

HOSTILE TAKEOVERS AS CORPORATE GOVERNANCE: A LEGAL ANALYSIS OF TENDER OFFER AND PROXY CONTEST IN CHINA AND MALAYSIA

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Abstract

This paper will specifically analyse from a legal perspective the applicability of tender offer and proxy contest as the most frequently used techniques in hostile takeovers in China and Malaysia. The purpose is to evaluate the adequacy of the related regulation and governance in place for companies in both jurisdictions. This paper unfortunately found that both China and Malaysia have not particularly adopted tender offer technique since in practice most hostile takeover cases were completed through mandatory offers triggered by negotiated purchases. Likewise, the existing Chinese and Malaysian laws are not supportive enough to supervise proxy contest exercises. As a result, they are losing the advantages that both techniques may offer to enhance corporate governance and promote fair competition. Both jurisdictions should consider putting on adequate laws and practices to better regulate hostile takeovers.

Keywords: Tender Offer, Proxy Contest, Hostile Takeover, China, Malaysia

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1. Introduction

A hostile takeover occurs when an acquiring company makes a purchase of the controlling shares from a target company's shareholders against the wishes of its management and the board of directors. In practice, an acquiring company may be able to complete a hostile takeover when the target company is publicly held and its ownership is widely dispersed among the shareholders (Steven M. Bragg, 2009). Some situations however do not allow a full opportunity for takeovers to take place. It is almost impossible for an acquiring company to conduct a hostile takeover when the target company is privately held, since its management team usually owns the company, and has an absolute power to reject any takeover bids. There are various external circumstances which influence the development of hostile takeovers in China and Malaysia. For instance, many state-owned Chinese listed companies used to reserve a certain number of non-tradable shares at hand to ensure an absolute controlling power over the company by the State. These shares can only be sold or transferred through an agreement between the acquirer and shareholders and are not through exchanges of shares in the secondary market. This constitutes a hindrance for acquirers to initiate hostile takeovers in China. In

contrast, owing to a relatively small capital market of Malaysia, many Malaysian listed companies conduct takeovers through the support of bank financings. Banks therefore have their own influence as they may have an indirect control over the companies by increasing shareholdings, entrusting voting shares, arranging internal directors and managements, etc.

A tender offer is a public invitation made by a potential acquiring company to all shareholders of the target company to tender their shares for sale at a specified price during a specified time, subject to that the acquirer manages to tender a specified minimum number of shares. A proxy contest (also called proxy fight or proxy battle) is a strategy that involves the employment of shareholders' proxy votes to replace the existing members of a company's board of directors. A public company's shareholders may appoint an agent to attend shareholder meetings and vote on their behalf. That agent is the shareholder's proxy (William A. Klein, J. Mark Ramseyer & Stephen M. Bainbridge, 2009). The focus of this paper is to analyze the most significant hostile takeover techniques—tender offer and proxy contest, and analyze how the listed companies exercise them in China and Malaysia respectively.

2. Hostile Takeovers in Corporate Governance

Hostile takeovers should play a key role in corporate governance. Some scholars opine that a hostile takeover is an effective measure of external inspection, from which various pressures compel the proprietors and executives to conduct their company with great efforts. It consequently raises the company's competitiveness in the market, and guarantees the interests of shareholders. On the contrary, some scholars believe that a hostile takeover is exactly arbitrage activity, which makes the proprietors and executives just pursue the short-term profit rather than long-term development of the company. They therefore advocate improving the corporate management through internal supervision.

Practically, a hostile takeover may not only affect internal and external shareholders, but also give impact to management, employees and even customers as it trickles through an entire organization. As for the internal and external shareholders, a hostile takeover may affect the bottom line of their further investments due to their vested financial stakes in both acquiring and target company. It may result in major changes in the ownership structures of both takeover parties. As for the management, a hostile takeover may bring in new members who come from the acquiring company to make decisions on the subsequent business of target company. The original target management may be dismissed or given notice. As for the employees, a hostile takeover may cause many organizational changes with a shift of corporate ownership. The new target management sometimes insists dismissing all employees, sometimes maintains a number of employees for good or trains their own people. Whatever decision is made on the employees, it can seriously affect their morale. As for the customers, a hostile takeover may bring in new organizational philosophy with the spin-off and sell-off of target company. It may not be beneficial to its loyal customers who frequently patronize the business. If the target companies trade their shares in the private market, they are not vulnerable to the hostile takeovers. On the contrary, if they choose to go public and sell their shares in the open market, they do put themselves in such risk.

Specifically speaking, a hostile takeover may result in dual effects on the management of a target company. The positive effect is that a hostile takeover always makes the business operator face external threats. The poor performance of corporate management may lead to the company being merged or acquired so that the corporate interest is damaged. This will prompt the business operator to work hard all the times. Moreover, once a hostile takeover is successful, the incompetent target board and management will be reorganized, which results in the replacement of board of directors and reappointment of managers. This will push the target company to

improve its management efficiency with great effort. Thus, as a significant component of corporate restructuring activities, the hostile takeover plays a positive role to improve the operation and management of the target company. By contrast, the negative effect is that an acquiring company usually conducts a hostile takeover to expand its business scale. Many shareholders only pursue personal interests before their eyes rather than the long-term development of their company. This leads to the drop of stock price where the company makes the long-term business plan and commits to the research and development of new products and technologies. As a result, such company becomes the hostile takeover target so that the interests of its shareholders, management, creditors, employees and even customers will be exploited at different levels. In addition, a hostile takeover may lead to the high concentration of capitals in the same production and sales area, and the vulnerable company will be swallowed up by the dominant one in the takeover battle. This may destroy the fair market competition and result in the industrial monopolization. Thus, in order to minimize the negative impacts of hostile takeovers on corporate governance, listed companies frequently adopt tender offers and proxy contests as strategic techniques in their takeover schedules.

3. Tender Offer in China and Malaysia

A tender offer circumvents the target company's board of directors and allows the acquiring company to address its offer directly to the target company's shareholders. The offer is accepted when the target company's shareholders tender their shares. Once all the conditions to the tender offer are satisfied, the acquiring company is contractually obliged to purchase each tendering shareholder's shares on the terms set forth in the tender offer (Bloomenthal, 1981). Tender offer is always used as an important technique in a hostile takeover. Many target companies are acquired by either the original hostile bidders or the subsequent ones in the takeover battles. In China and Malaysia, tender offer is principally regulated by the Chinese Administrative Measures on the Acquisition of Listed Companies and Malaysian Code on Takeovers and Mergers 2010 respectively. (See Chart I and Chart II)

By comparing the general procedures of tender offer in Chart I and Chart II, some notable similarities can be seen between China and Malaysia: Firstly, the offeror shall announce his tender offer to the public, and submit the offer documents to the Securities Commission and offeree. Secondly, the board of directors of offeree shall assess offeror's tender offer within the offer period. Thirdly, the offeror shall keep his tender offer open for acceptances for a certain period of time. Fourthly, the offeree shall announce his acceptance after the open period. The only differences between China and Malaysia are the

specific transaction durations in each stage of the tender offer. For instance, after the offeror announces his tender offer to the public, he shall submit the relevant documents to the Securities Commission within 4 days in Malaysia rather than within 3 days in China; after the offeror submits the offer documents to the Securities Commission, he shall inform the board of directors of offeree within 21 days in Malaysia rather than within 15 days in China; from the date of the offer documents is first posted to the board of directors of the offeree and offeree shareholders, the offeror must keep his tender offer open for acceptances for a period of not less than 21 days in Malaysia rather than 30 days in China.

Hostile tender offers are frequently preceded by a so-called 'bear hug letter' addressed to the board of a target company in which the acquiring company proposes to enter into negotiations with the target company concerning a possible takeover. The acquiror may propose a takeover price in the bear hug letter, as well as certain specific conditions (Stephen Kenyon-Slade, 2004). An aggressive hostile bear hug letter would be a formulation where an acquiring company proposes a higher price for a recommended or negotiated transaction, but threatens to pursue a lower priced offer if the board of a target company opposes the transaction or refuses to enter discussions.

In the case of a corporate takeover, tender offer may be classified into full offer and partial offer (Graham Stedman, 1993). The full offer is a takeover offer made by an acquiring company to purchase all shares of the target shareholders, which is in contrast with the partial offer, namely a takeover offer to purchase a significant portion of their shares. Making a takeover offer to all target shareholders does not necessarily mean making a full offer, since making a partial offer also has to follow the same way. This indicates the principle of equal treatment to all shareholders in a corporate takeover. In essence, an acquiring company makes a full offer for the purpose of annexing a target company, rather than barely obtaining certain number of target shares to become a major shareholder through a partial offer.

4. Full Offer With Reference To Hostile Takeover

A full offer particularly shows the offeror's takeover intention to enlarge the acquiring company's business scale within a short period. Nevertheless, not all full offers are voluntarily made by the offeror in a takeover exercise, while many have to be mandatorily made in accordance with the legislative requirements.

For instance, many countries' legislatures stipulate that when an acquiring company holds a certain amount of shares of the target company, it shall make a full takeover offer to such a target company. For example in China and Malaysia,

Section 88 of the Securities Law of the People's Republic of China states that

"when, through securities trading on a stock exchange, an investor comes to hold, or jointly hold with others through agreement or other arrangements, 30% of the issued shares of a listed company and continues to buy such shares, the investor shall, in accordance with law, issue to all the shareholders of the listed company a takeover offer for buying the whole of or part of the shares of the listed company".

Similarly, Section 9 of the Malaysian Code on Takeovers and Mergers 2010 states that

"an acquiror has the obligation to extend a mandatory offer to acquire all the shares of the target company, if he, together with persons acting in concert with him, holds more than 33% of the target company; or if he, together with persons acting in concert with him, holds between 33% and 50% of the voting shares, and acquires more than 2% of the voting shares in any period of 6 months".

The following two cases below may serve illustrations as to the applicability of these provisions. An example in China is China Merchants Bank v. Wing Lung Bank.

China Merchants Bank (CMB) is the first commercial bank with shareholders established by a Chinese corporate legal entity in Shenzhen, 1987. It has been listed on the board of Shanghai Stock Exchange and board of Stock Exchange of Hong Kong since 2002 and 2006 respectively. Wing Lung Bank (WLB) is one of the oldest Chinese family-owned banks established by Dr. Wu Yee-Sun in Hong Kong, 1933. It was listed on the Stock Exchange of Hong Kong from 1980 to 2009 until it was acquired by CMB. On 30th May 2008, CMB signed the agreement with WLB to purchase 53.1% of its shares at the price of HK\$156.5 per share. On 6th October 2008, CMB made a tender offer to the rest of WLB's shareholders to acquire all their shares. By 27th October 2008, CMB had totally spent HK\$36.3 billion and purchased 97.82% shares of WLB. In November 2008, CMB made a takeover offer to the dissenting shareholders of WLB to purchase the rest of 2.18% shares of WLB in accordance with the mandatory takeover requirements. On 15th January 2009, CMB eventually completed its full takeover, and on the next day WLB was delisted from the Stock Exchange of Hong Kong.

Daikin Industries, Ltd v. O.Y.L. Industries Bhd. is an example case from Malaysia. Daikin Industries, Ltd (Daikin) was established by Akira Yamada on 25th October 1924 in Osaka, Japan. It was a Japanese public listed company (TYO: 6367) which focused on manufacturing air-conditioning systems. O.Y.L. Industries Bhd (OYL), established in 1974, is one of the largest air conditioner manufacturers in the world. It was listed on the Main Board of Kuala Lumpur Stock Exchange until it became a member of the Hong Leong Group Malaysia in 1990. On 18th May 2006, Daikin announced that Hong Leong Secretarial

Services Sdn Bhd and Mr. Liu Wan Min, the substantial shareholders of OYL, had entered into a conditional share sale agreement to dispose off their equity interests in OYL of 531,526,130 shares and 69,000,000 shares, representing 40.0% and 5.2% respectively for cash considerations of RM5.73 per share of OYL. Subsequently Daikin began to offer the remaining shareholders of OYL to purchase their shares. During the period 6th October 2006 to 10th November 2006, Daikin purchased OYL shares under its mandatory general offer up to 99.3%. On 24th November 2006, compulsory acquisition was commenced to acquire the remaining 0.7% shares from minority shareholders who had not applied for mandatory general offer under Sections 34 of the Malaysian Securities Commission Act. In particular, Subsection (1) of the Section 34 states that “where a takeover offer by an offeror to acquire all the shares or all the shares in any particular class or classes in an offeree has, within four months after the making of the takeover offer, been accepted by the holders of not less than nine-tenths in the nominal value of those shares or of the shares of that class or classes, the offeror may, at any time within two months after the takeover offer has been so accepted, give notice in the manner prescribed under the code to any dissenting shareholder that it desires to acquire his shares together with a statutory declaration by the offeror that the conditions for the giving of the notice are satisfied”. On 18th January 2007, Daikin announced the completion of its full takeover of OYL with the total purchase price of 243.8 billion yen.

When the offeror voluntarily makes a full offer, not all the target shareholders may agree to sell their shares. The offeror may only acquire a controlling portion of the target shares in the end. Such a case is essentially different from a partial offer where the offeror only tenders to take part of the target shareholders in the very beginning.

Theoretically speaking, full offer is the most direct technique adopted by an acquiring company to wholly take over the target company. It always happens on an offeror who has vast working capitals at hands and intends to enlarge or diversify his business within a short period, as well as an offeree who has small or medium scale with relatively concentrated shareholdings (Ben Amoako-Adu & Brian Smith, 1993). Once a full takeover is completed, the target company will be delisted from the board of stock exchange, and the acquiring company will immediately reorganize its business structure.

Full offer is frequently practised in a friendly takeover, but hardly applicable in a hostile takeover. One reason is that a full offer clearly shows the investor’s takeover intention, which usually comes after his hostile offer consideration (if he has at the initial stage of his takeover planning) in a particular takeover transaction. This tactic may be easily detected and frustrated at the very beginning by the

target company. The other reason is that the investor always uses his working capitals cautiously for investment purpose. He never simply puts most of his working capitals into one particular investment without any internal or external guarantee, such as case of a full takeover. Thus, if the acquiring company intends to launch a hostile takeover, it prefers to make a strategic partial offer to the target company’s shareholders.

5. Partial Offer With Reference To Hostile Takeover

Takeover is part of investment plan of the acquiring company. In a takeover exercise, the acquirer would maximise its investment by employing a minimum amount possible of its working capital to obtain a maximum possible controlling power from the acquiree. To achieve such an objective, partial offer is introduced under the acquirer’s strategic planning, and partial takeover is accordingly concluded with the acquiree’s positive response (Fan Jian, 2002). In comparison with the full offer, a partial offer is considered more technical and tactical, because it needs to comply with more stringent legal requirements applicable in the respective countries.

In China, partial offer is generally interpreted in Chapter 3 of the Administrative Measures on the Acquisition of Listed Companies. In particular, Section 24 of the Chapter 3 states that

“if a purchaser, who has held up to 30% voting shares of a listed company in virtue of securities transaction through the stock exchange, continues to purchase its voting shares, he shall make a full offer or a partial offer to the shareholders of such company. The percentage of voting shares scheduled for his subsequent purchase shall not be less than 5%”.

In addition, Section 26 of the Chapter 3 states that

“if a purchaser launches a takeover offer for a listed company, he should treat all the target shareholders equally. The shareholders who hold the same type of target shares should be also treated equally”.

In Malaysia, partial offer is principally regulated by Section 10 of the Malaysian Code on Takeovers and Mergers 2010. Especially, Subsection (2) of the Section 10 state that

“an offeror in a partial offer, shall offer to acquire the same percentage of voting shares to which the takeover offer relates from all offeree shareholders; and shall accept all acceptances from all offeree shareholders who wish to accept the takeover offer up to the percentage of voting shares proposed to be acquired by the offeror”.

Particularly, Subsection (6) of the Section 10 states that

“where an offeror makes a partial offer which would result in the offeror and any other person acting in concert with the offeror holding in aggregate more

than 33% but not more than 50% of any class of voting shares of the offeree, the offeror shall state in the offer document, the number of such voting shares offered to be acquired in the takeover offer; and shall ensure that the offer document in the takeover offer contains a condition that the offeror shall not make a declaration that the takeover offer is successful unless the offeror has received acceptances for not less than that number of voting shares of the offeree”.

Moreover, both Section 43, Chapter 3 of the Administrative Measures on the Acquisition of Listed Companies and Subsection (3), Section 10 of the Malaysian Code on Takeovers and Mergers 2010 similarly prescribe that where an offeror in a partial offer obtains acceptances totalling more than the percentage of voting shares offered to be acquired in the takeover offer, the offeror shall accept such voting shares in the same proportion from each offeree shareholder who has accepted the offer in excess of the percentage of voting shares proposed to be acquired by the offeror to the extent necessary to enable the offeror to obtain the total percentage of voting shares for which the offeror has offered to acquire.

From these Chinese and Malaysian legal provisions, it is clear to see that shareholder coercion is the crux of a successful partial offer. On the one hand, the threat of an offeror’s shareholders gaining ownership of remaining target shares at an inadequate price compels the offeree’s shareholders to accept the partial offer. On the other hand, the fear of an offeree’s shareholders becoming minority shareholders in a business transaction may also press them to accept the offeror’s partial offer (Brudney, 1978). Under these pressures, minority shares are often traded at a discount price, especially where there is a fear that the target business will to some extent benefit the offeror’s business expansion. As a result, many offerors take advantage of the shareholder coercion resulted from the partial offers to conduct their hostile takeovers. The cases of Group SEB v. Supor and Telenor v. DiGi may serve as the examples in China and Malaysia respectively.

Group SEB was initiated by a tinker called Antoine Lescure in 1857 in Selongey, France. After more than 150 years of development, Group SEB has become a large French consortium that produces small appliances. A large proportion of its product lines are currently manufactured in China. Supor was established in 1994 in Hangzhou, China. It is the captain of cookware industry in China and the third largest cookware industry in the world, as well as the first listed cookware company in Shenzhen Stock Exchange (SZSE: 002032). Its products and household appliances have been exported to many countries. In order to raise foreign capitals, Supor, together with Su Zengfu and Su Xianze (Directors of Supor), transferred 24,806,000 equity shares of Supor to Group SEB by 24th August 2007. Subsequently Supor also issued 40,000,000 ordinary shares to

Group SEB. As a result, the ownership structure of Supor became to Group SEB (30%), Supor (25.03%), Su Zengfu (10.37%), Su Xianze (1.04%) and the other shareholders (33.56%). The amount of voting shares of Supor held by Group SEB was only 6.44 percentage points less than that held by Supor, Su Zengfu and Su Xianze. In order to gain the controlling interest, Group SEB launched a partial offer to the other shareholders of Supor through the secondary market on 21st November 2007 under Section 24, Chapter 3 of the Administrative Measures on the Acquisition of Listed Companies. The offer price was 47 RMB per share. As of 20th December 2007 when the partial offer expired, Group SEB had successfully purchased 49,122,948 additional equity shares, and become the largest shareholder who possessed a total of 52.74% equity shares of Supor.

Telenor started out as a public company in 1855 and have more than 150 years of telecom experiences. It is listed on the Oslo Stock Exchange, with headquarters in Oslo, Norway. Telenor is nowadays a leading provider of telecommunications services worldwide. It has a strong footprint in Central and Eastern Europe as well as Asia, and a leading Nordic position in mobile, broadband and TV services. On the other hand, DiGi is a leading mobile communications company in Malaysia. It is listed on the Bursa Malaysia under the infrastructure category. Currently, DiGi provides a comprehensive range of affordable, convenient and easy to use wireless services to simplify and enrich the lives of its customers. It also provides a variety of mobile communication services, including voice under their prepaid plans and postpaid plans, SMS, data plans and services, international roaming, international calling card and WAP services. On 21st June 2001, Telenor, through its wholly-owned subsidiary Telenor Asia Pte. Ltd., announced that it held 247 million (32.9%) ordinary shares of DiGi, and intended to make a voluntary partial offer for up to a maximum of 210.5 million additional shares, increasing its total ownership of DiGi to 61%. Under the terms of this offer, Telenor would offer to all shareholders of the remaining 503 million DiGi shares a cash consideration of RM 6.60 per share for up to 210.5 million shares. As of 11th August, Telenor has received sufficient acceptances on its partial offer in DiGi to meet the minimum condition of 50% plus 1 share in the company under Subsection (8), Section 11 of the Malaysian Code on Takeovers and Mergers 1998. Furthermore, Telenor has received the required shareholder approval of the partial tender offer from more than 50% of the shares not owned by Telenor. With the successful completion of Telenor's voluntary partial offer on 14th September, DiGi announced that it has become Malaysia’s first majority foreign-owned telecommunications service provider.

As can be seen from the above cases, a partial offer is always made under certain legal conditions, such as offer percentage, offer period, offer document

and so on, although there is some flexibility in the course of its operation. It usually occurs when a listed company largely needs public investment capital to diversify, strengthen and expand his business within a specific period. As a result, many transnational investment companies and multinational business consortiums take the partial offer as an opportunity to aggressively conduct their overseas hostile takeovers.

In general, tender offer is a commonly used technique for various corporate hostile takeovers. It may be made either voluntarily or mandatorily, either initially or subsequently. Sometimes a company even makes a tender offer to buy back shares from its own shareholders to consolidate controlling interests of its majority shareholders. Nevertheless, both full offer and partial offer may be exempted with the approval of securities regulatory body under certain circumstances. For instance, both Chapter 6 of the Administrative Measures on the Acquisition of Listed Companies and Practice Note 9 of the Malaysian Code on Takeovers and Mergers 2010 similarly provide several terms and conditions for exemptions from mandatory tender offers. Both Section 96, Chapter 4 of the Securities Law of the People's Republic of China and Section 219, Division 2, Part VI of the Capital Markets & Services Act 2007 (Act 671) also similarly provide for exemptions from takeover tender offers in a nutshell. In addition, both full offer and partial offer may also be revised by the original offeror with the approval of securities regulatory body, especially when any competitive offer has been announced by the subsequent offeror during the tender offer period. For instance, both Section 40, Chapter 3 of the Administrative Measures on the Acquisition of Listed Companies and Section 24, Part VII of the Malaysian Code on Takeovers and Mergers 2010 similarly provide several circumstances for the revisions of takeover offers. In particular, Section 38, Chapter 3 of the Administrative Measures on the Acquisition of Listed Companies and Section 23, Part VII of the Malaysian Code on Takeovers and Mergers 2010 similarly provide that, from the date the offer document is first posted, an offeror must keep a takeover offer open for acceptances for a period of not less than 30 days or more than 60 days in China, and not less than 21 days in Malaysia. Where there is a competitive takeover offer made during this period, the offer document sent by the offeror shall be deemed to have been posted on the date that the competitive takeover offer document was posted. In a word, the exemption and revision of a tender offer may not only help an offeror to save his investment capital or reduce his offer price, but also prevent the offeree from hostile takeovers.

6. Proxy Contest in China and Malaysia

By removing existing board members, the person or company launching the proxy contest can establish a new board of directors that is better aligned with their

objectives. Specifically speaking, the insurgent shareholders may solicit proxies in support of shareholder resolutions to influence the corporate control or to press the incumbent directors to adopt particular business strategies. Especially, insurgent shareholders increasingly combine proxy contests with hostile tender offers to open another front of attack and to increase the pressure on the target companies' incumbent directors. When combined with the tender offers, such proxy solicitations usually seek to replace incumbent directors with the insurgent shareholders' nominees, who will then approve and facilitate the tender offers. Thus, the proxy contests particularly will accompany corporate hostile takeovers. The acquiring company, or a large group of investors, always use a proxy contest as a strategy to force the target company to merge. It is however worth mentioning that besides the negative results the proxy contests can also induce various positive results, such as inspiring initiative of minority shareholders on corporate governance, restricting unreasonable internal control, promoting democratization of corporate operation, improving corporate management structure, and encouraging healthy development of capital market.

Normally, a proxy contest includes four fundamental steps. Firstly, the acquiring company or a group of major stakeholders will decide to join forces and launch a proxy contest against the target company. Secondly, these investors threaten to use their proxy votes to make the target company to comply with their wishes. Proxy voting allows shareholders who have confidence in the judgment of others to stand-in and vote for them on corporate governance matters such as the election of board members. Thirdly, if they succeed in gathering enough proxy votes, the acquiring company can then elect new board of directors using proxy ballots. Fourthly, these newly installed board members will be much more agreeable to the takeover or merger, and eventually the deal is finalized. Usually, just the mere threat of a proxy contest is enough for the target company to enter into serious merger talks with the acquiring company.

For instance, at the U.S. Federal law, proxy contest is mainly governed by Section 14(a) of the Securities Exchange Act of 1934 and Regulation 14A promulgated thereunder by the Securities Exchange Commission. Section 14(a) chiefly prescribes the solicitation of proxies in violation of rules and regulations, giving or refraining from giving proxy in respect of any security carried for account of customer, information to holders of record prior to annual or other meeting, tender offer by owner of more than five per centum of class of securities, untrue statement of material fact or omission of fact with respect to tender offer, election or designation of majority of directors of issuer by owner of more than five per centum of class of securities at other than meeting of security holders, filing fees, as well as

proxy solicitations and tender offers in connection with limited partnership rollup transactions. Regulation 14A primarily prescribes the requirements as to proxy, presentation of information in proxy statement, filing requirements, proposals of security holders, false or misleading statements, prohibition of certain solicitations, solicitation before furnishing a proxy statement, obligation of registrants in communicating with beneficial owners, modified or superseded documents, differential and contingent compensation in connection with rollup transactions, internet availability of proxy materials, electronic shareholder forums and so on. The principal goals of both Section 14(a) and Regulation 14A are to ensure that shareholders are provided with sufficient information to enable them to vote in informedly in a proxy solicitation, to ensure that the information provided to shareholders does not contain materially false or misleading statements, and to ensure that shareholders are adequately informed about the identities and interests of the persons who provides the information (Stephen Kenyon-Slade, 2004). At the U.S. State law level, the State corporation laws prescribe procedures and requirements for the holding of annual and special meetings of shareholders, the voting rights of shareholders and the use of proxies, the fixing of record dates, notice, and quorum requirements for the holding of annual and special meetings, the ability of shareholders to gain access to shareholder lists and books and records of the corporation; the voting thresholds required to approve certain corporate action, and the ability to effect corporate action by written consents (Brownstein & Presser, 1990). Overall, both the U.S. Federal and State laws provide the machinery for more effective shareholder communications to enable institutional shareholders to play a more active role in corporate governance.

Unlike the U.S., neither China nor Malaysia has yet established a unified comprehensive legal system for proxy solicitations, and as a result a proxy contest is still a grey area in the existing Chinese and Malaysian laws.

In China, Section 107 of the Company Law only mentions the basic conception of proxies in general. It states that

“shareholder may appoint a proxy to attend shareholder meeting, the proxy shall submit a power of attorney to the company, and exercise his voting power within the scope of shareholder’s authorization.”

In Malaysia, Section 149 of the Companies Act 1965 only prescribes the fundamental issues in relation to appointments of proxies, rights of proxies, offences against this Act and relevant penalties. In particular, Subsection (1), Section 149 of the Companies Act 1965 provides four different circumstances for the appointment of proxies by a member of the company. It states that

“(a) a proxy shall not be entitled to vote except on a poll; (b) a member shall not be entitled to appoint a person who is not a member as his proxy unless that person is an advocate, an approved company auditor or a person approved by the registrar in a particular case; (c) a member shall not be entitled to appoint more than two proxies to attend and vote at the same meeting; and (d) where a member appoints two proxies the appointments shall be invalid unless he specifies the proportions of his holdings to be represented by each proxy.”

There is no any provision in either Chinese Company Law or Malaysian Companies Act 1965 which regulates proxy solicitations or proxy contests in relation to the corporate takeovers. However, since the proxy contests have become an important instrument to encourage minority shareholders to participate in the corporate governance and to strike a balance for the corporate management, more and more related cases emerge in China and Malaysia. The legal loophole for the proxy contest may damage the minority shareholders’ interests in the corporate governance, deflate the minority shareholders’ investment enthusiasms in the stock market, and undermine the investors’ confidences in the financial market. The Chinese and Malaysian cases illustrating this are *Tong Bai Hui Services Co., Ltd. v. Sheng Bang Co., Ltd.* and *Tan Chong Motor Holdings Bhd v. Warisan TC Holdings Bhd* respectively.

In *Tong Bai Hui Services Co., Ltd. v. Sheng Bang Co., Ltd.*, *Tong Bai Hui Services Co., Ltd.* (TBHS) held 16.67% ordinary shares of *Sheng Li Co., Ltd.* (SL) by 23rd March 2000, which was only 0.68% less than the ordinary shares held by *Sheng Bang Co., Ltd.* (SB), the largest shareholder of SL then. In order to contest for the controlling power of SL, on 25th March 2000, TBHS began to solicit all public shareholders of SL for their proxy voting. Such proxy solicitations received warm responses. As a result, TBHS collected a total of 1500 power of attorneys, approximately 32 million shares, from various public shareholders, of which the effective shares are 26,257,781, representing 10.96% of total issued shares of SL. However, at the same time of TBHS collecting proxy voting from the public shareholders of SL, SB also intensified its proxy solicitations. The percentage of shares of SL held by SB had subsequently reached to 29.16% in total, which was still higher than the total percentage of 27.63% held by TBHS after its proxy voting collection. This led to the ultimate election failure of directors and supervisors nominated by TBHS in the shareholder meeting on 30th March 2000, and its proxy contest for the controlling power of SL also accordingly ended in failure (Yi Zhi, 2004).

Practically, this case is the first example for the proxy contest of various shareholders through the Chinese securities market. Academically, many scholars consider *Junan Securities Co., Ltd. v. Vanke Co., Ltd.* as the first proxy solicitation event in China.

In this case, Junan Securities intended to reorganize the board of directors of Vanke and restructure the core businesses of Vanke after its proxy voting collection. However, the proxy solicitation of Junan Securities is only among several institutional shareholders of Vanke, rather than through the notification for all public shareholders of Vanke. Thus, strictly speaking, the case of Tong Bai Hui Services Co., Ltd. v. Sheng Bang Co., Ltd. is the first proxy solicitation example with regard to a hostile takeover in China.

In *Tan Chong Motor Holdings Bhd v. Warisan TC Holdings Bhd*, Tan Chong Motor Holdings Bhd (TCMH) was established in Malaysia on 14th October 1972 and listed on the Main Board of Bursa Malaysia on 4th February 1974. It mainly engages in assembly and distribution of motor vehicles, provision of after-sales services and motor related financial services such as hire purchase, insurance agency and leasing. On the other hand, Warisan TC Holdings Bhd (WTCH) is principally engaged in investment holding and provision of management services. It has three core businesses, namely travel and car rental, machinery and consumer products. On 12th September 2002, a proxy fight loomed within the Tan Chong group. A faction led by Tan Bee Huat, the daughter of TCMH founder Datuk Tan Kim Hor and the cousin of WTCH Chairman Datuk Tan Heng Chew, tried to requisition an extraordinary general meeting (EGM) to remove Datuk Tan Heng Chew, Tan Eng Soon, Ismail Rautin Ibrahim and Datuk Nadzam Bin Haji Mohd Din from the board of WTCH (Fazli Ibrahim, 2002). However, Tan Bee Huat eventually failed to oust these four directors in the highly-charged EGM on 8th November 2002. Despite the setback, the Bee Huat faction claimed "moral victory" in a brief statement that "representing 42% in WTCH, more than 73% of the public independent shareholders voted for Kim Hor's family" (Francis Fernandez, 2002).

As can be seen from the above cases, proxy contest is not only confined to cases involving several major shareholders of a listed company to compete their controlling power, but also occur among various competitive shareholding corporations to take over another listed company. The most common objectives of dissidents commencing a proxy contest are to remove management due to poor corporate performance, to promote a specific type of restructuring of the firm, to sell the business outright, and to force a distribution of excess cash to shareholders (Donald M. DePamphilis, 2009). Proxy contest enable dissident shareholders to replace specific board members or management with those who are more willing to sit in their positions. By replacing board members, proxy contest can be either used as an effective means to gain corporate control without owning more than 50% of the voting stock, or be used as a defensive measure to eliminate a hostile takeover. Thus, a proxy contest may have a dual

impact on corporate governance. On the one hand, shareholders may adopt proxy contest to dismiss incompetent managers who failed to achieve the maximum value of the company. Especially in a listed company where the minority shareholders are not directly involved in its daily operation and management, the proxy voting collection can make the minority shareholders to express their opinions in the general meeting, and provide an alternative way for their decision-making and supervision on such a company. On the other hand, shareholders may adopt a proxy contest as a strategy to take over a listed company in a hostile tender offer. By collecting minority shareholders' voting stock in the extraordinary general meeting, the hostile bidder may become the largest shareholder to gain the controlling power of the target company. Corporate restructuring will be subsequently undertaken with the replacement of new board and management.

In both China and Malaysia, most proxy contest cases in relation to corporate governance ended in failure. Currently, it is not feasible for the external shareholders to supervise Chinese and Malaysian listed companies through the proxy contest mechanism. The first reason is that the ownership structures of most Chinese and Malaysian listed companies are still highly concentrated. It implies that the external shareholders are unlikely to exert pressures on the controlling shareholders through proxy solicitations. The second reason is that the Chinese and Malaysian listed companies have not yet created any groups of shareholders with good investment awareness. Most investors only buy stocks for the short-term interest margin rather than long-term investment, while they never care about the long-term operations of those companies. The third reason is that the existing Chinese and Malaysian legislations for proxy contest are still undeveloped. Many legal researches only concentrate on the basic introduction of proxy contest mechanism rather than its effectiveness in the corporate governance. As a result, it is treated coldly by many Chinese and Malaysian listed companies' shareholders. In order to improve the legal applications of proxy contest in the corporate mergers and acquisitions, China and Malaysia should reform their existing legislations to make the proxy contest more conducive to the minority shareholders rather than the hostile acquirors.

Conclusion

The hostile takeovers just emerged in China and Malaysia in the early 1990s and late 1980s respectively. There are not many cases reported in both countries concerning tender offer and proxy contest. There are however some common characteristics in practice from both jurisdictions which suggest the limited significance of both

techniques to be employed in enhancing corporate governance.

Firstly, the hostile takeovers normally occur where the target shareholdings are widely dispersed. The acquirors always stealthily accumulate the distributed target shares held by the relatively major shareholders from the market. Nevertheless, it is notable that many large Chinese and Malaysian listed companies are State-owned or Government-linked, of which the shareholdings are relatively concentrated in the hands of the governments and relevant departments. It is thereby not easy for the acquirors to seize the rare opportunities to conduct their hostile takeovers in China and Malaysia. Therefore, tender offers are not in practice employed. The existing Chinese and Malaysian hostile takeovers are mostly completed through the mandatory tender offers triggered by the negotiated purchases. The takeover actions are only subject to the legal requirements so that the acquirors' bid prices are not high enough to attract the acquirees' shareholders. For instance, *China Merchants Bank v. Wing Lung Bank and Daikin Industries, Ltd v. O.Y.L. Industries Bhd.* Further, the concerted actions are obvious in the hostile takeovers. In order to evade the procedural obligations of information disclosure to accomplish the takeovers in a short time, the various civil subjects of acquirors frequently work together to contest or consolidate the controlling power of acquirees. There are no prohibitions for such concerted actions by the existing Chinese and Malaysian laws. For instance, *Tong Bai Hui Services Co., Ltd. v. Sheng Bang Co., Ltd. and Tan Chong Motor Holdings Bhd v. Warisan TC Holdings Bhd.* Besides, proxy contests lack proper supervision of shareholders. Since the ownership structures of most Chinese and Malaysian listed companies are still highly concentrated, it is not feasible for the external shareholders to supervise them through the proxy contest mechanism. Overall, these common features are the weakness of corporate governance in both China and Malaysia, which reflect unresponsive legislations for hostile takeovers.

Accordingly, this paper recommends that an institutional reform is to be initiated to allow the tender offer technique to be fully practiced in China and Malaysia, thereby circumventing negotiated purchases. The technique will allow impelling acquirors to bid acquirees at a premium. At the same time, the proxy contest mechanism should be effectively supervised by the external shareholders in China and Malaysia to ensure the openness and fairness of hostile takeovers. Both China and Malaysia should consider this transformation to put in place a set of applicable rules to support tender offer and proxy contest in the immediate future by drawing on the successful legislative experiences of jurisdictions such as the U.S. and U.K.

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