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- Based on the Vanke Case

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Zhu Ciyun* Lanny Li Wen**

I. The governance level of listed companies in China leaves something to be desired

It is well known that the corporate governance status of listed companies is a concentrated embodiment of the corporate governance in a country, especially the hostile takeovers of listed companies that cast doubts on the rules of corporate governance in a country. This is because that regarding the competition for control of listed companies, acquirer and anti-acquisition party pull out all the stops to win or defend the company's control, which will always challenge corporate governance and lay bare the myriad corporate governance issues.

What is the level of corporate governance in China's listed companies? Let's take a look at the Corporate Governance Observation Report 2016 released by the Asian Corporate Governance Association (ACGA) in November 2016. Mainland China only scored 43 points in this assessment, ranking ninth, and in the same league as the Philippines (38th) and Indonesia (36th) at the bottom. The reasons for the decline in the governance of Chinese companies are discussed.¹

Score of corporate governance in 11 Asian countries and regions in 2010-2016

	2010	2012	2014	2016	Change from 2014 to 2016
Australia	-	-	-	78	-
1. Singapore	67	69	64	67	(+3)
2. Hong Kong, China	65	66	65	65	-
3. Japan.	57	55	60	63	(+3)
4. Taiwan, China	55	53	56	60	(+4)
5. Thailand	55	58	58	58	-
6. Malaysia	52	55	58	56	(-2)
7. India	49	51	54	55	(+1)

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¹http://www.xcf.cn/tt2/201705/t20170505_780676.htm Last time accessed on April 12, 2018.

8. South Korea	45	49	49	52	(+3)
9. Mainland China	49	45	45	43	(-2)
10. The Philippines	37	41	40	38	(-2)
11. Indonesia	40	37	39	36	(-3)

Source: Asian Corporate Governance Association's *Corporate Governance Observation Report 2016*

The focus of this article on corporate governance issues in China is based on the fight for control of listed companies. It was found that the hostile takeovers of listed companies reflect better the immaturity of the Chinese capital market and the imperfection of the regulatory system. On the surface, each case of acquisition and anti-takeover is a fight for control of the target company, but each fight is testing China's corporate governance rules. As we know, the current Company Law of China was amended in 2005. It has been over 18 years now. There are still a lot of deficiencies in the content of corporate governance. If we add the social practices of Chinese companies, it is self-evident that the company law is outdated. Let's take a look at the Guiding Principles on Governing Listed Companies that was tailor-made by China Securities Regulatory Commission for listed companies and promulgated in 2002. A major revision was made in 2006 but it does not keep abreast of the times thereafter. Therefore, it can be said that the level of corporate governance in China is reduced and there are some basic defects. This makes sense.

In the fierce battle between Baoneng, a company that focuses on high-end manufacturing, integrated finance, and cultural tourism and Vanke, a leading real estate development group, the media asked how CSRC regard the recent proposal by Vanke's shareholders to dismiss the company's board members. The spokesperson of the CSRC said that the CSRC has been paying attention to the relevant event and that the interests and aspirations of related parties should be properly addressed within the framework of corporate governance in accordance with the law. ²This actually reveals that, even under China's existing company law, securities law, and corporate governance rules, listed companies are beset with difficulties in specifically implementing the corporate governance rules. This article prepares to examine the governance rules of listed companies in the fight for the control of listed companies from hostile takeovers in the capital market in recent years.

II. Hostile takeovers test listed company's shareholders and rules on the exercise of shareholders' rights

²<https://3g.163.com/news/article/BQTLA57400252603.html>

(I) Problems of “three types of shareholders” of listed companies (assets management plan, trust plan, and contractual funds)

Statement of the case: In July 2015, there was a stock market crash in China and Vanke A shares continued to plummet. Baoneng Group, led by Mr. Yao Zhenhua, found the opportunities and hoped to become a shareholder of Vanke through the acquisition in the secondary market and eventually become a controlling shareholder of Vanke. On July 11, 2015, Baoneng purchased 5% of Vanke's shares through QianHai Life Insurance, Baoneng's affiliated company, marking the first purchase of Vanke shares. On July 25, Baoneng continued to increase its holding of Vanke shares to 10% through another affiliated company, Jushenghua. On August 27, Baoneng increased its holding of Vanke shares up to 14.23%, with a shareholding ratio close to the then Vanke's largest shareholder China Resources Group, a company that focuses on large-scale consumption, electricity, and finance.(14.89%). At this point, Vanke's largest shareholder and management (represented by Wang Shi) remained silent.

At the close of September 30, 2015, China Resources, Vanke's largest shareholder, increased shares a little, holding 15.23% of the shares. However, Baoneng made crazy purchase with limit prices on the secondary market through a number of asset management plans under its control. At the close of December 7, 2015, Baoneng increased its holding of Vanke shares to 20%, surpassing China Resources to become Vanke's largest shareholder. At this time, Vanke's management was alerted and said through the announcement of listed company that “barbarians are knocking at the door.” On December 17, 2015, Wang Shi made a speech, stating that Baoneng has “inadequate credit”. This represented that Vanke's management publicly indicated its attitude of not welcoming Baoneng. At this point, Baoneng held a total of 24.26%.

Obviously, Yao Zhenhua did not attack the listed company like many hostile takeovers on the capital market, but disclosed them in an upright manner. However, the acquisition funds used by Yao Zhenhua do have some problems, such as excessive leverage. One of the prominent issues is that of the 25.4% of Vanke's shares held by Baoneng, Jushenghua (under Baoneng) as the manager of nine asset management plans held a total of 10.34% of Vanke shares. This involves two major issues: First, how does the asset management plan exercise voting rights over the shares held? Or does the manager, principal or inferior client hold the voting rights? Second, how does the asset management plan exit Vanke?

1. “Three types of shareholders” such as asset management plans are not covered by the company law and securities law legislation

According to the relevant documents of the China securities registration agency, asset management plans, trust plans, and contractual funds are

collectively referred to as “three types of shareholders,” which are contractual finance management products or plans created by different financial institutions such as banks, securities, insurance, and trusts. These contracts can be registered as shareholders of listed companies, and are obviously different from traditional shareholders, legal persons, natural persons, or non-legal organizations (such as partnerships) stipulated in the Chinese company law and securities law.

We have conducted incomplete statistics on 513 listed companies of Shenzhen A-share stock market main board at the end of December 2017. Among the top ten sole shareholders of companies, 92 are registered as asset management plans; 88 are registered as insurance product plans (including universal insurance); 94 registered as trust plans; and 151 registered as contractual funds (including private placements and public placements). If we ignore the top ten sole shareholders of listed companies with more than two types of contractual products or plans, 283 out of the 513 listed companies on the Shenzhen A-Share board have the aforesaid “three types of shareholders” in the top ten sole shareholders, accounting for 55.2%. Of the 92 listed companies with such shareholders that have aforesaid asset management plans, there are 12 listed companies with a single shareholding of 5%. If we do not consider the top ten shareholders and singleness, there are even more “three types of shareholders” in the register of shareholders of listed companies in Shenzhen. They can achieve the status of the top ten shareholders or controlling shareholders through the persons acting in concert. For example, in the case of 25.4% of Vanke shares held by Baoneng Group, Jushenghua as the manager of nine asset management plans held a total of 10.34% of shares. The above empirical data shows that the shareholdings as contractual products in listed companies are not only common but also have a large proportion (including the rules of persons acting in concert). However, the company law and securities law in China have no stipulations on how the “three types of shareholders” exercise the rights of shareholders. The severity of how to define their legal status is evident.

2. How do “three types of shareholders” exercise their shareholder rights?

For starters, qualification of the “three types of shareholders” as shareholders is always being questioned. Generally speaking, shareholders must meet two conditions: First, make capital contribution to or subscribe for shares in the company; second, the names of shareholders are recorded in the company’s articles of association or on the register of shareholders.³ Traditional company law does not discuss or mention whether the “three types of shareholders” serve as qualified shareholders. But in practice, this issue has been acquiesced for shareholder registration. However, there is no denying that how to regulate the “three types of shareholders” as shareholders of listed

³Shi Tiantao: “On Company Law”, Law Press 2

companies, make disclosure of information and exercise the shareholder rights are not recognized by CSRC. Although the CSRC have raised certain requirements on such shareholders through such files as No. 54 W (2013) and the “Q&A of institution business of the National Equities Exchange and Quotations” (2017). However, for the sake of further discussion, how are the shareholders of listed companies that are essentially asset management plan for financial commodities registered on the register of shareholders and how relevant shareholder rights should be exercised? Will shareholders’ self-benefit rights, such as claims for allocation of dividends, rights for allocation of surplus assets, and rights to new shares benefit the ultimate investor? Can the ultimate investors exercise the common benefit right of shareholders, such as voting rights, the right to request the convening of shareholders’ meeting, the request for nullifying the shareholder meeting’s resolution, and the right to request access to the company’s books? From the point of view of corporate governance, how to determine the actual controller of the asset management plan has a sweeping impact on corporate governance. According to statistics, at the end of 2016, the scale of all kinds of asset management industries reached 113 trillion yuan,⁴ and a large part of the capital was invested in the secondary market for becoming shareholders of listed companies. To safeguard the rights of investors and maintain the stability of the financial market, the legitimate foundation of rights of “three types of shareholders” should be established as soon as possible based on the Company Law, Securities Law, Securities Investment Fund Law or other related basic laws.

3. The mismatch of the time limit of “three types of shareholders” and the long-term nature of equity investment and the exit issues

In general, asset management plans, trust plans and other contracts usually have a certain deadline, while the investment in listed companies’ stocks is generally a long-term investment. Therefore, whether the term mismatch of “three types of shareholders” will affect the stability of the company’s operating rights? This brings two problems: First, whether limit subscribers to the “three types of shareholders” to financial investors; second, when the contract such as asset management plans expires, what shall be done to eliminate its impact on stocks of listed companies? And this also involves how to protect the rights and interests of investors of these wealth management products, and how to determine the fiduciary obligations of the managers of “three types of shareholders”? How should the scope and standards of fiduciary obligations be defined?

As mentioned above, of the nine asset management plans invested by Baoneng in Vanke’s stock, only 7 expired at the end of 2017. As Vanke Independent

⁴2017 China Asset Management Industry Development Report, Zheng Zhi, Social Sciences Academic Press, Page 4.

Director Ms. Liu Shuwei made statement to China Securities Regulatory Commission in an open manner at the end of January 2018 to request that Baoneng withdraw these potentially illegal asset management plans, Vanke shares fell accordingly. It means that if the “three types of shareholders” hold huge capital share, the way and timing for this kind of withdrawal due to misallocation of funds need to be supervised. It is also necessary to make clear that the “three types of shareholders” should have certain limitations when investing in listed companies, such as limitations to financial investments or investing merely in one listed company.

(II) How to exercise the defective capital contribution obtained from illegal purchase of shares and make disposal

Statement of the case: Although Baoneng fulfilled in earnest its obligation of information disclosure in accordance with the Securities Law and relevant regulations in the case of Baoneng acquiring Vanke, there are quite a few illegal purchases of shares in the hostile takeovers from 2013 to 2017. The most typical case is Shanghai Kainan Investment Holdings Group Limited's (Hereinafter called Kainan), a company based on industrial investment, equity investment and financial capital operation acquisition of Shanghai Xinmei Real Estate Co., Ltd (Hereinafter called Xinmei), a company that focuses on real estate development and management. In this case, the acquirer “Kainan Account Group” has a total of 15 accounts (7 institutional accounts, 8 natural person accounts) which are actually controlled by the natural person Wang Binzhong. From July 2013, the company continued to acquire Shanghai Xinmei. By November 28, Kainan actually held 14.86% of shares of Shanghai Xinmei, and by January 27, 2015, the proportion of shares had reached 16.53%. At this time, Kainan made an announcement that the above 15 accounts were the persons acting in concert and made it clear that it intended to continue holding the shares of Shanghai Xinmei in the next 12 months. Since Kainan did not make announcement when the shares reached 5% or 10%, the former controlling shareholder Dongfang Xingsheng Industry did not strike back until Kainan actually became the largest shareholder of Shanghai Xinmei.

On February 1, 2015, Xingsheng Industry, a company that focuses on industrial investment, real estate development, and ecological agriculture. as the plaintiff, took a total of 16 subjects including Wang Binzhong and Kainan Account Group as defendants and Shanghai Xinmei as a third person to court at Shanghai No. 1 Intermediate People's Court, requesting the court to invalidate the purchase of third-party shares by the defendants since October 23, 2013, and requesting the court to order the defendants to pay the third party the compensation of 175 million yuan which is the earnings made by the defendants from selling the shares issued by the third party. The shares were purchased and held since October 23, 2013 and thereafter. On June 17, 2015,

Shanghai Xinmei issued an announcement that it would “ban Kainan’s participation in the 2014 Annual General Meeting of Shareholders”. Without the participation of 16.53% of the voting power held by Kainan, eight proposals were passed by the board of directors at this general meeting of shareholders. Since then, Kainan announced that it would convene a shareholders’ general meeting on its own initiative and pass a resolution to remove or replace 4 directors at the meeting. Since then, the Shanghai Intermediate People’s Court issued a verdict that Kainan had not fulfilled its statutory obligations of information disclosure, and the CSRC also imposed administrative penalties (including fines) on its conduct. However, there is no legal basis in the company law or securities law for invalidating the shares held through illegal purchase or prohibiting the exercise of such shares. ⁵

It can be seen from this that the acquirer through hostile takeover acquires the listed company in a manner that violates regulations, and the cost for violating the laws is very low. At this time, the company law and the securities law do not protect the law-abiding acquiree or the target company.

(III) How to determine the persons acting in concert: subjective criteria and objective judgment

In the several hostile takeovers through illegal purchase of shares, most of them make use of the “persons acting in concert” rules. In the Vanke case, the acquirer Baoneng had no act of illegal purchase of shares, but there are two asset management plans closely related to the management among the top ten shareholders of Vanke. These two asset management plans have never made information disclosure. According to the previous inquiries by the Shenzhen Stock Exchange, Vanke’s two asset management plans, “Jinpeng Plan” and “Deying Plan”, held a combined 7.79% of Vanke’s shares. According to media reports, the leverage ratios of the two asset management plans have reached 3.5 times. Recent financial reports by Caixin show that the real leverage is 2.5 times and 2 times, which is equal to or higher than the leverage ratio of the nine asset management plans of Baoneng. Faced with questions from the outside world and the Shenzhen Stock Exchange about whether the two asset management plans were persons acting in concert, Yu Liang, the incumbent chairman of Vanke’s board of directors, replied that these two asset management plans are independent within Vanke and we never ask about these. Zhu Xu, secretary of the board of directors of Vanke, said that Jinpeng and Deying are operating independently and have no connection with Vanke. So they thought the two plans are not persons acting in concert. According to the information disclosed, the actual principal and investor of Deying Asset Management plan is Shenzhen Vanke Enterprise Share Asset Management Center; the principal and beneficiary of Jinpeng Asset Management Plan is

⁵See (2015) HYZNL (S) CZ No. 66 Civil Judgment.

Ying'an Finance, which is collectively held by the partners of Vanke. The operator of these two plans is Zhu Jiusheng, the new President of Vanke.

Obviously, these excuses of the Vanke management are too far-fetched, subjective, and even anemic. It can be said that they have lied through the teeth. The asset management plan within the same company is not the person acting in concert because of the unconcern of the president? It has avoided the information disclosure for illegal purchase of shares, and kept a lot of information of the asset management plan in the dark. How can they say that it has not benefited from this? Moreover, Vanke Asset Management plans bought Vanke shares earlier than Baoneng. At the current market price, it has higher floating profit, and the rate of return has reached a staggering 13 times! Where is their rationality?

Actually, Article 83 of the Measures for the Administration of the Acquisition of Listed Companies (revised in 2014) promulgated by the China Securities Regulatory Commission stipulates the definition of persons acting in concert. It means the act or fact of investors, together with other investors, expanding the number of voting rights in a listed company through agreement or other arrangement. It also enumerates 12 situations.⁶ The China Securities Regulatory Commission has always stressed that the determination of actual controllers and persons acting in concert of listed companies should be based on the Substance over Form Principle. However, in practice, the concrete scenes of peoples acting in concert that are clearly stated can be easily avoided. That is to say, the list of persons acting in concert cannot be exhausted. Therefore, regarding the suspicious persons acting in concert, the regulators need to make serious judgments in order to treat all shareholders fairly.

III. Hostile takeovers test the rules of the Board of Directors and the fiduciary obligations of the directors

(I) Independent directors make a recusal request at the board of directors: Is the procedure correct?

⁶(1) There is an equity control relationship between investors; (2) Investors are controlled by the same entity; (3) directors, supervisors or main members of senior management of the investors concurrently serve as directors and supervisors or senior management personnel of another investor; (4) Investors participating in another investor may have a significant influence on the major decisions of the participating companies; (5) legal persons other than banks, other organizations and natural persons provide financing arrangements for the investors to obtain relevant shares; (6) There are partnerships, cooperation, joint ventures and other economic interests among investors; (7) Natural persons holding more than 30% of the shares of investors hold the shares of the same listed company with the investors; (8) directors, supervisors and senior management personnel of the investor hold the shares of the same listed company with investors; (9) Natural persons holding more than 30% of the shares of investors and the directors, supervisors and senior managers of the investors, as well as their parents, spouses, children and their spouses, spouse's parents, brothers and sisters and their spouses, their spouse's brothers and sisters and their spouses, and other relatives hold the shares of the same listed company with the investor; (10) directors, supervisors, and senior management personnel of the listed companies and their relatives under the preceding paragraph hold the shares of the said company at the same time, or hold the shares of the said company in concert with the enterprise controlled directly or indirectly by themselves or their relatives under the preceding paragraph; (11) Directors, supervisors, senior management personnel and employees of listed companies hold the shares of the said company together with the legal person or other organization controlled or entrusted by themselves; (12) There are other relationships between investors.

Case replay: from July 2015 when Baoneng began to acquire Vanke to December 7, 2015 when Baoneng held 20% of Vanke's shares to surpass the then largest shareholder China Resources (15.23%), the management of Vanke addressed the problem in a hurry. On the one hand it openly expressed the attitude of unwelcome; on the other hand, on December 18, 2015 it announced that the company was planning a major asset restructuring, and applied for a temporary suspension of trading. On June 18, 2016, Vanke disclosed its announcement on the resolution of the eleventh session of the 17th Board of Directors: It said that the board of directors passed the asset reorganization plan for the issuance of shares and the proposal to continue the suspension of trading. The asset reorganization plan stated that the listed company plans to purchase 100% shares of Qianhai International held by the Metro Group in the form of share issuance, and the transaction price is 45.613 billion yuan. It is estimated that after the completion of this transaction, the shareholding structure of Vanke is as follows: Shenzhen Metro Group Co., Ltd. will hold 2,872,355,163 A shares of the listed company, accounting for 20.65% of the total share capital (the largest shareholder); the total share capital held by Baoneng fell to 19.27%; the former largest shareholder China Resources only accounted for 12.10%. Obviously, neither the former largest shareholder China Resources Group nor the acquirer Baoneng Group agrees to such a scheme. But what has aroused fierce controversy is the recognition of whether the board resolution passes the resolution.

According to the announcement by Vanke's board of directors, 11 directors shall be present at the meeting of board of directors and the meeting was attended by 11 directors in person or by proxy. Independent director Zhang Liping applied for vote avoidance on this proposal of the assets reorganization of Shenzhen Metro; voting results: of the 10 directors, 7 voted in favor, 3 against (all directors nominated by China Resources), and 0 abstention. More than 2/3 voted in favor, and the proposal was passed (10:7). The director for recusal was not counted in the basic votes. However, China Resources believed that among the 11 members of the board of directors, Zhang Liping did not have a reason for recusal, and his position should be considered as abstention. The result of this vote was: 7 votes in favor, 3 votes against, and 1 abstention. It did not reach 2/3 majority, and the proposal was not passed (11:7). This case immediately sparked debate in the academic and practical circles. The bone of contention is Zhang Liping's reason for recusal. The director considered that he assumed the position of chairperson of the Greater China Region of the US Blackstone Group since June 2016; in June 2016, Vanke and Blackstone Group were negotiating a commercial real estate project. Since it has an interest relationship with Vanke, he should apply for recusal. Actually, pursuant to the laws, regulations, and administrative regulations such as the company law, securities law, and rules of corporate

governance of listed companies, the rules of procedure of the board of directors, and the guiding opinions of independent directors, there are areas of controversy surrounding independent director Zhang Liping's application for recusal in this case:

First, Zhang Liping worked for the Blackstone Group. Due to the transaction between Vanke and Blackstone Group, Zhang Liping needs to apply for recusal due to associated relationship. However, the matters discussed by the board of directors concern the introduction of Shenzhen Metro through asset restructuring. There is no fact proving that Zhang Liping has any relationship with Shenzhen Metro. Therefore, when the director applies for recusal in the Shenzhen Metro restructuring proposal on the grounds that he serves at Blackstone Group, is this reason tenable?

Second, when the directors apply for recusal, can they raise this at the meeting of board of directors? According to the articles of association of China Vanke, the regular meeting board of directors shall be notified to all directors 10 days in advance, including the agenda the meeting; the temporary meeting board of directors also needs to be notified 3 days in advance. Zhang Liping has already known about the meeting agenda upon receiving the notice of board meeting, but he did not report the recusal to the board of directors in a timely manner. Is it inappropriate to raise it at the meeting?

Third, in fact, Blackstone Group and Vanke established a joint venture Vanke Logistics Real Estate Company one month before Zhang Liping became the Chairman of the Greater China Region of Blackstone Group. For Vanke, Zhang Liping lost the independence as Vanke's independent director one month later.⁷ However, Zhang Liping did not resign as per the relevant rules of the Shenzhen Stock Exchange. Vanke itself has not relieved the director of the position.⁸ Is it a violation of regulations?

Fourth, the resolution of Vanke's board of directors also stated that whether there are procedures in the determination of the director's conflict of interest or related relationships? Can this be raised by the director himself/herself? There is no express provision.

⁷According to Article 3(1) of the "Guiding Opinions on Establishing an Independent Director System in Listed Companies" by the China Securities Regulatory Commission, independent directors may not serve in listed companies or their affiliated companies; Article 7 of the "Measures for the Filing of Independent Directors" of Shenzhen Stock Exchange stipulates the same.

⁸Article 13 of the "Measures for the Filing of Independent Directors" of the Shenzhen Stock Exchange (amended in 2017) stipulates that an independent director who does not meet any of the qualifications for an independent director as set forth in Articles 4 to 11 of these Measures after employment shall resign as an independent director within one month upon the occurrence of the situation. If the director does not resign as required, the board of directors of the listed company shall convene a board meeting immediately after the expiration of the one-month period to review and request that the general meeting of shareholders remove the independent director and complete the rules for new election of independent director within two months.

According to Article 4 of the "Guidelines on Performance of Duties by Independent Directors of Listed Companies" (2014) by the China Association of Public Companies, when a situation that affects the independence of an identity occurs, the independent director should notify the company in a timely manner and eliminate the impact. Director who fails to meet the conditions of independence shall resign.

(II) The postponement of the general election of the board of directors: whether is the term of office of the board of directors mandatory or arbitrary?

Case review: In accordance with the term of the board of directors, Vanke should hold the general election of the board of directors on March 27, 2018. However, on March 10, 2017, Vanke announced that the upcoming meeting of the board of directors will cover “review of the company’s 2016 annual report, financial statements and other related matters”, and there is no proposal for a change of board of directors. Obviously, this session of the board of directors “serves beyond its designated life.” In fact, this session of the Board of Directors is three months after its term of service.

Article 45 of the Company Law of China stipulates that the term of office of directors shall be stipulated in the company’s articles of association, but the duration of each term must not exceed three years. Obviously, this provision emphasizes that the duration of each term of the directors can be selected by a company within three years through the company’s articles of association. The three years are the upper limit. However, in the Vanke and Baoneng case in the limelight, the current board of directors expired on March 27, but the announcement made on March 10 shows that the board of directors remained silent. It did not launch the general election, nor explain why the election was delayed. Vanke’s board of directors did not heed the illegal act. Of course, there are an astonishing number of boards of directors in China’s listed companies that do not hold the general election in a timely manner. This becomes a common trend. ⁹There are more than 44 companies that have delayed the general election by more than one year. ¹⁰Some companies disclose the delay in general election on time, but the disclose procedures and reasons for disclosure are arbitrarily stated. The statutory arrangements concerning the term of office of directors in the company law essentially reflect the rights of shareholders to elect and serve as directors. But if a listed company delays the general election indefinitely or without justification, the meaning of this rule and the rights of the shareholders to elect and serve as directors are all eliminated.

In view of the extensive number of boards of directors serving overtime, the CSRC and stock exchanges seldom monitor and make punishment, ¹¹ and the

⁹According to incomplete statistics, the number of postponements of the general election of the board of directors of listed companies in China announced is as follows: 57 in 2013, 70 in 2014, 96 in 2015, 163 in 2016, and 187 in 2017. The trend of year-on-year increase is the same as that of the hostile mergers and acquisitions in the Chinese capital market. There are six listed companies that have disclosed many times the postponement of the general election of the board of directors. (4 listed companies have disclosed two announcements, and the other two 5 and 6 times respectively).

¹⁰In the case of the postponement of the general election of Minsheng Bank’s board of directors, its sixth board of directors expired on April 9, 2015, but it was not until February 20, 2017 that the company completed its change of the board of directors and formed the seventh board of directors.

¹¹In 2015, the Shanghai Stock Exchange issued the “Decision on placing China Minsheng Banking Co., Ltd. and the then Board of Directors Secretary Wan Qingyuan under Supervisory Concern.” The reason is that the term of office of independent directors violates the provisions. The main content is the confusion

court system is at a loss about this. ¹²Therefore, in the final analysis, there are drawbacks in the design of the entire Chinese legal system. We fail to realize that the deferral of general election of the board of directors is a major violation of shareholder rights, and there are no specific regulatory measures against the board of directors serving beyond its term.

(III) Can the board of directors adopt an interim proposal for general election? How to start the normal change of a company's board of directors

Case review: On May 14, 2017, Vanke issued an announcement stating that the company would hold the 2016 general meeting of shareholders on June 30, 2017, but there was no mention of change of the board of directors. However, on June 21, 2017, the board of directors of the company announced that the board of directors received the “Letter on Adding the Interim Proposal for Vanke 2016 General Meeting of Shareholders” issued by Shenzhen Metro Group on June 19, requesting the addition of three interim proposals of “Proposal on the General Election of Board of Directors and the Election of Non-independent Directors”, “Proposal on the General Election of Board of Directors and the Election of Independent Directors” and “Proposal on the General Election of Board of Supervisors and the Election of Supervisors who Are not the Employees’ Representatives” to the matters for deliberation at the 2016 general meeting of shareholders. The Board of Directors now agrees to submit the above three interim proposals to the 2016 annual general meeting’s resolution. At this time, it was less than 10 days to June 30 when the general meeting of shareholders would be held. None of the other shareholders had the opportunity to propose a resolution.

Obviously, Vanke’s board of directors has carefully choreographed the proposal for the general election of the board of directors. According to Article 97 of Vanke Company’s Articles of Association, the list of candidates for non-independent directors is proposed by the preceding board of directors of the or the shareholders who hold more than three per cent of the total number of shares with voting rights, individually or collectively, for 180 consecutive trading days. Regarding the nomination rights enjoyed by the shareholders, it is under the restriction that the shares held by them individually or collectively must not be less than 3%; second, the shareholding time of the shareholders must be more than 180 consecutive days. However, Shenzhen Metro, which proposes a change of the board of directors, has no right to

surrounding the change of independent directors of Minsheng Bank.

¹²Following the postponement of general election of Vanke’s board of directors, Vanke’s minority shareholders filed a lawsuit at Shenzhen Yantian District People’s Court, requesting the court to rule the postponement of Vanke’s board of directors illegal, and order Vanke to complete the general election within 45 working days. However, Yantian People’s Court held that shareholders could achieve the purpose of changing the board of directors by exercising the right to convene a shareholders’ general meeting. So, the court dismissed the case on the grounds that there is no clear legal basis for filing a lawsuit. See “Shenzhen Intermediate People’s Court officially accepts the case of minority shareholders v. Vanke for postponement in the change of Board of Directors”, Tencent Finance: <https://finance.qq.com/a/20170428/034994.htm>

nominate candidate for director because of its shorter shareholding period.¹³Therefore, the board of directors of Vanke needs to postpone the general election until Shenzhen Metro meets the time conditions for proposing candidates for board of directors during its general election. However, this results in the following problems:

First, can the general election of the board of directors be carried out through a temporary proposal? It is obviously not suitable. The general election of the board of directors involves the personnel arrangement of the company. All shareholders have the right to know and have the opportunity to nominate directors. In this case, Shenzhen Metro Group submitted a temporary proposal 10 days before the general meeting of shareholders. Two days later, the board of directors confirmed and announced that the resolution for the general election of the board of directors was included in the agenda of the general meeting of shareholders. This means that none of the other shareholders have the opportunity to propose a motion to the board of directors on the list of director candidates. This amounts to depriving the other shareholders of nomination opportunities.

Second, does the Board of Directors' acceptance of Shenzhen Metro Group proposal to carry out general election of the board of directors through the interim proposal violate the fiduciary duty of the shareholders? Does it violate the relevant rules of the company law regarding the selection system of the board of directors? As a major shareholder of Vanke Corporation, does Shenzhen Metro Group have the act of abusing the proposal rights? Does it constitute infringement against other shareholders? These questions merit discussion

(IV) Whether directors directly oppose hostile takeovers or obviously favor the management

Review of case: According to the relevant provisions of the Chinese company law and the securities law, the general meeting of the company has the right to make decisions on mergers and acquisitions. However, corporate mergers and acquisitions, especially hostile takeovers, are not welcomed by management. In fact, the board of directors and management often oppose this, consciously and unconsciously. In the case of Baoneng's acquisition of Vanke, Wang Shi repeatedly stated that Yao Zhenhua is an unwelcome savage. Vanke's former independent director Hua Sheng published a series of papers during the term of an independent director, questioning the acquirer Baoneng and the former largest shareholder China Resources and obviously favoring the management. The new independent director Liu Shuwei has never concealed the support for Vanke's management and the prejudice against Baoneng represented by Yao

¹³Shenzhen Metro obtained the corresponding shares from the former largest shareholder on January 13, 2017, but in March 2017, it had obtained authorization from Evergrande Group, another shareholder of Vanke. Evergrande Group irrevocably entrusted the voting rights of 14.07% shares of Vanke it held to Shenzhen Metro Group for one year.

Zhenhua. This position is even more blatant than her predecessor, Hua Sheng. On January 30, 2018, Ms. Liu Shuwei wrote an open letter to Liu Shiyu, the Chairman of the CSRC, stating that the seven asset management plans introduced by Baoneng through illegal purchase of shares of Vanke have already expired and should be liquidated and not renewed. On April 8, independent director Liu Shuwei again published the article “The Color Revolution of Baoneng”, accusing Baoneng of using huge insurance funds and bank funds to damage the real economy; there is a related transaction with the former largest shareholder. It is recommended that relevant authorities investigate Baoneng’s conduct, confiscate the listed company’s shares and profits made by it according to law, and hand it over to the National Social Security Fund. However, it turned a blind eye to the control issues of Vanke management and the same leverage in the asset management plan, and the illegal use of fund. Whether these are already contrary to the status of independent directors, or even against the laws and regulations? The independent directors publicly declared war on individual shareholders of the company. This once again raises the question of how the directors perform their duties.

When the public opinion questioned the error of “individual directors who are not independent” of Vanke, the regulators are conspicuously silent. This phenomenon reveals weaknesses in the practice of the company law in China on the one hand. The position and responsibilities of directors in the company are unclear. Directors are the company’s trustees and should be accountable to the company’s overall interests, and the interests of all shareholders of the company. They shall perform responsibilities independently rather than voice support for certain individual shareholders or management. On the other hand, it also deeply felt that the company law of China does not establish specific rules for the director’s fiduciary duties, including the lack of business judgment rules. This results in the ambiguous positioning of directors and widespread improper conduct, and even questions the hopelessness of the relevant regulatory measures against the directors’ breach of their fiduciary duties. There is no judicial practice precedent on the review of directors’ fiduciary duties.

IV. Appropriateness and compliance of anti-takeover measures

test the corporate legal system

With the booming China’s capital market in recent years, the number of hostile takeovers has surged in recent years, triggering a bewildering number of wars in acquisitions and anti-acquisitions. At the same time, many companies have begun

to introduce anti-merger measures in order to deal effectively with hostile takeovers. But are these anti-takeover measures legal and compliant?

(I) Is the suspension of trading arbitrary: Can the suspension of trading be used as a routine anti-takeover measure?

Of the anti-acquisition measures adopted by listed companies to fight hostile takeovers since 2011, including the introduction of white knights and the application for intervention of regulatory authorities, the target companies prefer to use suspension of trading tactics to put the acquirer in a dilemma, so that the acquirer loses the favorable opportunity to acquire.¹⁴

In the case of Vanke, the company also used the trading suspension tactics to the extreme; Vanke announced on December 18, 2015 that the company was planning a major increase of shares and restructuring, and applied for a temporary suspension of trading. On January 15, 2016, it announced again that the suspension was extended until March 18, 2016. On March 12, 2016, Vanke signed a memorandum of cooperation with Shenzhen Metro Group Co., Ltd. (hereinafter referred to as the "Metro Group") to disclose the initial intention of the parties regarding the proposed transaction. On March 17, 2016, the company held the 2016 First Extraordinary General Meeting of Shareholders to deliberate and pass the "Proposal on Application for Continued Suspension of Trading of VankeA Shares". Due to the planning of a major asset restructuring, the company will continue to suspend trading until no later than June 18, 2016. On June 18, Vanke once again disclosed the "Indicative Announcement Concerning the Temporary Non-Resumption of Shares of the Company", and the suspension of trading was extended.

In fact, the suspension of trading by listed companies in the capital market has been widely criticized by academicians, mainly due to issues such as unreasonably long suspension period,¹⁵ unreasonable reasons for suspension, and low market efficiency during trading suspension. Some scholars believe that long-term trading suspension for the purpose of anti-takeover lacks legitimacy and increases the trading risk of investors as well as losing the exchange functions of securities. Some even considered that the practice of long-term suspension of the company's stock trading to lower the company's stock price and attract the potential competitors of the acquirer is a typical poison pill plan

¹⁴In fact, it is not merely a listed company undergoing hostile mergers and acquisitions that implements the measures of suspension of share trading. This is also a common measure for the cases of mergers and acquisitions of other types. This measure is more common in a particular period. For example, in the "stock-related disasters" period in 2015, 1,313 listed companies applied for suspension of share trading during the peak period, and the market value of the suspended shares accounted for 72.4% of the total circulating market capitalization. The source of data is the WIND database.

¹⁵In the master's degree thesis, GuoBaoyun conducted statistics on 17,444 suspensions of share trading of listed companies from January 1, 2012 to October 1, 2016, and the suspension period of more than 20 hours accounts for 36.36% of the total.

or scorched earth tactics.¹⁶Therefore, the regulatory authorities also regulate the suspension of share trading for mergers and acquisitions by issuing a series of new regulations.¹⁷However, the effectiveness of these new regulations remains to be seen.

(II) The bottom line of the company's formulation of anti-takeover measures in the Articles of Association

As hostile takeovers of listed companies increase, listed companies have also set off a wave of amendments to the company's articles of association to prevent hostile mergers and acquisitions in advance, which seriously challenges China's current corporate legal system. We have conducted statistics on the announcement on amendments to the Articles of Association issued by 19 listed companies¹⁸ and made classification according to the frequency of the use of anti-takeover clauses. The results are as follows: staggered change of the board of directors (14 companies); special compensation plans (11 companies); clause of absolute majority resolution (9 companies); limitation on the qualifications of directors (8 companies); limitations on the shareholders' rights to put forward proposal (6 companies); increase the information disclosure obligations (4 companies); limitations on the right to convene general meeting of shareholders (3 companies). There is no denying that the company's articles of association have ample space for self-government. From the perspective of protecting investor rights and interests, listed companies amend the company's articles of association to enhance the ability of the acquiree to resist hostile takeovers, and better protect the rights of small and medium shareholders. However, the self-government of the company's articles of association is limited. If the goal of anti-takeover measures involved is to maintain the interests of the management or the original controlling party, or even violates laws and regulations, the effectiveness of these anti-takeover measures will be affected. This is much discussed among scholars. Some believe that its effectiveness shall be determined based on China's company law, and others demonstrate from the perspective of future development that some anti-takeover measures do not have a legal basis, but the law shall be amended in view of their reasonableness, etc. First, rules for the staggered change of the board of directors. In other words, Article 45 of the "Company Law" provides that the board of directors serves a term of three years, but a maximum of one-third of directors is replaced each

¹⁶Chen Peng: Analysis of the Legality of Some Anti-takeover Measures in the Fight for the Equities of Shanghai Xinmei, "Cross-Strait Legal Science" 2014(4): 74-81

¹⁷For example, "Guidelines for the Resumption and Suspension of Share Trading of Listed Companies Due to the Planning of Major Events", "Memorandum No. 9 on Main Board Market Information Disclosures - Resumption and Suspension of Share Trading of Listed Companies", "Memorandum No. 14 on SMEs Board Information Disclosure - Resumption and Suspension of Share Trading of Listed Companies", "Memorandum No. 14 on GEM Information Disclosure - Resumption and Suspension of Share Trading of Listed Companies"

¹⁸The 19 listed companies are Yahua Group, ST Xinyi, China Baoan, WorldUnion, Langfang Development, Yili, Shandong Jintai, Longping Hi-Tech, DFD, COSMOS, ST Jiangquan, Fangda Group, Huashen Group, HIGHSUN, Lanzhou Yellow River, Youhao Group, Longyu Fuel, Shang Ying Global.

year. In this way, even if the hostile acquirer successfully enters the target company, only one-third of the directors can be reelected this year, making it difficult for the acquirer to achieve full control. The listed companies such as China Baoan Group, Yuhua Group, Langfang Development Group, and WorldUnion have clearly stipulated in the Articles of Association the number of board members who will be reelected. The four companies of Black Cow Foods, GGEC, Zhongji Holding and LongpingHIGH-TECH have imposed stricter restrictions on the re-election of directors during their term of office in the company's articles of association. The maximum number of directors to be replaced during the term of office shall not exceed 1/3 of the total number of directors. However, this measure rarely works under the current company law in China, because the company law in 2005 abolished the stipulation that "directors shall not be relieved of their duties without cause during the term of office". Although Article 96 of the "Guidelines on the articles of association of listed companies" retains this clause, the guidelines do not have a mandatory force. Of course, we hold that the dismissal of incompetent directors is a basic right of the shareholders. If it is restricted by the rules on staggered election, it is in fact an obstacle to the rights of shareholders to select qualified managers. This issue merits consideration.

Second, the golden parachute or special compensation plan rules. Given that Articles 37 and 46 of the Company Law stipulate that the remuneration of directors and managers is determined by the shareholders' meeting and the board of directors respectively, special compensation for directors and senior executives should also be made according to different procedures, and shall not be unilaterally determined by the company's board of directors. The inclusion of special compensation provisions into Article 10 of the Articles of Association of China Baoan has attracted great attention. It stipulates that the directors and supervisors relieved of their positions obtain the compensation 10 times the annual salary and welfare benefits, and the company should also separately pay the liquidated damages under the Labor Law. Similar compensation clauses are also found in the articles of association of other A-share listed companies such as Vanke, DFD, Yili, Lanzhou Yellow River, Youhao Group and HIGHSUN. In China, although special compensation plans used as anti-acquisition measures face no legal obstacles, excessive compensation eventually results in the loss of all shareholders or other stakeholders of the company, causing unfair consequences. Therefore, the ceiling for special compensation should also be limited. In the United States, for example, the court generally considers that the amount of compensation paid to an outgoing supervisor is equivalent to 12 to 30 months of salary before resignation.¹⁹

Third, rules on super majority voting. For example, Fangda Group proposed a plan to amend the "Articles of Association" and "Rules of Procedure of the Board

¹⁹Chen Daisong, Han Jiang: "Controversial Golden Parachute Overseas", Board of Directors, No. 8, 2016, p. 24.

of Directors” and proposed that the resolution of board meeting on the issuance of additional shares and amendment to the company’s articles of association must be approved by over 3/4 directors. Likewise, the aforesaid two resolutions must be passed through voting by 3/4 shareholders attending the shareholders’ general meeting. Article 103 of the “Company Law” of China stipulates the content of the special resolution and the standards for its adoption. The company’s acquisition (anti-takeover clause is included, of course) is usually regarded as a special matter for resolution and a 2/3 majority voting is required. However, whether it is appropriate for the listed companies to set a higher voting standard is highly controversial in the academic community. Study of the legislation of various countries shows that the legislation usually only stipulates the minimum proportion of voting rights, leaving the right to set higher proportion to the company.²⁰ However, if the super-majority ratio is too high, it may also cause minority shareholders to abuse the veto power or lead to the corporate deadlock. Therefore, this measure should also be limited.

Moreover, there are rules that restrict the qualifications of directors, restrict the shareholders’ rights to put forward proposals, and restrict the right of the general meeting of shareholders to convene meetings, such as if a person serving as a director shall have worked for more than 10 years in the company; the shareholder exercising the shareholder rights shall have held the shares for 270 days or more. Whether it is reasonable or not depends on the specific circumstances.²¹

(III) Attitude of the board of directors in anti-takeover measures: activism versus neutralism

Regarding the ownership of the decision-making power on anti-takeover, the current laws and regulations of China stipulate that the centralism model of the general meeting of shareholders confers the decision-making power on anti-takeovers to the general meeting of shareholders. However, judging from the practical effect, all matters that are submitted to the general meeting of shareholders for discussion are proposed by the board of directors. Therefore, the decision-making power of the general meeting of shareholders is merely empty. In the case of Vanke or Xinmei, it is the board of directors that controls the company’s anti-takeover act. Therefore, in China, neither complete neutralism nor complete activism can be implemented for the board of directors. Scholars have argued that it is not appropriate to adopt the decision-making model of the

²⁰Wang Jianwen, Fan Jian: “On the Limitations of Regulations on China’s Anti-takeover Provisions”, Hebei Law Science, No. 7 (Vol. 25), p. 99.

²¹Wang Sijia. “On the Legal Force of Anti-takeover Provisions in the Listed Companies’ Articles of Association”, “Knowledge Economy”, No. 12, 2014, p. 48.

shareholders' meeting without making improvement;²² some argue that China's anti-takeover legislation should follow the UK's legislative model by granting the ultimate decision-making power of anti-takeover to the target company's general meeting of shareholders, without absolutely banning the right of target company's board of directors to take anti-takeover measures in certain circumstances; ²³some advocate that the conditions on the resolutions of the general meeting of shareholders that authorizes the board of directors to take an anti-takeover decision shall be strictly controlled and certain initiative is given to minority shareholders. ²⁴Some argue that anti-takeover legal frameworks in countries such as the United States, Britain, and Australia are not suited to the current legislative environment in China; it is possible for shareholders to adopt a decision-making model in advance and vote to choose which type of anti-takeover measures to defend at the time of acquisition. ²⁵Of course, whether the decision-making power of anti-takeover is conferred on the general meeting of shareholders or the board of directors, it is a matter of great urgency to establish the standards of fiduciary duty of directors and judicial review for the anti-takeover measures adopted by listed companies.²⁶ Article 8 of the "Measures on the Administration of the Acquisition of Listed Companies" promulgated by China Securities Regulatory Commission clearly stipulates the fiduciary obligations of the directors.²⁷ We earnestly hope that if the regulatory authorities and the judiciary can pass administrative enforcement and judicial trials, determine whether the adoption of anti-takeover measures maximizes the interests of all shareholders and the interests of the company, and exercise constraints through the fiduciary duties of directors, it will help to avoid the rigid treatment of anti-takeover measures and promote the healthy development of

²²Lin Wangwei: "On the Legislation of Anti-takeover Measures for Listed Companies in China and the United Kingdom", *China Business Law Journal*, No. 1, 2008, p. 789.

²³Hu Honggao, Zhao Limei. "On the decision power of target company's anti-takeover behavior and its regulations", *China Legal Science*, No. 2, 2001, p. 131.

²⁴Fan Jian, "Legislation Policies for Anti-takeovers in China: Institutional Foundations and Safeguards of Centralism of Shareholders' Meeting", *Journal of Business Economics*, No. 11 (Vol. 181), 2006, p. 66.

²⁵ Huang Hui. *China's Takeover Law: A Comparative Analysis and Proposals for Reform*. Del. J. Corp. L., 2005, 30: 145.

²⁶Tang Xin, XuZhizhan: *Inspection of the Legitimacy of Anti-takeover Measures*, *Tsinghua Law Journal*, No.6, 2008 (Vol. 2), p. 94.

²⁷The directors, supervisors and senior management personnel of the acquired company shall have duty of loyalty and duty of care to the company and shall treat all acquirers of the company fairly. The decisions made by the board of directors of the acquired company regarding the acquisition and the measures taken shall help safeguard the interests of the company and its shareholders. They shall not abuse their power to set up inappropriate obstacles to the acquisition, or use the company's resources to provide the acquirer with any form of finance, or damage the legitimate rights and interests of the company and its shareholders.

the M&A market in China.

V. Conclusion

In either Vanke case or other hostile takeovers that took place in recent years, the struggle for battle for the control of a company has triggered a heated debate in society and even becomes a nationwide education on the company law. These hostile takeovers test the governance of Chinese listed companies, highlighting the weaknesses and lack of the legal system and the anemic regulatory measures. Obviously, in order to effectively regulate China's capital market and M&A behavior and improve the governance of Chinese listed companies, we would need to -

First, fundamentally improve the relevant legislation, including the timely amendment to laws and regulations such as company law, securities law, and corporate governance standards. From the above case study, it can be seen that company practice has challenged the existing laws in China. It is precisely because of the lack of laws and regulations that a company's mergers and acquisitions and anti-takeover seem unjustified, and opportunism becomes rampant. Therefore, efforts shall be made to make timely amendments to laws, plug up legal loopholes, and establish corporate governance rules, guiding companies to improve clean up their act and achieve effective governance through corporate self-governance and self-discipline.

Second, establish the fiduciary duties of the board of directors and management, especially the detailed obligation to attention. From the perspective of Chinese company law and securities law, China's listed companies implement the centralism of shareholders' meeting. Major issues, including corporate mergers, division, capital increase, and capital reduction, are decided by the shareholders' general meeting of listed companies, but the fact that the board of directors provides relevant plans and the vast majority of shareholders merely accept the facts makes impracticable the positive effect of the centralism of the shareholders' meeting. Therefore, it is necessary to emphasize and elaborate the fiduciary duties of senior directors, especially introduce overseas mature legal precedents. The fiduciary obligations of senior executives shall become a sharp sword hanging over the directors. Putting restraints on the board of directors and the management will really put the interests of the company and all shareholders in the top place in its actions and decisions.

Third, effective administrative supervision and judicial trials are afterthoughts for promoting corporate governance, but they are of great significance in guiding corporate behavior. China Securities Regulatory Commission and the two exchanges are the main regulators of the Chinese capital market, and the innovation and development of the capital market are almost the basic microcosm of the entire economy. Regulators shall seriously study cases, amend regulations and rules in a timely manner, and adhere to the consistency of law

enforcement standards and efforts. All of these help to deter violations of laws and regulations in company practice. The importance of judicial trials is self-evident. In particular, strengthening and perfecting the mechanism of civil compensation against offenders will undoubtedly help promote the governance of listed companies.