Trading Suspension*], CNINFO (Sept. 26, 2015) http://www.cninfo.com.cn/finalpage/2015-09-26/1201641795.PDF (China).

trading months later.[142] This was an indication that at least some of the companies that suspended trading did not actually have a genuine proposed transaction in the pipeline. Likely, the trading suspensions were meant to serve other purposes, such as preventing stock prices from plummeting further, or as in the case of Vanke, preventing activist investors from being able to buy more shares.

Regulators failed to address the magnitude of the problem. During the 2015 market crash, the Shenzhen Stock Exchange and the Shanghai Stock Exchange approved trading suspensions for thousands of publicly-held companies at the same time, which made up almost half of all companies listed on the two exchanges.[143] The stock exchanges did not probe into, or even question, the companies' reasons for trading suspensions. In the aftermath of the stock market crash, the stock exchanges did not penalize companies that failed to materialize the plans contained in their announcements. As a result, there was no deterrent effect to public companies.[144]

B. Inadequate Regulatory Responses

Chinese listed companies' trading halt practice has been widely criticized globally. For example, Morgan Stanly Capital International (MSCI), a firm that runs global market indexes, criticized the practices of prolonged trading suspensions, specifically in regard to MSCI's process of including Chinese shares in its benchmark emerging market index.[145] During its lengthy negotiations with Chinese regulators, MSCI

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142. *See Trading Suspension Announcement*, *supra* note 140.

143. *See* Xie Yu, *Shanghai, Shenzhen Stock Markets Tighten Rules on Share Trade Suspension Ahead of MSCI Review*, S. CHINA MORNING POST (May 27, 2016, 8:40 PM), http://www.scmp.com/business/money/markets-investing/article/1956778/shanghai-shenzhen-stock-markets-tighten-rules-share; *see also* Jin Sheng, *supra* note 137, at 479, 481 (mentioning the massive scale of trading suspension).

144. The SSE made a public release about the state of trade suspension practices with respect to SSE-listed companies in the aftermath of the 2015 stock crash yet failed to mention any punishment it ever imposed on the listed company violators. *See Shenjiao Suo Tongbao Shen Shi Shangshi Gongsi Ting Fupai Qingkuang* (深交所通报深市上市公司停复牌情况) [*Public Release about the Trading Suspensions and Resumptions in Respect of Shenzhen Stock Exchange Listed Companies*], SHENZHEN STOCK EXCHANGE (Aug. 18, 2017), http://www.szse.cn/aboutus/trends/conference/t20170818_521668.html (China); *see also* Tom Mitchell & Gabriel Wildau, *Question and Answer: China's Share Trading Suspensions*, FIN. TIMES (July 7, 2017), https://www.ft.com/content/1bf693dc-24f9-11e5-9c4e-a775d2b173ca; *cf. Q&A on Stock Trading Suspension and Resumption in the Shanghai Stock Exchange Market*, SHANGHAI STOCK EXCHANGE (Aug. 10, 2018), http://english.sse.com.cn/aboutsse/news/newsrelease/c/4611653.shtml (China) (denying the extensiveness of trading halts and announcing the absolute number of halts on the Shanghai Stock Exchange remains "at a low level").

145. *See* Samuel Shen & John Ruwitch, *MSCI Warns Chinese Companies about Suspending Trading of Shares*, REUTERS (July 30, 2017), https://www.reuters.com/article/us-china-stocks-msci/exclusive-msci-warns-chinese-companies-about-suspending-trading-of-shares-idUSKBN1AG059.

urged the regulators to impose more stringent restrictions over A-shares listed companies' at-will trading suspensions.[146] After its conditional inclusion of China-listed A-shares, MSCI continued to monitor and remove shares from the index shares that were suspended for an overly lengthy period.[147]

Hence, external pressure from international investors, not the cry for a regulatory change by domestic investors, nudged the Chinese regulator to react to the abuse of trading halts. Pressured by MSCI, the CSRC committed to regulatory changes to curb the arbitrary and long suspensions.[148] Since May 2016, both the Shanghai and Shenzhen stock exchanges have tightened rules regarding halting trading activity by listed companies.[149] Shenzhen Stock Exchange's rules, entitled "Memorandum No. 9 in Relation to the Suspension and Resume of Trading by Listed Companies" (Trading Suspension MOU), set out measures aimed at curbing arbitrary and lengthy trading halts.[150]

In essence, the rules in the Trading Suspension MOU are centered on more disclosures and more procedural requirements for a listed company to follow before it announces a trading halt.[151] The Trading Suspension MOU imposes certain "soft" caps—soft in the sense that listed firms may refer to exceptions so as to break the caps—on the duration of trading suspensions.[152] For instance, there is now a three-month cap on trading suspension in connection with a material asset reorganization initiated by a listed company.[153] The trading suspension may then be further extended, at the company's discretion, for another three months.[154] Even after a six-month lapse, the firm does not have to

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146. *See* Mike Bird, *How China Pressured MSCI to Add Its Market to Major Benchmark*, WALL ST. J. (Feb. 3, 2019), https://www.wsj.com/articles/how-china-pressured-msci-to-add-its-market-to-major-benchmark-11549195201 (noting that MSCI head of research for Asia Pacific, Chin Ping Chia, commented "China was an outlier in global markets with too many suspensions in stock trading").

147. *See* Shen & Ruwitch, *supra* note 146.

148. *See* Benjamin Robertson, *China Says It Will Cut Maximum Length of Stock Trading Halts*, BLOOMBERG (Nov. 6, 2018), https://www.bloomberg.com/news/articles/2018-11-07/china-says-it-will-cut-maximum-length-of-stock-trading-halts.

149. *See* Gabriel Wildau, *China to Limit Length of Stock Trading Halts*, FIN. TIMES (Nov. 6, 2018), https://www.ft.com/content/cd054628-e247-11e8-a6e5-792428919cee.

150. Zhuban Xingxi Pilu Yewu Beiwanglu di 9—Shangshi Gongsi Ting Fupai Ye (主板信息披露业务备忘录第 9 号——上市公司停复牌业) [Mainboard Information Disclosure Memorandum No. 9—Trading Suspension and Resume of Trading in Relation by Listed Companies], SHENZHEN STOCK EXCHANGE (May 27, 2016) (China) [hereinafter Trading Suspension MOU]. An updated "Shenzhen Stock Exchange Guideline No. 2 in Relation to Information Disclosure by Listed Companies—Trading Suspension and Resumption of Trading," subsequently replaced the Trading Suspension MOU on Dec. 28, 2018.

151. *Id.*

152. *Id.*

153. *Id.* art. 7(3).

154. *Id.* arts. 7(4), 15.

resume trading if its financial advisor assesses that it is reasonable for the firm to continue with the halt.[155]

These measures do not adequately close the regulatory loophole and have had limited impact thus far. The root of the problem—the ability for listed companies to go on an endless trading suspension—remains uncured even though the stock exchanges have made it more difficult to do so.[156] Indeed, after the Trading Suspension MOU was promulgated, notorious companies like LeTV that traded on the GEM suspended their trading for a period far beyond the six-month limit imposed by the new Trading Suspension MOU.[157] When LeTV finally resumed trading almost a year later in March 2018, fraudulent activity uncovered during its trading halt brought its share price down to the floor, causing disastrous loss to its investors.[158]

It is notable that neither before nor after the promulgation of the Trading Suspension MOU has a listed company been penalized by the stock exchanges for their prolonged trading halt or for failure to materialize the proposed transaction announced as the reason for the trading suspension, which implies a possibility of misrepresentation.[159] The Shenzen Stock Exchange continues to exercise limited oversight of the trading suspension practices of listed companies. Its intervention in cases where abuse of trading suspension is suspected is limited to a refusal in granting its approval for a trading suspension,[160] and demanding a listed company to resume trading.[161] Administrative sanction, although documented as one of the possible sanctions,[162] has

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155. *Id.* art. 7(5).

156. *See, e.g.*, Lucille Liu et al., *China Bourses Set to Reduce Trading Halts to Curb Abuses*, BLOOMBERG (Nov. 21, 2018), https://www.bloomberg.com/news/articles/2018-11-21/china-proposes-to-limit-use-of-trading-halts-to-curb-abuses (stating that "trading halts in China are still too frequent and too long" and implying arbitrary trading halts remained a problem after the promulgation of the Trading Suspension MOU in 2016).

157. LESHI WANG XINXI JISHU (BEIJING) GUFEN YOUXIAN GONGSI (乐视网信息技术(北京)股份有限公司) [LETV INFORMATION TECHNOLOGY (BEIJING) CO., LTD.], *Guanyu Gupiao Tingpai de Gonggao* (关于股票停牌的公告) [*Announcement on the Suspension of Trading*], CNINFO (Apr. 14, 2017), http://www.cninfo.com.cn/finalpage/2017-04-17/1203299473.PDF (China) (announcing a trading suspension "expected not to exceed five trading days"); LESHI WANG XINXI JISHU (BEIJING) GUFEN YOUXIAN GONGSI (乐视网信息技术(北京)股份有限公司) [LETV INFORMATION TECHNOLOGY (BEIJING) CO., LTD.], *Zhongda Zichan Chongzu Tingpai Qijian Jinzhan* (重大资产重组停牌期间进展公告) [*Announcement on Development of Trading Suspension As a Result of Material Asset Reorganization*] CNINFO (Jan. 9, 2018), http://www.cninfo.com.cn/finalpage/2018-01-10/1204317988.PDF (China) (describing LeTV's prolonged trading halt).

158. LESHI WANG XINXI JISHU (BEIJING) GUFEN YOUXIAN GONGSI (乐视网信息技术(北京)股份有限公司) [LETV INFORMATION TECHNOLOGY (BEIJING) CO., LTD.], *Chengqing Ji Fupai de Gonggao* (澄清暨复牌的公告) [*Announcement on Clarification (of Certain Matters) and Resumption of Stock Trading*], CNINFO (Mar. 27, 2008), http://www.cninfo.com.cn/finalpage/2018-03-28/1204526511.PDF (China).

159. *See supra* notes 144–45 and accompanying text.

160. Trading Suspension MOU, *supra* note 151, art. 7.

161. *See id.*

162. *Id.* art. 3.

never been invoked. Therefore, despite the lack of deterrent effect on companies that abuse the trade suspension mechanism, the regulatory framework persists.

While public enforcement offers meager regulatory ability, there is no effective internal corporate governance working to curb abusive behavior. On its face, the Trading Suspension MOU adds more corporate approval requirements for a decision to halt trading. However, given the de facto control of Chinese listed companies by corporate management and controlling shareholders,[163] these procedural requirements do not adequately address the arbitrariness involved in the decision to suspend trading. Listed companies remain able to fabricate a transaction without having to substantiate it or validate the reason at a later date. In fairness, proposed transactions imply uncertainty as to their successful closing. A genuine, proposed transaction may legitimately fail to materialize. It is an entirely different scenario when listed companies fabricate a transaction and subsequently announce that the negotiations did not lead to a definitive agreement—this borders on misrepresentation, a fraudulent act.

In a securities market where a derivative action and a class action are readily available mechanisms for remedy, the inadequacy of stock exchange rules would not be as fatal. In a more developed jurisdiction, shareholders can challenge the prolonged trading suspension practice in court on the basis that it constitutes an illegal defense tactic.[164] After all, in lieu of public enforcement, aggrieved shareholders may step in to act as private attorney general and, with the de facto financing of law firms, bring about class actions, derivative actions, or both which deter corporate directors and officers from misconduct.[165] Unfortunately, this is not the case in China. The bar for initiating an action against corporate directors or officers, especially those of listed companies, is extremely high.[166]

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163. Chen Lin et al., *Corporate Governance and Firm Efficiency: Evidence from China's Publicly Listed Firms*, 30 MANAGERIAL AND DECISION ECON. 193, 197 (2009) (qualitatively characterizing Chinese listed companies' ownership structure as "usually one overwhelmingly large shareholder with controlling power in the listed firms"). Lin and the other author's summary statistics also show that controlling shareholders typically own 40–50% equity interests in Chinese listed companies, and hence the degree of ownership concentration is high. *Id.* at 199–200, tbl. 2.

164. For example, in the United States shareholders would be able to challenge the legitimacy of defenses and there is an abundance of cases in this regard. *See generally* Gary G. Lynch & Marc I. Steinberg, *Legitimacy of Defensive Tactics in Tender Offers*, 64 CORNELL L. REV. 901 (1978–79).

165. Coffee pointed out the virtue of the private attorney general model as a protection against political capture of the regulator, and hence a helpful supplement to public enforcement. The force of the argument remains decades after Coffee's justification. *See* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 724–25 (1986).

166. *See infra* Part VI.C.

So, what can minority shareholders depend on? The private attorney general model is not yet an accepted norm in China.[167] And regulators are not willing to encourage it. The private attorney general model works as a check against regulator control by interest groups.[168] A proper functioning private attorney general model would weaken the regulators' claim for a broader regulatory jurisdiction—a propensity of regulators. Moreover, it is particularly difficult to advocate for the private attorney general model in a jurisdiction like China, where the CSRC dominates the rulemaking process with respect to securities regulation and is vested with sweeping enforcement power. In addition, there is no judicial review in place to scrutinize whether the CSRC's rules and regulations are ultra vires.[169] Thus, the CSRC is unlikely to voluntarily rein in its own power to make room for the prosperity of private enforcement. Indeed, between the lines of the CSRC's opinions about strengthening the supervision over listed companies after their initial public offering as its policy leanings lies the unspoken message: the CSRC keeps a firm grip on, and would like to expand, its regulatory power.[170]

Yet, public enforcement is by no means fully capable of, and in fact has not been, living up to the expectation of curbing fraud on China's securities market. The rampant trading suspension practices will probably remain a unique symptom of Chinese securities markets despite pressures from MSCI, and hence a powerful extra-legal impediment to any activist investor bidding for target listed companies.

C. The Implications of Discrete Liquidity

The extensive and prolonged trading halts, unique to China's securities markets, jeopardize the liquidity that should otherwise be available to shareholders of a listed company. Public shareholders gain

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167. *See* Donald C. Clarke, *The Private Attorney-General in China: Potential and Pitfalls*, 8 WASH. U. GLOBAL STU. L. REV. 241, 242 (2009) (evaluating the Chinese political-legal culture and accordingly the feasibility of a private attorney general approach to law enforcement in China). Indeed, more restrictions are placed on the adoption of a private attorney general model in securities litigation than a general lawsuit. *See id.* at 248–49.

168. *See* Coffee, *supra* note 166, at 724–25.

169. Admittedly, there are lawsuits against the CSRC, which check the behavior of the CSRC to a certain extent. *See, e.g.*, Appendix One (cases 1, 3, and 8).

170. The CSRC has constantly emphasized the importance of ongoing and ex post supervision over listed companies in the event that a securities registration regime, as opposed to its existing pre-approval regime, should be put into place. By supervision, the CSRC does not intend to encourage other means of regulation, for example, ex post private litigation, but has in mind a stronger public enforcement led by the CSRC. *Zhengjian Hui Xinwen Fayan Ren "Guowuyuan Guanyu Jinyibu Ziben Shichang Jiankang Fazhan de Ruogan Yijian" Da Jizhe We* (证监会新闻发言人就《国务院关于进一步促进资本市场健康发展的若干意见》答记者问) [*A Press Spokesperson of the CSRC Answered Questions on the "Several Opinions of the State Council on Further Promoting the Healthy Development of the Capital Market"*], CHINA SEC. REG. COMM'N (May 9, 2014), http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201405/t20140509_248760.html (China).

access to liquidity at the expense of control, attributable to the separation of ownership and control feature of public corporations.[171] John Coffee Jr. observed that the trade-off between liquidity and control that institutional investors of listed companies have to make when they decide to make the investment.[172] What Coffee means is that to maintain the power to control a public corporation, a controlling institutional shareholder has to forgo certain liquidity that is otherwise available to ordinary shareholders.[173] In the context of Chinese listed companies, the gist is the same with respect to a bidder contemplating acquiring a target company: they are either looking for liquidity—the ability to dispose of the acquired shares at a profit later as a financial investor, or for control—the ability to exercise control over the target company as a strategic investor.[174] The flexibility adds to a bidder's willingness to bid. The last thing a bidder would want is access to neither.

One should not underestimate the importance of being able to dispose of securities. As Coffee explains, the ability to exit "has received less attention but may be more effective in inducing institutional investors to join and participate in control groups."[175] Yet in China, the ability for public shareholders to choose between these two trade-off options may vanish. If trading halts are used as a defense tactic, public shareholders cannot exit by means of utilizing the liquidity on the market.[176] This is because liquidity drains when arbitrary and extensive trading suspensions are prevalent in the market.[177] Nor can shareholders easily exercise control over a corporation if successful hostile takeovers are extremely difficult to achieve, as evidenced by the Baoneng/Vanke takeover.[178] The legal and extra-legal obstacles discussed throughout this article render it difficult for shareholders to take control of a listed company, even when serious management

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171. Walter Werner, *Corporation Law in Search of Its Future*, 81 COLUM. L. REV. 1611, 1662–63 (1981).

172. John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277, 1328 (1991) (distinguishing between a traditional controlling shareholder and an institutional investor).

173. For example, a controlling shareholder in the United States cannot sell its shares unless it registers the shares or qualifies for an exemption to registration. *See* 17 C.F.R.§ 230.144(e)(1) (Westlaw through Mar. 1, 2019).

174. Coffee, *supra* note 173, at 1281 (asserting that tradeoff exists for investors between liquidity and control); *see also* Patrick Bolton & Ernst-Ludwig Von Thadden, *Blocks, Liquidity, and Corporate Control*, 53 J. FIN. 1, 1–3 (1998) (modeling bidder's choice over dispersed ownership where there is sufficient liquidity, versus that of concentrated ownership where control is more accessible).

175. Coffee, *supra* note 173, at 1343.

176. *See supra* Part III.A.

177. *Id.*

178. *See supra* Part II.B; *see also* Cai, *supra* note 129, at 915–23 (Chinese listed companies take advantage of the regulators' silence on controversial anti-takeover provisions in the articles of association, and thereby hinder potentially efficient hostile takeovers).

misbehaviors and harm to the long-term value of the company are evident.

The adverse consequence regarding listed companies' corporate governance is deep rooted. If we consider activist investors as possible monitors of listed companies, an arbitrary drain on market liquidity creates an unwelcoming environment for bidders. When bidders have tremendous obstacles—both legal and extra-legal—to overcome before they can gain control over a target company, they tend to restrain their takeover targets to those that offer the highest premium. This is the only way to offset their efforts and the higher uncertainty involved.[179] In turn, few listed companies would be feasible targets for takeover, even if activist investors could improve profitability by replacing weak management.

In summary, the deeper concern underlying trading halts is that shareholders lose the option to choose between having liquidity and exercising control over a listed company—a premise in Coffee's works and in sophisticated securities markets.[180] As evidenced in the Baoneng/Vanke case, the power over the provision of liquidity to the market, including activist investors, rests with management.[181] Shareholders like Baoneng are unable to liquidate their positions after learning about adverse developments.[182] The situation is even worse for interested bidders in a potential takeover attempt. They are unable to effectively control the pace of their acquisition.[183] Instead, their ability to accumulate or liquidate shares on the open market is at the mercy of the incumbent management.[184] This may, in part, explain why successful hostile takeovers are sparse in China's securities market.

IV. THE DISPARITY IN CHINA'S DISCLOSURE REQUIREMENTS

In addition to being susceptible to arbitrary trading suspensions, activist investors must contend with a biased disclosure regime, which is favorable to incumbent management and, at the same time, unfriendly

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179. In this regard, extensive use of legal and extra-legal takeover defense may deter the occurrence of otherwise efficient takeovers by raising the bar for a takeover to succeed. For the economic analysis of efficiency of takeovers, *see, e.g.*, Randall Morck, Andrei Shleifer & Robert W. Vishny, *Characteristics of Targets of Hostile and Friendly Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 101, 116–25 (Alan J. Auerbach ed., 1988).

180. Coffee, *supra* note 173, at 1281.

181. *See supra* Part III.A.

182. *Id.*

183. For the importance of speed in tender offers, *see* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1178–79 (1981) (describing the preference of a bidder to have such advantages as speed over potential competing bidders in order to recoup the additional costs incurred to the first bidder).

184. *See* discussion *supra* Part III.A (Baoneng/Vanke).

to acquirers. The net effect is that bidders are forced to show all their cards while incumbent management is allowed to hide in the dark.

A. Favorable Disclosure Exemptions for Incumbent Management

While Baoneng's high leverage attracted most of the spotlight (and academic attention), a material fact about Vanke stayed under the radar. Since 2014, Vanke had multiple stock holding vehicles,[185] the details of which were hardly disclosed to the public.

Vanke directors and management utilized "collective asset management plans"—a scheme functionally analogous to passive investment management unit in the United States—as both their shareholding vehicle and financing platform.[186] The business partners (primarily directors, officers, supervisors, and other key employees of Vanke) subscribed for shares in the scheme, which with leveraged financing, invested in shares of Vanke.[187] During its peak, the two collective asset management products held more than RMB 15 billion in Vanke stock, comprising almost 8% of Vanke shares.[188]

However, Vanke chose not to disclose particulars about the insider shareholdings held through these collective asset management products. For instance, in Vanke's 2016 Half-Year Report, the aggregate 7.12% shares of Guosen Jinpeng and De Ying were disclosed,[189] whereas Vanke insiders' individual interests in these stock holding vehicles were not.[190] Instead, in accordance with the same report, Vanke management disclosed that it held a mere 0.2% stake in Vanke.[191] In other words, Vanke disclosed its directors', supervisors', and officers' direct holdings in the company, but not any indirect interests held by the stock holding vehicles, which might otherwise fall into the category of "beneficial interest" in the United States.[192]

Three legal issues arise here. First, and perhaps most importantly, their actions constituted an incomplete disclosure by Vanke insiders of possible conflict of interests with Vanke. Second, without full disclosure, it is likely that the two stock holding vehicles constituted parties acting in concert in the Baoneng/Vanke takeover. And third, if the answer to

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185. *See supra* Part II.A.

186. *See supra* notes 13–17 and accompany text.

187. *Id.*

188. Wang, *supra* note 18.

189. VANKE, *Interim Report 2016*, *supra* note 9, at 77 (Guosen Jinpeng holding 4.14% and De Ying holding 2.98%).

190. *Id.* at 85 (shareholdings of directors, supervisors and senior management).

191. *Id.*

192. 15 U.S.C.§§ 16(b), 78p(a)(1) (Westlaw through Pub. L. No. 116-5) ("[e]very person who is directly or indirectly the beneficial owner of more than 10 percent of any class of any equity security" is liable for short-swing profits); *see also* Huppe v. WPCS Int'l Inc., 670 F.3d 214, 215–17 (2d Cir. 2012) (Judge Parker's discussion of beneficial ownership).

the aforementioned issue is in the affirmative, the question of whether the parties are subject to China's early warning requirement becomes an issue.

China's takeover rules, "The Measures on the Administration of Takeovers of Listed Companies" as amended in 2014, or the "Takeover Measures,"[193] adopt an early warning system equivalent to § 13(d) of the United States' Securities Exchange Act. The rules require any person who becomes the beneficial owner of more than 5% of a class of equity securities registered pursuant to § 12, or of certain other issuers, to make a filing with the SEC.[194] Likewise, articles 13 and 14 of the Takeover Measures require a filing with CSRC, China's equivalent to the SEC, when any investor parties acting in concert[195] hold 5% of outstanding shares in a listed company.[196] A major difference between the United States and the Chinese rules is China's use of "shares" in lieu of "beneficial ownership" as referred to in the Securities Exchange Act.[197] This loophole works in favor of Vanke's director and managers' decision not to disclose.

Despite these differences,[198] the early warning provisions in the two jurisdictions serve similar purposes: to notify shareholders and management of a possible shift in control.[199] However, by employing collective asset management schemes, which enabled Vanke insiders to hold "beneficial interests" rather than shares in Vanke, the insiders avoided the disclosure requirement.[200]

Insiders are able to go undetected because Chinese regulators' unsophisticated draftsmanship lags behind financial practices. Articles 13 and 14 of the Takeover Measures merely require shares to count towards the 5% filing threshold, while other beneficial interests do not.[201] The idea of using shares instead of beneficial ownership permeates the Takeover Measures.[202]

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193. Takeover Measures, *supra* note 94.

194. 15 U.S.C. §§ 13(d), 78m(d) (Westlaw).

195. Either through secondary market trading or through a share transfer agreement. Takeover Measures, *supra* note 94, arts.13 & 14.

196. *Id.*

197. *Compare id.* (shares) *with* 15 U.S.C. § 16(b) (Westlaw) (beneficial ownership).

198. Preference shares, let alone different classes of shares, were a novel concept when the Takeover Measures were last amended. Therefore, preference shares were non-existent in China until they was legalized in 2013. For an introduction to preference shares enabled in China, *see* Wei Cai, *Use of Preference Shares in Chinese Companies as a Viable Investment/Financing Tool*, 11 CAP. MKT L.J. 317, 318–321 (2016).

199. *See* Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1, 27–28 (1978) (tender offer statutes provide advance warning of takeover bidding).

200. *See* VANKE, *Interim Report 2016*, *supra* note 9, at 85.

201. Takeover Measures, *supra* note 94, arts.13 & 14.

202. *See generally id.*

Moreover, in accordance with "The Administrative Rules on the Shareholding and Changes in Shareholding in Listed Companies in Respect of the Listed Companies' Directors, Supervisors and Senior Management" (Shareholding Changes Rules),[203] the calculation of the shareholding of directors, supervisors, and senior managers follows a "nominal holding" principle.[204] That is to say, only stock or derivatives registered under the names of directors, supervisors, or officers are required to make filings with the CSRC.[205]

The loose equity interest disclosure requirements also do not apply equally to incumbent management and shareholders (including acquirers).[206] Controlling shareholders, de factor controllers, and shareholders holding 5% or more of stock in a listed company must follow a different dual principle when calculating equity interest: "nominal shareholding" and "de facto shareholding."[207] That is, in accordance with the Takeover Measures, both shares that are registered under the names of the above shareholders and those that are de facto controlled by these shareholders are calculated towards the shareholding.[208] The rules create the combined result of more lenient disclosure requirements for corporate insiders (with respect to their interests in the listed company in which they serve and may have a conflict of interest) and more stringent disclosure requirements for shareholders of the same company.

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203. Shangshi Gongsi Dongshi, Jianshi He Gaoji Guanli Renyuan Suochi Ben Gongsi Gufen Ji Qi Biandong Guanli Guize (上市公司董事、监事和高级管理人员所持本公司股份及其变动管理规则) [The Administrative Rules on the Shareholding and Changes in Shareholding in Listed Companies in Respect of the Listed Companies' Directors, Supervisors and Senior Management] (promulgated by China Sec. Reg. Comm'n Apr. 10, 2007, effective Apr. 5, 2007) CHINA SEC. REG. COMM'N [hereinafter Administrative Rules on Shareholding], http://www.gov.cn/zwgk/2007-04/10/content_576962.htm (China).

204. *See China's Supreme People's Court Issues Rules on Foreign Investment Disputes*, JONES DAY (Sept. 2010), https://www.jonesday.com/china_supreme_peoples_court_issues_rules/ (Chinese laws and regulations generally follow a nominal shareholding principle, that is, to recognize only those shareholders registered with the company registry, and not the actual shareholders who may have de facto control over the company through the nominal shareholders. In practice, this approach gives rise to many issues over the relationship between nominal shareholders and actual shareholders awaiting judicial decisions in such areas as foreign direct investment regulation). *See generally* Xingxing Li, *An Economic Analysis of Regulatory Overlap and Regulatory Competition: The Experience of China's Interagency Regulatory Competition in Foreign Investment Regulation*, 67 ADMIN. L. REV. 685, 694–708 (2015).

205. Administrative Rules on Shareholding, *supra* note 204, arts. 3, 11 & 13 (considering only "shares" owned by directors, supervisors, and officers).

206. *See* Takeover Measures, *supra* note 94, art. 12.

207. *Id.* art. 13.

208. Art. 12 of the Takeover Measures reads "[t]he interest that an investor owns in a listed company includes shares registered under his/her/its name, and shares not registered under his/her/its name *but of which the investor has de facto control over the voting rights*." Takeover Measures, *supra* note 94, art. 12 (emphasis added).

By contrast, the United States disclosure requirements for insider holdings cover equity security, as well as security swap agreements.[209] Section 13(d) of the Securities Exchange Act provides that "[a]ny person who, after acquiring directly or indirectly the beneficial ownership" of certain securities, "is directly or indirectly the beneficial owner of more than 5 per centum of such class," must fulfill the statutory disclosure requirements by reporting to the SEC.[210]

Notably, the United States securities regulation includes the beneficial ownership concept, and treats directors, officers, and principal shareholders equally for purposes of determining their beneficial ownership holdings.[211] Beneficial ownership as defined in SEC Rule 13d-3(a) is as follows:

> A beneficial owner of a security includes any person who, directly or indirectly through any contract, arrangement, undertaking, relationship, or otherwise has or shares:
>
> (1) voting power which includes the power to vote, or to direct the voting of, such security; and/or
>
> (2) investment power which includes the power to dispose, or to direct the disposition of, such security.[212]

In determining whether a transaction by a third party should be attributed to an insider of the listed company, a beneficial owner is defined as "any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares a direct or indirect pecuniary interest in the equity securities."[213] Moreover, for the purpose of disgorgement of short-swing profits, a beneficial owner is defined as any person who, directly or indirectly, has or shares voting or investment power over and a pecuniary interest in a security.[214]

A series of United States cases have weighed in on this issue. In *Children's Investment Fund*,[215] the Second Circuit upheld the district court's ruling that the party receiving the stock-based return (the long

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209. 15 U.S.C. §§ 13(d)(1), 78m(d)(1) (Westlaw through Pub. L. No. 115-141). The Securities Exchange Act defines a beneficial owner as a person who exercises voting or investment control over and holds a pecuniary interest in a company's registered securities. *Id.* §§ 16(b), 78p(b).

210. *Id.* § 78m(d)(1).

211. For instance, with respect to a short-swing transaction, the Securities Exchange Act sets out that directors, officers, and principal shareholders of a company are liable for profits realized from the short-swing transaction, that is, the purchase and sale, or sale and purchase, of its shares within a six-month period. *Id.* §§ 16(b), 78p(b).

212. 17 C.F.R. § 240.13d-3(a) (Westlaw through Mar. 6, 2019). SEC Rules 13d-3b identify circumstances under which a person shall be deemed to be a beneficial owner. *Id.*

213. *Id.* § 240.16a-1(a)(2).

214. *Id.*

215. CSX Corp. v. Children's Inv. Fund Mgmt. (UK) LLP, 654 F.3d 276, 276 (2d Cir. 2011).

party) to an equity swap agreement has beneficial ownership of shares purchased by the other party (the short party) as a hedge.[216] The beneficial ownership of shares enables the long party to engage in a proxy fight with the incumbent management of the takeover target.[217] Subsequently in *Huppe v. WPCS International Inc.*,[218] the Second Circuit held that a limited partnership is a beneficial owner, even though the limited partners delegated voting rights and investment control over portfolios to their general partners' agents.[219]

Had they been in the United States, Vanke insiders would have had to disclose their interests in Vanke held through the collective asset management products in which they held beneficial ownership. However, in China, even though Vanke insiders clearly held indirect pecuniary interests in Vanke stock via the collective asset management plans, they were exempt from disclosure of such beneficial ownership.

For directors, officers, and supervisors in China, all that needs to be disclosed is personally held stocks, options, and restricted stocks.[220] As long as an individual director or officer's voting rights do not exceed the 5% threshold under the Takeover Measures, he or she is not required to disclose his or her shares in any asset management products. This rule applies even if the plans hold shares of the listed company in which the insider serves.[221]

B. Stringent Disclosure Requirements for Bidders

In a nutshell, the bidders are subject to more stringent disclosure requirements than incumbent management because investors in a listed company are treated differently. An insider merely needs to disclose his or her direct shareholding, as long as his or her shareholding has not reached the 5% threshold, which triggers the higher disclosure standard in the Takeover Measures.[222] By contrast, a bidder must always disclose his or her interests that amount to beneficial ownership.[223]

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216. *Id.* at 282 (confirming the District Court's finding that the long party "was deemed a beneficial owner under Rule 13d-3(b) because it had 'created and used the [swaps] with the purpose and effect of preventing the vesting of beneficial ownership in [the long party] as part of a plan or scheme to evade the reporting requirements of Section 13(d).").

217. *Id.* at 279.

218. Huppe v. WPCS Int'l Inc., 670 F.3d 214, 214 (2d Cir. 2012).

219. *Id.* at 216.

220. Administrative Rules on Shareholding, *supra* note 204.

221. *Id.*

222. *Id.*

223. A bidder is subject to the Takeover Measures as opposed to the Administrative Rules on Shareholding and therefore has to comply with the beneficial ownership requirement in the Takeover Measures. *See* Takeover Measures, *supra* note 94, arts. 13 & 14; Administrative Rules on Shareholding, *supra* note 204.

Allowing management to abstain from disclosing their indirect beneficial interest in the listed company is merely one of the many deficiencies in China's takeover regulation. Poor draftsmanship and lack of consistency between securities regulations is an easy scapegoat to find. But it is not a helpful criticism. An over-emphasis on the technical aspect may overshadow the deep-rooted bias in legislature tilted in favor of corporate insiders, not bidders. Indeed, the regulators are aware that asset management products are popular platforms for listed companies' share incentive schemes.[224] In China, asset management plans have long been a favorite conduit through which listed companies implement their share incentive schemes.[225]

One advantage of employing collective asset management plans is that there is no statutory cap on its maximum number of shareholders or partners, which is otherwise required of a limited liability company or a limited liability partnership.[226] Under China's Company Law, a limited liability company can have a maximum of fifty shareholders.[227] Likewise, limited liability partnership, another possible shareholding platform, also places a cap of fifty limited liability partners.[228] When a listed company contemplates a share incentive plan, it usually has more than fifty key employees in mind to benefit from the plan. As a result, a collective asset management plan becomes the only choice. Moreover, collective asset management plans make it possible for employees to use leverage to gauge their interests in listed companies. In this sense, regulators could not have turned a blind eye to such a popular scheme among listed companies. Neither can they claim ignorance of the challenges these plans brought to existing insider disclosure regimes. Considering the regulators' awareness of the challenges caused by the insider disclosure exemption, the disparity between the regulators'

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224. Shortly after the Baoneng/Vanke takeover battle, and more generally out of the policy consideration aimed at curbing China's colossal shadow banking industry, the regulators promulgated rules entitled "Guiding Opinions on Regulating the Asset Management Businesses of Financial Institutions" on Apr. 27, 2018 to regulate, among others, the asset management plans. *See* Kaiji Chen & Tao Zha, *Macroeconomic Effects of China's Financial Policies* 1, 5–6 n.6 (Fed. Res. Bank of Atlanta, Working Paper No. 25222, 2018), https://www.nber.org/papers/w25222; *see also China Steps Up Regulations on Wealth Management Products, Asset Management Business*, REUTERS (July 20, 2018, 5:43 AM), https://www.reuters.com/article/us-china-regulation/china-steps-up-regulations-on-wealth-management-products-asset-management-business-idUSKBN1KA19C.

225. *See* Emily Perry & Florian Weltewitz, *Wealth Management Products in China*, 2015 RES. BANK AUSTL. 59–69, https://www.rba.gov.au/publications/bulletin/2015/jun/pdf/bu-0615.pdf#page=61 (the popular use of asset management plans as "channels" for various purposes in the financial sector).

226. Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective Dec. 29, 1993, last amended Oct. 26, 2018), at art. 24 (China).

227. *Id.*

228. Hehuo Qiye Fa (合伙企业法) [Partnership Law] (promulgated by the Standing Comm. Nat'l People's Cong., Feb. 23, 1997, effective Feb. 23, 1997, last amended Aug. 27, 2006), at art. 61 (China).

attitudes towards Vanke insiders' asset management plans versus that of Baoneng is striking.

As enumerated above,[229] while Vanke insiders made use of collective asset management plans, they were not the only party to do so. Baoneng also implemented a number of these plans as its source of funding.[230] The plans helped Baoneng amass leverage for its takeover to the maximum extent.[231] As the takeover battle evolved, Baoneng became a subject of severe criticism for its use of collective asset management plans; ironically, Vanke remained clear of such critique.[232]

Critics initiated attacks on Baoneng's collective asset management plans on two fronts. First, they questioned the legality of the high leverage ratio in the collective asset management plans.[233] Amid the wave of condemnation, Vanke and critics demanded that Baoneng make detailed disclosure about these asset management plans.[234] But this means the bidder, rather than corporate managers or directors, needs to fully open up to its takeover target. The bidder must reveal its cards whereas insiders of the target company can be shielded behind the asset management plans.

Second, scholarship criticized that Baoneng was not legally entitled to exercise the voting rights attached to the underlying shares it accumulated via the asset management plans.[235] The rationale is that asset management plans should be deemed an agency contract, in which a manager acts as agent to the principal who provides funds.[236] Accordingly, the manager should act pursuant to the instructions of the

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229. *See supra* note 13.

230. *See supra* notes 24–29.

231. *See supra* notes 10–17.

232. *See* Wang Xiangwei, *Why "Barbarian" Insurers Have Forced Beijing to Intervene*, S. CHINA MORNING POST (July 20, 2018, 2:54 PM), https://www.scmp.com/week-asia/opinion/article/2053390/why-barbarian-insurers-have-forced-beijing-intervene (commenting that the CIRC imposed a series of administrative sanctions on Baoneng, including suspending Foresea Life Insurance).

233. *See Vanke Takeover Battle Highlights Market Regulation Defects*, CHINA DAILY (July 5, 2016), http://www.chinadaily.com.cn/business/2016-07/05/content_25971785.htm (China) (noting that critics are urging stricter scrutiny over leveraged buying of listed companies' shares to fend off financial risks). Critics also stress the debt crisis attributable to China's shadow banking industry, and hence accuse the use of leverage in the financial sector. *See* Xusheng Yang, *Deleveraging China Inc*, INT'L FIN. L. REV., May 2015, 20, 21.

234. *Vanke Takeover Battle Highlights Market Regulation Defects*, CHINA DAILY, http://www.chinadaily.com.cn/business/2016-07/05/content_25971785.htm (last updated July 5, 2016) (China) (quoting Professor Wang Jun that "[a]n acquiring firm can use funds raised at a leverage ratio as high as over twenty times to complete the purchase . . . [so] the buyer should be required to disclose more information about the risk" and prominent economist Zhou Qiren's call for the regulators to "make public where Baoneng's funds come from and evaluate their risks").

235. *See* Ciyun Zhu & Lanny Wen Li, *Hostile Takeovers Cast Doubts on the Defects of Chinese Corporate Governance Rules* 4–7 (EW Barker Ctr. for L. & Bus., Working Paper 18/03, 2018), https://law.nus.edu.sg/ewbclb/pdf/wps/EWBCLB-WPS-1803.pdf.

236. *Id.*

principals.[237] A variation of the rationale is that in lieu of treating an asset management plan as an agency contract, it should be treated as a trust.[238] As a result, the manager of the plan, acting as trustee, may exercise the voting rights.[239]

Vanke also attacked Baoneng regarding its right to vote through the asset management plans.[240] Vanke argued that it was unclear as to whether asset management plans have any voting rights after their acquisition of shares.[241] And assuming they have voting rights, Vanke questioned whether they could be exercised with instruction from Baoneng, as the general partner assuming unlimited liability, rather than those of creditors as leverage providers.[242]

Whether we define the asset management plan as an agency contract or trust, we should not ignore the fact that the existing regulatory regime does not bar Baoneng from, by way of contract, obtaining consents from the senior creditors in the asset management plans. With the proper delegation of voting rights, it was legitimate for Baoneng to vote on behalf of the plans. Moreover, the asset management plans as launched by Baoneng—including the voting arrangements—were pre-approved by regulators in the first place.[243] Why then are criticisms of Baoneng's asset management plans much more severe than those of Vanke? Baoneng, as a bidder, would have had to subject its asset management plans to close scrutiny and more stringent disclosure

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237. This analysis contrasts the prevailing views on the voting rights that institutional investors such as mutual funds have. *See* Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 882 (2010); Angela Morgan et al., *Mutual Funds as Monitors: Evidence from Mutual Fund Voting*, 17 J. CORP. FIN. 914, 927 (2011); Stephen Choi, Jill Fisch & Marcel Kahan, *Who Calls the Shots: How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35, 41 (2013).

238. *See* Jianbo Lou, *An Overview of PRC Trust Law and Trust Business* 19–22, JAPAN ASS'N ON THE L.OF TRUSTS, http://shintakuhogakkai.jp/activity/pdf/vol40_China2.pdf (last visited May 15, 2019) (Japan) (enumerating examples of asset management plans in the legal analysis of "trusts").

239. *Id.* This approach is in line with common law theories on the rights of trustees. *See* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 637–43 (1995) (pointing out that the historical development of asset management business calls for a transition from restricting trustees' powers to transact, termed as "disempowerment," to enabling trustees to actively administer the modern trust portfolio of financial assets).

240. Vanke moved to challenge Baoneng's voting rights in multiple ways. *See* Zhen, *supra* note 64.

241. *See Baoneng to Acquire Vanke or End: Process Review and Enlightenment*, BAZYD (May 28, 2018), http://bazyd.com/baoneng-to-acquire-vanke-or-end-process-review-and-enlightenment/.

242. *See* Zhen, *supra* note 64.

243. The CIRC has the authority to approve asset management products issued by insurance companies. It is extensively involved in many functions that are generally considered to be insurance companies' internal affairs. Stephen P. D'Arcy & Hui Xia, *Insurance and China's Entry into the WTO*, 6 RISK MGMT. & INS. REV. 7, 17 (2003) ("All new products must be approved by the CIRC before they can be issued, all changes in the ownership structure of a company need to be authorized by the CIRC before being implemented, and any change of investment allocations must be approved by the CIRC.").

requirements. Why were Vanke's asset management plans held to a different standard?

V. THE UNDER-ENFORCED FIDUCIARY DUTIES

As revealed in the Baoneng/Vanke case, even the most acclaimed listed companies in China are vulnerable to management misbehaviors. In the face of hostile takeovers, incumbent management can take advantage of various defensive tactics, many of which would seem unorthodox to Western securities markets. Surprisingly, the legality of these tactics is rarely put to test against the fiduciary duties owed by Vanke insiders. Indeed, in the aftermath of the Baoneng/Vanke takeover, the most curious fact is that no party endeavored to bring a lawsuit against Vanke insiders' breach of fiduciary duties.

In point of fact, it is actually a rational choice for the parties not to initiate a fiduciary duty lawsuit because breach of fiduciary duty is an under-enforced doctrine in Chinese courts. It is unrealistic to expect the doctrine of fiduciary duty to be helpful when incumbent management in listed companies engage in overreaching defense tactics.

A. Director's Fiduciary Duties in Enforcement

Outwardly, the text of China's Company Law does not deviate from the common law doctrine when it comes to fiduciary duty.[244] Article 147 of China's Company Law, last amended in 2018, sets forth that directors owe the duty of loyalty and the duty of diligence to the company.[245] It is uncertain how a "duty of diligence" resonates with a "duty of care" in common law context, but scholars tend to regard the duty of diligence and the duty of care as equivalent under Chinese law.[246] Unfortunately, the doctrines are by no means comparable to each other, in part because duty of diligence does not have a concrete meaning under China's Company Law.[247] By contrast, the duty of loyalty is given somewhat more specific meanings under articles 112, 148 and 150 of the Company

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244. *See* Rebecca Lee, *Fiduciary Duty without Equity: "Fiduciary Duties" of Directors under the Revised Company Law of the PRC*, 47 VA. J. INT'L L. 897, 902–05 (2007) (reading the text of the Chinese Company Law against the contour of fiduciary duty at common law); *see also* Nicholas C. Howson, *Twenty-Five Years On—The Establishment and Application of Corporate Fiduciary Duties in PRC Law* 21–28 (Law & Economics Working Papers, Paper No. 146, 2017), https://repository.law.umich.edu/law_econ_current/146 (analyzing corporate fiduciary duties in the Chinese Company Law).

245. Company Law, *supra* note 227, art. 147.

246. The term "duty of diligence" under the Chinese Company Law is interchangeable with that of "duty of care" at common law. *See* Lee, *supra* note 245, at 902, 902 n.23; *see also* Howson, *supra* note 245, at 14 (noting the relevant Chinese characters employed to signal a "duty of care" obligation when referring to a "duty of diligence").

247. Admittedly the Chinese Company Law includes certain provisions to specify the fiduciary duty, *e.g.*, the prohibition of self-dealing. *See* Lee, *supra* note 245, at 913–15. But it is by no means a comprehensive codification of fiduciary duty at common law. *Id.*

Law, rendering it more feasible for enforcement in the Chinese judicial system.[248]

By attempting to transplant the common law through regulation, the doctrine lost its viability in adjudication in China. For example, director and officer breach of fiduciary duty is seldom a cause of action in court.[249] When it is seen, it appears far more often in disputes involving privately held companies than in listed companies.[250] This constitutes an irony unique in China's context: fiduciary duties should play a much more prominent role in safeguarding shareholders' interests in listed companies—particularly given that the agency problem is more pressing relative to closely held companies—but in fact it is less often invoked.[251]

All judicial judgments that involve article 147 of the Company Law, which stipulates the duty of loyalty and the duty of diligence in respect of directors, officers, and supervisors during the period between January 1, 2010 and December 31, 2017, were empirically examined for purposes of the Table below.[252] The source of judicial decisions is China Judgments Online, a platform on which all judgments, in principle, should be disclosed.[253] The majority of entries dealing with directors' breach of duty of loyalty or duty of care concern limited liability companies rather than listed companies.

Indeed, as depicted in Appendix One enclosed in this article, when it comes to listed companies, between 2010 and 2017, there are only twelve cases concerning directors' fiduciary duties.

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248. Article 148 sets forth that certain types of act by directors or managers are deemed to be a breach of duty of loyalty, including: (i) misappropriating corporate fund, (ii) depositing corporate fund into individuals' accounts, (iii) loaning corporate fund to others or providing security for other persons using corporate property without due corporate procedures, (iv) self-dealing without due corporate procedures, (v) usurping corporate opportunities, (vi) accepting commissions in the corporate's transaction with other persons, and (vii) unduly disclosing corporate secretes. *See* Company Law, *supra* note 227, art. 148.

249. *See infra* Table One; *see also infra* Appendix One.

250. *See Shanghai White Paper*, *infra* note 270; s*ee also* Howson, *supra* note 245, at 42–43 ("The large majority of cases touching on corporate fiduciary duties involve the closely-held PRC corporate form . . . ; cases involving the joint stock form (or companies limited by shares) . . . are extremely rare.").

251. Robin Hui Huang provided an explanation that the phenomenon is attributable to the stringent standing requirement for brining derivative actions in respect of joint stock companies as opposed to limited liability companies. *See* Robin Hui Huang, *Shareholder Derivative Litigation in China: Empirical Findings and Comparative Analysis*, 27 BANKING & FIN. LAW REV. 619, 648–50 (2012).

252. *See infra* Appendix One.

253. For background on the China Judgments Online, *see generally* Björn Ahl & Daniel Sprick, *Towards Judicial Transparency in China: The New Public Access Database for Court Decisions*, 32 CHINA INFO. 1, 1–34 (2018).

Table One: Cases Involving Fiduciary Duties of Directors in Chinese Listed Companies, 2010–2017[254]

Categories of Judicial Decisions		Case Vol.	Percentage
1	The case was in conjunction with public enforcement – (i) preceded by or (ii) in parallel with public enforcement	7	58% (7/12)
1.1	When (i) preceded by or (ii) in parallel with public enforcement, decision was against director	5	71% (5/7)
2	The case was in conjunction with public enforcement – (iii) followed by public enforcement	1	8% (1/12)
2.1	When (iii) followed by public enforcement, decision was against director	1	100% (1/1)
3	The case was not in conjunction with any public enforcement – not (i) preceded by, (ii) in parallel with, or (iii) followed by public enforcement	4	33% (4/12)
3.1	When not in conjunction with public enforcement, decision was against director	1	25% (1/4)
4	Litigation was initiated by a shareholder of ListCo	3	25% (3/12)
4.1	Litigation was initiated by a shareholder of ListCo and was not in conjunction with any public enforcement	2	17% (2/12)
5	Litigation was intimated by a party other than shareholder of ListCo	9	75% (9/12)
6	Litigation was a derivative action	1	8% (1/12)
7	Litigation was not a derivative action	11	92% (11/12)
8	The court discussed criteria of fiduciary duty	1	8% (1/12)
9	The court did not discuss criteria of fiduciary duty	11	92% (11/12)

Table One and Appendix One show that out of the twelve cases in which the fiduciary duties of a listed company's director were at issue (some only loosely), eight are in conjunction with public enforcement. This study further breaks down the cases in conjunction with public enforcement into three sub-categories: (i) preceded by public enforcement—there was administrative sanction or criminal investigation or prosecution before the case was litigated; (ii) in parallel with public enforcement—there was concurrent administrative sanction, criminal investigation, or prosecution ongoing while the case

254. *See infra* Appendix One for a summary of individual cases.

was litigated; and (iii) followed by public enforcement – after the case was litigated, there was administrative sanction, criminal investigation, or prosecution initiated.

Of the twelve cases, seven were preceded by either administrative sanctions imposed by the CSRC or criminal investigation or prosecution brought by the public prosecutor.[255] In other words, the majority of civil cases were initiated *as a result of* public enforcement. When public enforcement precedes the civil case, the rulings of the civil court overwhelmingly disfavor the directors in question; 71% of the time the court held the directors accountable. Of the twelve cases, criminal prosecution followed immediately after only one of the cases.[256] In that case, the court held the director accountable.

The rationale for court decisions when the cases are in conjunction with public enforcement is straightforward: the judiciary relies heavily on the judgment made by the public enforcement to reach a conclusion on its own regarding director liability. In other words, while the courts should make independent decisions about the liability of directors in Chinese listed companies based on standards that are not completely overlapping with that of the administrative agency or the public prosecution, in fact the courts are greatly influenced by the behavior of public enforcement. Moreover, it is notable that when the cases were in conjunction with public enforcement, the courts were more likely to hold the directors accountable than not.

In contrast, pure private enforcement is dismal in number. There are only four cases that are strictly private litigations—not preceded by, in parallel with, or followed by any public enforcement activities.[257] When public enforcement is not involved, the court's decision tends to favor the directors, meaning exculpating the directors from the alleged breach of fiduciary duty. In 75% of these pure civil litigations, the decisions were favorable to the directors.[258]

Of the four purely private litigations, the listed company's shareholders initiated two cases.[259] The other two were brought before the court by either the director himself (for compensation after the listed company's termination of his employment contract due to his breach of fiduciary duty)[260] or the creditor.[261] The latter two cases are not within the scope of a shareholder or corporation's enforcement of fiduciary duties owed by directors.

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255. *Id.* (cases 1, 3, 5, 7, 8, 9, and 10).

256. *Id.* (case 12).

257. *Id.* (cases 2, 4, 6, and 11). Case 12 in Appendix One is not included because it was followed by criminal prosecution and is therefore considered to have involved public enforcement.

258. *See supra* Table One.

259. *Infra* Appendix One (cases 6 and 11).

260. *Id.* (case 2).

261. *Id.* (case 4).

Finally, of the twelve cases involving a director's fiduciary duties, only one contains a discussion about the specific criteria for the fiduciary duty.[262] The remaining cases simply failed to discuss the standard for fiduciary duties owed by directors.

This empirical account illustrates that private enforcement of directors' fiduciary duty in listed companies is almost negligible. While Appendix One does not reveal how often a shareholder of a listed company or the listed company brings an action against its directors claiming they breached their fiduciary duties,[263] it shows how often Chinese courts decide cases on the merits regarding directors' breach of fiduciary duty claims against directors of listed companies. In purely private litigation, it is extremely unlikely, if not impossible, to prevail against a director in a breach of fiduciary duty claim. This fact explains why Baoneng, or even Vanke's original biggest shareholder (China Resources), never brought the Vanke insiders' misbehavior to the court: it was a perfectly rational choice not to invoke judicial proceedings because they were unlikely to offer any help.

If one cannot count on private attorneys to enforce directors' and officers' fiduciary duties, is public enforcement a sensible fallback option?[264] Appendix One shows otherwise. Assuming the most serious violations are found with public enforcement, the minor punishments imposed on directors and officers have the effect of under-deterrence at best.

Admittedly, when there is public enforcement, the courts are more likely to rule against the directors.[265] This finding is not surprising because judicial decisions are usually based on the preceding administrative sanctions imposed by the CSRC. There are two problems with this state of affairs. One issue is commingling the burden of proof for a civil action with the criteria for an administrative sanction. Another is that the nominal pecuniary recovery awarded is hardly a deterrence to directors. Indeed, the huge payoff relative to the potential for only minor punishment works to encourage, rather than discourage,

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262. *Id.* (case 4).

263. In China, a plaintiff bringing an action does not equate to the court agreeing to try the case. Acceptance by the court to try a case can be difficult, so the number of cases tried in court is substantially smaller than the number of disputes the parties bring before the court. *See* Dan Harris, *China Litigation and Case Acceptance*, HARRIS BIRCKEN: CHINA L. BLOG (Mar. 24, 2012), https://www.chinalawblog.com/2012/03/china-litigation-and-case-acceptance.html (akin to American standing rules).

264. Some scholars have pointed out the danger embedded in an over-reliance on public enforcement in China, in that public enforcement for securities related violations can be unpredictable, selective, and inherently biased. *See* Tianshu Zhou & Wenjing Li, *Unpredictable Enforcement of the CSRC's Approach to Insider Trading in China*, *in* REGULATORY REFORM IN CHINA AND THE EU: A LAW AND ECONOMICS PERSPECTIVE 67–88 (Stefan E. Weishaar et al. eds., 2017).

265. In six out of eight cases, among which five (cases 1, 3, 7, 8, and 9) were (i) preceded by or (ii) in parallel with public enforcement, and one (case 12) was (iii) followed by public enforcement. *See infra* Appendix One.

directors and officers to engage in risky behaviors. This is an effect in sharp contradiction to the purpose of optimal punishment.

B. The Judicial Enforcement Paradox

As mentioned, many judicial decisions do not discuss the duty of loyalty or the duty of diligence in their opinions.[266] In almost all cases involving listed companies, the courts fail to explain what a director's duty of loyalty and duty of diligence entail.[267] These duties were only mentioned when lumped together with other statutory provisions or were used merely as window dressing.[268]

A disappointing conclusion is that in China, fiduciary duty claims (as they relate to listed companies' directors and officers) are not as effective as expected. This doctrine is unable to grow or thrive as Chinese judges confine themselves to the purview of black letter law, which ultimately produces hollow, undeveloped doctrines. One may argue that this observation should be confined to listed companies and should not apply to closely held companies. There is some quantitative research surveying the frequency of litigation involving director and officer duty of loyalty and duty of diligence.[269] For example, the Shanghai No. 2 Intermediate People's Court published a white paper (Shanghai White Paper) disclosing the cases tried in the court that involved the duty of loyalty of directors and officers between 2010 and 2015.[270] While the paper does not distinguish between listed companies and closely held companies, the Shanghai White Paper found a general upward trend in the number of cases involving director and officer fiduciary duties within this time frame.[271] In 2010, the court tried only two cases of the type. By 2015, the number had risen steadily to twenty-two.[272]

However, not one of those cases involved a listed company.[273] These numbers cannot justify an assertion that director and officer fiduciary duties are commonly applied, even in one of China's most highly regarded courts exercising jurisdiction over one of China's most developed economic regions. Moreover, the duty of diligence is not

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266. *See infra* Appendix One (column "Whether discussed standards for duty").

267. *Id.* (with the exception of case 4).

268. *See id.* (column "Whether discussed standards for duty").

269. *Nian She Gongsi Dongshi, Gao Guan Zhongshi Yiwu Shenpan* (2010–2015 年涉公司董事、高管忠实义务审判白皮书) [*White Paper on the Adjudication of Directors' and Officers' Duty of Loyalty between 2010 and 2015*], SHANGHAI NO. 2 INTERM. PEOPLE'S CT., http://www.shezfy.com/book/bps/2015/p06.html (last visited Mar. 29, 2019) (China) [hereinafter *Shanghai White Paper*].

270. *Id.*

271. *Id.* Figure One.

272. *Id.*

273. *Id.*

addressed in the Shanghai White Paper.[274] The omission is a telling indication that this more nuanced duty of care, which requires the judiciary to play a more proactive role in construing a standard, may not even be applied with enough frequency to warrant a white paper.

This omission also illustrates the irony emphasized in this article: Regarding fiduciary duties owed by directors and officers, the larger the company, the less likely it is for a dispute over director or officer fiduciary duties to be tried in court. Additional agency problems are also implicated when directors and officers are further removed from the oversight of shareholders.

C. Judicial Positivism at Play

The statistics about judicial enforcement of fiduciary duties owed by directors and officers explains in part why private litigation did not play any role in the Vanke takeover battle, despite the rising tensions between the parties. There is limited value, if any, for a shareholder, whether an activist investor or otherwise, to bring private actions against corporate insiders in listed companies. An academic question lingers here: How do we explain the passive role that Chinese courts play in enforcing and developing such a widely embraced doctrine in corporate governance?

Admittedly, Chinese judges possess neither the authority nor the willingness that Western common law judges have to substantiate or develop the doctrine against a set of facts before the court.[275] The disinclination of Chinese judges to give specific meaning to the doctrine of fiduciary duty is vividly illustrated by the Shenzhen Intermediate Court in the *Fujian Furi* case.[276] It is the only case about fiduciary duties owed by a listed company's director during the period between 2010 and 2017 where the court endeavored to define the standards for director and officer fiduciary duties.[277] The judgment reads:

> The duty of diligence with respect to directors is an affirmative duty that directors must fulfill as prescribed by various countries in their company laws. It requires that directors should exercise the care of a prudent administrator in managing the company's affairs. Duty of

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274. *Id.*

275. *See* Howson, *supra* note 245, at 35–36 (analyzing the significant constraints that Chinese courts face in adjudicating fiduciary duty cases).

276. Qiuzhenliang, Huangxionggui Yu Fujian Furi Dianzi Gufen Youxian Gongsi, Chen Xu Gudong Sunhai Gongsi Zhaiquanren Liyi Zeren Jiufen An (丘振良、黄雄贵与福建福日电子股份有限公司、陈旭股东损害公司债权人利益责任纠纷案) [Zhenliang Qiu & Xionggui Huang v. Fujian Furi Electrics Co. Ltd. & Xu Chen (as Shareholder) in Respect of Injury to Creditors' Interests], Shen Zhong Fa She Wai Zhong Zi No. 36 (Shenzhen Interm. Ct. 2014) (China) [hereinafter Fujian Furi case]; *see infra* Appendix One (case 4).

277. Fujian Furi case, *supra* note 277 (translated); *see* Appendix One (case 4).

> diligence requires that a director of company, in [his or her] exercise of power, should follow a certain standard so as to manage the company's affairs diligently. If the director breaches the duty, he should be held liable accordingly.[278]

It is evident that the court used the duty of diligence under China's Company Law and the duty of care under common law system interchangeably.[279] The court should have been aware of the possible constructions of duty of care in theory,[280] given the abundance of literature endeavoring to introduce the doctrine of fiduciary duty in the context of comparative studies.[281] The judiciary apparently does not share this academic zeal. Even with an understanding of what a duty of care may entail in the common law system, the court adhered to China's traditional conservative approach to statutory interpretation:

> Given the complexity of contemporary economic activities, it is difficult [for the court] to assess whether a director, in making business decisions, fulfills the duty of care with reason and prudence. Also, the duty of diligence for directors embeds subjectivity; *the boundary of 'reasonableness' or 'diligence' is not clear-cut . . . . The Company Law does not put forth an express rule [as to what constitutes] the duty of diligence for directors*, and hence [we] cannot ascertain whether the failure of the director [in the case at bar] to procure shareholders to pay in the capital they subscribed to constitutes a breach of duty of diligence.[282]

The Shenzhen Intermediate Court's reading of the duty of care sheds light on Chinese courts' general attitude toward doctrines transplanted from common law countries. Even though the doctrines in

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278. Fujian Furi case, *supra* note 277 (translated).

279. *See* Lee, *supra* note 245, at 902, 902 n.23; Howson, *supra* note 245, at 14.

280. *Cf.* Larry A. DiMatteo, *'Rule of Law' in China: The Confrontation of Formal Law with Cultural Norms*, 51 CORNELL INT'L L.J. 391, 441 (2018) (arguing that "rational judicial reasoning in the application of hard rules and principles is lacking in the Chinese judiciary because of its lack of skill and familiarity with the Western legal concepts"). *Compare with* Fujian Furi case, *supra* note 277 (translated) (reasoning that the inertia present in the Chinese judiciary is not simply attributable to lack of legal reasoning skill.).

281. *See* Note, *Chinese Characteristics in Corporate Clothing: Questions of Fiduciary Duty in China's Company Law*, 80 MINN. L. REV. 503, 505–506 (1995); Huang, *China's Takeover Law*, *supra* note 127, at 145; Lee, *supra* note 245; Chao Xi, *Foreign Solutions for Local Problems? The use of US-Style Fiduciary Duties to Regulate Agreed Takeovers in China*, 64 J. CHINESE ECON. & BUS. STUD. 407, 407 (2008); Han Shen, *A Comparative Study of Insider Trading Regulation Enforcement in the U.S. and China*, 9 J. BUS. & SEC. L. 41, 42–43 (2009); *Introduction* to COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES 1, 3 (Umakanth Varotti & Wai Yee Wan eds., 2017); Howson, *supra* note 245.

282. Fujian Furi case, *supra* note 277 (emphasis added) (translated).

their origins are highly developed and readily transplantable, they are unlikely to bear fruit in China's judiciary. The codification of these laws by the Chinese legislature is of limited help; the statutes merely include the name of the transplanted doctrines, not their underlying framework.[283]

Because of judicial inertia, Chinese courts are extremely reluctant to offer their interpretations of codified common law doctrine. Indeed, Chinese courts are reluctant to accept complicated cases, e.g., securities civil actions,[284] or politically provoking cases.[285] Thus, it is unfortunate that fiduciary duties, especially the duty of care, are largely under-enforced by the judiciary.

Chinese judges, in their application of common law doctrines, tend to follow the path of judicial positivism. They do not have sufficient incentives to delve deeper into laws and regulations. As vividly illustrated by the *Fujian Furi* case above, the court's rationale is that the meaning of law is exhausted in positive law; hence, the court should not attempt to enrich the meaning of fiduciary duty beyond the black-letter law.[286] The irony, then, is that a judicial positivist judge would then negate the applicability of fiduciary duties; the over-simplistic statutory provision does not contain the details necessary to apply the standard for fiduciary duties.

Several reasons account for this judicial inertia. Judicial opinions in China generally do not have precedential value.[287] Although the Supreme Court of China enthusiastically pursues a pilot case guidance program, which is intended to designate precedent-like cases for courts of subsequent jurisdiction to follow, the number of such cases is so small that it could hardly create any wave of reform.[288] A problem underlying an initiative like the pilot case guidance program is that "precedent" in China is created by way of the Supreme Court of China's top-down designation; thus, without first being filtered and selected by the Court,

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283. *See* Lee, *supra* note 245, at 925 (concluding that "it is difficult to completely codify an equitable fiduciary doctrine and thus there is a risk that the principle of fiduciary loyalty as embodied in the revised Company Law exemplifies only a generic description for the specific rules set out therein").

284. *See* Robin Hui Huang, *Private Enforcement of Securities Law in China: A Ten-Year Retrospective and Empirical Assessment*, 61 AM. J. COMP. L. 757, 769 (2013) (noting Chinese courts' inhospitality to accept securities civil cases).

285. *See* Benjamin L. Liebman, *China's Courts: Restricted Reform*, 191 CHINA QUARTERLY 620, 631 (2007) (observing Chinese courts' general tendency in dealing with difficult or sensitive cases is to refuse to accept the cases for trial or to leave the substances of the cases unresolved).

286. *See* Fujian Furi case, *supra* note 277 (case 4 in Appendix One).

287. Howson, *supra* note 245, at 35.

288. For review of the design and functioning of China's case guidance system, *see, e.g.*, William Jing Guo, *Cases as a New Source of Law in China?: Key Features of and Reflections on China's Case Guidance System*, 1 CHINA L. & SOC'Y REV. 61, 61–99 (2016); Note, *Chinese Common Law? Guiding Cases and Judicial Reform*, 129 HARV. L. REV. 2213, 2213–34 (2016).

a case would not become a guidance case.[289] The finite capacity of the Chinese Supreme Court presages its confined output.[290] Without a sufficiently large body of precedent-like cases, the reform initiative is doomed. As a result, because they are unincentivized to create precedent, Chinese judges immerse themselves in problem solving rather than the practice of enriching legal doctrine.[291] Furthermore, Chinese judges generally face heavy caseloads which prevent them from crafting carefully written opinions.[292] Venturing out to discuss what is entailed in the duty of loyalty and the duty of care will provide them with nothing but risks and costs.

Risk aversion also contributes to why Chinese judges fail to develop doctrine. Judicial independence is but a grand declaration in China's authoritarian governance.[293] Chinese judges are subject to the pecking order in the bureaucratic system the same way officials are in the administrative branch.[294] Strictly adhering to authorities—laws, regulations and various administrative rulings in China's context—is a judge's safest bet to remain on the bench. Further, what would be the payoff for a Chinese judge to venture into a highly contested field about which even American courts are uneasy? As former Supreme Court of Delaware Justice Henry Ridgely Horsey said, "No aspect of Delaware corporation law has been more unsettling to commentators than the Delaware Supreme Court's rulings in the area of the duty of care of a disinterested corporate fiduciary . . . ."[295] A Chinese judge attempting to develop the duty of care standard is likely to garner unwelcome attention. He would become an easy target for criticism, while receiving little payoff for his actions. Hence, his safest approach is to remain a judicial positivist.

Another more serious concern about widespread judicial positivism is the lasting effect on the already scant presence of Chinese

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289. Note, *supra* note 289, at 2213–34 (Chinese judges have no control over whether their decisions will subsequently be designated as guiding cases).

290. *Id.* at 2226 (acknowledging the low pace of issuance of guiding cases).

291. *See* Yifan Xian, *Grassroots Judges of China in the Resurgence from Adjudicatory to Mediatory Justice: Transformation and Roles and Inherent Conflict of Identities*, 10 J. COMP. L. 126, 132 (2015) (Chinese judges' preference for judicial passivity).

292. *Id.* (noting Chinese judges' heavy caseload).

293. For a more detailed analysis about the state of judicial independence in China, *see* Xin He, *The Judiciary Pushes Back: Law, Power, and Politics in Chinese Courts*, *in* JUDICIAL INDEPENDENCE IN CHINA: LESSONS FOR GLOBAL RULE OF LAW PROMOTION 180–95 (Randall Peerenboom ed., 2009) (describing the inferior position of Chinese courts relative to the political power).

294. Additionally, for a description of the sweeping influence of China's Communist Party (CCP) over the judiciary and the political manipulation of judicial process, *see* Zhu Suli, *Political Parties in China's Judiciary*, 17 DUKE J. COMP. & INT'L L. 533, 538–43 (2006) (Chinese courts are "certainly no exception" in CCP's ubiquitous presence "at every level and in every aspect of contemporary Chinese society"); *see also* Liebman, *supra* note 286, at 626 (noting that the CCP's intervention in judicial process is perceived to be "legitimate" in the Chinese court system).

295. Henry Ridgely Horsey, *The Duty of Care Component of the Delaware Business Judgment Rule*, 19 DEL. J. CORP. L. 971, 972 (1994).

judiciary in takeover regulations. The judiciary should have a role in overseeing the takeover process. In the United States, takeovers are subject to the dual regulatory regime of federal and state laws.[296] At the federal level, the SEC and federal courts play a pivotal role in enforcing federal laws and regulations.[297] At the state level, courts scrutinize the bidding process and the defensive mechanisms of the target company.[298]

United States courts have established numerous rules governing takeovers. For example, the landmark *Unocal*[299] and *Revlon*[300] cases are known to all corporate law scholars. To a large extent, the United States judiciary has shaped the landscape of takeover regulation. Yet, in China, if judicial positivism persists, it is unlikely that comprehensive ex post regulation from litigating in court will happen. The fact that United States courts are particularly apt to evaluate defensive tactics shows the missing link in China's takeover regulation. The result is an insufficient supply of developed law and a pervasiveness of regulatory gaps combined with China's already notoriously un-codified regulations related to takeovers.

VI. GENERAL POLICY APPROACH TO TAKEOVERS

Ad hoc regulatory interventions, prolonged trading halts, disparate disclosure requirements, and under-enforced fiduciary duties in the courtroom have all attributed to Baoneng's ultimate failure to take over Vanke. The Baoneng/Vanke case is representative of the state of hostile takeovers in China.

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296. For a classic article comparing the effects of the United States federal regulation versus state regulation on cash tender offers, *see* Gregg A. Jarrell & Michael Bradley, *The Economic Effects of Federal and State Regulations of Cash Tender Offers*, 23 J.L. & ECON. 371, 374–79 (1980) (introducing federal legislation including the Williams Act and state legislation).

297. The Hart-Scott-Rodino Act, among other United States legislations, also impacts the United States takeover regulation. *See* Hart-Scott-Rodino Act, 15 U.S.C. § 18a (Westlaw through Pub. L. No. 116-5).

298. Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. REG. 119, 155 (1992).

299. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 946–58 (Del. 1985) (establishing the *Unocal* proportionality review to distinguish defenses that benefit shareholders from those that merely protect management).

300. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 173–85 (Del. 1986) (requiring managers to maximize the price shareholders receive when their company is for sale).

China's A-shares market is extremely selective in terms of its market access.[301] It is difficult to get a CSRC approval to be listed.[302] So far, less than four thousand companies have been approved to be listed on the A-shares market.[303] For a country like China which has become increasingly important to the world economy, the number of A-shares companies is disproportionate to the scale of its own economy. Among these listed companies, a significant portion are SOEs.[304] As of 2016, 23.82% of all companies listed on China's Shenzhen Stock Exchange (including the Main Board, the GEM market, and the SME market) are SOEs.[305] More specifically, 58.79% of the listed companies on Shenzhen Stock Exchange's Main Board are SOEs.[306] The selectivity of the A-shares market is a barrier to entry and thus is a contributing factor to Chinese listed companies' high price earnings ratios relative to those listed on sophisticated markets. The scarcity adds to the premium that A-shares investors are willing to pay for the shares.

A. Strategically Important Listed Companies as Crown Jewels in Chinese Economy

The companies that manage to get listed on the A-shares market are often the crown jewels in the Chinese economy. This is particularly true for the listed SOE companies. Listed SOE companies use the A-shares market as an important source of funding.[307] The sovereign shareholders (usually the SASAC and its local branches) of these SOE

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301. Among other things, there is an implicit quota system for companies that are permitted to list on China's securities market. The quota is allocated across provinces, as well as different industrial sectors, in accordance with China's macroeconomic development goals. *See* Joseph D. Piotroski & Tianyu Zhang, *Politicians and the IPO Decision: The Impact of Impending Political Promotions on IPO Activity in China*, 111 J. FIN. ECON. 111, 114 (2014) (the politicization of the IPO selection process); Julan Du & Chenggang Xu, *Which Firms Went Public in China? A Study of Financial Market Regulation*, 37 WORLD DEV. 812, 812–15 (2009) (explaining the quota system used to determine which SOEs are listed).

302. Julan Du & Chenggang Xu, *Which Firms Went Public in China? A Study of Financial Market Regulation*, 37 WORLD DEV. 812, 812–13 (2009).

303. *Listed Domestic Companies, Total*, WORLD BANK, https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=CN (last visited, Mar. 3, 2019) (showing that, as of 2017, there were 3,485 listed companies on China's stock exchanges).

304. Mingyu Chen, *Shangshi Gongsi Nian Guoqi Gaige Quingkuang* (上市公司 2015 年国企改革情况分析) [*Analysis on the 2015 SOE Reforms in Listed Companies*], SHENZHEN STOCK EXCHANGE (2015), https://www.szse.cn/aboutus/research/secuities/documents/P020180328493797731182.pdf (China).

305. *Id.*

306. *Id.*

307. *See* Du & Xu, *supra* note 302, at 822 (stating that firms use the equity market to raise external capital when capital remains high and share prices are acceptable); *cf.* Mingyi Hung et al., *Political Considerations in the Decision of Chinese SOEs to List in Hong Kong*, 53 J. ACCT. & ECON. 435, 435–36 (2012) (noting that there is currently a wave of SOEs listed in Hong Kong as opposed to on China's A-shares market, and there are political considerations behind the SOEs' choice of listing venue).

companies do not want to lose control of the valuable crown jewels. They maintain a firm grip over the listed SOE companies, while freely utilizing the direct financing functions available to listed companies to fuel the business operations of the companies.[308]

This, of course, does not mean that hostile takeovers are not permissible in China. Otherwise, there would not be Takeover Measures in the first place. Nor would there be a growing prominence of takeover activities on Chinese stock markets. But regulators are unlikely to tolerate massive shuffling of corporate controls, the wave of which would also endanger the crown jewels.

These findings would help explain the policy concern behind regulations that impact the takeover market. Most recently, in January 2018, the CBRC published the "Interim Measures for the Equity Management of Commercial Banks" (Bank Equity Rules).[309] One notable provision imposes a cap on the maximum shareholding that an investor may acquire in a commercial bank.[310] The Rules state that "the financial products controlled by one single investor, issuer or manager together with its de facto controller, affiliate, party acting in concert, shall not invest in more than five percent of the total shares in one single commercial bank."[311]

Instead of creating a market for takeovers in the aftermath of the Baoneng/Vanke case, financial regulators opted to tighten their grips on the change of control in listed companies, particularly the crown jewels in the strategically important sectors.[312] An investor is no longer able to acquire more than 5% of shares in a listed bank using asset management products, which is exactly what Baoneng did in its takeover attempt.[313]

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308. *See generally* Yan-Leung Cheung et al., *Helping Hand or Grabbing Hand? Central vs. Local Government Shareholders in Chinese Listed Firms*, 14 REV. FIN. 669, 670–71 (2010) (studying the difference in behavior of central government and local government as shareholders of Chinese listed companies, and implying the Chinese government shareholders' tendency to have firm control—so called "grabbing hand"—over SOE listed companies).

309. *See* Shangye Yinhang Guquan Guanli Zanxing Banfa (商业银行股权管理暂行办法) [The Interim Measures for the Equity Management of Commercial Banks] (promulgated by the China Banking Reg. Comm'n, Jan. 5, 2018, effective Jan. 5, 2018) CHINA BANKING REG. COMM'N [hereinafter Bank Equity Rules], http://www.cbrc.gov.cn/chinese/home/docDOC_ReadView/CB5510B067C649C183490211E5E3B021.html (China); *see also* Jiejiang Wu, *CBRC Publishes New Rules on Equity Management of Commercial Banks*, INT'L LAW OFFICE (Apr. 6, 2018), https://www.internationallawoffice.com/Newsletters/Banking/China/Jingtian-Gongcheng/CBRC-publishes-new-rules-on-equity-management-of-commercial-banks#Requirements (summarizing the terms of the Bank Equity Rules).

310. *See* Wu, *supra* note 310 (summarizing the investment limits under the Bank Equity Rules).

311. *Id.*

312. *See generally* Bank Equity Rules, *supra* note 310; Insurance Company Equity Rules, *infra* note 318; Securities Company Equity Rules, *infra* note 320.

313. *See* Bank Equity Rules, *supra* note 310, art. 25; *see also* Wu, *supra* note 310 (summarizing investment limits).

Indeed, an official of the CBRC, in his explanations on the background of an earlier draft of the Bank Equity Rules, revealed that asset management products employed by insurers as activist investors were one of their concerns.[314] The CBRC official expressly indicated that "mutual funds, insurance asset management plans, trust plans, and other financial products alike may acquire shares of commercial banks on the open market on stock exchanges, but . . . the aggregate shareholding shall not exceed five percent."[315] When the Bank Equity Rules were finally promulgated, the statement targeting insurance asset management plans was removed to conceal the regulator's true intent, and replaced with a more ambiguous claim that "financial products do not comply with the relevant provisions of the current licensing regulations regarding the qualifications of shareholders holding more than 5% of shares . . . ."[316]

The Bank Equity Rules are merely one of the serial regulatory moves that China has taken to prevent takeovers. In the same vein, the CIRC promulgated its "Insurance Company Equity Administrative Measures" (Insurance Company Equity Rules).[317] The Insurance Company Equity Rules likewise impose a 5% shareholding cap in a listed insurance company that one single asset management plan or trust can hold.[318] The CSRC is also contemplating its "Administrative Rules on Equities in Securities Companies" (Securities Company Equity Rules).[319]

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314. *See Yinjianhui Youguan Bumen Fuze Ren Jiu "Shangye Yinhang Guquan Guanli Zhanxing Banfa (Zhengqiu Yijian Gao)" Da Jizhe Wen* (银监会有关部门负责人就《商业银行股权管理暂行办法(征求意见稿)》答记者问) [*CBRC Official's Responses to Media Regarding the Interim Measures for the Equity Management of Commercial Banks (Draft for Public Comments)*] CHINA BANKING REG. COMM'N (Nov. 16, 2017), http://www.cbrc.gov.cn/chinese/home/docView/F63B9AF0A7C04D438936E794A1D3A515.html (China).

315. *Id.* (translated).

316. *See Yinjianhui Youguan Bumen Fuze Ren Jiu "Shangye Yinhang Guquan Guanli Zhanxing Banfa" Da Jizhe Wen* (银监会有关部门负责人就《商业银行股权管理暂行办法》答记者问) [*The CBRC Official's Response to Media Regarding the Tentative Measures on the Administration of Equities in Commercial Banks*] CHINA BANKING REG. COMM'N (Jan. 5, 2018), http://www.cbrc.gov.cn/chinese/home/docView/502D514E85964108B7FC1ADDA4BF6BC4.html (China).

317. Baoxian Gongsi Guquan Guanli Banfa (保险公司股权管理办法) [Insurance Company Equity Administrative Rules] (promulgated by China Ins. Reg. Comm'n, Mar. 2, 2018, effective Apr. 10, 2018) CHINA INS. REG. COMM'N [hereinafter Insurance Company Equity Rules], http://bxjg.circ.gov.cn/web/site0/tab5176/info4101516.htm (China); *see also* Robert Cleaver et al., *China Publishes New Rules on Equity Holdings in Banks and Insurance Companies*, LINKLATERS (Mar. 26, 2018), https://www.linklaters.com/en/insights/publications/asia-news/asia-corporate/2018/china-publishes-new-rules-on-equity-holdings-in-banks-and-insurance-companies (summarizing the Insurance Company Equity Administrative Rules).

318. Insurance Company Equity Rules, *supra* note 318, at art. 7; Robert Cleaver et. al., *supra* note 318.

319. Zhengquan Gongsi Guquan Guanli Guiding (Zhengqiu Yijian Gao) (证券公司股权管理规定(征求意见稿)) [Administrative Rules on the Equities of Securities Firms (Draft for Public Comments)] (promulgated by China Sec. Reg. Comm'n, Mar. 30, 2018, effective Mar. 30, 2018) CHINA

In accordance with the proposed Securities Company Equity Rules, one single limited partnership—the usual form of asset management plan—is restricted from holding more than 5% of equity interests in a securities firm.[320]

These restrictions on hostile takeover efforts are not present in the Takeover Measures, and instead are hidden in a nexus of other regulations. It is foreseeable that these regulatory changes work to make it harder, not easier, to acquire the most valuable A-shares listed companies. The 5% cap on shareholding effectively puts activist investors in handcuffs if they wish to bid for listed banks, insurance companies, or securities firms—all crown jewels which are indispensable in China's financial system. Asset management plans function to bring about leverage in takeovers, so the provision prevents activist investors from using such leverage. As a result, an acquisition of 5% ownership cannot pose a substantial challenge to the control of a publicly held financial institution.

B. Deleveraging the Financial Market: Its Implications on the Takeover Market

There is a nuanced macroeconomic background behind the promulgation of rules like the Bank Equity Rules. After China launched its own credit ease program in 2009 in response to the 2007–08 financial turmoil in the United States and the following global quantitative easing waves, the widespread use of leverage that came with easy credit penetrated virtually every corner of China's financial system.[321] High leverage aggravated the systemic risk of the financial system dooming it to failure.[322] The possible risks include a sudden collapse of asset prices and increasingly risky loans from banks.[323] Hence, deleveraging has become the focal point of recent financial regulation initiatives. The policy shift away from tolerating or even encouraging use of leverage strikes hard on the policy approach toward

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SEC. REG. COMM'N, http://www.csrc.gov.cn/pub/zjhpublic/zjh/201803/t20180330_336014.htm (China) [hereinafter Securities Company Equity Rules].

320. Waishang Touzi Zhengquan Gongsi Guanli Banfa (Zhengshi Gao) (外商投资证券公司管理办法 (正式稿)) [Measures for Administration of Foreign Investment in Securities Companies (Formal Draft)] (promulgated by China Sec. Reg. Comm'n, Apr. 28, 2018, effective Apr. 28, 2018) CHINA SEC. REG. COMM'N, http://www.csrc.gov.cn/pub/zjhpublic/zjh/201804/t20180428_337509.htm (China).

321. *See* Douglas Elliott et al., *Shadow Banking in China: A Primer*, 3 ECON. STUDIES BROOKINGS 1, 7–9 (2015) (illustrating the size of shadow banking in China and the availability of credit provided by non-bank financial institutions that jack up leverage).

322. *See id.* at 18–21 (analyzing the systemic risk associated with China's shadow banking industry).

323. *See id.* at 15.

leveraged takeovers.[324] But this unintended consequence of financial conservatism sidetracks a much-needed reflection on China's takeover policy tendencies. As a result, the CSRC's then-Chairman Liu Shiyu's condemnation[325] of institutional activists in the takeover market, in part, underscores a deep concern over the use of leverage to support takeovers.

The implication of the deleveraging initiative on China's takeover market is foreseeable. Government policies regarding the financial market have profound impacts on the level of takeover activities. For example, in the 1990s the collapse of the junk bond market and the credit crunch in the United States led to decreased takeover activities.[326] Accordingly, the deleveraging initiative demands China shrink its shadow banking industry, including the popular asset management businesses.[327] It will negatively impact the leveraged buyouts or takeovers by cutting off debt-financing sources to bidders.

Extra-legal obstacles like this, together with the shareholding cap in the acquisition of financial listed companies, will likely have a chilling effect on activist investors. Yet these secondary restrictions are not readily visible in regulations like China's Takeover Measures, creating a misleading impression that activist investors have more leeway than they actually do to initiate takeovers. In this sense, China is unlikely to see an increase boom in takeovers in the near future.

C. Desirable Enabling Mechanisms in China's Takeover Market

A more appropriate addition for China's takeover regulation would be more enabling mechanisms for hostile takeovers. Distracted by the current top-down policy orientation, discussions about the regulatory apparatus for takeovers are carried away from a much-needed foray into the possible value of hostile takeovers as one of the corporate governance devices that render managers accountable to shareholders. The merit of hostile takeovers is especially worthy of consideration in

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324. For the key role of leverage in boosting takeover activities, *see* Erwan Morellec & Alexei Zhdanov, *Financing and Takeovers*, 87 J. FIN. ECON. 556, 556 (2008) (analyzing the interaction between leverage and takeover activity).

325. Liu, *supra* note 34.

326. Michael C. Jensen, *Corporate Control and the Politics of Finance*, 4 J. APPLIED CORP. FIN., Summer 1991, at 13, 13 (1991); Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 4–6 (1995) (stating that anti-takeover legislation, political pressure against leverage, collapse of the high yield bond market, and a credit crunch were among the explanations offered for the decline in takeover activities in the 1990s).

327. *Guanyu Guifan Jinrong Jigou Zichan Guanli Yewu de Zhidao Yijian* (关于规范金融机构资产管理业务的指导意见) [*Guiding opinions on Regulating Asset Management of Financial Institutions*], PEOPLE'S BANK OF CHINA (Apr. 28, 2018), http://finance.sina.com.cn/money/bank/bank_hydt/2018-04-27/doc-ifztkpip3713408.shtml (China). This is the regulation that strikes hardest as an effort to rein in China's shadow banking industry. *See* Chen & Zha, *supra* note 225, at 1.

China, where judicial lawmaking is essentially missing from the securities regulation landscape. Under-enforced fiduciary duties with respect to directors and officers in listed companies fail to meet the goal of curbing management misbehaviors. When shareholders cannot rely on courts to enforce or develop fiduciary duties, how will managers be held accountable?

In connection with China's takeover regulation, a theoretical debate over whether it is justifiable to encourage a market for takeovers, and if it is, how to assess the existing legal and extra-legal obstacles restricting activist investors like Baoneng, is largely missing from the picture. By contrast, the advantages and disadvantages of hostile takeovers have long been explored in Anglo-American scholarship.

Comparative scholarship has contributed to the key question about whether incumbent management should be permitted to use defensive tactics.[328] The premise of the scholarly work, mostly focused on the United States and European takeover markets, is that hostile takeovers are encouraged.[329] However, this presumption does not necessarily exist on the Chinese securities markets. The policy, at least during the era of Liu Shiyu, is to suppress hostile takeovers.[330] Therefore, the regulators are silent on the unorthodox and controversial antitakeover tactics employed by Vanke. It is also understandable why, in the event of the Baoneng/Vanke takeover, regulators rushed to discourage future hostile takeovers under the guise of complying with the deleveraging initiative.

Frank Easterbrook and Daniel Fischel advanced the notion that there should be more, rather than fewer, hostile takeovers.[331] They propose that managers should be prohibited from defending against a hostile acquirer.[332] The inherent concern is that managers, in the face of a hostile takeover, have a conflict of interest.[333] Incumbent managers' desire to preserve their vested interest in the target company—their jobs, pecuniary and nonpecuniary interests tied with their positions (as

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328. *See, e.g.*, Easterbrook & Fischel, *supra* note 184, at 1162–63; John Armour & David A. Skeel Jr., *Who Writes the Rules for Hostile Takeovers, and Why?—The Peculiar Divergence of US and UK Takeover Regulation*, 95 GEO. L.J. 1727, 1727 (2007).

329. *See, e.g.*, ANDREAS CAHN & DAVID C. DONALD, COMPARATIVE COMPANY LAW: TEXT AND CASES ON THE LAWS GOVERNING CORPORATIONS IN GERMANY, THE UK AND THE USA 654–74 (Cambridge University Press 2010).

330. Liu, *supra* note 34.

331. Easterbrook & Fischel, *supra* note 184, at 1201–04 (proposing managerial passivity so as to encourage takeovers).

332. *Id.* at 1201 ("[M]anagement should not propose antitakeover charter or bylaw amendments, file suits against the offeror, acquire a competitor of the offeror in order to create an antitrust obstacle to the tender offer, buy or sell shares in order to make the offer more costly, give away to some potential 'white knight' valuable corporate information that might call forth a competing bid, or initiate any other defensive tactic to defeat a tender offer.").

333. *Id.* at 1197–98 (discussing the conflict of interest between managers and shareholders when a tender offer has been made).

exemplified in the Baoneng/Vanke case)—would overcome the requirement of their fiduciary duties to act in the best interests of the company.[334]

Beyond the theoretical debates, there are two contrasting systems of takeover regulation in the Western world.[335] The United Kingdom's system is unfriendly to managerial defense tactics in takeovers.[336] Conversely, the United States system allows for certain defense tactics, an approach favorable to managers.[337]

While China was originally modeled after the United Kingdom's board neutrality model, it has transitioned into a system similar to the United States.[338] China's transplantation of the United Kingdom's City Code on Takeovers and Mergers (UK City Code) was a mere historical coincidence rather than a deliberate policy choice.[339] In the 1990s, Chinese policymakers chose Hong Kong as their destination when they traveled to study regulatory approaches to takeovers, in part because of Hong Kong's geographic proximity (and possibly because there is less of a language barrier).[340] It was also in part because former Premier Zhu Rongji contemplated listing Chinese SOEs on the Hong Kong Stock Exchanges.[341] Accordingly, it made sense for China to borrow the regulatory framework from Hong Kong.[342] As a result, the mandatory bid rule typical from the UK City Code was adopted into China's takeover regulatory regime upon the Securities Law's promulgation in 1998. In line with the board neutrality rule, it prohibited managers from

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334. *Id.* at 1175–76.

335. *See Introduction* to COMPARATIVE TAKEOVER REGULATION, *supra* note 282, at 18 (examining the mode of takeover regulation in Asia from a global perspective beyond the Anglo-American system).

336. Armour & Skeel, *supra* note 329, at 1736–37 (stating that the United Kingdom takeover regulation is significantly more shareholder-oriented and less management-oriented than the United States counterpart); KRAAKMAN ET AL., *supra* note 52, at 212–15 (discussing the United Kingdom Takeover Code, pursuant to which the acquirer can invoke the ban on frustrating action to neutralize any negative action that the target management might take against the tender offer without shareholder approval).

337. Armour & Skeel, *supra* note 329, at 1734 ("Managers of a target company are permitted to use a wide variety of defenses to keep takeover bids at bay.").

338. *See generally* Huang, *China's Takeover Law*, *supra* note 127, at 171.

339. *See* Fengqi Cao (曹凤岐), *"Zhengquan fa" Chutai Guocheng Ji Qi Dui Shichang Fazhan de Zhongda Yiyi* (《证券法》出台过程及其对市场发展的重大意义) [*"Securities Law" Legislative History and Its Importance for Market Developments*], 1 ZHENGQUAN SHICHANG DAO BAO (证券市场导报) [SECURITIES MARKET HERALD] 9 (1999), http://blog.sina.com.cn/s/blog_5f0c53cd0100dyoc.html (China) (providing an authoritative account of the legislative history on China's takeover laws).

340. *Id.* (mentioning the drafting committee for the Securities Law's solicited advice in Hong Kong).

341. *See* HENRY M. PAULSON, JR., DEALING WITH CHINA 132–53 (Grand Central Publishing, 2015) (recalling Premier Zhu Rongji's strategy to restructure China's troubled banking sector by listing the select banks and a few other SOEs on the Hong Kong Stock Exchange).

342. Huang, *China's Takeover Law*, *supra* note 127, at 170 (discussing the mandatory bid requirement in China's Securities Law); Cao, *supra* note 340.

adopting defensive tactics without first obtaining consent from shareholders.[343]

Despite its origin in the UK City Code, the takeover regulatory regime has drifted away from the United Kingdom board neutrality model and become more and more Americanized. A significant shift was China's introduction of partial tender offers typical of the United States takeover regulatory structure.[344] As a result, two incompatible mechanisms—mandatory bidding and partial tender offers—became coexistent in China's takeover regulatory regime.[345] Mandatory bidding tends to transfer takeover premiums from hostile bidders to shareholders, whereas a partial tender offer weakens the effect of such a mandatory bid rule.[346] In a partial tender offer, a bidder does not have to take "any and all" shares that are tendered, as in the case of a mandatory bid.[347] Instead, it may specify the percentage of shares it is willing to acquire—subject to a condition that some minimum number of shares be tendered.[348] If the target's shareholders oversubscribe to the partial tender offer, the bidder will return any excess shares to the shareholders—the so-called "pro-ration" under the United States' Williams Act.[349]

To reconcile the incompatibility between the mandatory bid rule and the partial tender offer rule, the CSRC grants generous exemptions to listed companies.[350] The high frequency of exemptions for mandatory bidding in effect nullifies the mandatory bid rule. One possible

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343. Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep's Clothing: Taking U.K. Rules to Continental Europe*, 11 U. PA. J. BUS. L. 135, 141 (2008).

344. *See* Zhang, *supra* note 127, at 3–8 (summarizing the partial offer rules in China). China's partial tender offer rules allow an acquirer to make a partial offer to purchase no less than 5% of the target's total equities instead of making a mandatory bid. *Id.*

345. *Id.* at 3 ("[I]f the shares held by an investor in a listed company have reached 30% of the issued shares of the company and the investor continues to increase its shareholding," it should make a general offer—the Chinese equivalent of mandatory bid—or alternatively a partial offer.).

346. *See* Nicholas Jennings, *Mandatory Bids Revisited*, 5 J. CORP. L. STUD. 37, 43–44 (2005) (stating that one rationale for the mandatory bid rule is that all shareholders should be entitled to an equal share in the premium paid for control—the so-called equal opportunity. This in effect results in a transfer of takeover premiums to target shareholders).

347. *See* Armour & Skeel, *supra* note 329, at 1737 (stating that the United Kingdom mandatory bid rule's requirement that "anyone purchasing what amounts to a controlling stake (deemed to occur on acquisition of 30% or more of the voting rights in the target's share capital) must make an offer . . . for the remainder of the target's share capital").

348. Jiangyu Wang, *China Overhauls Takeover Code (2006)*, EASTLAW (Sept. 21, 2017), http://www.eastlaw.net/?p=573 (summarizing China's partial offer requirement that "the promoter of a partial offer to offer to purchase at least 5% of the issued shares of the listed company.").

349. 17 C.F.R. § 240.14d-8 (Westlaw through Feb. 21, 2019) (stipulating that where a tender offer is oversubscribed, a bidder who commences a partial tender offer must accept all securities tendered during the entire period the tender offer remains open on a pro rata basis according to the number of shares tendered by each tendering shareholder).

350. Wei Cai, *The Mandatory Bid Rule in China*, 12 EUR. BUS. ORG. L. REV. 653, 665–68 (2011) (indicating that frequent exemptions are granted by the CSRC).

explanation for this phenomenon is that there is a compromise behind the mingling of mandatory bidding and partial tender offer in China. This intermingling sends dual signals to the market: that the regulators hope target shareholders can maintain the takeover premiums and simultaneously hope to encourage more takeover activities.[351] Mixed legal transplantation makes it difficult to characterize China's takeover regulation. It no longer looks like the United Kingdom model in which it was originated. Albeit drifting closer, neither does it resemble the United States model, which features judge-made rules to decide the legality of defenses.

China's takeover regulation has become increasingly similar to the United States model, by allowing defensive moves (including the typical tactics surveyed above,[352] and a recent wave of articles amendments by listed companies to incorporate tactics such as a staggered board), but its judiciary fails to live up to the proactive role comparable to United States courts. Without courts determining the legality of defenses, incumbent management can deploy conventional and unorthodox defenses at ease. This combined with China's general policy of discouraging hostile takeovers means hostile takeovers will be less likely.

Enabling mechanisms for hostile takeover is much needed in China. They would work to mitigate the negative effects of the legal and extra-legal obstacles to hostile takeovers. China should place more emphasis on one key value of hostile takeovers: that hostile takeovers, even a threat of one, can function to monitor the performance of managers.[353] The discipline function of hostile takeovers is especially valuable when both internal corporate governance and the enforcement of fiduciary duties fail to adequately police management, which is the case in China.[354] Shareholder monitoring does not sufficiently supervise

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351. Robin Hui Huang & Juan Chen, *Takeover Regulation in China: Striking a Balance Between Takeover Contestability and Shareholder Protection*, *in* COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES, *supra* note 282, at 214–16.

352. *See supra* Parts II–IV.

353. Easterbrook & Fischel, *supra* note 184, at 1169, 1174 (noting that a threat of takeover, not even an actual one, can alert managers whose performance is lagging).

354. *See* Ye, *supra* note 91 (describing the disappointing role that Chinese independent directors play in corporate governance); Wei Cai, *The Dilemmas of Independent Directors in China: An Empirical and Comparative Study*, 18 EUR. BUS. ORG. L. REV. 123, 124 (2017); Lei Gao & Gerhard Kling, *Corporate Governance and Tunneling: Empirical Evidence from China*, 16 PAC.-BASIN FIN. J. 591, 591–92 (2008) (discussing the pervasiveness of tunneling, that is, controlling shareholders embezzling listed companies' funds or assets by various means, which indicates the failure of corporate governance mechanisms in China); Guohua Jiang et al., *Tunneling Through Inter-Corporate Loans: The China Experience*, 98 J. FIN. ECON. 1, 1–2 (2010), https://ac.els-cdn.com/S0304405X10001145/1-s2.0-S0304405X10001145-main.pdf?_tid=c647ce08-8caf-48d0-980a 20c659d19250&acdnat=155264 1555_026b8ea6d249a7df12544656fbfd1ca3; *see also supra* Part V (discussing the enforcement of fiduciary duty in China).

management.[355] The potential for a hostile takeover, as an external monitoring mechanism, would help the widespread agency problem in firms—a phenomenon underlining Vanke management misbehavior.

The function of hostile takeovers to reduce agency costs is particularly valuable in China. There are limited viable alternatives in the existing regulatory apparatus to effectively align incentives of management and shareholders, especially minority shareholders. For instance, the role of Vanke independent directors in the Vanke takeover was called into serious question.[356] Independent directors, hired and paid by management, sided with management against Baoneng as an outsider acquirer, instead of representing minority shareholders' interests.[357] And as elaborated in Part V, judicial enforcement of fiduciary duty is negligible. Private enforcement is to a large extent dependent on the result of public enforcement, rendering public enforcement (largely by the CSRC) nearly the exclusive means of curbing management misbehavior.

Yet, like all of its counterpart securities regulators around the world, the CSRC suffers the same problem of understaffing, under-enforcement, selective enforcement, and vulnerability to regulatory capture.[358] Public enforcement is doomed to be constrained by its finite capacity, no matter how hard it strives to cope with problems like being under-staffed, under-funded, and resource-constrained.[359] Indeed, China's public enforcement force is already overly bloated and bureaucratic. It is not a reasonable solution to advocate a further expansion of the already clumsy bureaucracies.

Moreover, William Landes and Judge Richard Posner have long said that the danger behind a monopolistic public enforcer is the risk of discretionary non-enforcement.[360] China is no exception. Public enforcement as dominated by the CSRC inevitably suffers from the

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355. Easterbrook & Fischer, *supra* note 184, at 1173 (observing that "shareholder monitoring cannot supply the necessary supervision").

356. *Duli Dongshi Bu Duli, Shenfen Ganga Sun Liyi* (独立董事不独立，身份尴尬损利益) [*Nonindependent Independent Directors: Their Embarrassing Status Is Harming (Shareholders') Interests*], ZHENGQUAN SHIBAO (证券时报) [SEC. TIMES] (Apr. 13, 2018), http://stock.stcn.com/2018/0413/14113657.shtml (China) (criticizing the biased role that Vanke's independent directors played in the Baoneng/Vanke takeover).

357. *Id.*

358. Zhou & Li, *supra* note 265 and accompanying text; Wenming Xu et al., *An Empirical Analysis of the Public Enforcement of Securities Law in China: Finding the Missing Piece of the Puzzle*, 18 EUR. BUS. ORG. L. REV. 367, 382–87 (2017) (finding selectiveness in the CSRC's public enforcement, which favors listed SOEs controlled by the central government over those controlled by local governments).

359. JOHN C. COFFEE, JR., ENTREPRENEURIAL LITIGATION: ITS RISE, FALL AND FUTURE 174–94 (Harvard University Press 2015).

360. William M. Landes & Richard A. Posner, *The Private Enforcement of Law*, 4 J. LEG. STUD. 1, 38–41 (1975) (stating that "[a] public monopoly of enforcement enables the public enforcer in effect to nullify particular laws, or particular applications of law, simply by declining to prosecute violators").

problems of selective enforcement[361] and under-enforcement.[362] Recent research has reinforced the notable pattern of selective enforcement in the CSRC's public enforcement activities.[363] China needs to reassess and curb its reliance on public enforcement in securities regulation. But this is more a political topic that will invite strong resistance from vested interest groups than one of academics that awaits more extensive academic debates. By contrast, regulators use the rampancy of management misbehavior as a reason to further strengthen their power, as they view this as a call for more administrative interventions,[364] and not a case for more market-oriented mechanisms (such as allowing for more hostile takeovers so as to discipline management misbehavior).

Private litigation does not warrant much hope either. As demonstrated above,[365] corporate governance doctrines are underdeveloped in Chinese courts, and Chinese courts have yet to rule on the legality of various defenses invoking fiduciary duties. Moreover, the "opt-out" type class action that is prevalent (and possibly abused) in the United States is nonexistent in China.[366] The "opt-in" representative litigation system in China's Civil Procedure Law in no way resembles a class action mechanism.[367] Academics are calling for an import of a class

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361. *See, e.g.*, Henk Berkman et al., *Political Connections and Minority-Shareholder Protection: Evidence from Securities-Market Regulation in China*, 45 J. FIN. & QUANTITATIVE ANALYSIS 1391, 1393 (2010) (detailing empirical research touching on the selective enforcement issue in China's securities regulation).

362. *See supra* Part III.A (explaining that listed companies' at-will, lengthy trading suspensions are not penalized by securities regulators).

363. *See, e.g.*, Xu et al., *supra* note 359; *cf.* Tianshu Zhou, *Is the CSRC Protecting a "Level Playing Field" in China's Capital Markets: Public Enforcement, Fragmented Authoritarianism and Corporatism*, 15 J. CORP. L. STUD. 377, 405 (2015) (finding no salient bias of the CSRC against listed non-SOEs or listed SOEs controlled by the local governments, but nevertheless finding that the CSRC provides regulatory subsidies to listed SOEs controlled by the central government).

364. The CSRC has consistantly used the existence of misbehaviors in listed companies as rationale for empowering itself with more regulatory jurisdictions. It coined the term "ongoing and ex post regulation" ("shi zhong shi hou jian guan" in Chinese), which essentially means it can step in to exert regulatory power anytime after a company's IPO, takeover, or restructuring as it deems necessary. *See, e.g.*, *Shangshi Gongsi Binggou Chongzu Xin Gui Jiedu* (上市公司并购重组新规解读) [*Interpretation of the New Regulations on Mergers and Acquisitions of Listed Companies*], CHINA SEC. REG. COMM'N (Jan. 8, 2015) http://www.csrc.gov.cn/pub/newsite/hdjl/zxft/lsonlyft/201501/t20150109_266290.html?randid=0.6320518993482428 (China) (restating the necessity for the CSRC's "ongoing and ex post regulation" notwithstanding a superficial declaration that the CSRC should rely on the securities market to self-discipline market behaviors).

365. *Supra* Part V.

366. John C. Coffee, Jr., *The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action*, 54 U. CHI. L. REV. 877, 886 (1987) (noting the rampant abuse of class action as a phenomenon distinctive in the United States).

367. Minshi Susong Fa (民事诉讼法) [Civil Procedure Law] (promulgated by the Standing Comm. Nat'l People's Cong., Apr. 9, 1991, effective Apr. 9, 1991, last amended Jun. 27, 2017) at arts. 52–55 (China).

action system into China.[368] This call has been persistent for decades, yet is unlikely to be established in the near future.[369]

Therefore, revitalizing hostile takeovers becomes one of the few feasible options in China to align shareholder-management incentives and to curb the massive abuse of corporate power by incumbent management. A takeover may prove to be an effective remedy when other corporate governance devices that are expected to police performance, such as board of director oversight, fail to achieve the goal of optimally aligning incentives.[370] This approach may be beneficial to social welfare as well. Takeovers can be a value-maximizing opportunity for the shareholders of the target firm.[371]

John Coffee opines that optimal monitoring of corporations should satisfy three conditions: (1) having no conflicts of interests with the corporation in question; (2) owning a sufficiently large stake in the corporation; and (3) having a long-term horizon.[372] A candidate with these features would have sufficient incentive to improve corporate governance. Coffee remarks that financial institutions, especially indexed funds, fit these three criteria.[373] Further, a bidder, after it is successful in taking over control, may well qualify. Indeed, activist investors like Baoneng have greater incentive than indexed investors to monitor the public corporation.

The time for enabling more hostile takeovers is ripe: in fact, China has witnessed an increasing level of activity in takeovers. Graph One below summarizes the frequency of takeovers (both friendly and unfriendly ones) in China's A-shares market between 2009 and 2017.

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368. Benjamin L. Liebman, *Class Action Litigation in China*, 111 HARV. L. REV. 1523, 1523–24 (1998).

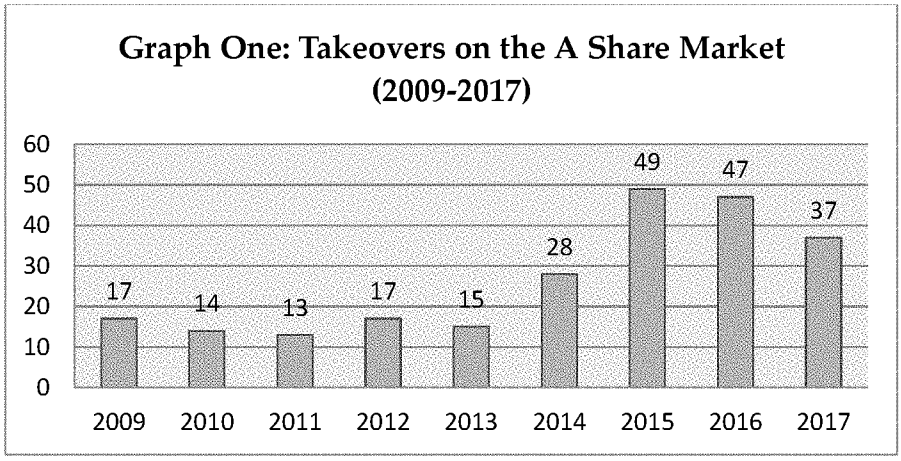
369. *Cf. id.* Liebman's optimism toward the development of class action in China has over the years turned out not to be carried out.

370. Randall Morck et al., *Alternative Mechanisms for Corporate Control*, 79 AM. ECON. REV. 842, 842 (1989).

371. Romano, *supra* note 299, at 125–33 (summarizing the possible effect of takeovers to enhance social efficiency). The debate over the social efficiency of a hostile takeover is centered on whether policy makers should encourage actions as one objective of takeover regulation, but the scholarly consensus is that takeover's value is reflected in the replacement of inefficient management. *Id.*

372. Coffee, *supra* note 173, at 1336.

373. *Id.* at 1366.



Source: Xu & Fu, *Market Effects, the Myth of Idiosyncrasy and Legislative Overhaul in Connection with Takeover Rules Governing A-Shares Listed Companies*[374]

In accordance with the statistics in Graph One, takeovers were sparse on China's A-shares market until 2015, when takeovers began to soar. Year 2015 coincides with Baoneng's hostile takeover launch. The tide seems to ebb in 2017 in light of the regulatory crackdown of hostile acquirers like Baoneng and the overall tightening of takeover-related rules.[375]

But it is important to note that the numbers in Graph One cover both friendly and hostile takeovers, and the vast majority of takeovers are not hostile in a strict sense. In accordance with this article's survey of public information about hostile takeovers, only single digit hostile takeovers made it to the finish line. At the end of 2017, there are several hostile takeovers that may be characterized as successful, meaning that the hostile acquirers succeeded in taking control over the target and replacing the Board of Directors. On this list, there are: (i) Xiamen Dazhou Real Property's takeover of Shanghai Industrial Real Property

374. Minglei Xu & Peng Fu, *A-Gu Shichang Shangshi Gongsi Shougou Zhidu de Shichang Xiaoying, Yihua Zhi Mi He Lifa Zhong Gou* (A 股市场上市公司收购制度的市场效应、异化之谜和立法重构) [*Market Effects, the Myth of Idiosyncrasy and Legislative Overhaul in Connection with Takeover Rules Governing A-Shares Listed Companies*], 22 ZHENGQUAN FA YUAN (证券法苑) [SECURITIES LAW REVIEW] 64, 67–68 (2017), http://www.sse.com.cn/aboutus/publication/actofcourt/law/word/c/4572193.pdf (China). Note that the statistics do not cover the entire population of takeovers. It filters out (i) all financial listed companies, (ii) takeovers that were in fact back-door listings, (iii) listed companies that had multiple rounds of takeovers, (iv) listed companies with missing financial data, and (v) listed companies that had other material events concurrently ongoing during the takeover. *Id.* In this sense, the actual number of takeovers on the A-shares market should be greater than that is presented in the graph.

375. *See* discussion *supra* Part VI.

in 2009;[376] (ii) Baoneng's takeover of CSG Holding in 2016;[377] (iii) Shenzhen Ruilaijiayu's takeover of Guangxi Huiqiu Technology in 2016;[378] and (iv) Hangzhou Zhemintou's takeover of ST Shenghua in 2017.[379]

Hopefully, more acquisitions will ensue, following a much needed revision of current takeover apparatuses that thwarts successful takeovers. By revising current takeover regulations, bidders will be faced with less hurdles than the law currently allows. To be sure, the position of this article is not necessarily to advocate for a Chinese regime that favors activist investors over incumbent management. Instead, it strives to level the playing field that currently tilts in favor of incumbent management. The neutrality between bidders and incumbent management as maintained by legislation like the Williams Act[380] has yet to be enabled in China. Currently, incumbent management may launch numerous legal and extra-legal tactics to fend off activist investors, while bidders are greatly handicapped by the legal, financial, and political restrictions imposed on them. As long as potential acquirers are constrained by limitations on credit financing and caps on shareholding, the number of hostile takeovers in China is likely to remain insufficient to curb management misbehavior and achieve the social efficiency associated with hostile takeovers.

VII. CONCLUSION

Arthur Fleischer's axiom holds true today, in China as well as in sophisticated securities markets: In the takeover world, "[n]ew strategies . . . appear with almost dazzling frequency."[381] As exemplified by the high profile Baoneng/Vanke takeover battle, Chinese companies can launch numerous takeover defenses against activist investors. These tools (such as arousing political pressure and halting trade) have

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376. The target's Shanghai Stock Exchange code is 600603. SHANGHAI STOCK EXCHANGE, http://english.sse.com.cn/home/search/?webswd=600603 (last visited Mar. 14, 2019) (showing current rates for target).

377. The target's Shanghai Stock Exchange code is 000012. SHANGHAI STOCK EXCHANGE, http://english.sse.com.cn/home/search/?webswd=000012(last visited Apr. 8, 2019) (showing current rates for target). Afterwards, Baoneng met its Waterloo in CSG Holding, having the same fate as it did in the Vanke takeover attempt. *See supra* Part II.A.

378. The target's Shanghai Stock Exchange code is 600556. SHANGHAI STOCK EXCHANGE, http://english.sse.com.cn/home/search/?webswd=600556 (last visited Apr. 8, 2019) (showing current rates for target).

379. The target's Shanghai Stock Exchange code is 000403. *See* SHANGHAI STOCK EXCHANGE, http://english.sse.com.cn/home/search/?webswd=000403 (last visited Mar. 14, 2019) (showing current rates for target); *see also Press Release, Zhenxing Biochemical Co., Ltd., Result and announcement of the company's stock resumption*, CNINFO (Dec. 13, 2017) http://www.cninfo.com.cn/finalpage/2017-12-14/1204220297.PDF (detailing the public announcement of takeover) (China).

380. 15 U.S.C. §§ 78g, 78l–78n, 78s (Westlaw through Pub. L. No. 116-5).

381. ARTHUR FLEISCHER, JR., TENDER OFFERS: DEFENSES, RESPONSES, AND PLANNING at vii (1981).

features specific to China's institutional setting that differ from other widely known takeover defenses like the poison pill and the golden parachute found in sophisticated securities markets.

A major problem with takeover regulation in China is that there is no meaningful check on unreasonable takeover defenses. Enforcement of takeover-related regulation is heavily, if not exclusively, dependent on public enforcement. Chinese public enforcement inescapably shares the deficiencies found in those of developed jurisdictions. Public enforcement is constrained by its finite capacity and its tendency for selective enforcement and under-deterrence. Corporate governance doctrines like director and officer fiduciary duties are under-enforced in China, which results in unchecked misconduct by incumbent management. Out of voluntary or unconscious judicial positivism, the judiciary to a large extent refrains from developing fiduciary duty doctrines.

Thus, activist investors face more obstacles in China than in other countries with sophisticated markets. Additionally, the general policies and certain financial regulations beyond the scope of securities regulation make hostile takeovers, especially leveraged buyouts, more difficult.

The policy implications derived from the failed Baoneng/Vanke takeover show that institutional activism is less concerning in China than in jurisdictions such as the United States. Activist investors face many challenges, not only from securities regulators. As a result, China's takeover market is lacking compared to that of sophisticated legal regimes. Restoring the function of hostile takeovers to curb management misbehavior is of particular merit in China, considering that there are limited alternatives available to enhance corporate governance in listed companies. To do so, it is essential to both level the playing field between bidders and incumbent management and enable more hostile takeovers. To accomplish this neutrality, China's Takeover Measures need to favor bidders to offset the headwind that comes from the various legal and extra-legal hurdles activist investors face beyond the securities rules and regulations.

APPENDIX ONE: CASES INVOLVING DUTY OF LOYALTY AND/OR DUTY OF DILIGENCE IN RESPECT OF DIRECTORS OF LISTED COMPANIES (JAN. 1, 2010–DEC. 31, 2017)

No	Case Name	Docket No.	Dispute	Standards for Duty	Public Enforcement	Favors Director	Pecuniary Recovery	Non-pecuniary Recovery
1	Simin Wang (王思民) v. CSRC	(2013) Bei Gao Xing Zhong Zi No. 11	Appeal against CSRC penalties	X	✓	X	Fine of RMB 200k (USD 30k)	Warning
2	Lianqing Mei (梅连清) v. Shenzhen Fuann (深圳富安娜家居用品股份有限公司)	(2014) Shen Zhong Fa Lao Zhong Zi No. 221	Termination of Contract & Severance Pay	X	X	X	N/A	Upholding Termination of Employment Contract
3	Ketian Zhou (周可添) etc. v. CSRC	(2014) Yi Zhong Xing Chu Zi No. 304	Appeal against CSRC penalties	X	✓	X	Fine of RMB 30,000 (USD 4,545) each independent director	Warning
4	Creditors v. Zhenliang Qiu (丘振良), Xionggui Huang (黄雄贵), Fujian Furi (福建福日电子股份有限公司) & Shareholders of Fujian Furi	(2014) Shen Zhong Fa She Wai Zhong Zi No. 36	Shareholders' failure to pay in subscribed capital	✓	X	✓	N/A	N/A
5	Shanghai Jahwa (上海家化联合股份有限公司) v Zhuo Wang (王茁)	(2015) Hu Er Zhong Min San (Min) Zhong Zi No. 747	Termination of employment contract	X	✓	✓	N/A	N/A
6	Beijing Zhengquan Holdco (北京政泉控股有限公司) v Founder Securities (方正证券股份有限公司)	(2015) Tian Min Chu Zi No. 05450	Noncompetition of director	X	X	✓	N/A	N/A

7	Prosecutor v Dini Yu (余蒂妮)	(2016) Yue 04 Xing Chu No. 131	Misrepre-sentation in disclosure (Criminal Offense)	X	✓	X	N/A	Criminal sentence
8	Hongxiang Zeng (曾宏翔) etc. v. CSRC	(2017) Hu 03 Xing Zhong No. 41	Misrepre-sentation in disclosure	X	✓	X	Fine of RMB 30,000 (USD 4,545) each inde-pen-dent direc-tor	Warning
9	Prosecutor v. Yi Liu (刘谊)	(2017) Wan 0208 Xing Chu No. 10	Breach of duty of loyalty (Criminal Offense)	X	✓	X	Fine of RMB 100,000 (USD 15,152)	Criminal sentence
10	Yu Wang (王钰) & Qing Li (李青) v. Anhui Sanlian (安徽三联投资集团有限公司)	(2017) Wan 01 Min Zhong No. 3291	Dispute over Equity Transfer	X	✓	✓	N/A	N/A
11	Yaoben Li (李尧奔) v. Beijing Jingxi (北京京西文化旅游股份有限公司)	(2016) Jing 0105 Min Chu No. 57794	Resolution of Listed Company	X	X	✓	N/A	N/A
12	Jiangsu Shuntian (江苏舜天国际集团有限公司) v. Junmin Wang (王军民)	(2016) Su 01 Min Chu No. 573-4	Listed Co. Chair-man's Infringe-ment of Share-holder Interests	X	X	X	N/A	Criminal Prosecu-tion

Source: China Judgments Online[382]

382. ZHONGGUO CAIPAN WENSHU WANG (中国裁判文书网) [CHINA JUDGMENTS ONLINE], https://wenshu.court.gov.cn/ (last visited Mar. 26, 2019) (China).