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London, United Kingdom

Contact

www.cecca.org.uk

contact@cecca.com.cn

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1. Special Observer

More Freedom and Less Costs: The Institutional Framework of the Free Trade Zone Pilot Programs of the P.R.C

Authored by Dr. Chi Zhang*

Introduction

Free trade zones (FTZs) are a specific type of special economic zones (SEZs) where goods can be imported, handled, manufactured, and exported without direct intervention from Customs. They play an important role in modernizing China's business landscape and serve as areas where authorities can experiment with pro-business regulations. The first FTZ was established in Shanghai in 2013 and currently there are eleven FTZs in total. Each FTZ has an industry focus and matching incentives to attract investment. FTZs are of critical consideration for foreign firms, but this decision process is highly dependent on an investor's business focus and growth prospectus. This article aims to provide an overview of the institutional framework of the FTZs in China.

Overview of China's FTZs

As early as September 2013, the Shanghai FTZ was inaugurated by the Chinese government which acts as a testing ground for legal innovation, attracting foreign investment with fewer restrictions. Basically, the Shanghai FTZ was created with four goals in mind:

- Maintaining and increasing competitive edge;
- Transitioning to a more market-friendly regulatory environment;
- Internationalizing the RMB; and,
- Testing new strategies for reform with intent to duplicate.

By implementing policies meant to fulfil these goals, the Shanghai FTZ laid the foundation for FTZs nationwide. It relaxed incorporation requirements, adopted the use of the Negative List for pre-approval procedures, and implemented a one-stop application process, all measures which were eventually adopted nationwide.

* Dr. Chi Zhang, Deputy Editor-in-Chief of the CECCA; Lecturer in Commercial Law at School of Law and Humanities of China University of Mining and Technology (Beijing). Ph.D. in Law, The University of Glasgow; LL.M. and LL.B., Tsinghua University. E-mail: chi.zhang@cecca.com.cn.

In 2015, the government announced three more FTZs in Fujian, Guangdong, and Tianjin. This time, the government assigned strategic positions for each of the FTZs: Fujian supports trade with Taiwan; Guangdong supports economic integration with Hong Kong and Macao; and, Tianjin supports the northeastern region and helps develop offshore financial markets. In 2016, the government announced plans for seven more FTZs, underlining the government's long-term plans to develop inland China and support the One Belt, One Road (OBOR) initiative. The FTZs are in Chongqing, Liaoning, Henan, Hubei, Shaanxi, Sichuan, and Zhejiang.

[1]

Major incentives provided by FTZs

There are several incentives to invest in an FTZ. For simplicity, we explore tax, customs clearance, international trading center, and, industry-specific liberalizations for illustrating how the FTZs in China are attractive to foreign investors.

Tax:

As FTZs are special areas for policy piloting in China, lower tax rates do not feature as heavily as might otherwise be expected. However, FTZs have started to experiment with other forms of tax benefits. For instance, in the Shanghai FTZ, any FTZ-registered company can pay corporate income tax (CIT) in installments over a five-year period, if the value of its interest in a portfolio company increases because of non-cash restructuring. Moreover, unless otherwise stipulated, most FTZs allow duty free import for any machinery and other equipment for company self-use. We would like to use

[1] The picture is extracted from the following link, all the rights are reserved by the author. <www.finance.k618.cn> accessed 14 Mar 2018.

the *Qianhai Shenzhen-Hong Kong Modern Service Industry Cooperation Zone* as a typical example to illustrate the tax advantage of the FTZs for foreign investors.

In the Qianhai Shenzhen-Hong Kong Zone, companies must be engaged in encouraged industries, meaning that their primary businesses are listed in the Preferential Corporate Income Tax Catalogue including modern logistics, information services, science and technology services, and, professional services. To benefit from the lower CIT, firms have to submit an enterprise income tax preferential application form stating preferential items to the tax authority. Moreover, Qianhai Shenzhen-Hong Kong Zone also offers preferential individual income tax (IIT) policies to those who work in the Zone or whose talents are judged to be in line with encouraged industries. If these workers' IIT on salaries exceeds 15 percent, then the Shenzhen government will subsidize the excess. The IIT preferential policy is only available to candidates who are:

- An overseas high-end talent as measured by the national, provincial, or city level government;
- Management or technical talents from World Top 500 enterprises or its branches, as well as enterprises headquartered in Qianhai Shenzhen-Hong Kong Zone;
- Have internationally recognized qualifications or an invention patent needed domestically;
- Management or technical talent of other enterprises with above-medium level position; or,
- Identified as a talent in short supply needed for the development of Qianhai.

The individual must have worked in the Qianhai-based enterprise for more than one year, and the IIT must be legally paid in the Qianhai tax bureau. The IIT fiscal subsidy should be applied for in the first two months of the year.

Customs clearance

The customs clearance process is more streamlined within the FTZs, particularly in regards to clearance declarations and payments. For instance, firms can declare several batches of goods on a single form and make a collective declaration for imports and exports of goods. This reduces clearance costs and increases declaration flexibility for firms. Additionally, if the firm has provided adequate guarantees, it can pay tax in a one-off lump sum payment within a specified period for goods that have already been imported. To maintain oversight, customs will follow up with tax audits.

In the Shanghai FTZ, border clearance can be done on a monthly or quarterly basis with all waybills. Goods shipped to the FTZ can be directly sent to the warehouse without having to first clear customs. Previously, shipments may have had to wait a few weeks before being sent to the warehouse. When being shipped outside of the FTZ, the goods must clear customs, but the clearance time has been decreased to about two to three days.

International trading center

Due to the number of companies already located within the FTZ and the existing infrastructure, FTZs have supply chain advantages. In the Shanghai FTZ, for example, goods can be delivered to the FTZ and stored within a warehouse without paying customs tax. The customs tax will only be due if it is shipped domestically. If the goods are shipped internationally, then they are not subject to tax or customs clearance. In the Plan for the Comprehensive Deepening of the Reform and Opening-up of the China (Shanghai) Pilot Free Trade Zone ("the Plan") issued by the State Council on March 31, 2017, the government announced creation of a "single window" for goods and services trade. Basically, the single window would establish a single point for customs clearance, documentation, IT, regulatory oversight of shipments, and connections with other major ports.

Industry-specific liberalizations

FTZs have liberalized policies for foreign investment enterprises (FIEs) in specific industries or capabilities that are not yet widely available in China. For instance, logistics companies established within FTZs are allowed to invest up to 51 percent in international or domestic shipping agencies. Additionally, in the Shanghai FTZ, foreign ships are able to ship to other domestic ports, shipment between domestic ports was previously limited to Chinese-owned ships. In the pharmaceuticals sector, under Article 10 of the Plan, owners of intellectual property (IP) for medical devices can entrust production of the device to an eligible original equipment manufacturer in Shanghai; the IP owner and the manufacturer previously had to be the same.

Where the Chinese FTZs will go next?

Ever since the Shanghai FTZ was established by the Chinese government, the deregulation of free trade zones has been paving the way for the success of OBOR initiative in the expected future. Not only the preferential tax policy, efficient custom clearance and deregulated domestic shipping rules, but also the innovative financial regime (such as internationalization of RMB) will make the FTZs increasingly attractive to foreign investors. Although the state control over the financial industry and shipping sector may still impact the degree and progress of liberalization of the FTZ policies in the future, there is no doubt that the institutional pilots in the Chinese FTZs will open a new window for international investor to facilitate and benefit their economic and business activities in China.

2. Company Law

Editor's Note:
In recent years, Chinese government has been promoted reforms from different perspectives in order to build a better business environment with international standards. More and more Chinese companies have evolved to cater to the demand of the international business.
To provide a better insight and understanding of changes in this field, we have organized the following: 'Company Law', with papers from our expert consultants and members.

2.1 To be or not to be?

— An Empirical S tudy on Dual-class Share S tructure of US Listed Chinese Companies (IV)

Authored by Judge Fa Chen* and Dr.Lijun Zhao**

[2]

4. The Framework of Limited Application of Dual-Class Share Structure in China

The former parts revealed that DCSS is necessary as a solution to the boom of hostile takeover in China. Moreover, the US listed Chinese companies with DCSS give out an overall satisfying corporate performance. Therefore, the adoption of DCSS in China may lead to a similar success. However, the weaknesses of this takeover defense should not be neglected, in particular, the potential risks to small

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[2] The picture is extracted from the following link, all the rights are reserved by the author. <https://image.baidu.com/search/detail?ct=503316480&z=0&ipn=d&word=%E4%B8%AD%E6%A6%82%E8%82%A1&step_word=&hs=0&pn=4&spn=0&di=59514798970&pi=0&rn=1&tn=baiduimagedetail&is=0%2C0&istype=0&ie=utf-8&oe=utf-8&in=&cl=2&lm=-1&st=undefined&cs=87052765%2C2342080833&os=892521865%2C1502616864&simid=3463697940%2C195889872&adpicid=0&lpn=0&ln=1948&fr=&fmq=1523020648785_R&fm=&ic=undefined&s=undefined&se=&sme=&tab=0&width=undefined&height=undefined&face=undefined&ist=&jit=&cg=&bdtype=0&oriquery=&objurl=http%3A%2F%2Fimg.sc115.com%2Fhb%2Fyl2%2F17%2F881603105619437.jpg&fromurl=ippr_z2C%24qAzdH3FAzdH3Fooo_z%26e3Bfv88c_z%26e3Bv54AzdH3FikAzdH3Fb0ccn_z%26e3Bip4s&gsm=0&rpstart=0&rpnum=0&islist=&querylist= > accessed 14 Mar 2018.

shareholders. On these grounds, the crucial issue lies in seeking a balance between the adoption of DCSS and its potential risks. In this part, the Chinese framework of limited application will be suggested with the purpose of utilizing the function of DCSS as a hostile takeover defense, while safeguarding the interests of companies and public shareholders to smooth its application.

4.1 The Applicable Mode of Dual-class Share Structure in China

4.1.1 The Scope of Application

Figure 3 reveals that 15 out of the 24 US listed Chinese companies with DCSS employ corporate businesses under the industry classification of either Computer & Software or General Retailers, jointly taking up 62.5%. In this sense, it seems plausible to restrict the application of DCSS to specific industries, i.e. Computer & Software and General Retailers, as they are leading forces in terms of numbers. However, in consideration of IPO raised funds and market capitalization, these 15 companies account for 52.2% and 55.2% of the 24 companies separately[3], which are both lower than that percentage counted by number. Moreover, 8 out of the 15 companies had outperformance in terms of share price[4], taking up a percentage of 53.3%. However, when calculating the 24 companies as a whole, 13 companies of which have a last sale above the IPO price with a percentage of 54.2%[5]. This means that these companies involving Computer & Software or General Retailers did not achieve better corporate performance than the average level. Therefore, it is not convincing to permit merely companies involving Computer & Software or General Retailers to employ DCSS. Furthermore, such a restriction may result in the problem of categorization, i.e. how to sort companies in the light of industry classification[6]. On these grounds, industry classification could not be a feasible restriction on the application of DCSS.

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* Fa Chen, formerly served as Judge – sitting in the Tribunal of Commercial Dispute and Intellectual Property Infringement – in Chaoyang District Court of Beijing, now as Senior Legal Consultant of a leading law firm. Specialty: Commercial Dispute Settlement and IP Litigation. Fa Chen conducted research in the UK as a Chevening Scholar. Currently, Fa is Director of Consultancy Services and Events, CECCA, http://cecca.org.uk/consultancy-1. Email: FaChen@outlook.com.

** Dr Lijun Zhao, Founding Director of the CECCA, Lecturer in law at Middlesex University London, Fellow of the Society of Legal Scholars and the Higher Education Academy. Specialty: Commercial Law, Maritime and T ransport Law , Comparative and Chinese Law . Email: L.Zhao@mdx.ac.uk
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[3] See Appendix I.

[4] See Appendix I.

[5] See Appendix I.

[6] Hong Kong Exchanges and Clearing Limited, Concept Paper on Weighted Voting Rights, August 2014 (Concept Paper), paragraphs 160-162, available at <http://www.hkex.com.hk/eng/newsconsul/mktconsul/Documents/cp2014082.pdf> accessed 13 September 2016.

Furthermore, NYSE and NASDAQ only permit new applicants to list with the issuance of dual-class shares, which means that existing listed companies are prohibited from converting into this share structure[7]. These stipulations are written under the consideration that during the IPO stage of a company, there are no public investors whose rights will be reduced by the issuance of multiple voting shares. The investors join a company via subscription, and it is their own choice, with full knowledge, to conduct the investment of purchasing shares with inferior voting rights. However, if after listing, an existing listed company could improve the voting power of specific persons through converting their single voting shares into multiple voting shares, it is extremely unfair to the other shareholders whose voting power will be reduced substantially. Therefore, where DCSS is adopted in China, the existing listed companies should be excluded from the application in order to treat the interests of all shareholders equally.

It should be noted that the existing listed companies may try to circumvent this limitation discussed above. The circumvention may be carried out through setting up a new company and listing it with DCSS, then merging the present company into the new company; or even through delisting the present company via going-private transactions and to relist it afterwards with DCSS[8]. Thus, CSRC should make strict regulation to prevent circumvention risks from occurring since it is responsible for checking and ratifying the listing of companies in China.

4.1.2 The Maximum Votes and the Unit of Shares

Figure 7 shows that 16 out of the 24 US listed Chinese companies with DCSS entitle 10 votes to each of their Class B shares, including 9 out of 11 listed on NYSE and 7 out of 13 listed on NASDAQ. In this sense, the ratio of one to ten is a leading mode. Moreover, the ceiling of 10 votes has jurisdictional supports. The restriction of maximum votes is clearly written in Swedish law[9], while Japan employs a mode of the unit stock system, which entitles one unit to be formed by either 100

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[7] It should be highlighted that VIPS initially issued a single class of shares at its IPO stage on NYSE in 2012, but it conducted recapitalisation to transfer to DCSS in 2014, see SEC, Company Filings, VIPS, Form 6-K filed on 16 September 2014, EX 99.1. Such practice seems to be inexplicable since it is expressly contrary to the NYSE listing rules. The only possible explanation is that NYSE sometimes permits listed companies to break through the restrictions stipulated in its listing rules just as the fact that Ford employed DCSS in the 1950s during its IPO stage on NYSE even though the OSOV restriction was clearly in use.

[8] Concept Paper (n 47) Paragraph 151.

[9] Swedish Companies Act 2005, Chapter 4, Section 5: No share could carry voting rights which are more than ten times greater than the voting rights of any other share.

Class A shares or 10 Class B shares[10], results in an actual outcome of the ratio are one to ten. Even though there is no theoretical footing regarding the maximum votes each multiple voting share could carry, a ceiling of 10 votes may be an appropriate choice for China since it could avoid over-diverse application of DCSS.

Rather than directly issuing dual-class shares with different voting rights, the Japanese stock unit mode could be transplanted by China to employ DCSS without annulling the present OSOV doctrine. In the light of the Chinese stock market, a stock transaction is conducted in terms of round lot, where one round lot comprises of 100 shares. Therefore, the Chinese mode could be designed as follows: voting power is conducted via stock units on the one unit, one vote basis. One stock unit could be made up of either 10 Class B shares or between 20 and 100 Class A shares in multiples of ten. Fractional stock unit is not counted in terms of voting rights but enjoys corporate dividends.

4.1.3 Internal Balancing and Legal Remedies

In case of the application of DCSS, the voting power of a company would be concentrated, which means that the election of directors is mainly decided by controllers. Under such a circumstance, how to avoid management entrenchment is the core issue to be solved, and internal balancing as well as legal remedies may be feasible solutions. With regard to legal remedies, it should be noted that relevant provisions similar to the US-based class action and derivative action have already been stipulated in China's company law[11]; therefore, the focus of this part is the establishment of internal balancing.

[10] Japan created a unit stock system in 2011 to reconcile the clash between the legislative OSOV principle and DCSS. In the light of the unit stock system, although per Class A share and per Class B share is equivalent in terms of voting right and dividend, they contribute different fractions to one stock unit. For example, according to the articles of association of Cyberdyne, one stock unit could be made up of 100 Class A shares or 10 Class B shares. Since each stock unit carries one vote regardless of its component, such system results in an outcome that when shareholders own the same amount of shares, a Class B shareholder is entitled to ten times as many voting rights as a shareholder with Class A shares actually. See Koji Toshima, 'Cyberdyne's dual-class IPO' (2014-2015) 33 (10) International Financial Law Review 43, 43.

[11] CLOC 2014, Article 151: Where the directors or senior executives violate the fiduciary duty, any shareholder individually or shareholders collectively as a group own over 1% of shareholding for consecutive 180 days could request the board of supervisors to launch a lawsuit in written from…In case this request is rejected by the board of supervisors or is not implemented within thirty days or is initiated under emergency so that any delay may result in irreparable corporate loss, the aforesaid shareholders could launch a lawsuit directly in their own names for the sake of the company; Civil Procedure Law of People's Republic of China 2013, Article 52: Where different lawsuits relate to the same object of action, the court could integrate these lawsuits into one class action, and the outcome is binding to all the plaintiffs if they approve the integration in advance no matter they attend the trial or not.

The employment of independent directors is a solution to managerial misconducts, and may be applicable to companies with DCSS[12]. Independent directors of listed companies with DCSS should be elected and appointed at the general meeting of shareholders. However, a restriction should be set that only Class A shareholders are entitled to elect independent directors, who may serve as the representatives of Class A shareholders to voice their opinions at board meetings. Furthermore, there should be a minimum percentage of independent shareholders occupy the board. More importantly, whenever a transaction is conducted between a company and its shareholders who nominated directors, these directors should be excluded from voting in order to safeguard the interests of the other shareholders and the company.

It is generally accepted that control *per se* is valuable[13], and this value is estimated to be an average 14% of the stock value according to a statistical analysis[14]. Compared with a company with the OSOV principle, an insider of a company with DCSS could get the same level of control via smaller equity. Therefore, where all the other factors are excluded, superior voting shares are more valuable than inferior voting shares. Consequently, it is a universal practice that inferior voting shares of companies with DCSS are traded at a lower price than single-class shares[15].

Currently, the 24 US listed Chinese companies employ a common model that each outstanding share enjoys equal dividend as well as the same issuing price regardless of the voting power it carries. In other words, the only difference between superior voting share and inferior voting share is voting power. Such a mode is relatively unacceptable in China which emphasizes visible justice. Instead, a mode of either entitling different classes of shares with equal dividends but issuing inferior voting shares at a discounted IPO price or issuing all shares at equal IPO price, however, empowering inferior voting shares with higher dividends is more practical in China. Such a design could be supported by the practice in the US. According to an empirical analysis that sampled 70 American

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[12] Similar restrictions have already been in use in the US that some listed companies employed a mode of entitling Class A shareholders and Class B shareholders to nominate their directors respectively, and the percentage of shareholders that each class of shareholders could nominate was set in the articles of associations in advance, see Marcia Millon Cornett and Michael R. Vetsuypens, 'Voting rights and shareholder wealth: the issuance of limited voting common stock' (1989) 10 Managerial and Decision Economics 175, 178; see also M. Megan Partch, 'The creation of a class of limited voting common stock and shareholder wealth' (1987) 18 Journal of Financial Economics 313, 318-319; Paul A. Gompers, Joy Ishii and Andrew Metrick, 'Extreme governance: an analysis of dual-class firms in the United States' (2010) 23 The Review of Financial Studies 1051, 1057.

[13] Concept Paper (n 47) Appendix IV, Paragraph 11; see also Mike Burkart and Samuel Lee, 'The one share-one vote debate: a theoretical perspective' (2007) ECGI-Financial Working Paper 6 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=987486> accessed 15 May 2017.

[14] Alexander Dyck and Luigi Zingales, 'Private benefits of control: an international comparison' (2004) 59 Journal of Finance 573, 573.

[15] An empirical analysis showed that outstanding shares of dual-class shares companies were priced at a discount of about 18% than their counterparts with single-class shares, see Scott B. Smart, Ramabhadran S. Thirumalai and Chad J. Zutter, 'What's in a vote? The short- and long-run impact of dual-class equity on IPO firm values' (2008) 45 Journal of Accounting and Economics 94, 100.

listed companies with DCSS during 1962-1986, 46 companies entitled superior dividends to their inferior voting shares, and another 2 companies set a sunset clause with regard to the preferential dividends that inferior voting shares enjoyed[16].

Furthermore, in consideration of the Chinese stipulation that 'shares could be issued with a price equal to or over their par value, but not below their par value'[17], where Class B shares are issued at par value, it would leave no space for Class A shares to be issued at a discounted price. Therefore, the latter mode, i.e. Class A shares are issued at IPO price equal to Class B shares but enjoy higher dividends, is more feasible.

4.2 The Limitations of Application

DCSS is commonly employed by the US listed Chinese companies with some restrictions on the rights enjoyed by the holders of weighted voting shares. In this part, these restrictions will be reviewed to discuss their implications. Some typical restrictions adopted by American companies with DCSS will also be discussed to enrich comparative analysis[18].

The most common limitation on the application of DCSS is the restriction on the transfer of multiple voting shares to outsiders. It means that once multiple voting shares are assigned to a person who is not a member of the initial beneficial owners or their affiliated entities, those assigned multiple voting shares must be converted into OSOV shares immediately. All the 24 US listed Chinese companies employ such a restriction, while it is also commonly applied by American companies, e.g. Alphabet (formerly Google), Facebook Inc and LinkedIn. In consideration of the purpose of adopting DCSS in China, i.e. keeping specific persons on board to maintain their control, it is reasonable to employ a similar restriction on the transfer of Class B shares since the aforesaid purpose will become meaningless without such restriction.

One company (ATHM) requires that in case a change of control event takes place, all its Class B multiple voting shares must be converted into Class A shares without delay. Such a restriction is not found among American companies. In addition, one company (JD) requires that where its founder Richard Liu could not serve as the CEO or attend board meetings any longer due to any physical or mental condition, the conversion of all JD's multiple voting shares into the same amount of Class A shares will be triggered. Similar restrictions are also adopted by American companies, e.g. Alphabet, LinkedIn, Groupon, etc. Even though these two sorts of restrictions are not leading modes by

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[16] See Cornett and Vetsuypens (n 53) 178; Also in the practice in the US, inferior voting shareholders were generally entitled preferential dividend (often 10%) in order to smooth the recapitalization of DCSS, see Gregg A. Jarrell and Annette B. Poulsen, 'Dual-class recapitalizations as antitakeover mechanisms: the recent evidence' (1988) 20 Journal of Financial Economics 129, 136; Gompers, Ishii and Metrick (n 53) 1057.

[17] CLOC 2014, Article 127.

[18] A detailed summary of the restrictions, see Appendix IV. All the restrictions discussed in this part are from the articles of associations of these companies filed on SEC.

number, they are in consistent with the purpose of keeping specific persons as controllers; therefore, these two restrictions could be transplanted into the Chinese framework.

One company (EHIC) sets a minimum threshold with regard to the issuance of its multiple voting shares, i.e., Class B shares must take up no less than 5% of the total outstanding shares. It means that provided its Class B shares as a whole fall below 5% of the total outstanding shares, all these Class B shares must be converted into Class A shares. LinkedIn sets a similar restriction with a threshold of 10%. Considering the fact that the Class B shares of both EHIC and LinkedIn carry 10 votes per share, the threshold of 5% means the insiders could control approximately 34.5% of voting rights; while this maximum voting power is 52.6% if the threshold is 10%[19]. Therefore, the threshold of 10% could guarantee a simple majority of voting power while the threshold of 5% could not achieve this goal. Even though 34.5% of voting power is significant enough to decide most corporate affairs, in consideration of the purpose of adopting DCSS, the threshold of 10% is more reasonable.

Another common restriction adopted by these US listed Chinese companies is the requirement of minimum equity held by insiders. Indeed, 11 out of the 24 companies with DCSS adopt such a restriction though with different percentages (see Appendix IV). In view of the purpose that multiple voting shares should be held by insiders or their affiliated entities exclusively, this requirement is meaningless in China.

There are some restrictions applied by American companies but are not employed by their Chinese counterparts. Two American companies, Facebook and Groupon adopt a mechanism of voting to exit, which requires that in case sufficient multiple voting shares holders approve the transfer to SCSS, the conversion of all multiple voting shares into single voting shares will take place. Facebook sets its requirement at 50%, while Groupon employs a threshold of 66.6%. In addition, Groupon establishes a sunset clause in its sixth amended certificate of incorporation, which requires all its multiple voting shares to be converted into single voting shares mandatorily in five years. No similar restrictions are employed by the 24 US listed Chinese companies.

The system of voting to exit is the autonomy of corporation in nature. Nevertheless, such autonomy relates to the recapitalization of a company, and thus it is regarded as a significant corporate affair that requires two-thirds special majority of votes held by the shareholders at the general meeting in China. Therefore, it is practical to localize the mechanism of voting to exit via conferring such power to the general meeting of shareholders with a criterion of two-thirds approval.

In respect of the sunset clause, it may be more reasonable not to adopt such a mandatory expiration because there is no practice relating to the application of DCSS in China, and thus the

[19] When Class B shares contribute 5% of the total outstanding shares and all these Class B shares are held by the insiders, provided there is only one Class B share and 19 Class A shares, the voting power of Class B shareholder is calculated as follows:

= 34.5%. According to a same method of calculation, the threshold of 10% means 52.6% of voting power.

actual outcome of such an application is hard to predict. In case the application is practically beneficial, it is not appropriate to limit it within a fixed duration. On the contrary, if the application of DCSS is problematic, it is proper to abolish it timely rather than after 5 years' adoption. On these grounds, an elastic lifespan of the application of DCSS is more feasible in China. It means that there is no sunset clause; instead, CSRC is responsible for conducting the periodical evaluation of the application of DCSS, e.g. every two years. In case the outcome of evaluation is positive, a company is permitted to prolong the application for another two years; otherwise, a negative outcome means a company must transfer to SCSS.

Based on the discussions above, the framework of limited application of DCSS as a hostile takeover defense in China could be constructed as follows: Any new applicant, regardless of its industry classification, could employ DCSS during its IPO stage with both Class A and Class B shares carrying one vote per share. Voting rights are conducted according to units of shares on the one unit, one vote basis, of which each unit could comprise 10 Class B shares or at least 20 but no more than 100 Class A shares in multiples of ten. Class A shares and Class B shares are issued at the same price, but Class A shares enjoy higher dividends. In a company with DCSS, Class A shareholders at the general meeting of shareholders enjoy the right to appoint independent directors exclusively. Class B shares should be no less than 10% of the total outstanding shares, and are transferable among insiders or their affiliated entities merely. The retirement of insiders or a change of control event will bring about a mandatory conversion of Class B shares into Class A shares. CSRC is responsible for checking the necessity of the application of DCSS on a case-by-case basis and conducting the periodical evaluation to decide any extension.

Conclusion

In China, a number of recent amended financial policies and legislation have been facilitating hostile takeovers hugely through providing abundant leverage capital and increasing the difficulty of takeover regulation. Therefore, it is a feasible solution to the boom of hostile takeover via entitling companies to adopt more takeover defenses autonomously, in particular, DCSS.

The Chinese companies with DCSS listed on the US stock exchanges after 2011 have achieved a great success in terms of not only financial scale and raised funds, but also stock return and market capitalization. Such outperformance could provide practical insights that the adoption of DCSS in China may bring about a similar outcome.

However, the potential risks to companies and shareholders which may be symbiotic with the adoption of DCSS should not be ignored. Therefore, the core issue lies in seeking a balance. In case DCSS is adopted, a set of strict restrictions is a feasible way to achieve the balance. Both the US and Japan permit the adoption of DCSS, and their practices provide some useful experience which could be transplanted to China with localization, e.g. the restriction on transfer and the stock unit system.

Moreover, CSRC should try its best to avoid misuse of DCSS through undertaking more responsibilities, e.g. periodical assessment.

In conclusion, it is feasible to adopt DCSS as a hostile takeover defense in China; however, the application should be employed with strict restrictions.

2.2 Venture Capital Investment Trusts in China: Legal Framework, Challenges and Reform (I)

Authored by Dr. Chi Zhang*

[20]

Introduction

* Dr. Chi Zhang, Deputy Editor in Chief of the CECCA; Lecturer in Commercial Law at School of Law and Humanities of China University of Mining and Technology (Beijing). Ph.D in Law, The University of Glasgow; LL.M. and LL.B., Tsinghua University. E-mail: chi.zhang@cecca.com.cn. *The full version of this paper has been published in Trusts & Trustees (7) 2017, pp. 806-822.*

[20] The picture is extracted from the following link, all the rights are reserved by the author. < www.chinamoneynetwork.com> accessed 14 Mar 2018.

In the recent decade, the limited partnership has been applied as the most popular organizational form for venture capital (VC) businesses in China.[21] Prior to the limited partnership was introduced into the Law of Partnership Enterprises of the People's Republic of China[22] in 2006, however, the business trust has been widely applied as an important organizational form for VC investment in China. Under the present commercial law system in China, all the venture capital investment trusts (VCITs) are soundly regulated by both the Law of Trusts of the People's Republic of China (2001)[23] and China Banking Regulatory Commission (CBRC)'s regulations. Owing to a series of economic and political factors, however, the governance structure of VCITs under the Chinese legal system is still inefficient, which has given rise to failures of initial public offerings (IPOs) of VCIT-held companies in Chinese stock markets. Undoubtedly, this seriously reduces the competitiveness of trust corporations in Chinese VC industry.

This article aims to review the legal practices of VCITs in Chinese financial market and to explore feasible approaches to address above issues, which proceeds as follow: section two briefly draws a whole picture of both the market and legal framework of VICTs in China; section three discusses the three main problems in relation to investor protection of China's VCITs in detail: (i) the inefficient decision-making process of the VCITs; (ii) the ineffective monitoring mechanism of custodian banks; (iii) the 'zero-loss promises' of the trust corporations which distorts Chinese trust market; section four then discusses the main problem of Chinese VCITs, namely the barrier to initial public offerings (IPOs) of VCIT-held companies in Chinese stock markets and shows how costly the alternative approaches to list such companies on the stock exchanges in China can be. The section that follows tries to put forward advices for improving the efficiency in organizational governance and for enhancing the protection of beneficiaries of VCITs in China. Based on the discussion above, this article tries to summarize the nature of the VCITs in Chinese legal system and briefly foresee the legal reform of it.

2 Venture Capital Investment Trusts in China

2.1 An Overview of China's Market of VCITs: 1990s–2010s

[21] Lin Lin, 'Private Equity Limited Partnerships in China: A Critical Evaluation of Active Limited Partners' (2013) 13 (1) Journal of Corporate Law Studies 185, 186.

[22] Hereinafter referred to as 'the Law of Partnerships (2006 Revision)'.

[23] Hereinafter referred to as 'the Law of Trusts (2001)'.

As one of the early achievements of the 'opening up policy', the first trust investment corporation, namely China International Trusts Investment Corporation (CITIC) was incorporated by the China State Council in 1979. Thereafter, hundreds of trust investment corporations were incorporated all around China. By late the 1990s, as many as 239 trust investment corporations (including the collective investment departments of commercial banks) were established in China.[24] After six waves of reorganization from the 1990s to 2007, most of those small-scale and unqualified trust investment institutions were ordered to dissolve and at present the number of the licensed trust investment corporations has declined to 68,[25] all of which are regulated by the China Banking Regulatory Commission. In a practical respect, the first VCIT was issued by CITIC in 2007.[26] Afterwards, the quantity and capitalization of VCITs in the Chinese capital market were expanded at a high rate.

Generally speaking, during the time from the 1980s to 1990s, the main business of most Chinese trust investment corporations includes cross-border investment, real estate investment, international trade, finance leasing and trust loans, whereas collective investment did not emerge until 1991.[27] By the end of 1997, there were 79 collective investment funds in China with capitalization of RMB6.83 billion.[28] However, there was almost no typical venture capital fund organized in trust form until a series of laws and regulations were legislated in 2007. In terms of VCITs, the two specific regulatory documents established the basic legal structure for carrying out venture capital investment trusts in China. The one was the Rules on Trust Schemes of Collective Funds by Trust Companies (released in 2007 and revised in 2009)[29] and the other was the Guidelines for Trust Companies to Operate the Trust Private Equity Investment Business (2008),[30] both of which will be discussed in detail later.

2.2 The Legal Structure of China's VCITs

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[24] Hui Guo, 'Trust Industry in China: Theories and Practices' (Doctoral thesis, Southwestern University of Finance and Economics 2000) 8.

[25] China Trustee Association's (CTA) official website: http://www.xtxh.net/About_Us/.

[26] The 'CITIC JINXIU Private Equity Investment Trust Scheme (**I**)' <http://trust.ecitic.com/upload/product/jxyh-1.pdf> accessed 14 April 2016.

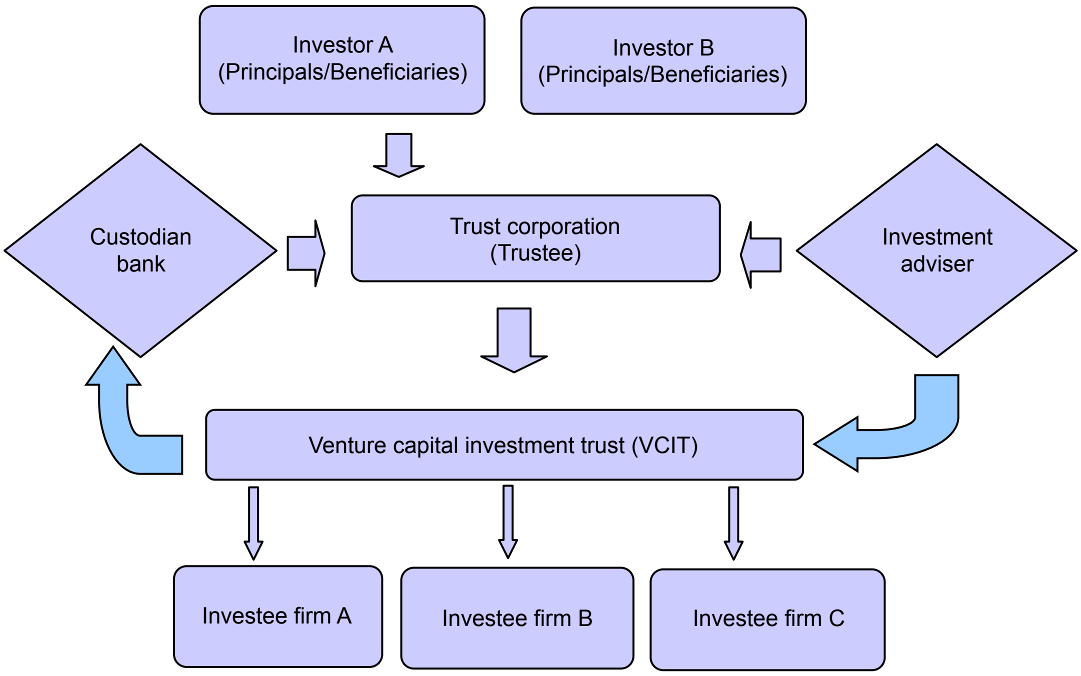
[27] Hui Guo (n 5) 3–7.

[28] Ibid., 6.

[29] Hereinafter referred to as 'the Rules (2009 Revision)'. The official English version is available at http://www.cbrc.gov.cn/EngdocView.do?docID=2008021460B29446D37C7BD8FF97A8A63BC79000.

[30] Hereinafter referred to as 'the Guidelines (2008)'. The official English version is available at http://www.lawinfochina.com/display.aspx?lib=law&id=7069&CGid.

According to the Law of Trusts (2001), the Rules (2009 Revision) and the Guidelines (2008), the VCITs in China are commonly structured as follows: the licensed trust investment corporation issues the venture capital collective investment schemes to qualified investors.[31] The trust investment corporation, as the trustee, should be responsible for prudently investing the funds in unlisted companies. In terms of the distribution of profit, the trustee has the right to charge management fee in the amount of 1% to 2% of the total trust assets. Only if the profit rate surpasses the hurdle rate, can the trust corporation enjoy 20% of the gross profit and the rest of profit will be allocated to the beneficiaries.[32] The basic legal structure of VCITs under Chinese law can be illustrated simply by a classic VCITs project Hu Nan Trust Corporation–Venture Capital Collective Investment Trust Scheme (I) (2007)[33] as follows:



[34]

Figure 1: The legal structure of VCITs in China

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[31] According to s 6 of the Rules (2009 Revision), the so-called 'qualified investor' refers to

> (1) a natural person, legal person or an organization established according to law, whose minimum investment in a trust plan is 1 million Yuan or more; (2) a natural person whose total individual or family financial assets exceed 1 million Yuan at the time when he/she subscribes the trust plan and who can provide the relevant property certificate; (3) a natural person whose annual income exceeds 200,000 Yuan for the latest three years or whose annual income plus the annual income of his/her spouse exceeds 300,000 Yuan for the latest three years and who can provide the relevant income certificate.

[32] Zhi Zheng, Wentao Wang, *Decoding the Trusts* (Citic Press 2014) 294-300.

[33] Hereinafter referred to as the 'Hu Nan Project 2007'.

[34] This picture is extracted from the published article, Oxford University Press, the publisher obatins the copyright.

The Hu Nan Trust Corporation is the trustee who has the power to control and to manage the trust capital independently for the interests of beneficiaries and, at the same time, beneficiaries are not allowed to get involved in the daily business of the project. Moreover, the trust investment corporation employed Fortune Capital Corporation, a Shenzhen-based VC firm to provide professional consultation for the purpose of reducing risk. Additionally, the VC firm did not control the fund directly, but deposited fund capital into an independent account in a custodian bank, namely the Hunan Branch of the Industrial and Commercial Bank of China. For the safety of transaction, neither the trust corporation nor the VC firm is able to dispose of the funds, unless a given investment proposal has been approved by the custodian bank pursuant to the statutes and trust agreement.[35]

Furthermore, the trustee set up the beneficiaries' meetings to decide collectively on (i) proposals for reinvestment; (ii) termination and extension of the project; and (iii) the arrangement of management fees for trustees. With the exception of the above matters, any conduct should be controlled and determined exclusively by the management staff of the trust fund. According to the agreement, the management fees of the Hu Nan Project (2007) was counted as (i) the fee for the trust corporation made up of 1% of the gross capital in the fund; (ii) the fees for the investment adviser (VC firm) took up of 2.5% and (iii) the custodian fee represented 0.6% of the gross capital in the fund. Finally, after deducting the aforementioned fees and tax, if the hurdle rate of profit was realized, the VC firm was entitled to obtain 15% of the net profit of the project, while 85% of the profit will be distributed to each investor.[36]

3 The Challenges of the Governance Structure of China's VCITs

3.1 Beneficiaries' Intervention in Fund Management

3.1.1 Beneficiaries' Voting Rights in the Decision-making Process

[35] See details of the trust agreement of Hu Nan Trust Corporation–Venture Capital Collective Investment Trust Scheme (I) at <http://www.baike.com/wiki/%E2%80%9C%E6%B9%96%E5%8D%97%E4%BF%A1%E6%89%98%E5%88%9B%E4%B8%9A%E6%8A%95%E8%B5%84%E4%B8%80%E5%8F%B7%E9%9B%86%E5%90%88%E8%B5%84%E9%87%91%E4%BF%A1%E6%89%98%E8%AE%A1%E5%88%92%E2%80%9D%E6%A1%88%E4%BE%8B%E5%88%86%E6%9E%90> accessed 2 May 2016.

[36] Ibid.

Although the Law of Trusts (2001) stipulates that the trustee must honestly and prudently deal with trust affairs in the best interests of beneficiaries,[37] the most serious problem is the lack of a practical standard of fiduciary duties for standardizing the trustee's conduct in China. This shortcoming results in that the investors are unable to foresee whether the loss of investment in VCITs can be repaid by the trustee and the trustees are confused about the boundary of liability as well. Consequently, most VCIT investors tend to actively participate in fund management for the purpose of securing their interests in trust funds.

Another typical VCIT in China is the Bo Hai Industrial Investment Fund[38] which was organized in the form of investment trust. The investors entrusted funds to the two trustees, namely BOC International Holdings Limited and Tian Jin Tai Da Investment Holding Company Limited. The two corporations would be responsible for managing the fund on behalf of investors. Unlike limited partnership funds, the trustees did not assume unlimited liability for the loss of the fund nor enjoy any equity interests in the trust fund, the security of fund management were under question. Therefore, all the investors emphatically required direct decision-making power in the management of the fund. As a result of the compromising, the trustees of the fund and the investors agreed to jointly incorporate the Bo Hai Industrial Investment Fund Management Company Limited which was supposed to be the actual trustee of the Bo Hai Fund. The problem is that the actual managers of the investment were the two investment management corporations holding 70% of the shares of the management company, while the beneficiaries obtained 30% shares of the company. Such a kind of shareholding structure has actually altered the VCIT into a corporate-type investment fund, in which the beneficiaries' voting power could substantially weaken the independent management and efficient operation of the fund.

3.1.2 The Inefficient Decision-making Procedures of Beneficiaries' Meetings

Ever since the promulgation of the Rules (2009 Revision) in 2007, most VCITs established beneficiaries' meeting as the supreme decision-making body of the fund. Section 42 of the Rules (2009 Revision) stipulates that if there is no rule of '1) terminating trust agreement or extending contract term; 2) altering utilization approaches of trust assets; 3) replacing the trustee; 4) raising remuneration for the trustee; 5) other items that need to be decided by the beneficiaries' meeting as prescribed in

[37] The Law of Trusts (2001), s 25.

[38] All the details in relation to this case are summarised from The Official Introduction of Bo Hai Industrial Investment Fund Management Co., Ltd at <http://wenku.baidu.com/view/32e35c1ba300a6c30c229f97.html> accessed 14 May 2016; Jianfei Zhao, 'Bo Hai Fund: PE Made in China' (2007) <http://futures.money.hexun.com/2009103.shtml> accessed 14 May 2016.

trust scheme documents', a beneficiaries' meeting shall be convened to decide the aforementioned issues. Section 46 of the same regulation also provides that 'any decision on the issues for deliberation shall be agreed by at least two thirds of the effective votes before it goes into effect, except for the decisions on replacing trustees, altering trust assets utilization approaches and terminating trust agreement in advance, which shall be agreed by all the beneficiaries present at the meeting'. Such provisions actually entitle beneficiaries to extremely powerful veto right to intervene in the management of VC funds. Practically, all the participants of VCITs have to negotiate all the provisions and details in fund operation, otherwise the trustee and all beneficiaries have to canvass or negotiate with one another to propose any alteration regarding fund utilization.

In recent years, several legal disputes regarding the inefficient voting procedure of beneficiaries' meeting have emerged in China. In the case of Zheng Da Jin Niu Investment Trust Scheme (2012), owing to the continual huge losses suffered by the trust fund, some beneficiaries requested that the trust should be terminated ahead of schedule by convening a meeting of the beneficiaries, but were refused permission by the trustee, CCB Trust Company Limited. Pursuant to the trust deed and the Rules (2009 Revision), if the trust investment corporation refuses to convene the beneficiaries' meeting, 'those beneficiaries who hold more than 10 per cent of the total trust units shall have the right to convene a meeting'.[39] However, the gross capital of such a trust scheme is as huge as RMB 400 million and most investors only held RMB 3 to 5 million, which means that the beneficiaries' meeting could only be convened by at least ten investors' joint calling. [40] Eventually, the gross rate of loss to the fund has been increased from 28% (April 2012) to 50% (January 2013) when a protracted negotiation between the beneficiaries was reached.[41] In a technical sense, it is obvious that such a decision-making procedure of the beneficiaries' meeting was inefficient and the long-term process of the meeting had seriously increased transaction cost.

3.2 The Ineffective Monitoring Mechanism of Custodian Banks

3.2.1 The Relationship between Custodian Banks and Trust Corporations in China

In traditional trusts the settler generally is now allowed to control the trust fund directly, and owing to the complexity and risk in modern investment funds, however, the agency problems in business

[39] The Rule (2009 Revision), s 43.

[40] Shuo Zhang, 'CCB Da Jin Niu Scheme: Huge Losses, Few Remedy' (30 January 2013) <http://finance.qq.com/a/20130130/000326.htm> accessed 20 May 2016; Zosenda Group, 'A Case Study of CCB Da Jin Niu Scheme' (19 December 2012) <http://blog.sina.com.cn/s/blog_b565528c0101ay90.html> accessed 20 May 2016.

[41] Ibid.

trusts have been exacerbated considerably. For settling this matter, trusts in common law jurisdictions commonly require a qualified third party to safeguard the funds and to supervise fund management.[42] Similarly, the existing Securities Investment Fund Law (2012 Revision)[43] of China and the Rules (2009 Revision) both require the investment fund manager and trustee to employ a commercial bank as custody of the fund. Theoretically, for the effectiveness of the supervision, the basic requirement of a custodian bank is that the custody should not be an affiliated enterprise of the fund management corporation. For example, s 36 of the SIFL (2012 Revision) prohibits a custodian bank and a fund manager from holding or making capital contribution to each other's shares. Additionally, s 19 of the SIFL (2012 Revision) also prevents the directors and managers of fund management firm from serving as any employees in custodian banks and from holding any equity interest in the custodian banks. In contrast, however, the Rules (2009 Revision) only requires that 'in the duration of a trust scheme, the trust company shall choose a sound commercial bank as its custodian',[44] but does not restrict the affiliated relationship or any conflicts of interest between the trust corporation and the custodian bank.

In comparison with other types of collective investment trusts, the management of VCITs is more complicated, hence the trustees of VCITs are required to have not only special skills and experiences in financial investment but also much wider scope of knowledge such as corporate management and other related fields. However, since the early 1980s, most of China's trusts corporations were only allowed to invest in some particular low-risk markets, such as debt financing, finance lease or even international trading[45], and until 2007 the development of China's VCITs was officially admitted by the Chinese authorities; in other words, the trust corporations in China have not built up their own networks and reputation in the venture capital market. Hence, at present, quite a large number of VCITs are sold and raised by commercial banks, and the professional private equity and venture capital firms are employed to be in charge of the daily management of such VCITs. In this way, the trust corporations have the opportunity to use the commercial banks' network of clients[46] and to build up their reputation by co-operating with professional VC firms. Accordingly, those trust

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42 See 'Collective Investment Schemes Sourcebook' of the Financial Conduct Authority Handbook <http://fshandbook.info/FS/html/FCA/COLL/6/6> accessed 21 June 2016.

43 Hereinafter referred to as 'the SIFL (2012 Revision)'.

44 The Rules (2009 Revision), s 19.

45 Lihong Zhai, Linfeng Yang (ed), *The Innovation of Investment Trusts* (China Finance and Economics Publishing House 2008) 103-105.

46 For more details, see Jianchun Zhang, Jingyi Yu, 'The Relationship between China's Monetary Trusts and Commercial Banks' 2005(4) China Urban Economy 24.

corporations that are held by commercial banks[47] are more competitive in Chinese VC market. This is the main reason why the laws and regulations in China do not forbid the connected relationship between the trust corporations and custodian banks.

3.2.2 The Legal Status of the Custodian Bank of VCITs

According to the Rules (2009 Revision), the statutory duties of custodian banks of a VCIT mainly include:

> 1) safely keeping the entrusted property in custody; (2) opening different accounts for different trust schemes to ensure the independence of entrusted property; (3) confirming and carrying out the trust company's order of managing and utilizing entrusted property; checking up the transaction records, funds and accounts of the entrusted property;
> (4) recording entrusted funds transfers and keep letters of illustration for fund use delivered by the trust company; (5) periodically working out custody reports to the trust company. (Section 21)

and

> In case that the trust company violates laws and regulations, or trust documents, or the custody agreement, the custodian shall immediately notice in written the trust company to set right; where material violation or an event that seriously threaten the safety of entrusted property occurs, the custodian shall report to the CBRC promptly. (Section 22)

In other words, the function of the custodian bank of VCITs is to be responsible for the security of the trust funds and to supervise the trustees, but not to directly dispose of the trust property. However, according to the definition of a 'trust' under the Law of Trusts (2001), a trustee's role in a trust is managing or disposing of the property.[48] A further question is whether the custodian bank is a joint trustee under Chinese law; in other words, although the custodian bank's functions of VCITs are unlikely to be regarded as 'disposition of trust assets', but whether it should be regarded as 'managing trust property'?

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47 By 2013, China Industrial International Trust Company Limited held by China Industrial Bank, CCB Trust Company Limited held by China Construction Bank and Bank of Communication International Trust held by Bank of Communication accumulatively managed RMB1,170 billion in China's trusts industry, represented 11% of the whole trust asset of China trusts market. The stable and wide client base is the most important advantage of the above trust corporations. See Zhuoqing Yang, and Huiru Zhong, 'Huge Strength Disparityof Trust Corporations, Bank-based Trust on the Top' (7 July 2014) <http://finance.china.com/fin/xt/201407/17/9486013987.html> accessed 22 August 2016.

48 The Law of Trusts (2001), s 2.

Although the existing statutes of Chinese trust law and relevant regulations do not provide an express answer to this question, the Law of the People's Republic of China on Commercial Banks (2003 Revision)[49] excludes the possibility of trust investment businesses operated by commercial banks in China.[50] Therefore, it can be asserted that the relationship between a trust corporation and a custodian bank of VCITs in China is not a 'co-trusteeship', but a sort of general contractual relationship; that is to say, the employment of a custodian bank only depends on the trust corporation's selection, and there is no legal connection between investor (beneficiaries) and custodian banks. Therefore, in a legal sense, the custodians are not responsible for any loss to the beneficiaries of VCITs.

3.2.3 The Ineffective Supervision by Custodian Banks

As mentioned above, the prime function of the custodian is to keep the fund safe by virtue of supervising the trust investment corporation's disposition of the funds. Nevertheless, the governance structure of Chinese VCITs can hardly achieve this goal. The affiliated relationship between some trust corporations and commercial banks may benefit the managers or shareholders of the custodian banks from the trustee's opportunistic behaviors, which substantively weakens the effectiveness of custodians' supervision. Moreover, the trust corporations tend to select those commercial banks that are likely to compromise with trustees, because the employment and selection of custodian banks are absolutely determined by the trustees of VCITs; that is to say, the market of custodian banks in China's trust industry is distorted and incompletely competitive.

In addition, the custodian fee is the only source of income for the custodian banks in custodian business, once the fixed custodian fees are earned, the custodians may have no further motivation to diligently supervise the performance of the trustees. Owing to the unclear liability mechanism in Chinese laws,[51] the custodian banks may also have very little pressure to supervise the trustees. In sum, the main problem regarding the custodian banks of Chinese VCITs is the lack of both economic incentive and independent legal status, which results in weak protection for trust beneficiaries of VCITs.

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49 Hereinafter referred to as the 'Law of Commercial Banks (2003 Revision)'.

50 The Law of Commercial Banks (2003 Revision), s 43.

51 As mentioned above, the legal status of custodian banks are not clearly defined as co-trustees with the trust corporations, so that the custodian banks are not statutorily liable for the loss to beneficiaries.

3. Academic Frontier

Notable Recent Achievements of Greek Shipowners

Authored by Richard Scott[52]

Among remarkable maritime trends, one of the most remarkable is the continued success of Greek shipping. Today, the Greek-owned merchant ship fleet is still in top position, remaining by far the world's largest capacity fleet by owner nationality, with one-sixth of the global total.

Greece stands out as a small economy with an exceptionally large maritime involvement. The other two largest shipowning countries - Japan and China - are much bigger economies. At the beginning of 2017 the Greek-owned fleet comprised 16.7 percent of the world fleet's deadweight capacity, according to UNCTAD data.[53] This proportion was over four percentage points higher than number two Japan, with 12.1 percent of the total, followed by China with 9.0 percent. The next two largest, Germany and Singapore had 6.1 percent and 5.7 percent shares respectively.

Amid the struggle for economic stability in Greece in recent years, the Greek-owned fleet's upwards trend has continued unabated. The chart emphasises growth measured in gross tonnes. Using deadweight capacity, all seagoing vessels[54] reached 309 million deadweight tonnes on 1st January 2017, 85m dwt higher than Japan's 224m dwt and 143m dwt above China's 165m dwt. These comparisons emphasise the powerful position of Greek merchant shipping.

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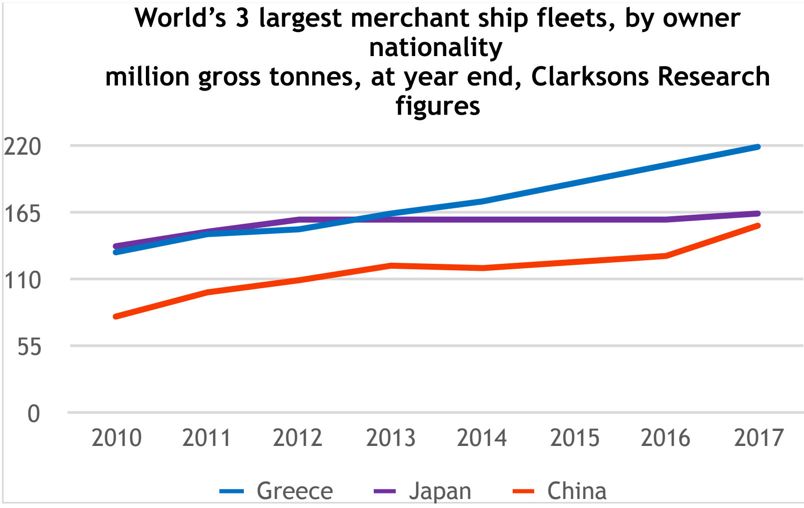
52 Richard Scott, MA MCIT FICS, Senior Consultant, CECCA; Associate, China Maritime Centre, Southampton Solent University .
This article was first published in SOLENT Global Maritime Weekly Digest, 9 January 2018.

53 UNCTAD (2017), Review of Maritime Transport, 2017 (Geneva: UNCTAD), 28

54 statistics include seagoing vessels of 1000 gross tonnes and above, as compiled for UNCTAD by Clarksons Research



[55]

Valuable detail has been added to this outline by statistical research, published in mid-January this year, prepared by consultants *Petrofin Research*.[56] These statistics reveal the composition of the Greek-owned fleet, together with a close analysis of companies involved. Accompanying comments emphasise the changes taking place and what has influenced shipowning decisions. The latest 2017 figures are based on the position at year-end.

An Expanding Fleet, Getting Younger

Based on Petrofin's calculations, at the end of 2017 the Greek-owned fleet totalled 387m dwt, representing growth of 7 percent compared with twelve months earlier. In the preceding year, 2016, growth of 10.3 percent was recorded, following a 7.5 percent increase in 2015. The calculated capacity figures differ from those of other sources, probably due to the method of identifying Greek tonnage.[57] Fleet expansion therefore totalled 28 percent over three years.

The average age of vessels in the entire fleet decreased to 11.8 years in 2017, down slightly from 12.2 years twelve months earlier. Over five years the fall was much larger, from a 14.7 years average in 2012, an age reduction of thirty five months. This movement

[55] This picture is extracted from the published article, the author obtains the copyright.

[56] Petropoulos, T (2017), Research and Analysis: Greek Shipping Companies (1st part) and Greek Fleet Statistics (2nd part), Petrofin Research.

[57] Statistics compiled by Petrofin include "groups that operate abroad, provided they have an office in Greece" and also include "US and UK listed companies initiated/promoted/managed by Greek interests, which also hold a Greek presence". These inclusions appear to result in larger totals for Greek ownership than identified by other statistics providers.

towards younger vessels has been seen in all the main sectors – bulk carriers, tankers, container ships and gas carriers. Moreover, the so-called 'overage' fleet element, elderly vessels of 30 years age and older, continued declining last year to about a minimal one quarter of one percentage point.

How were these results (expanding fleet, reducing average age) achieved? In 2017 there was what Petrofin describes as "a concerted effort, on a wide scale, to renew the fleet".[58] Purchasing secondhand vessels from foreign owners was the preferred option. The economics of replacing older tonnage with younger good-quality secondhand ships at attractive market prices proved persuasive. Ordering new vessels from shipbuilding yards was not seen as so beneficial.

Acquisition of second-hand vessels increased greatly last year, by almost one-third, raising the number bought by Greek owners to 260, from 200 in the preceding twelve months. Among other opportunities, buying modern ships in bank-promoted deals was exploited, partly reflecting financial pressures being experienced by German owners and banks.

Consolidation: Declining Number of Companies

Another aspect highlighted by the Petrofin statistical analysis is the continued downwards trend in the number of Greek shipowning companies. By the end of last year there was a net loss of 41 companies over the twelve months period, reducing the number to 597. Eight years earlier, at end-2009, there were 773.

Since the overall fleet was growing strongly over that period, individual company size became larger, further emphasising the consolidation process. The proportion of the entire Greek-owned fleet's deadweight capacity represented by companies owning large individual company fleets, comprising twenty five or more ships, rose to 67 percent at the end of 2017. This proportion compares with a 42 percent fleet share at end-2010.

Small companies (those defined as owning just one or two ships) saw an especially rapid attrition during the past twelve months, declining to 233 at end-2017, from 265. That reduction comprised most of the entire fleet's fall in company numbers last year.

Whether this trend will persist, and for how long, is not entirely clear. The Petrofin report expresses expectations of future growth in the Greek-owned fleet. It suggests that a market improvement in most sectors would be expected to slow the decline in the number of owning companies, and the

[58] Petropoulos, T (2017), Research and Analysis: Greek Shipping Companies, Petrofin Research, 12

decline might be at least partly reversed with a modest market recovery unfolding. Even small owners, it is contended, could benefit from better returns and remain operating in the market.

Box 1 **Greek Shipowners' Superior Performance: How Do They Do It?**

The foregoing, largely statistical, outline of the Greek-owned fleet's recent evolution does not reveal the reasons for its impressive performance. For an explanation of the ongoing success of Greek shipowners, two sources provide valuable insights.[59] First, what can be deduced from extended observation of Greek shipowners' activities and operational mode in the marketplace. Second, a range of academic studies which confirms and elaborates upon traits and trends.

Greek owners function within a paradigm which in principle is replicable elsewhere but, in practice, is hard to replicate. It is a paradigm reflecting a unique combination of circumstances and characteristics, a particular mindset and attitude to organising and financing shipping business activities and assessing risk taking.

What are the explanations for success as the leading player in global shipping? A stylised list includes several ingredients, in varying combinations.[60] Private capital is a major contributor to finances. Greek owners are entrepreneurs and professionals, maintaining absolute control of strategy and operations. A typical family structure facilitates entrepreneurial flexibility and quick responses. Island and kinship ties are features.

Fragmentation of business units is a phenomenon. Family members form new companies separate from the existing arrangements. A low-cost objective accompanies innovation and distinctive investment schemes often include counter-cyclical strategies.[61]

Emphasis also has been placed on the aspect of shipowning as a lifestyle choice for Greek owners in many instances.[62] Ownership is combined with management not just in broad terms but in detailed supervision and decision-making on operational matters, taking a personal interest in these activities.

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[59] Scott, Richard (2012), Greek Shipping's Success: Fame and Fortune for Shipowners, Second Half 20th and Early 21st Centuries, unpublished slides and notes for Greenwich Maritime Institute postgraduate students' seminar

[60] Theotokas, Ioannis & Harlaftis, Gelina (2009), Leadership in World Shipping – Greek Family Firms in International Business (Basingstoke: Palgrave Macmillan), 11, 38, 44, 46, 53, 64

[61] Kapetanakis, Panos (2013), Greek Shipping 1945-2010:a success story of tradition, innovation and modernisation, Greenwich Maritime Institute blog, 21 October

[62] Goulielmos, Alexandros M (2017), 'The Great Achievement of Greek-Owned Shipping (1946-2017) and Keynes' Animal Spirits', Modern Economy, number 8, 1190

Some of these features are visible elsewhere, among other shipowning nationalities. But the precise combination and proportions displayed by Greek shipowners are a unique formula, based on a distinctive business philosophy, culture and strategy. While there are many variations of the theme among individual owners, the basic principles endure.

The characteristics listed provide clues to why activity within the bulk charter markets has been favoured by Greek owners. In these markets there is great potential for a type of decision-making which aligns with an entrepreneurial ownership and management style. By contrast, setting up and running international liner services in the container shipping sector has generally not been an appealing option. That activity requires a larger business scale than many Greek owners have operated in the past, involves micro- management, and necessitates a long-term commitment to an activity which may prove 'unexciting' given its history of often mediocre or poor returns.

During the extended adjustment period for global shipping markets, since the especially severe world recession of late 2008 and 2009, Greek shipping as well as that of other nationalities has been adversely affected. Yet fleet expansion and renewal continues. One characteristic previously highlighted, the "legendary flexibility and market 'feel'" of the Greeks[63] has prevailed. In addition to the crucial underpinnings of traditions and networks, the sensitive market-feel and bold initiatives of executives and entrepreneurs persisted.

[63] Thanopoulou, Helen A (2007), 'A Fleet for the 21st Century: Modern Greek Shipping' in Pallis, Athanasios A (ed) Maritime Transport: The Greek Paradigm (Oxford: Elsevier), 23, 50.

4. New Book Information

Ship Market Trend

Authored by Junjian Wang[64]

65

Introduction

For the last ten years of my career, my main job has been to predict the future of the shipping market movement. What factors will influence the shipping market, and how are they linked? By studying the current and historical market, we are going to discover some new links. This book's charts and historical data are derived from Clarksons Research and Baltic Exchange. I very much appreciate their support in fulfilling the writing of this book. The study is based on the high liquidity shipping market with available transparency market data, like dry bulk carriers, oil tankers, and container ships. There are limitations to the data and method being used, and it may not work in some cases, but this will leave an opportunity for further discussion or development in the future.

Executive Summary

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64 Mr. Jianjun Wang holds a BSc degree from Wuhan University of Technology and an MBA from South Columbia University. He started at CSSC Jiangnan Shipyard and later joined Lloyd's Register (including being seconded to the Royal Bank of Scotland for three years), with a short time at EA Gibson shipbrokers. He has been in role current role at Commonwealth Bank of Australian (CBA) for five years, located in London and now Hong Kong. In his 25-year shipping career life, he has worked in Shanghai, Korea, London, and Hong Kong. One of his main interests is in finding the market movement, which this book is aiming for. After reading this book, the readers will get a clear picture of where the shipping market is and where it is going based on the principles introduced. This book is published by Sune Global Limited in January 2018.

65 The picture is used from the following link, all the rights are reserved by Sune Global Limited, the publisher. < http://www.sohu.com/a/217923619_175033> accessed 14 Mar 2018.

Markets are always balanced by supply and demand. In shipping, cargo demand drives ship supply. When cargo demand overtakes ship (tonnage) supply, it will bring ship charter rate/earnings higher, and will then help to push up the asset price, bring up new building orders, and reduce scrap. When ship supply overtakes cargo demand, it will react in the opposite way. These two forces are acting and reacting, and influence other factors moving with them to form a typical shipping circle, as in the chart below.

Between demand and supply, the fleet supply is a reaction to cargo demand. Charter rate/earnings is a reflection of cargo demand, and it is the link between ship supply and cargo demand: it will move up and down in line with demand and supply. The key driver in the market is cargo demand. Ship owner, fleet size, shipyard, scrap, and second hand/new building assets are all from the fleet supply side. For the ship owner, he can build a ship to catch up with demand growth or scrap a ship to follow the demand down. The cargo demand is not controlled by people who work in shipping.

For better understanding this book, here we would like to introduce some new terminology:

1. *NDG (net demand growth)*

NDG = Demand growth (seaborne cargo growth) − supply growth (fleet growth)

This is demand growth minus fleet growth. When NDG is positive, it means demand growth is quicker than supply growth. When NDG is negative, it means supply growth is quicker than demand growth. In this book, we are going to study in detail the link between NDG and charter rate/earnings, when the charter rate/earnings market is going to change, and what the mechanics are that drive these changes.

2. *T/F ratio*

Using annual seaborne cargo volume divided by fleet size, this indicates how many times each DWT (deadweight tonnage) needs to travel to accomplish the shipping task.

T/F ratio = (Annual world seaborne trade cargo volume tons) / (fleet size tonnage)

For example, in 2016, annual seaborne dry bulk trade volume was 4,884 million tons and fleet size was 777 million DWT: 4,884 divided by 777 equals 6.29. This means every DWT of the dry bulk carrier needed to travel 6.29 times annually to cover the shipping demand. A higher T/F ratio means better utilization.

3. C/F ratio

This is the annual new signed contract volume divided by annual fleet size.

C/F ratio = (Annual new contract tonnage) / (fleet size tonnage)

For example, in 2016, 7.61 million DWT new crude tanker contracts were signed while crude tanker fleet size was 349 million DWT: 7.61 divided by 349 equals 0.0218, so the C/F ratio was 2.18%.

4. D/F ratio

This is the annual new delivery volume divided by annual fleet size.

D/F ratio = (Annual delivery tonnage) / (fleet tonnage)

For example, in 2016, 47.23 million DWT dry bulk carrier was delivered while the dry bulk carrier fleet size was 777 million DW: 47.23 divided by 777 equals 0.061, so the D/F ratio was 6.1%.

5. S/F ratio

This is the annual scrap volume divided by annual fleet size.

S/F ratio = (Annual scrap tonnage) / (fleet size tonnage)

For example, in 2016, there 645,000 TEU container ships were scrapped while container ship fleet size was 19,743,000 TEU: 645,000 divided by 19,743,000 equals 0.033, so the S/F ratio was 3.3%.

The book will discuss the links between the above five key factors, how the NDG links with the charter rate/earnings market, and then the link to T/F ratio, C/F ratio, S/F ratio and D/F ratio, and to asset price. There are two key factors which we need to consider, these being every ton of cargo travel distance and every ship's service speed. This book also will discuss how the current market links with the market average. We are going to use 30 day, 12 month, and three year averages to see their peak and bottom circle and movement trend.

Demand is normally reported in the form of ton miles, being total cargo tonnage multiplied by every ton of cargo travel distance. In the last 20 years, from 1996 to 2016, in the dry bulk carrier sector, the annual ton miles increased from 13.2tn to 27.2tn, and seaborne dry cargo volume also increased from 2bn to 4.9bn tons in the same period. However, every ton of seaborne dry cargo travel distance has been kept within the range of 5,500 miles.

The same is true of the tanker sector, wherein annual seaborne crude oil ton miles increased from 7tn to 9.5tn and seaborne crude cargo volume increased from 1.5bn to 1.9bn tons. Meanwhile every ton of seaborne crude cargo travel distance was kept within the range of 4,700 miles. A similar pattern is seen for the container ship. Annual seaborne container ton miles increased from 2.8tn to 8.5tn, and seaborne container trade volume increased from 0.4bn to 1.7bn tons. However, every ton of seaborne container cargo travel distance was kept at about 5,100 miles.

It is interesting to note that the average of every ton cargo travel distance has changed marginally in last twenty years. The growing demand is mainly driven by the increased cargo volume. We therefore use the growth in cargo volume as demand growth in the book. In relation to ships' speed, in the last twenty years there has been no revolutionary change on the ship performance side: once the ship is built, the economic speed is limited within a predefined range. Therefore the speed factor is not included in the study.

5. News in Brief

5.1 **China's new rules over outbound investment aims for moderately prosperous and wider foreign investment.**

Chinese government's adjustments of new rules to strengthen the regulation over outbound investment will be validated in March this year. According to the National Development and Reform Commission (NDRC), the new rules requires corporation's foreign projects or bid worth at least 3 billion US dollars and the investment activities from domestic companies will be put under government management framework. This document, which released in last August, has led to some slump in overseas direct investment and down 39 per cent in value than 2016 with some irrational tendency. Yet, China enters 2018 with more robust and rational economic-growth and its upward trajectory will continue with a focus on artificial intelligence (AI), the Internet of Things (IoT), aviation, wealth management and healthcare.[66]

5.2 **The construction of China's free trade ports and India-ASEAN summit's impact for regional maritime cooperation**

More than ten coastal provinces, including Shanghai, Tianjin, Qingdao, Zhejiang province, and Liaoning province, are seeking and competing to secure the State Council approval for free port construction plan. The construction of China's free trade ports will help to promote more comprehensive and deeper maritime trade and commerce liberalisation.[67] The highest-level of participation at the recent ASEAN-India summit comes with the backdrop of promoting Chinese economic growth and military assertiveness in the South-East Asian region. The commitment of Cooperation in maritime domain also marked a significant opportunity for the common growth and development in the region with an open, transparent, inclusive and rule-based regional architecture through existing ASEAN mechanisms.

5.3 The P.R.C Visa policy for foreign talented people is updated

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[66] See Orr, Gordon. December, 2017 https://www.mckinsey.com/global-themes/china/what-can-we-expect-in-china-in-2018

30See Jing, Shuiyu. January, 2018. Free trade ports to propel China's opening-up. http://www.chinadaily.com.cn/a/201801/23/WS5a668f73a3106e7dcc135e95.html.

The Chinese visa policy for foreign talents is being continuously loosened by the P.R.C authorities. Starting from 1st January 2018, the first pilot program offering foreigners the 'Foreign Talent Visa (FTV)' has been launched in Beijing, more than twenty foreign scientists, entrepreneurs and scholars including the CEO of Siemens Group, for example, will be offered such sort of special P.R.C visa. In November 2017, The Implementation Measures for Foreign Talents was promulgated by the State Administration of Foreign Experts Affairs of the P.R.C. In accordance with this new regulation, the foreign persons who have high-level skills, reputation, experience or qualifications in specific areas can be issued FTVs by the P.R.C diplomatic agencies. The duration of validity of FTVs varies from five to ten years and the FTV holder will be permitted to stay in the Mainland China for no longer than 180 days each time, multi-entry.