

# A BRIEF COMPARISON OF THE CHINESE AND UNITED STATES SECURITIES REGULATIONS GOVERNING CORPORATE TAKEOVERS

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## I. INTRODUCTION

In May 1993, the China Securities Regulatory Commission ("CSRC") officially released, for the first time, securities regulations governing the trading of securities on Chinese securities exchanges.<sup>1</sup> Among other things, the Interim Securities Regulations specified how a company could purchase the publicly-traded shares of another company. Soon thereafter, in September of the same year, Shenzhen Bao An Enterprises ("Bao An"), a Shenzhen legal-person company, attempted the first hostile takeover of a Chinese public company by accumulating a large block of the publicly-traded shares of Shanghai Yanzhong Industrial ("Yanzhong"), a Shanghai-exchange-listed company.<sup>2</sup> In response to the takeover attempt, Yanzhong planned legal action against Bao An because it believed that Bao An had not followed the Interim Securities Regulations in acquiring its block of shares of Yanzhong.<sup>3</sup>

After a closed-door meeting on October 22, 1993, the CSRC fined Bao An one million Renminbi ("RMB") for illegally buying shares of Yanzhong and required Bao An to pay its short-swing profits of 500,000 RMB to Yanzhong.<sup>4</sup> "We mean to be very serious about these violations

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1. Administration of the Issuing and Trading of Shares Tentative Regulations (*effective* April 22, 1993), as translated in CHINA L. & PRAC., Aug. 1, 1993, at 23 [hereinafter Interim Securities Regulations].

2. Andrew Browne, *China's First Company Takeover Bid gets under way*, REUTERS ASIA-PACIFIC BUS. REP., Sept. 30, 1993, available in LEXIS.

3. Yanzhong Battles Predator, S. CHINA MORNING POST, Oct. 7, 1993, Business at 2, available in LEXIS.

4. Jeffrey Parker, *China Watchdog Snarls over First Hostile Takeover*, REUTER ASIA-PACIFIC BUS. REP., Oct. 22, 1993, available in LEXIS.

and intend to punish violators seriously," said CSRC's General Counsel Mr. Gao Xiqing.<sup>5</sup> Specifically, the CSRC determined that Bao An violated the Interim Securities Regulations in two ways: (1) it failed to publicly disclose its ownership within the required period of time when it became a five-percent shareholder of Yanzhong through stock purchases by its two affiliates and (2) it continued to purchase shares of Yanzhong when it was required to cease such activity immediately prior to publicly disclosing its ownership position in Yanzhong.<sup>6</sup> Nevertheless, in spite of the serious violations, the CSRC allowed Bao An to retain ownership of its shares of Yanzhong.<sup>7</sup>

Ultimately, the takeover attempt stalled when Bao An was unable or unwilling to add to its block of shares of Yanzhong because it had become unattractive to continue.<sup>8</sup> When Bao An had initially accumulated its shares representing 19.8% of the outstanding shares of Yanzhong without publicly disclosing its trading activity, Yanzhong's shares were trading at around 9.8 RMB per share.<sup>9</sup> On October 6, 1993, after Yanzhong held a press conference to denounce Bao An's tactics, Yanzhong's shares closed at 21.98 RMB per share.<sup>10</sup> The next day, with the market fully aware of a company in play, after reaching a high of 42.2 RMB per share, Yanzhong's shares closed at 34.61 RMB per share.<sup>11</sup>

Although Bao An did not gain majority control of its target, with the shares it had accumulated, it eventually secured two seats on Yanzhong's board of directors.<sup>12</sup> The general manager of the Bao An Group was named chairman of Yanzhong's board of directors while Yanzhong's managing

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5. *Id.*

6. *RMB 1 Million Fine Imposed for Failure to Report Share Holdings*, CHINA L. & PRAC., Jan. 31, 1994, at 21.

7. *Id.* (the CSRC held that the share rights of the Yanzhong shares purchased by Bao An were valid; Bao An and its affiliates had violated regulations in dealing with the shares).

8. Andrew Browne, *Friendly Corporate Raid Roils Shanghai Stocks*, REUTER ASIA-PACIFIC BUS. REP., Nov. 10, 1993, available in LEXIS ("The raid was repelled as Yanzhong threatened legal action to defend itself.").

9. *Shanghai A Shares Down as Turnover Withers*, REUTER ASIA PACIFIC BUS. REP., Sep. 16, 1993, available in LEXIS. See also *Shanghai Market Hits Record Turnover Value*, REUTER EUROPEAN BUS. REP., Oct. 7, 1993, available in LEXIS ("Yanzhong was trading at just 9.8 renminbi about three weeks ago when Bao An made its move.").

10. *Yanzhong Battles Predator*, *supra* note 3 ("Yanzhong rocketed by 34 per cent yesterday to 21.98 yuan with 11.1 million shares changing hands, accounting for almost 20% of the turnover.").

11. *Shanghai Stock Market Hits Record Turnover Value*, *supra* note 9.

12. Christine Chan, S. CHINA MORNING POST, Mar. 19, 1994, Business at 6, available in LEXIS.

director resigned and became honorary chairman of the board of directors.<sup>13</sup>

A month after Bao An's attempt to gain control of Yanzhong, Shenzhen Vanke ("Vanke"), another Shenzhen company, appeared to attempt to acquire control of a Shanghai publicly-traded company, Shanghai Shenhua Industrial ("Shenhua"). In this case, although the government explicitly approved the takeover attempt as a sign of a modern and liquid stock market and Shenhua's management welcomed the unsolicited bid,<sup>14</sup> there was no change in control of the target company. After acquiring five percent of Shenhua's outstanding shares, Vanke found that it could not cheaply increase its stake to gain majority control.<sup>15</sup> "The cost of further increasing the stake would be too high to buy in the market so we will be very careful in deciding our next move," said Vanke chairman Mr. Wang Shi.<sup>16</sup>

Then, on December 22, 1993, Shenzhen Tianji Optical Electronics Technology ("Tianji"), a Shenzhen company, acquired 5.2% of the outstanding shares of Shanghai Feile Acoustics ("Feile Acoustics").<sup>17</sup> A week later, it made an additional purchase of two percent of the outstanding shares.<sup>18</sup> In contrast to the previous two takeovers, there was another bidder for the target company: Shanghai Feile Company ("Feile Company"),<sup>19</sup> the founder and major shareholder of Feile Acoustics who, at that time, owned 16.3% of the outstanding shares of Feile Acoustics.<sup>20</sup> While Feile Company increased its ownership in Feile Acoustics to 20.2% of the outstanding shares over two weeks of buying, Tianji did not acquire

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13. *Id.*

14. Christine Chan, *Vanke Grabs 5pc of Shanghai Firm in China's First 'Friendly' Raid*, S. CHINA MORNING POST, Nov. 11, 1993, Business at 1, available in LEXIS.

15. *Plenum's Growth Edict Fillip for Shares*, S. CHINA MORNING POST, Nov. 16, 1993, Business at 19, available in LEXIS ("However, Vanke has since said under the takeover rules, a full takeover would be very expensive because it had to announce increases in its stake which would encourage speculation in its shares and a rise in the share price.").

16. Christine Chan, *Shenhua Stake Cost Vanke 39M Yuan*, S. CHINA MORNING POST, Nov. 15, 1993, Business at 3, available in LEXIS.

17. Christine Chan, *Shenzhen Company Buys 5pc of Shanghai Feile Acoustics*, S. CHINA MORNING POST, Dec. 23, 1993, Business at 2, available in LEXIS.

18. Christine Chan, *Tianji Increases Feile Stake*, S. CHINA MORNING POST, Dec. 29, 1993, Business at 2, available in LEXIS.

19. *Shanghai Shares Close Lower Amid Battle Over Feile*, REUTER ASIA-PACIFIC BUS. REP., Dec. 28, 1993, available in LEXIS.

20. Chan, *supra* note 18.

any additional shares of Feile Acoustics.<sup>21</sup> Needless to say, Tianji did not win the bidding contest for Feile Acoustics.

These three failed takeover attempts of publicly traded companies provide a basis for analyzing the Interim Securities Regulations and its likely effect on the success of future hostile takeovers in China. It appears that the Interim Securities Regulations effectively serve as a restraint on hostile takeovers by reducing an acquirer's profit incentive to complete an acquisition.

By comparing the Interim Securities Regulations to the Williams Act, one can attempt to understand the Regulations' corporate governance implications in view of company management's sensitivity to stock market fluctuations. While the Williams Act does require an acquirer to disclose its position by filing a Schedule 13D within 10 days once it becomes a five-percent shareholder,<sup>22</sup> the acquirer can continue to purchase shares in that ten-day period at a price that does not yet reflect full information.<sup>23</sup> In this way, an acquirer has a profit incentive to attempt a takeover if it identifies an undervalued company that it can restructure for increased value.<sup>24</sup> Under the Williams Act, company management is then more sensitive to the market valuation of the company's shares and cannot be complacent in investing corporate assets. Management's interests are directly aligned with those of the shareholders.

On the other hand, since the management of a Chinese listed company is effectively insulated from potential acquirers by the Interim Securities Regulations, they may be in a better position to more effectively manage for the long-term development of their company. They do not have to concern themselves with the daily price fluctuations of their company's

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21. *Shanghai A Shares Close Down, But Gains Seen*, REUTER ASIA-PACIFIC BUS. REP., Jan. 11, 1994, available in LEXIS ("Its [Feile Company's] total holdings now stand at 20.2% percent, making it by far the biggest shareholder.").

22. Securities Exchange Act of 1934, 15 U.S.C. § 78m(d) (1996) (This section is also known as section 13(d)).

23. RICHARD W. JENNINGS, et. al., SECURITIES REGULATIONS: CASES AND MATERIALS 210-211 (1992) (If one assumes that the stock prices only reflect public information, not all available information, then some investors may be unaware that one investor is acquiring a large block of stock and the target share price will not reflect that takeover activity. This is the semi-strong theory of efficient capital markets.).

24. Michael C. Jensen, *The Takeover Controversy: Analysis and Evidence*, in KNIGHTS, RAIDERS, AND TARGETS, THE IMPACT OF THE HOSTILE TAKEOVER 314, 348 (John C. Coffee, Jr. et al. eds., 1988) ("Since market prices adjust to the expected value of the takeover bid immediately after the 13d announcement, the acquirer's profits are made almost entirely on the difference between the price paid for the shares purchased prior to the filing of the 13d and their value after the acquisition.").

stock. Therefore, they should not implement short-term strategies to boost their company's share price need it happen to be undervalued by the market. Instead, they can focus on creating sustainable shareholder value.

In regulating publicly-traded securities, one would like to align the interests of company management with those of their shareholders in creating value. One could adopt the view that management knows more than their dissatisfied shareholders as evidenced by an unfavorable share price and a hostile takeover would disrupt a carefully developed strategy. Alternatively, one could believe that management needs to feel threatened, otherwise they will "stray too far from the service of the shareholders."<sup>25</sup> In such a regulatory framework, a hostile takeover is an instrument for dissatisfied shareholders to regain control of corporate assets should management not properly invest them.<sup>26</sup>

Part II of this note briefly describes the Chinese securities regulatory environment under the Interim Securities Regulations and focus in detail on the specific sections that regulate takeovers: disclosure and tender offers. In analyzing the disclosure regulations, I will use the three takeover attempts previously described to illustrate how the CSRC will interpret and enforce the Interim Securities Regulations. I will also discuss an apparent ambiguity in the tender offer regulations in which an aggressive company can avoid making a series of open-market purchases and instead make a tender offer before being required to do so.

Part III compares the Interim Securities Regulations to the Williams Act and discusses the policy implications of the two regulatory frameworks in providing incentives for management to create sustainable shareholder value. The Williams Act forces management to be more responsive to shareholders while the Interim Securities Regulations allow management to operate in a vacuum. It is unclear which regulatory framework would ensure a more effective utilization of corporate assets.

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25. Fank H. Easterbrook and Daniel R. Fischel, *The Proper Role of a Target Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161, 1169 (1981) [hereinafter Easterbrook & Fischel] ("The most probable explanation for unfriendly takeovers emphasizes their role in monitoring the performance of corporate managers. The tender bidding process polices managers whether or not a tender offer occurs, and disciplines or replaces them if they stray too far from the service of the shareholders.").

26. Michael C. Jensen, *The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems*, 48 J. FIN. 850 (July 1993) (discussing the capital markets as one of four control forces with which to resolve the problem of "divergence between managers' decisions and those that are optimal from society's standpoint.").

## II. THE PRC LAWS GOVERNING HOSTILE TAKEOVERS

### A. *The Chinese Regulatory Framework*

Chinese securities laws are evolving over time. The Chinese securities markets developed without any national legislation; local administrative regulations were created by the People's Bank of China and the Shanghai and Shenzhen municipalities.<sup>27</sup> In 1993, the State Council created a regulatory body, the Securities Commission of the State Council and its executive body, the CSRC, to regulate the trading of securities.<sup>28</sup> The CSRC is chartered with enforcing the securities regulations as well as drafting additional disclosure regulations.<sup>29</sup> It also investigates violations of the securities regulations and imposes appropriate penalties.<sup>30</sup>

### B. *The Interim Securities Regulations*

Chinese securities are divided into two classes of shares depending upon who can own the shares and how they can be traded. A-type shares are shares that can be owned by Chinese state-owned entities, Chinese legal persons, otherwise known as companies, and Chinese citizens.<sup>31</sup> B-type shares are shares that can be owned by foreigners. A-type shares held by Chinese individuals are the shares that are freely traded on Chinese exchanges; state-owned shares are not traded.<sup>32</sup> In this way, the Interim Securities Regulations, as it is specifically written, regulates the trading of A-type shares by individuals and legal persons.<sup>33</sup>

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27. Cy Leung and Raymond Gu, *China*, IFL REV. SPECIAL SUPP., Jul. 1994, at 17 [hereinafter Leung & Gu].

28. Interim Securities Regulations, *supra* note 1, art. 5 ("The State Council Securities Commission shall be the organization in charge of securities markets throughout the country and shall centrally administer securities markets throughout the country in accordance with laws and regulations.").

29. *Id.*, art. 5.

30. *Id.*, arts. 68 and 75 (Article 68 describes investigating violations; Article 75 describes the penalties for violations.).

31. Leung & Gu, *supra* note 27, at 19.

32. *Id.*

33. Interim Securities Regulations, *supra* note 1, art. 6 ("Specific measures for the issue and trading of special renminbi denominated shares shall be formulated separately.").

A legal person is either a company "limited by shares" or a "limited liability company."<sup>34</sup> A company limited by shares is a company in which the capital of the company is divided into equal shares and the shareholders are liable to the extent of their share holdings.<sup>35</sup> In other words, it is a public corporation with outstanding shares. A limited liability company is a company in which the shareholders are liable to the company to the extent of their capital contributions to the company.<sup>36</sup> An equivalent entity in the United States would be a limited liability corporation.<sup>37</sup>

A point to note is that only companies can acquire a significant amount of shares of a publicly-traded company. An individual citizen can hold no more than 0.5% of the outstanding shares.<sup>38</sup> If an individual citizen's equity interest exceeds the threshold, then the company must acquire the excess shares with the CSRC's approval at a price that is the lower of the market price or the individual's original purchase price.<sup>39</sup>

### C. *The Interim Securities Regulations: Broad Disclosure*

Two areas of the Interim Securities Regulations that regulate takeovers are the specific regulations that mandate disclosure and govern tender offers. The Interim Securities Regulations provide for broad disclosure to shareholders once one becomes the beneficial owner of five-percent of the outstanding shares of a listed company.<sup>40</sup> After reaching that ownership level, that five-percent shareholder is required to disclose its position within three business days by issuing a statement in at least one national newspaper and filing written notice with the target company, the

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34. PRC Company Law, art. 3 (*adopted at the 5th Session of the Standing Committee of the 8th National People's Congress, promulgated on Dec. 29, 1993 and effective as of Jul. 1, 1994*), as translated in CHINA'S NEW COMPANIES (Asia Law & Practice Ltd., 1994.)

35. *Id.*

36. *Id.*

37. JACK S. LEVIN, STRUCTURING VENTURE CAPITAL, PRIVATE EQUITY, AND ENTREPRENEURIAL TRANSACTION 78 (1996).

38. Interim Securities Regulations, *supra* note 1, art. 46 ("no individual may hold 0.5% or more of the outstanding common shares of a listed company"). See also *id.*, art. 81.

39. *Id.*, art. 46 (Under Article 46, it does not appear that the company has a choice, since "any excess amount shall be acquired by the company.").

40. *Id.*, part 4.

securities exchange and the CSRC.<sup>41</sup> Furthermore, once that certain shareholder becomes subject to the reporting requirements, it must disclose further purchases or sales representing two percent of the outstanding shares within three working days of such a transaction.<sup>42</sup>

The target company whose shares have been purchased is also subject to the reporting requirements of the Interim Securities Regulations. It is required to give notice to both the CSRC and the securities exchange as well as publish such notification in a national newspaper when a five-percent shareholder acquires or disposes of two percent of its outstanding target shares.<sup>43</sup> According to Article 60 of the Interim Securities Regulations, the company must disclose information when a major event occurs that will have an impact on the market value of the company and of which its shareholders may be unaware. An acquisition or disposition by a five-percent shareholder of two percent of the company's outstanding shares is just such an event that must be reported.<sup>44</sup>

Furthermore, the CSRC must disclose to the public the information submitted by the company and the five-percent shareholder.<sup>45</sup> The CSRC must make the information available for inspection by investors.<sup>46</sup>

Finally and most importantly, prior to the date on which the company has filed its notice and publicly disclosed its position, and for two working days thereafter, the company may not buy or sell shares either directly or indirectly.<sup>47</sup> The buyer is prevented from changing its ownership position until the market is aware of its ownership position.

Suppose a shareholder was attempting to acquire a significant amount of shares of a publicly-traded company. According to Article 47

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41. *RMB 1 Million Fine Imposed for Failure to Report Share Holdings*, *supra* note 6 (citing Article 20 of the Disclosure of Information by Companies Issuing Shares to the Public Implementing Rules (*promulgated by China Securities Supervision and Control Commission in 1993*)).

42. Interim Securities Regulations, *supra* note 1, art. 47, para. 2.

43. *Id.*, art. 60. *See also id.*, art. 63 (Article 63 states that when listed companies are required to publish information to the public, the information must be placed in national newspapers and periodicals designated by the Securities Supervision Commission.).

44. *Id.*, art. 60 (Article 60 states that "when a major event occurs which may have a comparatively large impact on the market value of a listed company's shares and which investors are not aware of, the listed company shall promptly submit a report concerning such important event to the securities trading place and the Securities Supervision Commission, and publish the event for the public." Article 60 goes on to list 14 major events one of which is a two-percent purchase or sale by a five-percent shareholder.).

45. *Id.*, art. 64.

46. *Id.*

47. *Id.*, art. 47, para. 3.



of the Interim Securities Regulations, if such a shareholder were to become a five-percent shareholder on Monday, it would have to make an announcement of its position by Thursday, three working days after the triggering event. In addition, it is blocked from acquiring additional shares before the announcement and two days thereafter.<sup>48</sup>

Now suppose that shareholder wanted to resume buying shares as soon as possible after becoming a five-percent shareholder. Article 47 of the Interim Securities Regulations requires only that a company make prompt disclosure of its holdings within three days; it does not appear that it must wait the full three days before making its announcement.<sup>49</sup> Then, under the same scenario, if a company reached the five-percent threshold on Monday and promptly gave notice, it could resume buying on Thursday, two days after its announcement.

#### D. Case Studies in Takeover Disclosure

To understand how the CSRC will interpret and enforce the takeover disclosure regulations, one can use the three takeover attempts as case studies, starting with Bao An's attempt. On September 16, 1993, several newspapers began to publish rumors that someone was buying Yanzhong's shares.<sup>50</sup> Yanzhong was a particularly attractive target because it had 30 million shares outstanding, none of which were owned by the state.<sup>51</sup> The freely transferable shares were trading at 9.8 RMB per share.<sup>52</sup>

On September 30, Bao An informed the CSRC, the Shanghai Exchange and Yanzhong that it owned more than five percent of Yanzhong's outstanding shares.<sup>53</sup> Bao An also made a public announcement.<sup>54</sup> Circumventing the Interim Securities Regulations, Bao An already beneficially owned 17.07% of Yanzhong's shares.<sup>55</sup>

Through discrete buying, Bao An had obtained a block of Yanzhong's shares. With its two Shanghai affiliates, Huayang and

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48. Parker, *supra* note 4 (Mr. Gao Xiqing, CSRC's General Counsel, was quoted as saying that Bao An should have stopped when it became a five-percent shareholder.).

49. Interim Securities Regulations, *supra* note 1, art. 47.

50. *Shanghai A Shares Down as Turnover Withers*, *supra* note 9.

51. Brown, *supra* note 2.

52. *Shanghai A Shares Down as Turnover Withers*, *supra* note 9. See also *Shanghai Stock Market Hits Record Turnover Value*, *supra* note 9.

53. *RMB 1 Million Fine Imposed for Failure to Report Share Holdings*, *supra* note 6.

54. *Id.*

55. *Id.*

Baoling,<sup>56</sup> Bao An beneficially owned 6.09% of Yanzhong's shares sometime before September 28.<sup>57</sup> On September 29, Bao An purchased 4.56% of Yanzhong's shares on the market.<sup>58</sup> The next day, before issuing its statement to the CSRC, Bao An bought all the available shares of Yanzhong on the Shanghai Exchange and the Yanzhong shares owned by its two affiliates to bring its total ownership to 17.07%.<sup>59</sup>

Following Bao An's statement, on October 4, the Shanghai Exchange announced that Bao An owned over 16% of Yanzhong's shares.<sup>60</sup> Yanzhong followed that announcement with a press conference two days later in which it declared that Bao An's actions were illegal.<sup>61</sup> On the same day as the press conference, Bao An made its final purchase of Yanzhong's shares, bringing its ownership to 19.8% of Yanzhong's shares.<sup>62</sup>

After an investigation, the CSRC determined that Bao An committed two violations of the Interim Securities Regulations and fined Bao An one million RMB under Article 74 of the Interim Securities Regulations.<sup>63</sup> First, the CSRC found that Bao An violated Article 47 of the Interim Securities Regulations by not disclosing its full ownership of Yanzhong's shares.<sup>64</sup> Although Bao An announced that it had acquired more than five percent of Yanzhong on September 30, the CSRC found that Bao An should have made an announcement earlier, before September 28, when it initially became a five-percent shareholder through its two affiliates.<sup>65</sup>

Second, the CSRC also fined Bao An for buying shares in violation of Article 47 of the Interim Securities Regulations.<sup>66</sup> As stated previously, once Bao An became a five-percent shareholder, it should have refrained from buying shares, both before making its announcement and for two days thereafter.<sup>67</sup> Since Bao An initially became a five-percent shareholder

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56. *Listed Company Fined One Million Yuan for Breaking Rules*, XINHUA GENERAL OVERSEAS NEWS SERVICE, Oct. 22, 1993, available in LEXIS.

57. *Id.*

58. *Id.*

59. *RMB 1 Million Fine Imposed for Failure to Report Share Holdings*, *supra* note 6.

60. *Shanghai Stocks End Up on Takeover Fever*, REUTER ASIA-PACIFIC REP., Oct. 4, 1993, available in LEXIS.

61. *Yanzhong Battles Predator*, *supra* note 3.

62. *Id.*

63. *RMB 1 Million Fine Imposed for Failure to Report Share Holdings*, *supra* note 6.

64. *Id.*

65. *Id.*

66. *Id.*

67. Interim Securities Regulations, *supra* note 1, art. 47.

through its affiliates, its purchases on September 29 and 30 were violations, as were any purchases before October 3.

Third, the CSRC required Bao An and its affiliates to pay back its short swing profits to Yanzhong.<sup>68</sup> Bao An realized about 500,000 RMB in short-swing profits.<sup>69</sup> By Article 38 of the Interim Securities Regulations, five-percent shareholders must repay their profits from sales within six months of the purchase to the company.<sup>70</sup>

In contrast to its actions in the Bao An takeover, the CSRC did not intervene in either Vanke's or Tianji's attempted takeovers as they both apparently complied with the disclosure regulations. In November 1993, Vanke began accumulating the shares of Shenhua, a company listed on the Shanghai Exchange. As was the case in the Bao An takeover attempt, none of the target company shares were owned by the state.<sup>71</sup> In contrast to Bao An, Vanke properly announced that it owned five percent of the target company. According to Mr. Gao Xiqing, the General Counsel of the CSRC, the takeover attempt was carried out in conformance with the Interim Securities Regulations.<sup>72</sup>

On December 22, 1993, the Shanghai Exchange announced that Tianji had acquired five percent of the shares of Feile Acoustics and suspended trading of its shares for an hour.<sup>73</sup> Tianji had specifically purchased 5.2% of the shares of Feile Acoustics.<sup>74</sup> Three business days later on December 28, Tianji made an additional purchase of two percent of the outstanding shares of Feile Acoustics.<sup>75</sup> However, it had to compete with Feile Company for control of Feile Acoustics.<sup>76</sup> On the day that Tianji made its two-percent purchase, Feile Company increased its total ownership to 16.3% of the Feile Acoustics shares.<sup>77</sup> On January 10, 1994, with no other activity from Tianji, Feile Company brought its ownership

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68. RMB 1 Million Fine Imposed for Failure to Report Share Holdings, *supra* note 6.

69. Parker, *supra* note 4.

70. Interim Securities Regulations, *supra* note 1, art. 38.

71. Another Shenzhen Predator Pounces on Shanghai Target, STRAITS TIMES, Nov. 11, 1993, Money at 35, available in LEXIS ("The company has a total of 27 million shares outstanding and none is owned by the state, making it an easy target for a stock market predator.").

72. Takeover Bid Could be a Scam to Lift Price, Warns Official, S. CHINA MORNING POST, Nov. 12, 1993, Business at 1, available in LEXIS.

73. Shanghai Stocks End Down, Feile Targeted in Raid, REUTER ASIA-PACIFIC BUS. REP., Dec. 22, 1993, available in LEXIS.

74. Chan, *supra* note 17.

75. Shanghai Shares Close Lower Amid Battle Over Feile, *supra* note 19.

76. *Id.*

77. *Id.*

of Feile Acoustics up to 18.3% and announced its acquisition to the Shanghai stock exchange.<sup>78</sup> The next day, Feile Company made a final purchase to increase its ownership to 20.2%.<sup>79</sup>

In this case, it seems that the participants generally followed the Interim Securities Regulations and consequently, the CSRC did not intervene. Tianji made its required disclosure once it crossed the five-percent ownership threshold and resumed buying more than two days after its announcement.<sup>80</sup> It also publicly announced its purchase of two percent of the shares. Similarly, Feile Company disclosed its subsequent two-percent purchase of Feile Acoustics shares and its additional share purchases.<sup>81</sup> It should not have made its final purchase because it was within two days of its announcement, but there is no further information as to whether the CSRC found that Feile Company had committed a violation.

#### *E. The Interim Securities Regulations: Tender Offer Regulations*

The second area of the Interim Securities Regulations regulating takeovers concerns tender offers. By examining the tender offer regulations of the Interim Securities Regulations, one can conclude that the regulations provide a great degree of protection to target shareholders by ensuring their participation in the takeover, providing them information about the tender offer and granting them rights should they become minority shareholders.<sup>82</sup>

First, the target shareholders can fully participate in the tender offer at a reasonable cash price. Once a company beneficially owns 30% of the total outstanding common shares of a publicly-listed company, that 30% shareholder must make a mandatory tender offer in cash to all of the target company shareholders at a specified price within 45 days.<sup>83</sup> The tender offer price is the greater of either the highest price paid by the acquirer for its shares during the 12 months preceding the takeover offer, or the average market price of such shares during the preceding 30-working-day period

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78. Chan, *Shanghai Listing Fortifies Against Takeover From Southern Predator*, S. CHINA MORNING POST, Jan. 11, 1994, Business at 2, available in LEXIS ("Shanghai Feile notified the Shanghai stock exchange yesterday that it had increased its stake in Feile Acoustics to 1.84 million shares.").

79. *Shanghai A Shares Close Down, But Gains Seen*, *supra* note 21.

80. *Shanghai Shares Close Lower Amid Battle Over Feile*, *supra* note 19.

81. *Id.*

82. Interim Securities Regulations, *supra* note 1, arts. 48 - 52.

83. *Id.*, art. 48.

before the acquirer makes the tender offer.<sup>84</sup> Since the offeror must pay for the shares in cash,<sup>85</sup> the selling shareholder is assured of liquid consideration in exchange for its shares. Apparently no alternate financing can be used, such as an exchange of the acquirer's shares for the target shares.<sup>86</sup>

Additionally, the offeror cannot coerce target shareholders to tender quickly. The tender offer must be open for at least 30 working days from the date of issuance<sup>87</sup> and during that time, the shareholders who tender have the right to withdraw their shares.<sup>88</sup> Also, if they choose to participate and the tender offer is oversubscribed, the offeror must buy their shares on a pro rata basis.<sup>89</sup> Of course, the offeror is not obligated to purchase all the shares that are tendered.

Next, to further ensure target shareholder participation in the takeover, the offeror is restricted, within the 45-day period after becoming a 30% shareholder, from buying shares until it makes its mandatory tender offer.<sup>90</sup> Once the tender offer is made, the offeror cannot purchase shares of the target company during the term of the tender offer.<sup>91</sup> Also, for 30 days after the tender offer expires, the offeror can only purchase shares on the same terms as the tender offer.<sup>92</sup>

Along with ensuring full participation for target shareholders, the Interim Securities Regulations gives them "a right to" information by requiring disclosure. Before issuing the tender offer, the offeror must file

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84. *Id.*

85. *Id.*

86. See Roger Lowenstein, *Why All Takeovers Aren't Created Equal*, WALL ST. J., Mar. 6, 1997, at C1 ("Investors are casual about whether an acquisition is made with stock or cash, but the dynamics of these deals differ far more than people realize. So do the results. Acquirers who in the past used their stock fared worse – considerably worse than those who used cash. Such a finding agrees with the suspicion, previously aired by a certain financial columnist, that at least some share mergers were effected with financial funny money. Until now, it was merely a suspicion." The article goes on to describe a study by Tim Loughran and Anand M. Vijh which found "[c]ompanies that made cash acquisitions saw their stocks rise an exuberant 113% in the five years following the merger. Those that used stock rose a meager 61%." In other words, those target shareholders who received cash and invested in the acquirer would do far better than those who received their takeover premium in stock of the acquirer.).

87. Interim Securities Regulations, *supra* note 1, art. 49.

88. *Id.*, art. 52 ("Until a tender offer becomes void, offerees who have preliminary accepted the offer shall have the right to withdraw their preliminary acceptance.").

89. *Id.*, arts. 51 - 52.

90. *Id.*, art. 48.

91. *Id.*, art. 52.

92. *Id.*

a report with the CSRC.<sup>93</sup> The CSRC, in turn, discloses the report to the public and makes it available to investors.<sup>94</sup> Once the tender offer is made, the offeror must disclose information about itself and the offer to the target shareholders and the securities exchange.<sup>95</sup> The offeror guarantees the accuracy of its filing by warranting that "the information is truthful, accurate, complete and not misleading."<sup>96</sup> Finally, while the tender offer is outstanding, the offeror must notify the target shareholders of any changes through a press conference, an announcement in a newspaper, or through any other means of dissemination.<sup>97</sup>

Finally, since the target shareholders have a second chance to sell their shares after the tender offer closes, they can avoid becoming minority shareholders. If the tender offer expires and the acquirer has less than majority ownership, and unless the acquirer issues another tender offer, it can purchase only another five percent of the target company's outstanding shares per year.<sup>98</sup> In this way, the controlling shareholder cannot easily gain majority ownership without making a tender offer to the remaining shareholders who can at least participate pro rata.<sup>99</sup>

If the tender offer expires and the acquirer has 90% of the total outstanding shares of the target company, the remaining shareholders can enforce the sale of their shares to the offeror on "equal conditions."<sup>100</sup> The remaining shareholders have the right to have the tender offer extended to their shares; they can avoid a freeze-out merger on terms less favorable than those of the tender offer.

#### *F. Early Tender Offers Before the 30% Equity Ownership Threshold*

A takeover strategy that is not explicitly addressed by the tender offer regulations is that of making a tender offer before reaching the mandatory threshold level. After the Bao An takeover attempt concluded, CSRC's General Counsel Mr. Gao Xiqing stated, "If you want to do a

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93. *Id.*, art. 49.

94. *Id.*, art. 64.

95. *Id.*, art. 49.

96. *Id.*

97. *Id.*, art. 52, para. 1.

98. *Id.*, art. 51.

99. *Id.*

100. *Id.*, art. 51, para. 4.

takeover overnight, there's only one way. You have to make a general offer." He went on to say, "The message is this: if anyone wants to make massive purchases of shares in a company – whether they want to take control or not – they must take heed of the philosophy of law as well as of the specific regulations."<sup>101</sup> The implication is that although the Interim Securities Regulations do not specifically allow a tender offer to be made before the 30% threshold, a company can make a tender offer at any time as long as one conforms to the tender offer regulations. Pursuant to Article 48 of the Interim Securities Regulations, should the offeror then become a 30% shareholder, the offeror would then be obligated to make a tender offer to all of the shareholders at the mandated price. The Interim Securities Regulations would then be similar to the British system, which also requires a mandatory bid once a shareholder crosses the 30% threshold, regardless of whether the shareholder had made a partial or full bid.<sup>102</sup>

The acquirer would enjoy two advantages over making open-market purchases if it could make a tender offer before reaching the 30% threshold. First, it could gain a foothold in the target company without making a series of fully-disclosed purchases at successively higher prices. Since a tendering shareholder has the right to withdraw its acceptance of a tender offer, it seems reasonable to assume that one measures change of ownership at the time the tender offer closes, not when the shareholder tenders its shares. In this way, the acquirer would not have to halt its purchasing at every two-percent purchase and watch the share price adjust upwards accordingly. Second, the tender offeror could make the bid at a price of its choosing. Only if it became a 30% shareholder would it be required to make the tender offer at the price mandated by Article 48 of the Interim Securities Regulations. Of course, the tender offer price must be at a premium to the market price, otherwise target shareholders would not tender their shares

While the acquirer benefits from an early tender offer, it would appear that the target shareholders might be worse off. However, since the acquirer must make a filing before issuing its early tender offer, the market should then properly reflect that information in its valuation of the target

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101. Parker, *supra* note 4.

102. Deborah A. De Mott, *Comparative Dimensions of Takeover Regulation*, in KNIGHTS, RAIDERS, AND TARGETS, THE IMPACT OF THE HOSTILE TAKEOVER 398, 409 (John C. Coffee, Jr. et al. eds., 1988).

stock.<sup>103</sup> Risk arbitragers should bid up the share price to the tender offer price if they believe the tender offer is likely to be successful in attracting shareholders to tender. The share price could rise higher if risk arbitragers believe there will be other bidders for the target company. Therefore, the target shareholders might receive higher consideration than if they had sold their shares on the market.

### III. THE INTERIM SECURITIES REGULATIONS AND THE WILLIAMS ACT

The United States securities markets are regulated by federal securities laws and the Securities and Exchange Commission ("SEC"). The fundamental purpose of the Securities Exchange Act of 1934 ("Exchange Act") is "to substitute a philosophy of full disclosure in place of the philosophy of caveat emptor."<sup>104</sup>

Congress created the Williams Act in 1968 and amended it in 1970 to address the problem of short tender offer bids that lasted only several days, by requiring disclosure and specifying certain aspects of tender offers.<sup>105</sup> It may be that the purpose of the Williams Act was to preserve a balance in hostile takeovers so that defensive tactics increase value to target shareholders.<sup>106</sup> Therefore, the Williams Act does not tip the balance to either target management or to the acquirer; but rather helps target shareholders make informed decisions on whether or not to tender their shares.<sup>107</sup>

To fully appreciate the implications of the Interim Securities Regulations for corporate governance, one can compare it to the Williams Act in regard to disclosure and tender offers, Sections 13(d) and 14(d) of the Exchange Act, respectively. One can begin with the purpose of the Interim Securities Regulations, which is to "meet the need for development of the socialist market economy, to establish and develop highly efficient stock markets that are uniform throughout the country, to safeguard the lawful rights and interests of investors and the public interest and to promote the development of the national economy."<sup>108</sup>

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103. Interim Securities Regulations, *supra* note 1, art. 49.

104. *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477 (1977).

105. Jennings, Marsh & Coffee, *supra* note 23, at 652.

106. *Id.*, at 655.

107. *Id.*, at 657.

108. Interim Securities Regulations, *supra* note 1, art. 1.



### A. Takeover Disclosure Regulations

In contrast with the Interim Securities Regulations, the Williams Act requires an acquirer to make a similar level of disclosure to target shareholders in a takeover attempt, but allows the acquirer more flexibility. An acquirer must disclose information to shareholders in two ways. First, an acquirer must disclose its holdings by filing a Schedule 13D within ten business days after becoming the beneficial owner of five percent of the target company stock<sup>109</sup> with beneficial ownership defined in Rule 13d-3 as the power to vote or dispose of the shares.<sup>110</sup> The information contained in a Schedule 13D is essentially the information a target shareholder would receive in a proxy contest.<sup>111</sup> The acquirer sends by certified mail the Schedule 13D to the securities exchange and the target company and must file six copies with the SEC.<sup>112</sup> Second, should there be a material change to the Schedule 13D, including an acquisition or disposition of one percent of the target company's outstanding stock, the acquirer must file an amendment within two business days.<sup>113</sup> Once the acquirer crosses the five-percent threshold, it must anticipate entering a "fish bowl of public disclosure" in which it will be scrutinized by the target company and risk arbitrageurs.<sup>114</sup>

In stark contrast to the Interim Securities Regulations, an acquirer who has five-percent ownership of the target company can continue to purchase shares during the ten days before making its announcement.<sup>115</sup> In that ten-day period, acquirers purchase on average 7.6% of the shares of

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109. 15 U.S.C. §78m(d)(1) (1996) (This is section 13(d)(1) of the Exchange Act. Under Schedule 13D of the Exchange Act, one is required to complete five items:

- i) the background of such person whether the person is a corporation or a natural person;
- ii) the source of the funds used for the acquisition;
- iii) the purpose of the acquisition including changes to board of directors or an extraordinary corporate transaction such as a merger;
- iv) the number and percentage of the class of securities beneficially owned
- v) the relevant contracts, arrangements or understandings with respect to securities of the issuer such as finder's fees, joint ventures, loans.)

110. Rules and Regulations of the Securities Exchange Act of 1934, 17 CFR 240.13d-3 (1996) (Determination of Beneficial Ownership.).

111. Jennings, *supra* note 23, at 658.

112. 17 CFR 240.13d-1 (1996) (Filing of Schedule 13D and 13G.).

113. 17 CFR 240.13d-2 (1996) (Filing of Amendments to Schedules 13D or 13G.).

114. Jennings, *supra* note 23, at 658.

115. 17 CFR 240.13d-1(b)(3)(ii) (1996).

the target company.<sup>116</sup> Through these purchases, the acquirer secures its profit in the transaction since the prices quickly adjust after the Schedule 13D announcement.<sup>117</sup>

### *B. Tender Offer Regulations*

There are two major differences between the tender offer regulations of the Interim Securities Regulations and the Williams Act. First and most importantly, an acquirer under the Williams Act has greater flexibility. It is free to make a tender offer at any time and is not required to make an offer if it becomes a 30% shareholder as it would under the Interim Securities Regulations. It gets its offer out directly to the shareholders and can gain a foothold in the target company without making open-market purchases. However, the acquirer would most likely have to offer a large premium of about 50% in its tender offer.<sup>118</sup>

Second, the Interim Securities Regulations provide greater protection for surviving target shareholders than the Williams Act.<sup>119</sup> Under the Williams Act, there is no protection for a shareholder in a freeze-out merger. "Current takeout law allows successful bidders to pay minority shareholders in an immediate takeout a consideration with a value lower than the bid price."<sup>120</sup> The minority shareholders' remedy would be to

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116. Jensen, *supra* note 24, at 347-348 ("Current rules allow the acquiring firm to buy as many additional shares as it can in the ten-day window between the time the 5% filing barrier is reached and the time of the filing. This rule allows buyers to acquire shares that average 7.6% of the target firm.").

117. *Id.*, at 348 ("Since market prices adjust to the expected value of the takeover bid immediately after the 13d announcement, the acquirer's profits are made almost entirely on the difference between the price paid for the shares purchased prior to the filing of the 13d and their value after the acquisition.").

118. *Id.*, at 314 ("Takeovers benefit target shareholders – premiums in hostile offers historically exceed 30%, on average, and in recent times have averaged about 50%.").

119. Interim Securities Regulations, *supra* note 1, art. 51.

120. Lucien Arye Bebchuk, *The Pressure to Tender: An Analysis and Proposed Remedy*, in KNIGHTS, RAIDERS, AND TARGETS, THE IMPACT OF THE HOSTILE TAKEOVER 371, 374 (John C. Coffee, Jr. et al. eds., 1988). See also *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462 (1977) (An issue was a Rule 10b-5 claim involving a takeout merger pursuant to the "short-form merger" statute of §253 of Delaware General Corporation Law. The minority shareholders could have sought appraisal in Delaware court. Instead, they brought a claim to set aside the merger for a violation of Rule 10b-5 because the freeze-out price was inadequate. The Supreme Court held that since there was no deception nor manipulation, there was no violation of either §10(b) of the Exchange Act or Rule 10b-5.).

request a state court to appraise the value of their stock; but the shareholders do not have a remedy for fraud under Rule 10b-5.<sup>121</sup>

Also, the Williams Act does not give remaining target shareholders an opportunity to avoid becoming minority shareholders. The acquirer does not have to make another tender offer to gain majority control if it does not attract a sufficient number of shareholders in its initial tender offer. The remaining shareholders are protected only in the sense that the acquirer faces a penalty for short-swinging trading profits if it sells its stake within six months.<sup>122</sup>

Despite these two major differences, both act to prevent coercive behavior by the tender offeror. The target shareholders are informed of the terms of the tender offer and any material changes to it<sup>123</sup> and do not need to tender their shares immediately.<sup>124</sup> The target shareholders can withdraw their acceptance and can participate on a pro rata basis.<sup>125</sup> Finally, the tender offeror cannot buy target shares while the tender offer is outstanding.<sup>126</sup>

### C. Implications for Corporate Governance

The implications for corporate governance are that while the Chinese system provides greater protection from hostile takeovers for the target shareholders, it insulates the management of a publicly-listed company from external threats to their continued employment should the market

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121. *Santa Fe Indus., Inc.*, 430 U.S. 462.

122. 15 U.S.C. §78p (1996) (Section 16 of the Securities Exchange Act of 1934).

123. Cf. Interim Securities Regulations, *supra* note 1, art. 52 with 15 U.S.C. §78n(d) and (e) (1996) (Under Section 14(d) of the Exchange Act, no person can make a tender offer which would result in his owning more than 5% of a class of registered securities by Section 12 of the Exchange Act unless he has filed with the SEC and furnishes to each offeree a statement as specified under Section 13(d).). Also, the courts have applied a variety of tests to determine what a tender offer is. See e.g., *Wellman v Dickinson*, 475 F.Supp 783, 823-824 (S.D.N.Y. 1979) (adopting an eight element test suggested by the SEC. To meet the requirements of Section 14(d), when one makes a tender offer, one must file a Schedule 14D-1 statement with the SEC, send it to the issuer and send or give the schedule to the security holder. The Schedule 14D-1 must include the same information as Schedule 13D along with information about the tender offer, past negotiations between the bidder and the target, the bidder's financial statements, any regulatory information, and any other material information.).

124. Cf., Interim Securities Regulations, *supra* note 1, art. 49 with 17 CFR 240.14e-1 (1996) (By Rule 14e-1(a), the tender offer must be open for not less than twenty business days.).

125. Cf., Interim Securities Regulations, *supra* note 1, arts. 51 with 52 and 15 U.S.C. §78n(d)(5), (6) and (7) (1996).

126. Cf., Interim Securities Regulations, *supra* note 1, art. 48 with 15 U.S.C. §78n(e) (1996).

disagree with their performance, insofar as the share price reflects shareholder satisfaction with management's performance. Dissatisfied shareholders sell their shares and the price falls accordingly. With this lack of shareholder accountability, will management have an incentive to manage effectively, thus creating shareholder value?

From an acquirer's point of view, it may discover a target company trading at less than its true value because of shareholder dissatisfaction and decide to capture the arbitrage gain.<sup>127</sup> However, under the Interim Securities Regulations, it cannot buy additional shares after crossing the five-percent ownership threshold until two days after making its public announcement.<sup>128</sup> It must also make continual public disclosure of every two-percent open-market purchase.<sup>129</sup> Also it cannot freeze out the minority at a price lower than the tender offer price.<sup>130</sup> Its only tactic is to make a tender offer before becoming a 30% shareholder.<sup>131</sup> All of these regulations reduce the arbitrage profit potential and transfer a premium to the target shareholders.

On the one hand, managers faced with the possibility of hostile takeovers have an incentive to manage more efficiently and therefore keep the share price high. They are directly accountable to their shareholders:

Tender offers are a method of monitoring the work management teams. Prospective bidders monitor the performance of managerial teams by comparing a corporation's potential value with its value (as reflected by share prices) under current management. When the difference between the market price of a firm's shares and the price those shares might have under different circumstances becomes too great, an outsider can profit by buying the firm and improving its management. The outsider reduces the free riding problem because it owns a majority of the shares. The source of the premium is the reduction in agency costs, which makes the firm's assets worth more in the hands of the acquirer than they are worth in the hands of the firm's managers.<sup>132</sup>

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127. Easterbrook & Fischel, *supra* note 25, at 1173.

128. Interim Securities Regulations, *supra* note 1, art. 47.

129. *Id.*

130. *Id.*, art. 51.

131. *Id.*, art. 48.

132. Easterbrook & Fischel, *supra* note 25, at 1173.

Alternatively, some argue that the threat of hostile takeovers forces managers to behave myopically with a view towards short-term profits only (although that assertion has not been resolved one way or the other).<sup>133</sup> Thus, the argument runs, some managers then do not invest corporate assets for the long-term future and industries may lose their competitive advantage.<sup>134</sup> Shareholders would not receive long-term value for their investment. Of course, others assert that management's concern with the performance of their company's stock does not lead to short-term

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133. See Jensen, *supra* note 24, at 319. ("It has been argued that growing institutional equity holdings and the fear of takeover cause managers to behave myopically and therefore sacrifice long-term benefits to increase short-term profits. . . . There is little formal evidence on the myopic-manager issue, but I believe this phenomenon does occur. Sometimes it occurs when managers hold little stock in their companies and are compensated in ways that motivate them to take actions to increase accounting earnings rather than the value of the firm. It also occurs when managers make mistakes because they do not understand the forces that determine stock values."). *But see* John C. Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 COLUM. L. REV. 1145 (1984). ("Some of these critics have advanced broad claims, arguing either (a) that hostile takeovers produce only 'paper profits' and a preoccupation with short-run profit maximization, which undesirably divert management's attention from the pursuit of greater operational efficiency, or (b) that the stock market is so inefficient as to make it unlikely that tender offers will focus selectively on companies with inferior managements. These assertions suffer serious flaws: the first claim is essentially an impressionistic critique that relies chiefly on anecdotal evidence and never explains adequately why shareholders should not be able to determine the optimal time frame within which the profits are to be maximized in the business they own.").

134. See Jensen, *supra* note 26, at 837 ("Indeed, Marty Lipton, prominent defender of American CEOs, expresses a common view of the 1980s when he states that 'the takeover activity in the United States has imposed short-term profit maximization strategies on American Business at the expense of research, development and capital investment. This is minimizing our ability to compete in world markets and still maintain a growing standard of living at home.'"). *But see* Jeffrey N. Gordon, *Corporations, Markets, and Courts*, 91 COLUM. L. REV. 1931 (1991) (Professor Gordon discusses the Delaware Supreme Court's decision in *Paramount Communications, Inc. v. Time, Inc.*, 521 A.2d 1140 (Del. 1989) in which Time's management was allowed by the Court to block Paramount's cash bid for Time in favor of a combination with Warner Communications. "The final economic argument is that the Delaware Supreme Court acted to rein in hostile takeovers on the view that they disserve the general economic welfare in any of several ways: they result in lost productivity from business disruption; they put pressure on managers to plan for the short-term, which means reduced research and development and other poor decision-making; they create dangerously leveraged capital structures; and they divert talent from 'real' economic activity to financial reshuffling. These claims are all controversial, which at least partially explains why the United States Congress has failed to pass takeover legislation despite many hearings and legislative proposals in recent years. No conclusive empirical evidence resolves any of these claims, although most academics believe that the available evidence tilts decidedly in favor of takeovers.").

planning because if shareholders demand valuable long-term strategies, the share price will reflect their desired strategies.<sup>135</sup>

Without the threat of hostile takeovers, the managers of Chinese companies can make major capital investments without the fear that, once their companies' share prices drop, they will become vulnerable to hostile takeovers. As a result, they can well position their companies for future growth. Accordingly, managers can maintain their focus on creating value for their shareholders, not on manufacturing short-term profits to support immediate investor expectations.

Nevertheless, a common view is that managers have trouble abandoning their strategies and thus, the only way to redirect a company is through a hostile takeover.<sup>136</sup> "While the corporate control activity of the 1980s has been widely criticized as counterproductive to American industry, few have recognized that many of these transactions were necessary to accomplish exit over the objections of current managers and other constituencies of the firm such as employees and communities."<sup>137</sup> One may guess that some Chinese companies may not be as well run as they could be because those managers do not feel threatened and may not alter their unsuccessful strategies.

Therefore, the issue is how to align the interests of management with those of their shareholders. The threat of hostile takeovers could provide a final check on management's ability to act without regard to shareholder preferences and it would also give management an incentive to perform and prevent a hostile takeover. However, without this threat, management may plan more efficiently for sustainable shareholder value, as they would not have to be responsive to immediate shareholder demands.

#### IV. CONCLUSION

In comparing the Interim Securities Regulations and the Williams Act, I conclude that Chinese target shareholders are afforded greater

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136. Easterbrook & Fischel, *supra* note 25, at 1183 ("The threat of takeovers does not prevent managers from engaging in long-range planning. If the market perceives that management has developed a successful long-term strategy, this will be reflected in higher prices that discourage takeovers.").

137. Jensen, *supra* note 24, at 318 ("Managers often have trouble abandoning strategies they have spent years devising and implementing, even when those strategies no longer contribute to the organization's survival. . . . It is easier for new top level managers with no ties with current employees or communities to make such changes.").

137. Jensen, *supra* note 26, at 851.

protection since the Interim Securities Regulations transfer the turnaround premium from acquirers to target shareholders. In this way, for better or worse, Chinese public companies are protected from those who might wish to utilize their assets differently.

While the Interim Securities Regulations prevent takeovers, one could argue that it increases social welfare in preserving the status quo and achieves the goal of developing a socialist market economy.<sup>138</sup> The workers of acquired companies are not laid off and there is no large disruption in society. This state of affairs would be consistent with the dated idea of the "iron rice bowl" of guaranteed employment in state-owned enterprises ("SOEs").

However, some would argue that takeovers have social benefits that could outweigh the disruption to social welfare.<sup>139</sup> As the Chinese government urges SOEs to raise private capital, the Chinese economy is changing. Recognizing this, perhaps, one should consider the effect of stimulating further takeover activity.<sup>140</sup> The threat of hostile takeovers would give management an incentive to perform effectively and provides a means for dissatisfied shareholders to regain corporate control.<sup>141</sup>

Since these three 1993 takeover attempts, there does not appear to be any additionally reported takeover activity in China. One possible explanation is that the regulatory environment under Interim Securities Regulations has removed all profit potential from takeovers. Another is that the publicly-traded companies are efficiently priced and there simply are no arbitrage opportunities. If one rejects the latter explanation, then to stimulate market activity, one could amend the Interim Securities Regulations to allow acquirers to continue to purchase shares once they become five-percent shareholders and before they make their filing. One could even go a step further and extend the period before a shareholder must make a filing to ten days. In that way, the Interim Securities Regulations would become consistent with the Williams Act.

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138. Interim Securities Regulations, *supra* note 1, art. 1.

139. Jensen, *supra* note 26, at 847 ("In industry after industry with excess capacity, managers fail to recognize that they themselves must downsize; instead they leave exit to others while they continue to invest. When all managers behave in this way, exit is delayed at substantial cost of real resources to society.").

140. *Condemned to Live China's Great Contradiction*, *ECONOMIST*, Dec. 14, 1996, at 61.

141. Easterbrook & Fischel, *supra* note 25, at 1173 and Jensen, *supra* note 26, at 850-851.

