Corporate Takeovers: Legal Aspects of Takeovers among Chinese Airlines

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I. INTRODUCTION

Since 1980, many corporate takeovers and restructuring activities have developed within and across companies, and developing countries have stimulated the consolidation of corporations, improved the management of corporations, and rearranged the distribution of wealth and resources. The forces pushing these activities forward have been national and international deregulation, new information and communication technologies, globalization, the opening of emerging economies and traditionally closed economies, and the rescuing of the deteriorating economic sectors.

Generally speaking, takeovers are consistent with corporate governance boosting productivity and giving the corporation managers an incentive to work hard to increase corporate value. The faster the economies of the developing countries modernize and privatize, the greater the chance of transactional ownership and more active operation of business entities. Also, takeovers are a useful and important tool for creating these ends, especially for a developing economy like China.

China's economy used to be traditionally socialist and highly centralized. By opening China's economy to the outside world, takeovers in China have become important in its economic re-
structuring and have drawn much attention. Recently, China declared the Scheme of Restructure for nine major airlines directly under General Administration of Civil Aviation of China (CAAC), which is essentially a takeover among those airlines. The three biggest airlines in China, Air China (a wholly State-owned company), Eastern Air Group Company (a majority share holding company of China Eastern Airlines Co., Ltd.), and Southern Air Group Company (a majority share holding company of China Southern Airlines Co., Ltd.), will take over the other six airlines. These takeovers among China's airlines are good examples for understanding the takeover legislation and takeover practice in China.

A variety of laws affect takeovers, including the company law, antitrust (competition) law, securities law, and other regulations. This article first discusses the definition and scope of takeovers. Then it briefly discusses European Community (EC) competition law, American antitrust law, as well as China's anti-unfair competition law, company law, and securities law.

The abolition of international frontiers enables firms in the Community to embark on new activities and enables Community consumers to benefit from increased competition. As EC competition law is applicable in the Member States, it is worthy to focus on EC competition law. Community law preempts the national laws of the Member States when conflicts arise between national and Community competition law. The simultaneous application of law must be resolved in accordance with the principle of the precedence of Community law. Therefore, the national competition laws of the Member States will not be discussed in this article.

Thus far, China has promulgated Anti-Unfair Competition laws and some other regulations; however, China still needs to improve its competition law to create a legal environment for competition. Therefore, this paper discusses China's competi-

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3 Article 10 (former Article 5) of the EC Treaty provides that Member States shall take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising out of this Treaty or resulting from action taken by the institution of the Community. They shall facilitate the achievement of the Community's tasks. Treaty Establishing the European Community, Nov. 10, 1997, O.J. (C340) [hereinafter EC Treaty].

tion law and regulations. Furthermore, because the takeovers among the Chinese airlines are closely related with China's company law and securities law, this paper also discusses each of these. In addition, this paper explores takeover cases in the United States (U.S.) and Europe. As the takeovers among Chinese airlines have strong governmental involvement, a brief introduction of the U.S. Airline Deregulation Act of 1978 and its effects are discussed to better understand the takeovers among the Chinese airlines.

II. TAKEOVER: DEFINITIONS AND SCOPE

The term "takeover" must be defined. Black's Law Dictionary defines the word "takeover" as follows: "The acquisition of ownership or control of a corporation. A takeover is typically accomplished by a purchase of shares or assets, a tender offer, or a merger."5

Takeovers are common in the market economy. Takeovers can be divided into two types: takeovers through the public securities market, and takeovers through non-public securities.6 Public takeovers generate significant opportunities for investors to make a profit. Takeovers also allow the market to discipline errant management and allow productive wealth to shift to high-valued uses. As for a non-security-market, takeovers can be used both in well-developed capital markets and less developed capital markets.

Takeovers can also be divided into: (1) a friendly takeover that is approved by the target corporation's board of directors; and (2) a hostile takeover that is resisted by the target corporation's board of directors.7 In terms of scope, a "takeover" is larger than both a "merger" and an "acquisition."8 For example, in addition to a merger and an acquisition, a takeover can also be accomplished through a management buyout (MBO) or a

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5 Black's Law Dictionary 1466 (7th ed. 1999).
7 Id.
8 Other approaches might be unsolicited merger proposals to directors, accumulations of shares in the open market, or proxy fights seeking to install new directors.
leverage buyout (LBO). Some argue that takeovers parallel mergers and acquisitions.¹⁹

Under most circumstances, a merger and an acquisition occur between two corporations in the same industry. The scope of takeovers is wider than the scope of a merger or an acquisition. For example, a takeover might also include an LBO. An LBO adjusts the mix of the debt and equity contracts within a corporation, where investors purchase the stock of a corporation and retire most of it.²⁰ By doing this, they can control the day-to-day affairs of the corporation, at least indirectly, through their power to vote on the retention of management.

In the European Union (E.U.), when exploring takeovers from the angle of competition law and regulations, another word, “concentration,” might be used to describe the process of a “takeover.” A concentration shall be deemed to arise where:

(a) two or more previously independent undertakings merge, or
(b) one or more person already controlling at least one undertaking, or one or more undertakings acquire, whether by purchase of securities or assets, by contract or by any other means, direct or indirect control of the whole or parts of one or more other undertakings.²¹

In this article, the term “merger,” used in the context of the takeover of one corporation by another, means the absorption of one corporation that ceases to exist into another corporation that retains its own name and identity and acquires the assets and liabilities of the former. The term “acquisition” in the same context means gaining possession or control over another corporation’s assets or shares.²² However, sometimes words like takeover, merger, and acquisition might be used interchangeably in this article.

As the takeovers among the Chinese airlines are strongly infused with governmental involvement, the authors of this article

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¹⁹ For example, George Bittlingmayer, professor of The Management Graduate School of Management University of California, Davis. See George Bittlingmayer, The Market for Corporate Control (1999).


²¹ See Council Regulation 4064/89 on Control of Concentration Between Undertakings, 1990 O.J. (L257) 13, art. 3.1.

²² Investors are always looking out for companies that are likely to be acquired, because those who want to acquire such companies are often willing to pay more than the market price for the shares they need to complete the acquisition. See John Downes & Jordan Elliot Goodman, Dictionary of Finance and Investment Terms 7 (5th ed. 1998).
TAKEOVERS: CHINESE AIRLINES refer to these takeovers as "administrative mandate takeovers." For purposes of this article, takeovers include, but are not limited to, friendly takeovers (including mergers and acquisitions through agreements) and administrative mandate takeovers. The discussion on takeovers in this article focuses on friendly and administrative mandate takeovers rather than hostile takeovers. Hence, this article does not cover the legislation on hostile takeovers.

III. TAKEOVERS AND EC COMPETITION LAW, U.S. ANTITRUST LAW, AND CHINESE COMPETITION LAW AND POLICY

Takeovers can occur when two or more corporations decide to consolidate or merge their businesses into a single firm. This kind of takeover is called a friendly takeover. Among airlines, there are two main considerations that might impede takeovers: 1) competition law concerned with preventing the undue concentration of enterprises, which may lead to the distortion of competition; or 2) abuse of dominant position in the market.

A. TAKEOVERS UNDER EC COMPETITION LAW

1. EC Competition Law

Antitrust (competition) law was created to regulate the domestic market.13 In the European Union, competition law is concretely considered as the set of rules and disciplines to realize the internal unified market and the free movement of goods, persons, and capital. The laws, maintained by the European Commission and the Member States, relate to agreements between firms that restrict competition, or the abuse of a dominant position, such as attempts to create a monopoly position through takeovers by acquisition or merger.

EC competition law is reflected in Article 81 (former Article 85) and Article 82 (former Article 86) of the Treaty Establishing the European Community ("EC Treaty"). These two articles prohibit the prevention, restriction or distortion of competition and the abuse of a dominant position in the EC market.14 In addition, there are some commission or council regulations to implement the principles as set up by Articles 81 and 82, which

14 EC Treaty, supra note 3, at arts. 81, 82.
will be mentioned in a latter part of this section. Articles 81 and 82 are the cornerstones of EC competition law. Article 81 is the first operative provision of the EC Treaty, ensuring that competition in the internal market is not distorted. Article 82 prohibits abusive exploitation of the dominant position from one or more undertakings.

Agreements and concerted practices, which may prevent, restrict, or distort competition, can be divided into two broad subsets: horizontal and vertical arrangements. A horizontal agreement is an agreement between two or more competitors at the same level of supply. Basically, it is an agreement between direct competitors to fix prices or to share markets. It can arise in the form of a cartel agreement, a price fixing agreement, a production quota, or a market sharing agreement. Horizontal cartel arrangements are the main target of Article 81 of the EC Treaty. This is clear from the first three examples provided in Article 81(1), which prevent, restrict, or distort competition from this type of agreement.

Article 81(2) provides that any agreement or decision prohibited pursuant to Article 81 shall automatically be void. However, Article 81(3) considers some agreements and decisions that do not prevent, restrict, or distort competition, and are thus, not prohibited by EC law.

There are two recent EC regulations that relate to horizontal agreements. One is Regulation 2658/2000, effective on November 19, 2000, which discusses the application of Article 81(3) of the EC Treaty to categories of specialization agreements. The other is Regulation 2659/2000, effective on November 29, 2000, which discusses the application of Article 81(3) of the EC Treaty to categories of research and development agreements.

The elements may be present in vertical arrangements as well. A vertical agreement is an agreement between competitors at different levels on the economic chain, such as, between a producer of raw materials and a manufacturer, a manufacturer

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15 Id. at art. 81(1).
16 Id. at art. 82.
17 See Robert Lane, EC Competition Law 82 (2000).
18 EC Treaty, supra note 3, at art. 81(1).
19 Id. at art. 82.
20 Id. at art. 81(3). For example, any agreement or decision that contributes to improving production or distribution, or promotes progress in technology and brings benefits to consumers.
21 Id.
and a distributor, a distributor and a retailer, a retailer and a customer, or any variation within these distinctions. The common types of vertical agreements include exclusive distribution agreements, exclusive purchasing agreements, franchising agreements, licensing agreements and resale price maintenance agreements.


Article 82 of the EC Treaty is intended to prohibit the abuse of a dominant position, and it points out that a dominant competitor has the responsibility to ensure that its conduct does not impair or diminish competition in the common market. Such abuse, according to Article 82, may consist of imposing unfair purchase or selling prices, unfair trading conditions, applying different transaction conditions with trading parties, and making the conclusion of contracts subject to supplementary and irrelevant delegations.

In air transportation, either domestic or international, the economic value of traffic rights is conferred by the doctrine of sovereignty, or is dealt with in a bilateral framework. National carriers usually enjoy a dominant position in a particular national air market, as well as within their own extensive networks. The regulatory environment in air transportation may easily make an air carrier fall into a dominant position in a particular market.

In 1962, the EC Council adopted Regulation No. 17/62 to implement Articles 81 and 82, directing the EC Commission to apply EC competition law in all industries. However, due to the distinctive features of the transport industry, the EC Council adopted Council Regulation No. 141/62 in an attempt to ex-

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24 EC TREATY, supra note 3, at art. 82.
empt the transport sector from the application of Regulation No. 17/62.

According to Article 1 of Council Regulation 141/62, the exemption for implementing Articles 81 and 82 only applies to air transport service itself, to the services directly connected with the operation of air transport service, or the services directly connected with the operation of air transport service and performed by the airlines themselves.

Due to the development of EC integration, the application of EC competition law in air transportation has been changed by a series of regulations and case law. Examples include Council Regulation 3975/87, as amended by Council Regulations 1284/91 and 2410/92, and Council Regulation 3976/87, as amended by Council Regulations 2344/90 and 2411/92. Regulation 3975/87 officially applies Articles 82 and 83 to the air transport sector, while Regulation 3976/87 grants the Commission the power to adopt block exemptions for certain categories of arrangements. Other regulations concerning the competition issues in the air transport sector also exist.

2. Council Regulation No. 4064/89

Articles 81 and 82 set out basic principles of EC competition law. Together with other regulations, which are not sufficient to cover all operations that might be incompatible with the system of undistorted competition envisioned in the EC Treaty, Council Regulation 4064/89 (ECMR) was adopted on December 21, 1989, and entered into force on September 21, 1990.

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27 Article 1 of Council Regulation 141/62 reads: "Regulation 17 shall not apply to agreements, decisions or concerted practices in the transport sector which have as their object or effect the fixing of transport rates and conditions, the limitation or control of the supply of transport or the sharing of transport markets; nor shall it apply to the abuse of a dominant position, within the meaning of Article 86 of the Treaty, within transport market." Council Regulation 141/62 on Exempting Transport from the Application of Council Regulation No. 17, 1962 O.J. (124) 2751, art. 1.


ECMR stated that a concentration shall be deemed to arise where:

(a) two or more previously independent undertakings merge, or (b) one or more persons already controlling at least one undertaking, or one or more undertakings acquire, whether by purchase of securities or assets, by contract or by any other means, direct or indirect control of the whole or parts of one or more other undertakings.\(^{31}\)

The creation of a joint venture performing on a lasting basis all the functions of an autonomous economic entity . . . shall constitute a concentration within the meaning of paragraph (b).\(^{32}\)

The word "control" is comprehensive in the ECMR. Control can constitute rights, contracts, or any other means that, either separately or in combination with the considerations of fact or law involved, confer the possibility of exercising decisive influence on an undertaking, in particular by: "(a) ownership or the right to use all or part of the assets of an undertaking; (b) rights or contracts which confer decisive influence on the composition, voting or decision of the organs of an undertaking."\(^{33}\)

Furthermore, control is acquired by person or undertakings that: "(a) are holders of the rights or entitled to rights under the contracts concerned, or (b) while not being holders of such rights or entitled to rights under such contracts, have the power to exercise the right deriving therefrom."\(^{34}\)

It is evident that friendly takeovers through mergers and acquisitions are subject to the ECMR if they fall within the scope of all concentrations having a community dimension\(^{35}\) as defined by the ECMR. However, according to the ECMR, under certain conditions, a concentration that has no community dimension that creates or strengthens a dominant position, and that impedes competition within the territory of one or more States, would be treated as the type of concentration defined by the ECMR.\(^{36}\)

The ECMR defines the scope of a concentration with a community dimension.\(^{37}\) This scope will be discussed in subsection

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\(^{31}\) Council Regulation 4064/89 on the Control of Concentrations Between Undertakings, 1989 O.J. (L395) 1-12, art. 3.

\(^{32}\) Id. at art. 3(2).

\(^{33}\) Id. at art. 3(3)(a), (b).

\(^{34}\) Id. at art. 3(4)(a), (b).

\(^{35}\) Id. at art. 1.

\(^{36}\) Id. at art. 2.2(2).

\(^{37}\) Id. at art. 1.
four of this section with the Boeing / McDonnell Douglas takeover.\textsuperscript{38} The ECMR also provides for the powers of the Commission, formalities and procedures of investigation, as well as prior notification of concentration.

3. Takeovers Under U.S. Antitrust Law

Like in the European Community, antitrust law in the United States is aimed at promoting free competition in the marketplace. Under U.S. antitrust law, any agreement, co-operative effort, or intent by two or more entities that affects or restrains, or is likely to affect or restrain their competitors, is illegal.\textsuperscript{39} Monopolies or an abusive use of a dominant position in the market is also illegal.\textsuperscript{40}

The legal framework of U.S. antitrust laws is based on the Sherman Act\textsuperscript{41} and the Clayton Act.\textsuperscript{42} Takeovers such as mergers and acquisitions come within the Sherman Act, as would any other business transaction, but the Clayton Act is the principle law governing mergers and acquisitions. The philosophy dictating the legality of mergers and acquisitions is that competition is more intense when there are more competitors in a given market. In turn, the market size as well as the relative size of the competitors, become factors.

In U.S. antitrust law, the prohibition against monopolies is also divided into horizontal\textsuperscript{43} and vertical restraints.\textsuperscript{44} The 1992 Horizontal Merger Guidelines\textsuperscript{45} ("1992 Guidelines") won a greater role in U.S. competition law than its counterpart in the EU. The Horizontal Merger Guidelines, issued by the Justice

\textsuperscript{38} See infra part. III(A)(4).
\textsuperscript{40} See supra note 39.
\textsuperscript{41} Sherman Act, ch. 647, 26 Stat. 209 (1890) (current version at 15 U.S.C. §§ 1-7 (1994)).
\textsuperscript{43} Horizontal restraints include price agreements, agreements that result in price alignment or limit sales, territorial division agreements, horizontal boycotts, and tying.
\textsuperscript{44} Vertical restraints include resale price maintenance agreements, territorial restriction agreements, and exclusive dealing agreements. Although some of the cases are no longer per se prohibited, it is obvious they will still be prohibited under the rule of reason.

The 1992 Guidelines apply only to horizontal mergers, leaving vertical and potential competition mergers to be covered under the Guidelines issued in 1984. The 1992 Guidelines contain a detailed description of how the government agencies define relevant markets in horizontal merger cases. The Guidelines generally reflect more economic sophistication in market definition than has been shown by the courts.

Subsequently, the antitrust laws in the U.S. and in the EU are aimed at promoting free competition in the market place. They may be paraphrased collectively as declarations of principle that any agreement, co-operative effort, or intent by two or more entities that affects, restrains, or is likely to affect or restrain their competitors, is illegal.

The airline industry in the United States used to be highly regulated by the now defunct Civil Aeronautical Board (CAB), and the Department of Transportation (DOT). After the promulgation of the Deregulation Act of 1978, the takeovers (including mergers and acquisitions) among U.S. airlines were stimulated by the market change and were primarily reviewed by the U.S. Department of Justice Antitrust Division ("Antitrust Division"). The Antitrust Division analyzes the takeovers among U.S. airlines and between U.S. airlines and foreign airlines using the same standards as those applied to other industries.

4. The Boeing / McDonnell Douglas Takeover Case

On December 15, 1996, Boeing and McDonnell Douglas announced their intention to merge. Boeing’s $13 billion takeover bid for McDonnell Douglas was the most dramatic step in the consolidation of the U.S. military industry, as well as in the airliner manufacturing industry. The European Union gave its formal permission to Boeing’s $15 billion takeover in July 2003.

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46 The 1992 Guidelines establish relatively clear standards for assessing the anti-competitive consequences of mergers with the introduction of the Herfindahl-Hirschman Index (HHI) to measure the market concentration. See Herbert Hovenkamp, Antitrust 219 (3d. ed. 1999).


The Boeing / McDonnell Douglas case involved a number of competition issues. Lessons from the Boeing / McDonnell Douglas case include the relative merits of competition law and trade agreements to solve cross-border competition problems.\footnote{\textit{Id.}} For Boeing, the benefits of cooperation include expanding their limits to an international level. The European Union and the U.S. discussed the case in detail and understood each other's positions very well. As a result, conflict was ultimately avoided. However, if the European Union prohibits a merger that the U.S. does not challenge, no World Trade Organization dispute settlement could be decided about whether the merger could proceed.

The civil aircraft construction industry is a highly concentrated sector, with only three companies sharing the market. Consequently, any contract signed by a competitor could directly influence the other parties' market shares or benefits. In order to have a successful takeover, Boeing had to give up its exclusivity contracts with European clients, surrendering some of its benefits. If Boeing merged without making any concessions, it would face the threat of commercial retaliation. This kind of practice in takeovers could greatly affect multinational corporations' future mergers and acquisitions.

The European Commission has become an important player in all mergers, even those involving non-European firms. Its legal competence is based on European Competition. Because the concerned corporations have sizeable market shares in Europe, the European Commission's involvement is essential. Although the Commission has no jurisdiction for operations that do not take place in Europe, it does, nevertheless, have considerable powers. The legal basis for the European Commission's intervention is EC Council Regulation No. 4064/89.\footnote{Council Regulation 4064/89, \textit{supra} note 11.} Following Article 1(2) of this Regulation, a concentration is consid-
ered to be of European dimension when the two following conditions are met:

1. the total world turnover of all concept firms represents an amount greater than 5 billion Euro or the European individual turnover of at least two of the firms concerned represents an amount greater than 250 million Euro, unless every firm concerned realizes 2/3 of its turnover in a single Member State; or

2. the combined aggregate world-wide turnover of all the undertakings concerned is more than 2.5 billion Euro or the combined aggregate turnover of all the undertakings concerned is more than 100 million Euro or in each of at least three Member States included, the aggregate turnover of each of at least two of the undertakings concerned is more than 25 million Euro and the aggregate Community-wide turnover of at least two of the undertakings concerned is more than 100 million Euro.\(^5\)

The thresholds provided for in this Regulation are maintained, but the application areas are broadened after the promulgation of Regulation No. 1310/97, which stresses the secondary nature taken by national concentration controls. The results clearly show that investors took a lot of time to judge how credible the intervention of the European Commission is in a case concerning U.S. firms, which also led to the signing of an anti-trust agreement between the European Union and the United States.\(^5\) This agreement allows the competition authorities on each side to ask each other to investigate anti-competitive business practices by companies based in their counterpart’s territory in an effort to improve enforcement action.\(^5\)

The different approaches taken by U.S. and EU enforcement authorities on the lawfulness of the Boeing / McDonnell Douglas merger raises the prospect of increasing conflict among the world’s antitrust authorities. Both the U.S. and the EU claim the right to evaluate transactions that produce economic effects within their borders, but which occur abroad. Traditional means of avoiding conflict through doctrines of comity or other balancing processes seem unpromising. This case became a milestone for governments and scholars to make new proposals

\(^5\) Id. at art. 1(2).
\(^5\) Id.
for minimizing conflict in the antitrust evaluation of transactions involving significant multimarket effects.

The most important differences in competition law among jurisdictions are primarily traceable in the amount and design of the distributional concerns they incorporate. Therefore, some propose, as a means of lessening international conflict over competition policies, that when a jurisdiction asserts the authority to evaluate a transaction involving significant multimarket effects, the acting jurisdiction bases its evaluation on the common element in all antitrust laws: efficiency.55

B. CHINA'S COMPETITION LAW AND POLICY


Acts of "unfair competition" are defined as follows:

1) counterfeiting or using without authorization of a registered trademark, name, package, decoration of another person, etc.;57
2) governmental agencies restricting people to purchasing commodities from the business operators designated by them, thereby precluding other business operators from fair competition;58
3) abusing administrative powers to restrict commodities, originating in other places, from entering the local markets or the local commodities from flowing into markets of other places;59
4) offering money or goods or by any other means, in selling or purchasing commodities;60

60 Id. at art. 8, available at http://www.ultrachina.com/english/doc.cfm?OID=274.
5) advertisements or any other means that make false or misleading publicity of his commodities as to their quality, ingredients, functions, usage, producers, duration of validity, or origin;\(^61\)

7) infringing upon trade secrets;\(^62\)

8) selling the commodities at prices lower than costs, selling perishables or live commodities, disposing of commodities near expiration of their validity duration or those kept too long in stock, seasonal sales; or selling commodities at a reduced price for the purpose of clearing off debts, change of business or suspension of operation;\(^63\)

9) conducting tie-in sales of commodities or attach any other unreasonable conditions to the sale of their commodities;\(^64\)

10) lottery-attached sale.\(^65\)

Apparently, there are no provisions in this law addressing a number of concerns. These unaddressed concerns include: restriction of potential anti-competitive results of a takeover (a merger or acquisition) of a business or company; the restriction of the market share percentage by which a takeover can prevent, restrict, or distort competition in the market; or the abuse of the dominant position in the market. Furthermore, there are no provisions in the Competition Law of 1993 about the notification systems or authorities in charge of competition affairs.

To the contrary, it seems that the Competition Law of 1993 focuses on more commercial transactions rather than on the possible abuse of market position. As China is moving towards a market-oriented economy, more attention is paid to the openness of the traditionally closed markets throughout China. The Regulations of the State Council Concerning Prohibiting the Implementation of Regional Barriers in the Course of Market Economy Activities were promulgated, and came into force, on April 21, 2001 ("Regulations of 2001").\(^66\)

\(^{61}\) Id. at art. 9, available at http://www.ultrachina.com/english/doc.cfm?OID=274.


\(^{63}\) Id. at art. 11, available at http://www.ultrachina.com/english/doc.cfm?OID=274.

\(^{64}\) Id. at art. 12, available at http://www.ultrachina.com/english/doc.cfm?OID=274.


\(^{66}\) See Regulations of the State Council Concerning Prohibiting the Implementation of Regional Barriers in the Course of Market Economy Activities (Apr. 21,
Under these regulations, units and individuals are prohibited from obstructing or interfering with entry into the local market of non-local products or "construction project-type services." The prohibition extends to any manner that violates laws, administrative regulations or State Council regulations, or deceives or covers up acts of obstructing or interfering with entry into the local market of such products and services, thereby restricting unfair competition.

The Regulations of 2001 list a number of specific "regional barrier" acts that local people's governments and their departments are prohibited from committing. They also provide that no local authorities may enact or implement regional barrier regulations or regulations containing regional barrier elements.

A large part of the Regulations of 2001 contains rules that government departments will be responsible for such as correcting various types of protectionist conduct that branches of the Government will be responsible for modifying or repealing. Again, the Regulations do not address takeovers of local corporations. It is difficult to find similarities between competition law in China and the law in the EU or in the U.S.

China is quickly moving from a State-owned economy to a market oriented economy. Industries in China are being deregulated, broken up, and reorganized geographically according to value chains. There are foreign investments flowing in and out of China. All of these potential investments need competition and antitrust considerations. While there are more takeovers occurring in China, the need for legislation on preventing restrictions (dominant market position) or distortions to competition is becoming important.


67 "Unit" is a comprehensive word in Chinese. It may refer to a governmental agency or a commercial entity.

68 See Regulations of 2001, supra note 66.

69 Id. at art. 3.

70 Id.

71 Id. at art. 5.
IV. TAKEOVERS UNDER CHINA'S COMPANY LAW AND SECURITIES LAW

A. TAKEOVERS UNDER CHINA'S COMPANY LAW

As a consequence of the need to retain State control and the lack of legal provisions, takeovers in certain industrial sectors in China were limited. There are, however, specific regulations that specify the level of shareholdings of certain industries that must be retained by the State or through State-owned enterprises or legal persons. The State has been particularly conscious of keeping interests balanced among citizens and protecting the interests of those connected with smaller Chinese enterprises that may be absorbed by larger, wealthier overseas corporations.

However, takeovers among privately owned or collectively owned companies now occur in China. Furthermore, the forming of mega companies is encouraged in China to face the challenges, such as more foreign counterparts entering in China, making the competition tougher since China became a member of the World Trade Organization (WTO) in 2001.

Under the Company Law of the People's Republic of China ("Company Law of China"), companies are classified as joint stock limited companies, limited liability companies, and wholly State-owned companies. In reality, there are many State-owned companies that are partly privatized as joint stock limited companies or that are changed into limited liability companies. In addition, there are other companies with foreign investments such as Sino-foreign companies that are governed by other special laws of China. These are all considered as foreign-invested companies.

There are some provisions in China's Company Law concerning takeovers (mergers). For a merger or division of a company to take place, a resolution must be passed in a
shareholders’ meeting. In addition, the State-authorized department or other authorities must approve any merger or division of a joint stock company. A company may use a takeover or create a new entity to achieve a merger. Indeed, the Company Law describes the process of mergers and acquisitions, differentiating between the dissolution of one entity by way of a takeover, and the dissolution of two separate entities by way of a merger. The key to the merger or division of a State-owned company is the application package and the required approvals.

In practice, companies seeking to rely on the above mentioned provisions need to hold substantial discussions with relevant governmental departments for a considerable period of time prior to convening a shareholders’ meeting. Moreover, the support of the shareholders in terms of the relevant Ministry or department, which acts as the promoter of the enterprise, is fundamental to takeovers.

Chinese Company Law also provides that when undertaking a merger, parties must sign an agreement and a balance sheet, and list the assets of the company. These actions must occur not less than ten days prior to the passing of the resolution on the company merger.

The company must notify the creditors of the merger by a public announcement in the relevant newspapers at least three times within thirty days. Creditors have thirty days from the receipt of the notice or ninety days from the first announcement of the takeover, if the creditors did not receive any notice, to request the company to settle its debts or to provide the creditors with a guarantee of repayment. If the company fails to do so, the merger will not proceed. The provisions also require the acquiring company or the company established as the result of the merger to assume all debts receivable and payable of the merging parties. These are relatively standard provisions intended to protect creditors. However, parties to such transactions should be conscious of the need to follow the procedure correctly. Any approval of the ultimate merger may depend upon the proper discharge of these obligations.

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77 Id. at art. 182.
78 Id. at art. 183.
79 Id. at art. 184.
80 Id.
81 Id.
According to Article 188 of the Company Law of China, where the merger or division of a company involves changes in registered items, such changes must be registered with the Company Registration Authority. Where a company is dissolved, the company must apply for cancellation of its registration in accordance with the law: (1) where a new company is incorporated; (2) where the registration of the incorporation of the company shall be carried out according to law; and (3) where a company increases or reduces its registered capital, it shall apply to the Company Registration Authority for registration of the changes in accordance with the law.

If a company being merged or divided reduces its registered capital or carries out liquidation, and fails to notify its creditors or fails to announce the same to its creditors, the company must rectify the situation and will be fined.

In addition to the Company Law of China, which contains provisions on mergers and divisions of companies in China, on September 23, 1999, the Ministry of Foreign Trade and Economic Co-operation (MOFTEC) and the State Administration of Industry and Commerce (SAIC) jointly promulgated the Provisions of MOFTEC and SAIC on Merger and Division of Foreign Invested Enterprises ("Merger Provisions of 1999"). The Merger Provisions of 1999 took effect on November 1, 1999. The Merger Provisions of 1999 attempt to address deficiencies in corporate merger and division rules under the Company Law of China and to add clarity to the procedures that must be followed in a merger or division of Foreign Invested Enterprises (FIEs).

If any entity violates the statutory procedures to takeover companies to seek improper earnings, the offender must rectify the matter, the illegal income will be confiscated, and a fine will be imposed.

B. TAKEOVERS UNDER CHINA’S SECURITIES LAW

In China’s legislation governing takeovers of public listing companies, the Securities Law of the People’s Republic of China...
("Securities Law") are the most important rules.88 There are many provisions in the Securities Law, including takeover announcement, information disclosure, and security companies. The law is deemed a milestone in the development of Chinese securities and it varies in many aspects to the previously promulgated legislation. Chapter IV of the Securities Law, entitled Takeover of Listed Companies, includes Articles 78 to 94.89

Article 78 of the Securities Law provides that a listed company may be taken over by offer or by agreement.90 Here, the words "offer" might include hostile takeovers while the word "agreement" means friendly takeovers. Article 89 provides for the case of a takeover agreement with shareholders of the company under takeover, as prescribed in the laws and administrative regulations.91 The Securities Law also requires that the transfer of shares must be done via a securities registration and clearing institution with a deposit of the funds in a designated bank.92

The Securities Law further prescribes that a person who acquires the shares of a company through a takeover offer or takeover agreement and closes down the company taken over, is deemed to have merged.93 The purchaser must have the existing shares of the closed-down company replaced according to law.94 Apparently, under the current Securities Law, there are two kinds of takeovers of listed companies in China: mergers and acquisitions.

In China, laws normally provide principles as guidelines for certain issues, and administrative regulations or ministerial regulations are issued as complementary provisions. On September 28, 2002, the China Securities Regulatory Commission (CSRC) issued its Regulating Methods on Takeovers of Listed Companies ("Methods on Takeovers of Listed Companies"),95 which also allowed takeovers of a listed company by means of adminis-
V. UNITED STATES AIRLINE DEREGULATION AND TAKEOVERS

A. BACKGROUND

Before 1978, the United States airline industry was highly regulated on the sheer belief of protecting the public interest. From 1938 to 1978, the Civil Aeronautics Board (CAB) provided cradle-to-grave economic regulation of the U.S. airline industry, literally. For example, an airline could not go into business or out of business, or anything in between, without the permission of a majority of the five presidential appointed CAB members. At that time, the industry resembled a public utility, with a government agency, CAB, determining the routes each airline flew and overseeing the prices they charged.

There are some key factors that led to the deregulation of the United States airline industry. One of these developments was the advent of the wide body aircraft, which increased airline capacity dramatically. Another factor was the Middle Eastern oil embargo in 1973, which caused oil costs to skyrocket and led to price inflation. In addition, an economic downturn at that time put severe strains on the airline industry. In line with its mandate to ensure a reasonable rate of return for the airline industry, CAB responded to this crisis by allowing carriers to increase fares, embarked on a four-year moratorium to authorize new services, and approved a series of agreements among the airlines

96 Administrative Transfer (xing zheng hua bo or xing zheng hua zhuan) is a special phrase in Chinese law when two State-owned enterprises are merged or one enterprise is taken over by another, the government agency decides. The assets of one enterprise shall be transferred to another enterprise without payment because both of them belong to the State. This situation normally happens within the same industry. As for the takeovers occurring in different industries, payments will happen.

97 See Methods on Takeover of Listed Companies, supra note 95.

98 See Methods on Takeover of Listed Companies, supra note 95.


100 Id.

101 Id.
to limit capacity on major routes. However, these measures failed to improve the situation.

Concerned that government regulations had caused high fares in many heavily traveled markets and inhibited the airline industry's growth, the U.S. Congress deregulated the American airline industry. The driving force behind deregulation was the perception that regulation by the CAB had resulted in reduced competition and higher fares.

B. DEREGULATED AND NON-DEREGULATED ASPECTS

The U.S. Congress took the first legislative step toward airline economic deregulation in November 1977. It gave American cargo carriers the freedom to operate on any domestic route and to charge whatever the market would bear. Congress also declared that one year following enactment of the bill, the CAB could certify new domestic cargo carriers as long as they were found fit, willing, and able. Deregulation gave express carriers the operating freedom high-quality services demanded, and the result was outstanding growth for that segment of the aviation industry over the next decade.

The Deregulation Act of 1978 applied free market competition to the transportation of passengers. Restrictions on domestic routes and schedules were eliminated, as well as government controls over domestic rates. The CAB was dismantled on January 1, 1985.

International air transportation is regulated extensively by bilateral agreements between governments exchanging commercial rights for air services and agreeing on ways to regulate capacity, tariffs, and other matters. Bilateral negotiations involving the United States were led by the State Department, with active Department of Transportation (DOT) policy input and participation. The DOT also has the authority to approve and immunize agreements affecting international air transportation,

102 Id.
104 Costello, supra note 99.
107 Several of the CAB's functions were shifted to other government agencies, primarily to the Department of Transportation.
as well as the responsibility to maintain air services in small communities by establishing the Essential Air Service program.\textsuperscript{109} This program provides subsidies to carriers willing to serve domestic locations that would be economically infeasible to serve. Last but not least, the Airline Deregulation Act ended the Government's economic regulation of airline routes and rates, but not airline safety regulation.

C. EFFECTS OF Deregulation AND THE PRESENT SITUATION

There are many effects and possible effects of deregulation, such as the widespread development of hub-and-spoke networks, easy access to the market by new entrants, increased competition caused by new entrants, rapid expansion into new markets by many of the established carriers, discount fares resulting from competition, and growth of air travel.

Nevertheless, because of the competition and some ruthless price wars unleashed by deregulation, in the past two decades, bankruptcy and mergers have become far more common, even among mega-carriers. In the past two decades, Braniff, Eastern, and Pan American have gone bankrupt, while Continental, America West, and TWA all filed for bankruptcy protection.\textsuperscript{110} The fact is that deregulation might not be a panacea.

After the September 11 terrorist attacks, the U.S. Congress passed the Air Transportation Safety and System Stabilization Act, which entered into force on September 22, 2001.\textsuperscript{111} The U.S. Government provided $5 billion in direct payments to carriers to assist them in recovering from financial losses sustained as a result of the attacks. The U.S. DOT moved quickly to distribute nearly half of this amount to 111 carriers,\textsuperscript{112} and continues to distribute the remaining funds. In addition, the U.S. Government has also provided billions of dollars in loan guarantees to U.S. air carriers.\textsuperscript{113}


\textsuperscript{110} Walter Goraalski, Deregulation Déjà Vu (June 17, 1996), available at http://telephonyonline.com/ar/telecom_deregulation_deja_vu.


\textsuperscript{112} Id.

\textsuperscript{113} Id.
The deregulation of the airline industry in the U.S. meant that the airlines controlled decision making with regard to service entry and exit, pricing, bankruptcy, and, to a lesser extent, takeovers.114 Today, the U.S. Government, through financing, helps U.S. air carriers to survive, which clearly demonstrates that the Government will not truly deregulate the airline industry when the industry is in trouble and when deregulation may negatively affect the American economy. Essentially, the U.S. Government does not need to take the initiative to mandate takeovers among the U.S. airlines because the market conditions in the U.S. are mature and more competitive than those in China.

VI. TAKEOVERS AMONG THE CHINESE AIRLINES

A. BACKGROUND

In a discussion of the Chinese airline industry, a brief history must be mentioned. In 1949, the General Administration of Civil Aviation of China or the Civil Aviation Administration of China (formerly the CAAC) was formed by the Chinese Government in order to oversee and operate all aspects of civil aviation in China.115 The work of the former CAAC included managing China’s air transportation and airports. Additionally, the former CAAC was a part of the Air Force of the Chinese army. The former CAAC acted as a government agency and a commercial entity. Today, the CAAC116 is used only for the General Administration of Civil Aviation of China, which falls under the State Council of China.

On July 17, 1952, the People’s Airline was founded in Tianjin, China, which was the first State-owned enterprise set up in China. This airline, however, was terminated and merged into the CAAC in June 1953.117 For many years, the CAAC was vested with the combined functions of a regulatory authority and a commercial entity. In the latter role, it was involved in the oper-

114 Sayles, supra note 103.
116 According to Article 2 of the Civil Aviation Law of the People’s Republic of China, the CAAC is authorized to exercise unified supervision and administration over civil aviation activities in the whole country. The CAAC also authorizes, issues, regulations and decisions concerning civil aviation activities within the scope of its authority.
A great change through a process of decentralization. The CAAC was separated from the commercial section, which turned out to be some major airlines, with a certain degree of autonomy over their commercial operations in the 1980s.118

Gradually, the CAAC's commercial section of air transportation of passengers, baggage, and cargo was divided into nine major airlines.119 Each of these was authorized or designated to fly domestic, Hong Kong regional routes, and some international routes. Currently, the routes of these airlines primarily originate from their home airport or other airports within their respective geographic coverage areas. Each airline is incorporated with its own business license, managed independently, and is responsible for its own operations, profits, and losses.

On pace with the economic reform and development in China during the mid-1980s to the mid-1990s, some other airlines, either through shares or the financial support of the local government, were established from scratch. These include Shanghai Airlines and Shenzhen Airlines, mainly to fly domestic routes.

The Chinese airline industry has been rapidly growing for the past twenty years. In 1980, there were only 191 commercial flight routes in China, of which, 159 were domestic routes, four regional,120 and the rest were international routes. In 2000, there were 1,165 flight routes, of which, 133 were international routes, and the rest were domestic routes.121 In the same year, Chinese civil aviation air transport traffic totalled 12.25 billion tonne-kilometre.122 In the past decade, passengers and cargo traffic carried increased by an annual average rate of 16% and

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118 Id.
119 There were ten major airlines, but the following are the current nine major airlines: Air China, China Eastern Airlines, China Southern Airlines, China Northern Airlines, China Northwest Airlines, China Southwest Airlines, Xinjiang Airlines, Yunnan Airlines, and China Airlines (HK). The original China General Airlines merged with China Eastern Airlines in 1998. Now another wave of restructuring is under way within the Chinese airline industry.
120 At that time, the routes to Hong Kong and Macao were called regional routes, which were actually treated as international routes from the commercial point of view.
121 See Statistical Data on Civil Aviation of China as published by General Administration of Civil Aviation of China (2001).
122 Id.
total traffic by more than 18%, both exceeding China's gross domestic product growth from between six and eight percent.\textsuperscript{123}

\textbf{Table-1}

\textbf{2000 Statistics of Traffic Volume Performed by the Whole Industry}

<table>
<thead>
<tr>
<th>Traffic performed</th>
<th>2000</th>
<th>Increased(%) v. previous year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Traffic performed</td>
<td>1225007.42</td>
<td>15.5</td>
</tr>
<tr>
<td>Domestic routes</td>
<td>759817.19</td>
<td>13.9</td>
</tr>
<tr>
<td>Including inland to HK&amp; Macao regional routes</td>
<td>56879.19</td>
<td>11.0</td>
</tr>
<tr>
<td>International routes</td>
<td>465189.83</td>
<td>17.9</td>
</tr>
</tbody>
</table>

Source: CAAC Annual Report.

\textbf{B. Industry Issues}

Today, there are about 28 airlines in China servicing the air transportation of passengers, baggage, cargo, and mail. Among them, nine major airlines are directly controlled by the CAAC, which accounts for 80\% of the market share of the traffic volume. However, economic problems have frustrated the airline industry in recent years. Quickly increasing capacity, rising fuel prices and steep fare discounts have driven most of China's airlines into the red.

One perspective is that the CAAC's tight control of management appointment, employee welfare and purchasing rendered airline companies unable to adjust their flights and fares in light of market demand. This inability to change has led to poor performance throughout most of the industry.\textsuperscript{124} The aim of the takeovers among Chinese airlines is to solve the deep-rooted problems such as scattered transportation capability, small scale of air transportation enterprises, high rate of liabilities, and slow pace of modern enterprise establishments.\textsuperscript{125}

\textsuperscript{123} China Southern Airlines Positioned for Growth, 10 Int'l Airport Report 2 (2002).
C. The Scheme of Restructure (Takeovers)

In order to raise the efficiency and competitiveness of the airline industry, China has decided to restructure its State-owned airline industry by mergers. On October 11, 2002, a State-ordered consolidation of the Chinese airline industry was announced. Three new holding companies were established to take over nine airlines directly under the control of the CAAC:

1) China National Aviation Holding Company ("CNAirHolding," based on existing Air China);
2) China Southern Air Holding Company ("CSAirHolding," based on present Southern Air Group Company); and

These three holding companies and their senior management staff were to be established and appointed on the same day. For the sake of convenience throughout this article, these three holding companies are referred to together as the "Three Holding Companies."

In fact, the original flag-carrier, Air China, will take over China Southern Airlines and China National Aviation Corporation. The new holding company will be the China National Aviation Holding Co., with assets of 57.3 billion yuan ($6.94 billion), a fleet of 119 aircraft, 307 routes, and 22,960 employees. Southern Air Group Company and its main subsidiary, China Southern Airlines Co., Ltd. (the mainland's largest airline and dozens of other subsidiaries), will merge with China Northern and Xingjiang Airlines. This merger will result in assets totaling 50.1 billion yuan ($6.06 billion), a fleet of 180 aircraft, 666 routes, and 34,268 employees. China Eastern Air Company with China Eastern Airlines Co., Ltd., its biggest subsidiary, and dozens of other subsidiaries will take over Yunnan Airlines and China Northern Airlines. This will result in a total of 47.3 billion yuan ($5.73 billion) in assets, a fleet of 142 aircraft, 386 routes, and 25,000 employees.

Apart from the three major carriers, three other major aviation industry groups were announced: China Travelsky Holding Co., China Aviation Oil Holding Co., and China Aviation Supplies Import and Export Group Company.


Id.

Id.
According to the abstracts of the Scheme of Restructure issued in the CAAC Journal, the General Administration of Civil Aviation of China cut its economic ties with those nine airlines. The top management staffs of the Three Holding Companies shall be appointed by the central Government, the assets and financial relations shall be regulated by the Ministry of Finance, and the CAAC shall retreat to functioning only as an industry regulator.

It was said that the CAAC’s duty would be transformed into maintaining a fair market environment and protecting consumer’s fundamental interests. In other words, the CAAC will not be responsible for managing the assets of those airlines after the takeovers because the structure of the combined role of assets-owner and industry regulator no longer suits China’s fast developing market economy.

The Three Holding Companies are said to be legal entities and market subjects, which operate independently and will enjoy the operation benefits and will be responsible for losses. The Three Holding Companies will not bear any governmental function.

Among the Three Holding Companies, CNAirHolding does not have any public subsidiary listed, and CSAirHolding and CEAHolding have two subsidiary airlines publicly listed at home and abroad. According to the president of CSAirHolding, the restructure (takeovers) will be completed in two steps. The first step is the establishment of SCAirHolding Company, followed by a transferring period where the original three airlines remain legal persons, but shall gradually coordinate their operations into one operation. The second step is to insert the assets of the core business (air transport) of the two other airlines into those of China Southern Airlines Co., Ltd. The main goal of the takeovers is for CNAirHolding to transform its air transportation section (Air China) into a joint stock limited company. The other two companies, based on their overseas and domestic listed companies, plan to inject the assets of air transportation of the other airlines into the listed companies.

130 Abstracts of the Scheme of Restructure, CAAC J. (Oct. 11, 2002).
131 Guo Ai Bing, Airlines on Path to Consolidation, CHINA DAILY (Oct. 12, 2002).
132 Id.
133 Id.
134 Abstracts of the Scheme of Restructure, CAAC J., art. 1 (Oct. 11, 2002).
### TABLE-2
**CNAir Holding Company**
**And its Present & Future Subsidiaries (Airlines)**

<table>
<thead>
<tr>
<th>No</th>
<th>Present</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Air China (100% ownership)</td>
<td>Air China (less 100%) if public listing</td>
</tr>
<tr>
<td>2</td>
<td>China National Aviation Co. (100%)</td>
<td>The same</td>
</tr>
<tr>
<td>3</td>
<td>China Southwest Airlines (100%)*</td>
<td>Dissolved</td>
</tr>
<tr>
<td>4</td>
<td>Zhejiang Airlines (100%)*</td>
<td>Dissolved</td>
</tr>
</tbody>
</table>

*The assets (including the fleet) and personnel relating air transportation shall be transferred into Air China.*

Source: Scheme of Restructure.

### TABLE-3
**CSAir Holding Company**
**And its Present & Future Subsidiaries (Airlines)**

<table>
<thead>
<tr>
<th>No</th>
<th>Present</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China Southern Airlines Co., Ltd. (65.2%)</td>
<td>Subject to equity change in the market and taking over the air transport related assets from the other two airlines.</td>
</tr>
<tr>
<td>2</td>
<td>China Northern Airlines*</td>
<td>Dissolved</td>
</tr>
<tr>
<td>3</td>
<td>Xinjiang Airlines*</td>
<td>Dissolved</td>
</tr>
</tbody>
</table>

*The assets (including the fleet) and personnel relating air transportation shall be transferred into China Southern Airlines Co., Ltd.*

Source: Scheme of Restructure.

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1. This table does not include other subsidiaries not directly connected with air transportation.
2. Registered in Hong Kong, China National Aviation Co. is listed in Hong Kong and owns 43% of Hong Kong's second largest airline, Hong Kong Dragon Airline Ltd., known as Dragonair.
3. This table does not include other subsidiaries not directly connected with air transportation.
4. Publicly listed in Hong Kong, New York and mainland, China.
TABLE 4
CEA HOLDING COMPANY
AND ITS PRESENT & FUTURE SUBSIDIARIES (AIRLINES)\textsuperscript{139}

<table>
<thead>
<tr>
<th>No</th>
<th>Present</th>
<th>Future</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China Eastern Airlines Co., Ltd. (61.64%)\textsuperscript{140}</td>
<td>Subject to equity change in the market and taking over the air transport related assets from the other two airlines.</td>
</tr>
<tr>
<td>2</td>
<td>China Northwest Airlines (100%)\textsuperscript{*}</td>
<td>Dissolved</td>
</tr>
<tr>
<td>3</td>
<td>Yunnan Airlines (100%)\textsuperscript{*}</td>
<td>Dissolved</td>
</tr>
</tbody>
</table>

\* The assets (including the fleet) and personnel relating air transportation shall be transferred into China Eastern Airlines Co., Ltd.

Source: Scheme of Restructure

VII. LEGAL ISSUES CONCERNING TAKEOVERS AMONG CHINESE AIRLINES

The takeovers among the nine major airlines will involve legal issues that should not be neglected. They cover, but are not limited to, the legal status of the Three Holding Companies, the market environment, ownership, agency, and the debts and credits of the airlines. The following discussion will cover some of these legal issues.

A. THE LEGAL STATUS OF THREE HOLDING COMPANIES

Under the Scheme of Restructure, the newly established Three Holding Companies will act as wholly State-owned companies. According to the Company Law of the People’s Republic of China (“China Company Law”), a wholly State-owned company means a limited liability company invested in and established solely by the State’s authorized investment institution or a department authorized by the State.\textsuperscript{141}

The CAAC used to be responsible for the value increase and preservation of the assets of the State and those airlines directly under it. After the establishment, the Three Holding Companies will be separated financially with the CAAC and will act as airline enterprises, State authorized investment institutions, and share holding companies.\textsuperscript{142}

\textsuperscript{139} This table does not include other subsidiaries not directly connected with air transportation.

\textsuperscript{140} Publicly listed in Hong Kong, New York and mainland, China.

\textsuperscript{141} Company Law of China, \textit{supra} note 73, at art. 64.

\textsuperscript{142} Abstracts of the Scheme of Restructure, CAAC J. (Oct. 11, 2002).
Under Chinese law, a wholly State-owned company shall not establish a shareholders’ meeting, but shall establish a board of directors to exercise part of the functions and powers of a shareholders’ meeting and make decisions on important company matters. However, mergers, divisions, dissolutions, increases, and reductions of capital, and the issuance of company bonds, must be decided by the State’s authorized investment institution or the department authorized by the State.

Obviously, some contradictions exist between the functions of the Three Holding Companies declared in the Scheme of Restructure with China’s Company Law. For example, as wholly State-owned companies, the Three Holding Companies are forbidden to decide on the issues of merger, division, dissolution, and increase and reduction of capital. Instead, the State’s authorized investment institutions are entitled to decide on the above-mentioned issues.

These problems may be solved by means of the articles of association of the companies. These articles can be formulated by the State’s authorized investment institution, a department authorized by the State, or by the board of directors for the approval of the relevant State authorized investment institution or department.

Apparently, the Three Holding Companies shall have a dual function, as limited liability companies, and as the trustees of the State-owned assets. The method of selecting the board of directors for the Three Holding Companies remains unclear, although the general managers and deputy general managers have already been appointed.

The takeovers among the nine Chinese airlines will be finished in two steps. First, the Three Holding Companies will take over the existing Air China, Eastern Air Group Co. (including China Eastern Airlines Co., Ltd.), Southern Air Group Co. (including China Southern Airlines Co., Ltd.) and the other six airlines. Then the aircraft, relevant assets, and personnel of the other six airlines shall be separated and injected into Air China, China Eastern Airlines Co., Ltd., and China Southern Airlines Co., Ltd., respectively. This process will be complex and will require time to digest.

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143 Company Law of China, supra note 73, at arts. 66, 68.
144 Id. at art. 66.
145 Id.
146 Id. at art. 65.
B. THE MANAGING STAFF AND THEIR LEGAL STATUS

In China, theoretically speaking, all citizens in the country own a wholly State-owned company. Today, the ownership and management of most wholly State-owned companies are separate. In the past, as the caretaker of the assets of State-owned enterprises, the CAAC exercised a significant degree of control in choosing the general managers or deputy general managers of airlines.\(^\text{147}\) The procedures of selection of these managers are similar to those for choosing government officials, emphasizing the balance of powers and the movement of these managers among the nine airlines. Under the provisions of the Scheme of Restructure, the general mangers and deputy general managers of the Three Holding Companies shall be appointed by the central Government. It is unclear what kinds of standards shall be applied in the future selection of those managers.

The problem with China’s current managerial incentive system in State-owned companies is that it either provides too little personal incentive to managers, or it tends to give biased incentives toward short-term accounting profits. Furthermore, the management is delegated in part to government bureaucrats and in part to enterprise managers.

However, the biggest problem might be the scope of the powers conferred to the general managers of the State-owned companies because they are the legal representatives of the companies. Under this kind of regime, the legal representatives have far reaching powers. This kind of phenomenon is also rooted in China’s traditional culture advocating top decision and the communist party’s decision procedure, democracy and concentration, where there is always a final decision maker. To avoid abuse of the legal representatives’ powers, the State Council of China decided to appoint supervisory board members to the major State-owned enterprises.

The Scheme of Restructure declared that the senior management staff shall be appointed by the Government. It is interesting to find that the general managers of the Three Holding Companies are from the three airlines that are going to merge with the other six airlines while deputy general managers include general managers from the airlines to be taken over.

This kind of arrangement is like a double-edged sword. On one hand, there is a balance of power and the interests of the

\(^{147}\) The general managers or deputy general managers are equal to CEO’s or excessive vice-presidents in American corporations.
employees can be heard in the highest decision making process. On the other hand, certain demands, such as salaries, flight routes, and arrangement of the fleet from different airlines involved, might affect the time and process of the takeovers.

In recent years, China has been trying to establish a modern enterprise regime, where the powers of a company shall be divided into three groups—board of directors, managers, and supervisory board. However, the majority of the board of directors are normally also managers. Therefore, they have overwhelming power to do what they intend to do, especially the general managers. On the other hand, the managers can easily be removed from their positions because they are sometimes still considered governmental officials. Though the method of delegating the powers of the State-owned enterprises needs to be improved, China’s Company Law has set up the basic principles for it. The question is how to implement the law properly and how each holding company and its subsidiaries will establish their enterprise culture.

C. Debts and Credits of the Airlines to be Taken Over

Too many airlines were trying to become global players in the 1990s. For example, Swiss Air moved into rapid expansion during that period and took over a number of financially weak airlines, including buying a 49% stake in a Belgian carrier that was later dragged into the debt abyss.

Among the Chinese airlines, one main question is how to merge or reorganize their capital and workforce so that airlines’ needs are properly addressed. Unless adequately addressed, the planned takeovers will further mask deep-seated structural problems in a sector set by underperformance.148 To create efficiency, the Chinese airline industry urgently needs to follow a number of strategies such as adjustment of routes, cost control, and proper allocation of human resources.

In a typical market economy, the use of bankruptcy, due to poor performance, is one of the most important disciplinary mechanisms for firms. In China, because of the fear of massive unemployment and social instability, some airlines whose debts

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exceed their assets might further burden the three major airlines that are making slim profits. Fortunately, the assets of the airlines to be taken over will be divided into two parts, with aircraft and relevant assets to be inserted into three major airlines. The rest of the assets and liabilities will be absorbed by the holding companies.

Another concern to be addressed is that the takeovers are against the will of managers whose airlines will be taken over. Such takeovers (administrative maneuvering) may only transfer the burden of liabilities and other problems to those well-performing airlines, but not solve the fundamental underlying problems such as the cultural recognition of the employees from different airlines.

D. Legal Status of Three Major Airlines

1. Air China

Air China, founded on July 1, 1998, is a wholly State-owned enterprise. It operates passenger and cargo services, special and chartered flights, and general aviation. Air China has a fleet of 64 aircraft. Air China now operates 114 routes, including 43 international routes and 71 domestic routes, and serves 39 cities in 28 countries and regions, and most of the provincial capitals, major cities, and tourist attractions in China. It has two branch offices in Tianjin and Innermongolia, 36 overseas representative offices, and several domestic ones. All of these routes connect Beijing with various destinations both in China and around the world, forming a well-established transport network with Beijing as the center.

Over 15,000 people work for Air China, including more than 100 pilots and more than 1500 flight attendants. The registered capital is 1.5 billion RMB (approx. $200 million), and the total assets are 35.9 billion RMB (approx. $4.4 billion).

After the takeover is finished, Air China will have a fleet of 119 aircraft, and 307 routes. Air China will probably benefit by the takeover, reshape its flight network, and have more mar-

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150 Id.
151 Id.
152 Id.
153 Id. RMB is the abbreviation of Ren Min Bi, the legal currency of China.
154 Id.
ket shares throughout China, especially in the Beijing region and in the Southwest part of China. It can be predicted that Air China will be partly privatized and become a joint stock listed company in the future.

2. China Southern Airlines Co., Ltd.

China Southern Airlines Co., Ltd. ("China Southern"), formerly a wholly State-owned company, was incorporated on March 25, 1995 as a joint stock listed company. Later, China Southern succeeded in publicly listing the company in Hong Kong and New York. As of mid-June 2002, China Southern operated 323 routes—263 domestic, 39 international, and 21 Hong Kong routes. China Southern operates a fleet of 109 aircraft. China Southern together with its subsidiaries is the largest airline in the People’s Republic of China.

China Southern provides commercial airline services throughout China, Hong Kong, and the Macao regions, as well as in Southeast Asia and other parts of the world. China Southern conducts a portion of its airline operations through Xiamen Airlines Company Limited, Southern Airlines Group, Shantou Airlines Limited, Guangxi Airlines Company Limited, Zhuhai Airlines Company Limited, and Guizhou Airlines Company Limited ("the Airline Subsidiaries"). Each of the Airline Subsidiaries is 60% owned by China Southern. The Airline Subsidiaries' operations are fully integrated with its airline-related businesses.

China Southern's State-owned parent, Southern Air Group Company, which holds a 65.2% stake in the China Southern, will be replaced by the newly established China Southern Air Holding Company and assume direct ownership over 100% State-owned China Northern Airlines and Xinjiang Airlines. These three airlines will become subsidiaries of China Southern Holding Company. The revenue from those routes will be allocated in proportion to the traffic capacity, calculated by reference to the model of the aircraft, frequency of the flights, and the seat capacity.

156 Id.
157 Id.
158 Id.
159 Id.
160 Id.
Gradually, all transport assets and relevant personnel of China Northern Airlines and Xinjiang Airlines will be separated into China Southern Airlines Co., Ltd. Finally, China Southern Airlines Co., Ltd. will have a fleet of 180 aircraft and 660 routes.161


China Eastern Airlines Co., Ltd. ("China Eastern"), incorporated in April 1995 as a joint stock company, is one of the three major airlines in China.162 The fleet of China Eastern Airlines includes more than 60 large and medium size aircraft, mostly Airbus and Boeing. It has formed a network, with the center in Shanghai, radiating to the whole country, and linking to Asia, Europe, America, and Australia.163 China Eastern is the first Chinese airline to be publicly listed in New York, Hong Kong, and Mainland China.164

China Eastern accounted for approximately 16.9% of the total commercial air traffic handled by Chinese airlines in 2001.165 China Eastern operates primarily from Shanghai's Hong Qiao International Airport and Pudong International Airport. The primary focus of China Eastern's business is the provision of domestic, Hong Kong regional, and international passenger airline services. In 2001, China Eastern operated over 1,722 scheduled flights per week (excluding charter flights), serving a route network that covers 76 cities within China and abroad.166 Also in 2001, the company operated approximately 200 routes—142 domestic, 13 routes to and from Hong Kong, and 45 international routes.167

China Eastern, its subsidiaries, and its branches are located in Eastern and Northern China with more than 40 sales offices all over the country.168 China Eastern also constructed the holding company of China Cargo Airlines with China Ocean Shipping Company (COSCO). It merged with China General Aviation

161 Id.
163 Id.
164 Id.
165 Id.
166 Id.
167 Id.
168 Id.
Company successfully and made the scale of the company larger.\textsuperscript{169}

According to the Scheme of Restructure, the new parent, CEAHoldings, will first take over its original parent company—Eastern Air Group Company, which owns 61.64\% of China Eastern.\textsuperscript{170} CEAHoldings will later assign all transport assets and relevant personnel of China Northwest and Yunnan Airlines to China Eastern. Thus, China Eastern will have a fleet of 142 aircraft and 386 routes when the takeover is complete.\textsuperscript{171}

\section*{E. \textbf{Competition Issues and Consumers' Rights}}

The lack of legal intervention in competition and the administrative intervention of the CAAC sometimes restricts the vitality of the airlines and damages the consumers' interests. Administrative intervention, more often than not, is used by the CAAC to artificially raise ticket fares or ban discounts launched by individual airline companies in order to obtain a larger market share. For example, the airline pricing policies adopted by associated companies since April 1, 2001, are a typical example of how the CAAC steps in when airline companies’ ticket fares fail to meet CAAC requirements.\textsuperscript{172} To save losses that plagued the entire industry, the administration demanded that 15 airline companies sell airline tickets at a set price.\textsuperscript{173} Such a non-market price policy, if not altered and modified, will continue to discourage competition within the sector. It is unpredictable to what extent the Government will assert influence over the Chinese airline industry when the takeovers are finished and the CAAC only acts as an industry regulator.

The takeovers among these airlines might reduce consumer choices and ultimately increase airfares or commit a predatory act in pricing due to less competitors or lack of competition. It is necessary for the relevant organizations such as the consumers’ associations to play a more active role in such kinds of activities. However, the top priority might be more legislation on the competition in the market.

\textsuperscript{169} Id.

\textsuperscript{170} Id.

\textsuperscript{171} Id.

\textsuperscript{172} At that time, the CAAC issued a notice, forbidding airlines to sell discounts on some routes.

VII. SUMMARY AND CONCLUSION

In the final 20 years of the last century, China experienced an economic boom. China has been transferring from a highly concentrated economy to a market economy, which has made it possible to adjust the natural resources in her economy, including the restructuring of China's many State-owned enterprises.

Spurred by the growing globalization and China's entry into the World Trade Organization, a wave of takeovers is expected among the enterprises in China. Through takeovers, many domestic industries might become strong enough to compete with their foreign counterparts.

In the airline industry, takeovers of Chinese airlines reflect the change in the Government's policy to raise the efficiency of the industry, thus stimulating the industry's healthy development. However, China should also notice experience and the legal framework of takeovers occurring outside China. It seems to the authors that law and regulations can play an important role in the takeover activities and can create a better environment for free competition.

On one hand, China should develop a legal framework on takeovers involving more transparency and coherence, and offer competitors equal opportunities to do business. On the other hand, China must establish a set of domestic procedural requirements regarding the notification of mergers, such as thresholds, timetables, quantity, and quality of information required, and the uniformity of filing criteria. Last but not least, it is suggested that China should draft or amend the existing competition law to include provisions such as those in the EU. Further, China should establish a national trade commission as a watchdog to supervise takeovers, including those in the airline industry.
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