Joseph Lee *Editor*

# Takeover Law in the UK, the EU and China

## State Interests, Market Players, and Governance Mechanisms

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*Editor*
Joseph Lee
School of Law
University of Exeter
Exeter, United Kingdom

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# Preface

This book was born out of two seminars organised at Tsinghua University in China and at the University of Exeter in the UK. Its aim is to re-examine takeover law at this critical time when global economies are being re-shaped by new international relations between major economic and political powers, largely caused by China's participation in the global takeover market. This restructuring of global power has raised a number of theoretical, legal, and practical challenges concerning the takeover market. Up to now, the prevailing view has been that takeover law should have the objective to ensure the well-functioning of an efficient market for corporate takeovers. However, this view has started to be questioned. Policy makers have begun to limit the application of free market theory to corporate takeovers as a result of internal pressure from their electorates as well as from perceived foreign threats. At the beginning of the millennium, the EU subscribed to this theory of market efficiency in order to construct the EU Takeover Directive which has subsequently influenced emerging markets such as China in shaping their takeover law. The UK's influence on the EU Takeover Directive as well as on China's development has also been significant. However, the Brexit referendum in 2016 sent a strong political message to policy makers. There is now a general feeling that growing economic and social imbalances demonstrate that London's international financial market is disconnected from the UK's overall economy. Yet policy makers have not been able to make any significant reform to takeover law to rebalance this perceived disconnect.

UK takeover law is based on the US market efficiency theory but in an 'improved' version with a stronger emphasis on minority shareholder protection, transparency, and legal certainty. This gives more power to financial market participants but reduces the power of the judiciary, as the guardian of justice, to provide redress for human suffering caused by takeovers. Politicians do not make proposals to change what is believed to be working well for the country. Brexit means that less will be done to address any imbalances due to corporate takeovers as emphasis is placed on making the UK a more competitive global financial centre. Will the EU amend its Takeover Directive as a response to the competing UK model? Some member states may begin to make themselves more competitive for corporate

domicile and listing and formulate takeover law in a way that favours minority shareholder protection, thereby attracting capital.

The study of takeover law can no longer be focused on Western markets. China's outbound M&A activities have alarmed many Western policy markets and the USA has taken a tough stance by engaging in a trade war, a technology war, and to some extent a finance war with China. For many years, China has diligently studied the Western models and adopted some of their elements to develop its own financial market. While there are gaps in governance, China's impressive development and its successes are starting to have an impact on takeover market theory. The restrictions imposed on Chinese takeovers by some Western economies are a direct challenge to the transformative power of the market economy on the political system. This will feedback to the US, EU, and UK takeover models and the lesson may be that policy and political considerations should be embedded in the free market economy.

The White Paper on levelling the playing field as regards foreign subsidies, adopted by the European Commission on 17 June 2020, proposes that the Commission can block a takeover if the Commission believes that foreign subsidies given to the buyer may distort competition in the EU. The UK National Security and Investment Bill, if enacted, will give the UK government power to block M&A and investment activity that could create a national security risk. If politics and policy start to intervene in the global takeover market, we will begin to see that it becomes more national (within the USA and China), regional (within the EU), and less global.

This book shows how the UK, the EU, and China have been building their takeover markets and governance. There are major differences in their governance mechanisms, reflecting the interplay between market interests and political powers. In the life of this project, I have witnessed how Brexit has unfolded, tensions between the EU and the UK, the US–China trade war, and the global COVID-19 pandemic. The USA will have a new administration in 2021. Vaccines are being rolled out globally. I have just learnt that the EU and the UK have reached an agreement on trade a few minutes ago. The world needs much more sincere, honest, and transparent cooperation. If we can apply virtuous principles to aggressive and unkind hostile takeover tactics, freedom and good law in the marketplace can be preserved and continue to serve our common goal of sustainability.

London, UK Joseph Lee
24 December 2020

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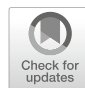
# Understanding Takeover Law in the Global Context



**Joseph Lee**

**Abstract** This chapter discusses the political economy of global takeover laws in light of the current power restructuring in the global economy brought about by events such as Brexit and the US-China trade war. It discusses how such changes may give rise to economic nationalism, and analyses how China will react in the global takeover market, in its M&A activities in the US and EU markets, in its regulatory responses to domestic takeover laws, and in its approaches to foreign financial intermediaries providing services in the Chinese market. Neoliberalism has provided the theoretical basis for the development of the takeover market and takeover governance but we may now begin to see more policy-based interventions. Digital economy, tech giants' governance, and climate change initiatives are areas where policy considerations will shape the market and its governance. The US and EU have been influencing global takeover market and its governance. China will start to be a player—not only as a rule-taker in the global takeover market, but a rule-maker in its governance.

## 1 Introduction

This book is based on two seminars on takeover law held in Beijing in 2017 and in London in 2018. They form part of the Exeter-Tsinghua research project on takeovers and corporate governance; a project funded by the University of Exeter.

This chapter attempts at gaining a deeper understanding of takeover law by analysing the key issues raised in this project against the background of the current geo-political and economic context. It is structured as follows. Section 2 analyses power restructuring in the current global economy. Section 3 examines how this power restructuring may give rise to economic nationalism. Section 4 shows how these two factors may have an impact on the Chinese domestic takeover market and governance. Section 5 discusses the influence of China on the global takeover

J. Lee (✉)
School of Law, University of Exeter, Exeter, United Kingdom
e-mail: j.lee@exeter.ac.uk

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market and governance. Section 6 explores areas where China may learn from EU and vice versa. Finally, some concluding remarks will be made.

## 2 Power Restructuring

In the past few years, we have witnessed a number of major global political events that have changed economic and political relations among global powers.[1] This also has an impact on international and geopolitical relations. The US-China trade war has affected not only global economies but also regional and bilateral relationships with China.[2] Brexit has not only affected the unity of the European Union but also created opportunities for bilateral relations with China within the EU block and between UK and China.[3] China has both political and economic ambitions, and has expressed them through controversial projects such as 'One Belt One Road'[4] in order to engage, as a major economic and trading nation, with the global liberal economic system.[5] These changes have also exposed gaps in expectation between China, the EU and the US.[6] A major issue in the US-China trade war is access to China's services sector and in particular,[7] financial services in which western economies currently have a competitive advantage.[8] The restrictions applied by China in the services sector, including financial services, have sparked a more general mistrust of China's approach which is perceived as an attempt to gain an unfair trade advantage.[9] Among other examples, one might cite the alleged intellectual property right ("IPR") violations by China[10] and the security issues raised with respect to European inbound M&A.[11] The US and UK's treatment of Huawei,[12] an integrated technology and telecommunication company, and the heightened scrutiny of China's M&A activities in the EU, UK and US[13] are the consequence of the

[1]Basedow (2019).

[2]Meltzer and Shenai (2019).

[3]Gee et al. (2016).

[4]'One Belt One Road' Initiative has been regarded as a 'twenty-first century silk road', and it was made up of a 'belt' of overland corridors and a maritime 'road' of shipping lanes. This initiative includes 71 countries from south-east Asia to Eastern Europe and Africa. For detailed introduction, see Kuo and Kommenda (2018).

[5]Weber (2020).

[6]Weber (2020).

[7]Wong and Koty (2020a).

[8]Financial Times (2020).

[9]Petsinger et al. (2019).

[10]Li and Alon (2019).

[11]See chapter "Disclosure Rules in Takeovers: Making Sense of Fragmentation in German Law".

[12]Millward (2020).

[13]Moon (2018).

unequal access to the Chinese market which is also evidenced in the trade deficit between China and the western economies.[14] The trade deficit between China and the EU stood at 164 billion Euros in 2019.[15] China is the third largest partner for EU export of goods and largest for EU imports of goods.[16] China's relations with western countries have deteriorated further as a result of the situation in Hong Kong and the protests there against Beijing's recent amendments to the laws on extradition and national security.[17] This deterioration in relationships has not only affected Hong Kong's ability to act as a hub for the western financial services sector to provide finance to mainland Chinese companies in the future,[18] but also the possibility of creating a market competition model for mainland China and Hong Kong, equivalent to the competition within the EU market.[19]

This research project started before the US-China trade war began and before Britain's departure from the European Union. At the time of writing, China's relationships with western economies especially those of the US and the UK continue to be turbulent.[20] We have witnessed many Chinese companies delisting in the US, with an increased capital inflow to Hong Kong and mainland Chinese capital markets.[21] This may reduce the incentive for China to make listing on its capital market more attractive.[22] The US tech-companies are relocating their manufacturing operations from China to the US and to India[23] as a consequence of the increased tariffs on Chinese goods and security measures imposed by the Trump administration.[24] These events change the power dynamics in the development of takeover law: US politics and the US political stance are increasingly significant while market players are taking a more subordinate role.[25] The revision of the UK takeover law with the intention of taking a more detailed approach to scrutinising foreign takeover[26] is but one example of this.

[14]Cainey and Nouwens (2020).

[15]Eurostat (2020).

[16]Eurostat (2020).

[17]Giles (2020).

[18]Li (2018).

[19]See chapter "On the Supply Side of Western Hostile Takeover Law and its Implications for China".

[20]Ford and Hughes (2020).

[21]He (2020).

[22]He (2020).

[23]WIRED (2019).

[24]Wong and Koty (2020b).

[25]Graaff et al. (2020) and Meltzer and Shenai (2020).

[26]Payne (2020) and Boland (2020).

## 3 The Rise of Economic Nationalism

The concentration of financial power in the US and dominance of US tech companies have spurred China to foster its own national champions under state control in order to compete globally.[27] In Europe, we have witnessed the London Stock Exchange's rejection of the Hong Kong Stock Exchange's takeover bid on the basis of security concerns.[28] In addition, the UK has changed its takeover law in response to security concerns about China,[29] mainly in response to the Hong Kong issue but also to reinstate its strategic partnership with the Trump's administration's stance on China. While the EU has not taken a concerted step to change its relationship with China, the departure of the UK from the EU has weakened the block's current ability negotiate a good trade deal with China.[30] This has reduced its ambition of gaining more access to the Chinese market and of affirming its values on issues such as human rights.[31] Since 2016, the EU has struck trade deals with other Asian countries such as Japan and Vietnam.[32] There is a currently competition between the EU and the UK to secure enhanced access to the Chinese market[33] and that in turn has meant that China has more power to explore differences between the EU and the UK when they do not take a united approach to such issues as regulatory standards. The principle of free movement of capital has a strong focus on the efficient allocation of resources and independent monitoring of the global economic system, including cross-border takeovers and M&A.[34] But currently the idea of a global economic system and the favour for cross-border takeovers and M&A are in regression.

## 4 Impact on China's Domestic Takeover Market

In this book, we have explored the themes and issues relevant to economic power relations in the context of corporate takeovers. They expose the differences in the economic and political developments between China, the EU, and the US. The UK's primary interest in takeovers lies in the financial services sector where financial intermediaries (the private sector) act as gatekeepers for market governance.[35] In

[27] Lippert and Perthes (2020).

[28] London Stock Exchange (2019).

[29] Payne (2020).

[30] European Movement International (2016).

[31] Herrero and Xu (2016) and Winders (2016).

[32] European Commission (2020).

[33] HM Government (2018).

[34] European Parliament (2020).

[35] See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China".

China, state industrial policy is directed towards optimising capital by diversifying state-owned enterprises and dispersing corporate share ownership.[36] Yet, this does not prevent China from fostering national champions, and state-owned enterprises use the takeover market to dispose of under-performing assets.[37] Private sector financial intermediaries do not play as significant a governance role as they do in the EU and UK because the financial services sector in China still has as its main role that of distributing funds according to state policy, which means that they are not independent of the state.[38] This affects the ability to develop new services and products in the sector. It also affects the relationship between the state regulators and clients and shapes takeover market governance.[39] This also explains why China has been cautious in allowing foreign financial intermediaries to operate in China.[40] China's financial institutions do not have a competitive advantage because the equity market is still developing,[41] as are laws on asset management,[42] and significant principles of corporate governance such as fiduciary duty are yet to be introduced.[43] There is much infrastructural work needed to establish a rule-based Chinese financial market[44] and a premature opening up of its financial services sector could cause a shock to the Chinese market as happened in the Asian financial crisis in 1998.[45] China has been learning more about the in-depth operation of the takeover market from Hong Kong[46] and even though it has adopted the UK takeover law model via Hong Kong, it has revised many of the UK provisions to meet its own economic policy objectives.[47] China is evidently keen to establish rule-based governance of the takeover market while at the same time rejecting UK-style market-led governance.[48] When will China move away from the state regulatory centrism to a UK style of self-regulation?[49] It is unlikely to happen soon. When will China adopt the US court-led governance based on the principle of fiduciary duty and the class action

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[36]Ibid.

[37]Milhaupt and Zheng (2015).

[38]See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China.

[39]Ibid.

[40]Bradsher (2017).

[41]Aberdeen Standard Investments (2019).

[42]Xu et al. (2019).

[43]OECD (2011).

[44]Bughin et al. (2019).

[45]Federal Reserve Bank of San Francisco (2009).

[46]Lin (2017).

[47]Cai (2011).

[48]See chapter "The Role and Future of Self-Regulation in the Market for Corporate Control: A Comparative Narrative of the Two Models in the UK and China".

[49]See chapter "On the Supply Side of Western Hostile Takeover Law and its Implications for China".

enforcement model?[50] This is even less likely. A court-led model only has real benefits when there is a true separation of powers, stable law, and courts with the ability to adjudicate disputes rather than relying on the guidance of the Supreme Court and other state regulators.

Politically, the Chinese state plays a dominant role in regulating the takeover market, more so than its courts, and the CSRC, the state takeover market regulator, can directly intervene in the takeover process.[51] It has the power to dispense with the mandatory bid requirement and there is evidence that if a takeover involves state-owned enterprises, the CSRC always grants exemption from mandatory bid rules in line with state industrial policy.[52] Such preferential treatment of state-owned enterprises is unlikely to be seen in the US or the EU, either by the regulators or in the courts. Yet, we have begun to see the US and UK governments taking account of policy reasons such as national security or industrial policy in determining the outcome of a takeover.[53] In the EU, the board neutrality principle is also beginning to be eroded by other policy considerations.[54] The departure of the UK from the EU bloc may allow even more flexibility in the board neutrality rule as this was a particular issue for the UK in the EU Takeover Directive negotiation.[55] In the future, the EU and UK may take different approaches to takeovers and regulatory standards so that they may diverge in terms of board neutrality, the disclosure regime, and the breakthrough rule. Board neutrality has up to now been a cornerstone of the EU takeover law[56] and China has followed suit instead of taking the US fiduciary duty based approach.[57] If the EU finally revised this rule in the Takeover Directive, China may see this as an unstable principle in takeover law and may change its position accordingly. The result would be to slow down the process of dispersing share ownership in state-owned enterprises and would affect China's internal economic transformation.

[50] See chapters "On the Supply Side of Western Hostile Takeover Law and its Implications for China" & "The Role and Future of Self-Regulation in the Market for Corporate Control: A Comparative Narrative of the Two Models in the UK and China".

[51] See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China.

[52] See chapters "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China", "On the Supply Side of Western Hostile Takeover Law and its Implications for China" & "The Role and Future of Self-Regulation in the Market for Corporate Control: A Comparative Narrative of the Two Models in the UK and China".

[53] Meltzer and Shenai (2019).

[54] Beuerle et al. (2011).

[55] Mukwiri (2020).

[56] Habersack (2017).

[57] See chapter "The Role and Future of Self-Regulation in the Market for Corporate Control: A Comparative Narrative of the Two Models in the UK and China".

## 5 Will China Reshape the Global System?

It may be that China will be able to export its economic model and reshape global governance.[58] But it is difficult to define the current Chinese model and to predict how it will change in the future, who will choose to adopt it or how overall global financial markets will change. In terms of the infrastructure supporting the takeover market, there are more takeovers, especially hostile takeovers, in China than in Japan.[59] China has so far shown its willingness to use the market mechanism to facilitate its economic growth as well as to distribute economic benefits to investors.[60] China has also introduced a broad legal framework for takeovers, including general principles of investor protection, market transparency, and corporate governance. The rules and principles in Chinese takeover law can be compared with the other models such as UK and EU in order to measure their effectiveness and efficiency.[61] There is no evidence that China's takeover model is moving away from its core values and general policy, and there is evidence that China is developing its asset management industry to act as intermediaries in the takeover market.[62] There have been changes in the law to open up China's financial services sector to foreign providers,[63] yet the internationalisation of its financial market still lags behind the takeover markets of the UK and the EU.[64] The lack of internationalisation of the Reminbi (RMB) and the restrictions on capital flow also create disincentives for foreign investment in China.[65] Internationalisation of China's financial market sector and its currency, along with relaxation of the restrictions on capital flow could catalyse a more international takeover market, as would a better disclosure regime,[66] better access to foreign takeovers,[67] and a more effective dispute resolution mechanism to protect domestic and foreign investors.[68] But the question is whether China is willing to take such action considering the competitiveness of this sector, the systemic risk, and the impact on its political grip

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[58] Economy (2020).

[59] Lee (2017).

[60] Zhou and Xiao (2018).

[61] See chapter "Evaluating the Mandatory Bid Rule for Takeover Law in China: An Empirical and Comparative Analysis".

[62] See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China.

[63] Xinhua Net (2020).

[64] Kharpal (2020).

[65] See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China.

[66] See chapter "Disclosure Rules in Takeovers: Making Sense of Fragmentation in German Law".

[67] See chapter ""The Takeover Mirror": On the EU Side of the Looking Glass, Most Regulatory Checks Are Ex Post, Not Ex Ante".

[68] See chapter "The Role and Future of Self-Regulation in the Market for Corporate Control: A Comparative Narrative of the Two Models in the UK and China".

on its economic development and social transformation.[69] In the EU, there have been concerns about violations of IPRs by Chinese companies at home and abroad.[70] This has always been a major consideration in any takeover where the bidder's primary aim is to acquire the intellectual property developed by the target company and the control premium paid does not reflect the true value of the target company's IPRs.[71] This is also why Japanese companies are structurally protected against foreign hostile takeovers, through cross-shareholdings and restrictions on takeover financing.[72] Would China adopt the Japanese approach or would it use investment law to prevent the outflow of IPRs developed by Chinese companies?

As the second largest global economy, China has joined the US and EU in using competition law to influence global economic development, especially in the technology sector.[73] Such soft power is also a leverage to political and economic relations with the US and EU.[74] There are some implications here for competition law. Western economies such as the UK and EU may focus on fostering national champions in response to the economic rise of Chinese companies in a way that will see EU competition law becoming more merger-friendly and possibly even with increasing hostile takeovers.[75] There will be more policy-based considerations by the regulators as they determine the outcome of a takeover—both friendly and hostile. This will show a shift from the liberal and policy-neutral open market approach to a more policy-determinant approach. China regularly uses industrial policy to influence the outcome of domestic takeovers or to change the domestic market structure.[76] It is important to observe whether western economies such as the UK and EU increase their use of industrial policy and regulatory objectives in this way to influence takeovers, and if so, what policies will be favoured.[77] The tech-sector and environmental issues have begun to shape the global economic governance and this is now an area where we may see either convergent or divergent approaches between the EU and China.[78] How these issues will contribute to economic nationalism and protectionism is still to be seen. The EU's human

[69]Orsmond (2019).

[70]European Commission (2018).

[71]Gabriela (2013).

[72]Lee (2017).

[73]See chapters "Mergers and Competition in Digital Markets: Learning from our mistakes" & "The Amendment of Anti-monopoly Law of Merger Remedies: Based on the Empirical Analysis in China".

[74]Buthe (2014).

[75]See chapters "Mergers and Competition in Digital Markets: Learning from our mistakes".

[76]See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China.

[77]See chapters ""The Takeover Mirror": On the EU Side of the Looking Glass, Most Regulatory Checks Are Ex Post, Not Ex Ante", "Mergers and Competition in Digital Markets: Learning from our mistakes" & "The Amendment of Anti-monopoly Law of Merger Remedies: Based on the Empirical Analysis in China".

[78]Hobbs (2020).

rights-based governance has not significantly influenced the development of corporate law, capital market regulation or the takeover market. However, legal principles enshrined in the EU General Data Protection Regulation (GDPR) that are based on human rights will affect the development of the tech companies by creating a free flow data market (or a data fortress) which may exclude countries such as China with no equivalent protection.[79] Will human-rights based governance lead the development of the global financial markets? We will need to see how successful the EU is at playing such a role in international trade negotiations, particularly with the US and China. For the environmental protection initiatives, there has been no major evidence on how sustainable financing will influence the takeover market.[80] China is familiar with sustainable financing and this is an area where the EU is keen on working with China to develop an accord that might be included in EU-China trade deal negotiations.[81] How environmental protection is eventually reflected in the relevant takeover laws is still an open question.

## 6 What Can the EU Learn from China, and What China Can Learn from the EU?

What factors have contributed to China's exceptionally fast rate of economic growth? It is often said that China's economic success is a result of manufacturing with low wages, at the expense of the environment, and with strong state control.[82] Whether or not that is true, it is unlikely that EU can learn from China's experience for its own development as the two economies are at very different economic stages and operate under very different political regimes. However, their respective models can offer lessons to other developing economies such as India, Russia, and Brazil. Even though China's development is very much state-led, there is still property right protection through the developments in company law and corporate governance,[83] the capital markets function under a regulatory framework that disperses investment power and protects investors, and competition has been created to stimulate economic growth.[84] The so-called 'socialist market economy model with Chinese characteristics' is still evolving.[85] The financial market is still immature,[86] financial intermediaries do not act as independent market gatekeepers, and the equity market

[79] Leplay (2020).

[80] OECD (2017) and Atanassov (2012).

[81] Wang (2018).

[82] Morrison (2019).

[83] Jiang and Kim (2020).

[84] Knight and Ding (2009).

[85] Hong (2020) and Lim (2013).

[86] Ellyatt (2018).

needs to develop further. Furthermore, company law reform is ongoing[87] and the rules for capital markets are being developed to strengthen the asset management sector to deal with hedge funds and derivative markets.[88] China's development over the past 30 years is not necessarily a guide to its future, and it still has much to learn from the EU and other advanced economies about many aspects of the law on takeovers and M&A for it to continue its development. It would be wrong to assume that the 'socialist market economy with Chinese characteristics' is now a stable model. More change will come and more will need to be learnt from the EU and the UK in terms of board fiduciary duty,[89] the regulatory framework for asset management,[90] the market disclosure regime,[91] market access regulation,[92] detailed takeover rules,[93] corporate governance,[94] and competition law.[95]

## 7 Conclusion

Neoliberalism provided the theoretical basis of the development of the global takeover market. The takeover market has become a very important part of the global financial markets and the financial intermediates have also been structured to provide services for the takeover market to function and deliver the result of efficient allocation of capital. The US, EU and China have all subscribed to this theoretical basis and structured their respective capital markets and laws to accommodate takeover activities. However, the differences in their laws and practices have also demonstrated the level of their belief or doubt in this theoretical basis. These three jurisdictions have taken strategic positions to enhance their interests and manage risks in the game of cross-border takeovers. It is hard to predict if the major economies will continue to embrace the idea of the takeover market as an efficient way to allocate capital. The political economy of takeover law has so far been shaped

[87] Shevlin (2018).

[88] ASIFMA (2018).

[89] See chapter "On the Supply Side of Western Hostile Takeover Law and its Implications for China".

[90] See chapter "Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China".

[91] See chapter "Disclosure Rules in Takeovers: Making Sense of Fragmentation in German Law".

[92] See chapter ""The Takeover Mirror": On the EU Side of the Looking Glass, Most Regulatory Checks Are Ex Post, Not Ex Ante".

[93] See chapter "Evaluating the Mandatory Bid Rule for Takeover Law in China: An Empirical and Comparative Analysis".

[94] See chapter "The Role and Future of Self-Regulation in the Market for Corporate Control: A Comparative Narrative of the Two Models in the UK and China".

[95] See chapters "Mergers and Competition in Digital Markets: Learning from our mistakes" & "The Amendment of Anti-monopoly Law of Merger Remedies: Based on the Empirical Analysis in China".

by major economic powers -such as the US and the EU. China, on the other hand, does not yet have the capability to export its takeover market model or its law to more advanced economies. However, how Chinese companies engage in global M&A, how the Chinese government implements the law, and how foreign players are allowed to have a role in the Chinese market are beginning to be important contributing factors in shaping the global governance of the takeover market. The approach to the digital economy with the tech giant operations and major policies such as climate change initiatives may act as game changers for global takeovers in the years to come. These are areas where China—as the second largest world economy with two major capital market exchanges in Shanghai and Shenzhen—will want to have a strong voice.

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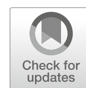
# Conflict of Goals in Takeover Law: The Impossible Regulatory Alignment Between UK and China



**Joseph Lee and Yonghui Bao**

**Abstract** In this chapter, the takeover market is used as an example to examine the extent to which regulatory alignment between the UK and China is possible. The focus is on the role of financial intermediaries in the two markets and how they may influence the governance model of transfer of corporate control by an open offer to the shareholders of the target company (a takeover bid). This chapter argues that the policy goals are very different, making regulatory alignment difficult to be realised. There are differences between the UK and China in their economic model, ownership structure and institutional arrangements, which is reflected in the differences in the interests served by takeover law in the two regimes. The design of the framework for takeover law in the UK empowers financial market participants, so as to attract capital to the London markets. In contrast, China's takeover law is mainly aimed at facilitating industrial restructuring and creating globally competitive national companies (national champions). Hence, the UK's shareholder-centred takeover model, with a strong focus on financial intermediaries and international investors, could not easily be replicated in China. However, the UK model could provide lessons for China as it develops its takeover market, extends its market structure reform, develops independent financial intermediaries and attracts an increasing number of investors.

## 1 Introduction

Regulatory alignment is a means to achieve an interconnected market, which is an aim of the EU.[1] However, without regulatory alignment, an integrated market is unlikely to be successful,[2] or if it is implemented, its scope would be limited.

[1]Armstrong (2018).

[2]European Parliament (2018).

J. Lee (✉) · Y. Bao
School of Law, University of Exeter, Exeter, United Kingdom
e-mail: j.lee@exeter.ac.uk

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Financial intermediaries such as investment firms and asset funds would have to operate in a different regulatory system and with different value chains. There would be limited synergies to be gained by companies, investors, and financial intermediaries, as they would continue to choose favourable places for raising capital, for realising their investment returns, and for gaining revenue. Without regulatory alignment, financial intermediaries would be unlikely to achieve synergy in their operations.[3]

In this chapter, we use the takeover market as an example to examine the extent to which regulatory alignment between the UK and China is possible. We focus on the role of financial intermediaries in the two markets and examine how they may influence the governance model of transfers of corporate control by an open offer to the shareholders of the target company (a takeover bid). The preconditions for hostile takeovers include: sufficiently dispersed ownership structure, macroeconomic factors such as the traded value of target firms' equity being below their asset value, and the bidder having sufficient funding.[4] Until very recently, China's capital market did not fulfil such preconditions, especially on attractive targets with dispersed shareholding, and bidders' adequate funding.[5] The Vanke takeover case,[6] an unsuccessful hostile takeover attempt by Baoneng, shows that hostile takeovers have become a reality in China's capital market.[7] This case demonstrated that crucial problems existed in the takeover market there: systemic risks raised by shadow banking, drawbacks of sectoral supervisions in the financial (takeover) market, vagueness of takeover regulations, state (or local governments) intervention and corporate governance issues, such as information disclosure.

There are five sections of this chapter. Section 2 focuses on how the role of the financial services industry in the national economy model influences the governance of the takeover market. Section 3 examines how such a role influences the ownership structure of listed companies, which, in turn, affects the rules for minority shareholder protection. Section 4 investigates how the institutional arrangements of the takeover regulatory framework might be influenced by financial intermediaries. Sections 5 and 6 draw some conclusions and discusses possible moves by the UK and China.

[3]Tella (2019).

[4]Armour and Skeel (2007).

[5]Huang (2019).

[6]For introduction of facts of the Vanke takeover battle (by Baoneng).

[7]Armour and Skeel (2007).

# 2 Economic Model and the Focus on Its Industry Policy

## *2.1 Differences in National Economies and the Impacts on the Takeover Regulatory Model*

There is a distinct policy difference between the UK and China, and such a difference reflects in the countries' takeover policies and regulations. The financial services industry is a pillar of the current UK economy, and the takeover market provides major revenue to the industry's financing, advising, brokering, and asset management sectors. The financial services industry also performs an independent gatekeeping role to ensure a smooth and orderly takeover market. China is a manufacturing economy, and its financial services industry mainly serves the domestic economy. There is little internationalisation in its financial services industry and it does not act as an independent gatekeeper for the takeover market. The Chinese capital market lacks the UK's independent professional investors. Such a structural difference leads to a different approach to policy with regard to takeovers and hence, to different regulatory systems: the UK's is one of self-regulation[8] while the Chinese state uses a command-and-control model.[9]

## *2.2 UK's Self-regulatory Model and the Influence of the Financial Services Industry*

The financial services industry is critical to the UK economy. The sector contributed £110 billion to the UK economy in 2017, which was 6.5% of total economic output; 50% of this was generated by the financial services industry in London. There were 1.1 million financial services jobs in the UK, which was 3.2% of all jobs. Exports of UK financial services were worth £61 billion in 2016, and imports were worth £11 billion. For 2016–2017, the UK financial sector as a whole contributed £71.4 billion in taxes (which includes wider measures of taxation such as business rates), totalling 11.5% of total government receipts. Annual financial revenues from the UK industry are approximately £200 billion; £90–95 billions of this is domestic business, £40–50 billion relates to the EU, and £55–65 billion relates to the rest of the world. The London Stock Exchange, though not as large as the Shanghai or Tokyo

[8] Lee (2017).

[9] Xi (2015).

Stock Exchanges based on capitalisation, is more international, with non-UK investors holding 53.9% of the value of the UK stock market at the end of 2016.[10]

Hence, the UK Corporate Governance Code and the design of the framework for takeover law empower financial market participants to attract capital to the London markets.[11] Financial market participants have direct steering power over the design, development, and decision making of individual cases as well as over areas for further reform. The Takeover Panel comprises up to thirty-six members, representing a breadth of expertise in takeovers, securities markets, industry and commerce. Twelve members are appointed by the major financial and business associations.[12] The hard law of the Companies Act 2006 simply confers powers on the panel to enforce the code but does not regulate the constitution of the panel, its composition or its power. The Takeover Code and Takeover Panel are beyond the immediate remit of Parliament and the Judiciary. However, it would be incorrect to say that the Takeover Code is soft law operating as the Corporate Governance Code does, or that it is hard law interpreted and enforced as the provisions of Companies Act 2006 are. The Takeover Code and the Takeover Panel are practical solutions to specific problems that financial market participants face and are aimed at ensuring a competitive market for corporate control.

Financial intermediaries play a role in providing finance, advisory services, and gatekeeper functions in UK takeovers. Unlike in China, UK banks are not restricted in providing financing to bidders. Lending is a commercial decision, and the government does not impose control or supervision of takeover funding. In fact, it is a requirement under the Takeover Code that the bidder needs to ensure funding is in place, which is usually provided by a letter of guarantee from a bank rather than by cash from the bidders' account.[13] And such bank letters of guarantee satisfy the Takeover Panel. Investment banks also provide advice on the processes of the Takeover Panel. Since investment banks are experienced in acting as a sponsor in an initial public offering, they are experienced in takeover processes, the valuation of share prices, and the impact of a bid on the secondary market. Although the Takeover Code does not require an advisor in the takeover process, as is required in an IPO, in practice, bidders and target companies appoint investment banks as advisers in both solicited (friendly) and unsolicited (hostile) takeovers.[14] Such practices are common because expert valuation reports are required for setting the offer price, preparing the financing, obtaining approval from the board and shareholders, and satisfying the pension requirement.[15] Investment banks also have better insight into setting the offer price, taking into account any subsequent revision due to

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[10]National Statistics (2016).

[11]Lee (2017).

[12]The Takeover Panel (2020).

[13]Takeover Code, General Principle 5, Rule 24.16 and Rule 25.8.

[14]Bodnaruk et al. (2009).

[15]Ibid.

the target board's rejection or a bid from a white knight.[16] The revenue gained by UK banks amounted to GBP 108–117 billion and a total of 2.2 million people were employed in professional services such as accounting, legal, and advisory services in the UK in 2016.

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

Financial institutions act as gatekeepers in many ways. Since the takeover process is based on the detailed rules in the Takeover Code, it is unlikely for a non-market player to launch a random takeover bid without the necessary finance, advice, and securities services. Under China's circumstances, recent cases, such as Vanke takeover case (by Baoneng) revealed that financial intermediaries developed asset management plans (funds) which assisted commercial banks to conduct regulatory arbitrage.[17] In this model, the commercial banks charged a fixed rate from the leveraged bidder and financial intermediaries charged a commission fee from the leveraged bidders.[18] Asset managers gave the right of control of asset management funds to the leveraged bidder rather than the independent management.[19] Hence, the financial intermediaries lost their independent ability to manage the funds. In the UK, banks need to confirm the bidders' financing,[20] hence a financially underprepared bidder is unlikely to satisfy the Takeover Panel about its ability to pay without the support of a reputable bank.[21] Furthermore, target companies, if listed on a UK exchange, are subject to corporate governance requirements[22] So such companies need to provide valuation reports to satisfy the board as well as its

[16]Ibid.

[17]Liu and Lou (2016).

[18]Ibid.

[19]Ibid.

[20]Takeovers Code, Rule 19.

[21]Takeovers Code, Rule 24.8.

[22]Takeovers Code, Rule 24.10.

shareholders.[23] For the target company, the board needs to obtain an independent valuation report,[24] which may cause the shareholders to accept or reject the offer.[25] Such independent advice from banks limits boards' conflicts of interest, such as CEOs' personal egos or board entrenchment, in a takeover contest.[26] Furthermore, investment banks have better insight into the secondary market of different trading venues.[27] Therefore, information about prior dealings between the bidder and the target company is more likely to be known within the investment circle. This knowledge can prevent the bidders from avoiding having to pay the highest price obtained in the preceding 12 months before the mandatory offer is triggered, as is required under the Code to protect minority shareholders.[28]

## 2.3 China's Economic Model and Lack of Institutional Investors

The experience of the UK as a leading global centre for international financial and related professional services, such as banking, equity and bond markets, and fund management industries, provides lessons for China with regard to its ambition to become a financial power house. For example, many scholars are suggesting that China should learn from UK's "twin-peak" financial supervision model to "balance the regulatory tasks for the over-concentrated risk in China's large banking sector but the underdeveloped securities market".[29] However, China has a different market structure than the UK's highly dispersed and liberalised market with its relatively concentrated ownership, strong state-owned or controlled enterprises that hold significant market shares, and non-independent financial institutions.[30]

The financial services industry is increasingly important to China's economy. The contribution of the financial sector to China's GDP growth has increased from 2183.68 billion RMB in 2009 to 7061.03 billion RMB in 2018. The sector also accounted for 6.993 million people in employment in 2018 compared with 4.49 million in 2009.[31] Although the financial sector plays an increasingly significant role in the growth of the national economy, China has also experienced a soaring trade deficit with regard to the export and import of financial service industries from 2010 to 2012, with a deficit of 765 million RMB in the former and 2.86 billion RMB in the

[23]Takeovers Code, Rule 3.1 and Rule 26.3.

[24]Takeovers Code, Rule 3.3 and Rule 16.2.

[25]Takeovers Code, Rule 25.2 (a).

[26]Kershaw (2016).

[27]Servaes and Zenner (1996).

[28]Takeovers Code, Rule 9.5.

[29]Han (2017).

[30]Armour et al. (2002a, b).

[31]National Bureau of Statistics of China (2018).

latter. The capital market in China has been criticised for a lack of sufficient professional institutional investors and it remains a retail investor-oriented market.[32] In recent years, the China Securities Regulatory Commission (CSRC), the watchdog of China's securities market, has vigorously promoted the development of institutional investors. Commercial banks, securities investment funds, insurance companies, pension funds, and securities companies have grown at a gradual pace.[33] Institutional investors are increasingly changing their role from passive shareholders and speculative traders to active shareholders engaging in the governance of their portfolio companies.[34] As a result, essential rules and regulations for protecting the interests of minority shareholders have been adopted.[35] There has been a series of cases in which institutional investors were in disagreement with the resolution of the board of directors and revoked board motions. For example, in 2010, the Shuanghui Group, which is listed on the Shenzhen Stock Exchange, intended to abandon the pre-emptive right, leading to some asset funds voting against and eventually revoking the board resolution. This case was regarded as the first case in which the institutional investors invalidated the plan of the major shareholders.[36] Subsequently, there have been several cases in which institutional investors actively participated in corporate governance and rejected the proposals of major shareholders. These efforts made by institutional investors actively brought the corporate governance rules into practice and promoted Chinese corporate governance standards.

Although the number of such cases and the level of institutional shareholders' engagement in corporate governance in China remain limited, there is an upward trend in the percentage of the total floating A-shares held by institutional investors, from 5% in 2003 to over 45% in 2016.[37] Among them, foreign investors hold 2.66% of the market shares.[38] The Corporate Governance Code of Listed Companies (2018 revision) emphasises the positive effects that institutional investors make to improving the corporate governance of their portfolio companies, and it encourages institutional investors and financial intermediaries to engage in the process of corporate governance.[39] If institutional investors are actively involved in their portfolio companies' corporate governance, they can act as efficient external monitoring mechanisms. For instance, when a company encounters a takeover bid, institutional investors could voice their opinions on whether the takeover bid should be accepted or rejected, based on their professional skills and with sufficient market information, through exercising voting rights, inquiry rights and advisory right. Hence, the active

[32] Xi (2006).

[33] As of 2018, the market value of funds in China amounted to 130 billion.

[34] Xi (2006).

[35] Ibid.

[36] Ibid.

[37] The figure was 19.86% in accordance to the survey report conducted by OECD in 2017.

[38] WFE data in 2016; also see OECD Survey of Corporate Governance Frameworks in Asia 2017.

[39] Corporate Governance Code of China's Listed Companies, Art. 78, 79, 80, 81 & 82.

involvement of institutional investors is able to promote the development of an active market for corporate control.

Meanwhile, an increasing number of foreign institutional investors are participating in China's financial market following China's commitment to opening the capital market. Foreign institutional investors take a more active part in the corporate governance of portfolio companies as independent institutional investors, compared with domestic institutional investors. This is despite the fact that there are ownership requirements and currency restrictions for foreign investors, and these requirements are less likely to be removed entirely in the short term. However, some of the restrictions that have been in force for a long time have been relaxed as new policies and regulations are gradually introduced. For instance, in accordance with the Chinese-Foreign Equity Joint Ventures Law, the proportion of an investment that is contributed by foreign joint ventures generally had to be more than 25% of the registered capital of a joint venture.[40] Otherwise, foreign investors are not normally eligible to receive preferential tax treatment.[41] When the Foreign Investment Law (FIL) came into force in January 2020, the minimum shareholding requirements of foreign investors were removed, and this provides more flexible options for foreign investors as minority shareholders. In terms of currency restrictions, FIL does now allow foreign investors to remit their contributed capital, profits, capital gains, asset disposal income, intellectual property license fees, legally obtained damages and compensations, or liquidation proceeds overseas in RMB or any other foreign currency,[42] although in practice foreign investors are still not able to engage freely in cross-border remittances.[43]

FIL was interpreted as an olive branch to the US amid trade war negotiation. The law confirms that national policies favouring the development of enterprises will be applicable to foreign-invested enterprises (national treatment).[44] Meanwhile, it should be admitted that although FIL provides various ways in which the current broad principles of the law on foreign investment can be changed, further explanation is needed to clarify and guide the practice.[45] It is expected that foreign investors will play the role of independent institutional investors incrementally. In 2018, President Xi Jinping said that China will create a more attractive investment environment for foreign investors.[46] The Securities Law revision that came into force on 1st March 2020 amended the rules governing takeovers to enhance the requirements of information disclosure and strengthen investor protections. For instance, if an acquirer fails to comply with information disclosure rules, the corresponding voting

[40]Chinese-Foreign Equity Joint Ventures Law, Art. 4.

[41]See 'Notice Concerning the Relevant Issues on Strengthening the Approval, Registration, Foreign Exchange Control and Taxation Administration of Foreign-Funded Enterprises (2003)'.

[42]Foreign Investment Law, Art. 21.

[43]Schaub et al. (2019).

[44]Foreign Investment Law, Article 9.

[45]Koty (2019).

[46]Xin Hua News (2018).