

VIEing for Success and Failure: AliBaba and Ant Group's Contrasting IPOs and the Future of  
Chinese Technology Investment

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## Introduction

The intertwined 25-year histories of Alibaba and Ant Group highlight a three-way tension among domestic regulators, founders, and foreign investors that drives the dynamics of foreign investment in the People's Republic of China (PRC) and around the world. Through their stories, we can trace the evolution of the PRC's approach to foreign investment and domestic markets and draw lessons for the Chinese economy and foreign investors.

Beginning in the 1970s with the PRC's great economic liberalization, the PRC government became a supporter of foreign direct investment (FDI) and domestic entrepreneurship as a way of facilitating economic growth. Between Alibaba's founding in 1999 and the company's spinoff of its Alipay subsidiary in 2011, foreign investors were at the peak of their power and influence in the PRC economy, highlighted by Yahoo's investment in Alibaba in 2005 and subsequent acquisition of significant governance rights. The decade between 2011 and Ant Group's paused IPO in 2020 showcased the dominance of PRC founders over foreign investors (and to some extent the national government), beginning with the expropriation of Alipay (one of Alibaba's most valuable subsidiaries and predecessor to Ant Group) by PRC founders and including Alibaba's 2014 IPO and stunning public-market success. Throughout both of these periods, the PRC government enabled the success of foreign investors and PRC founders through quiet toleration of legal structures like the Variable Interest Entity (VIE) that bent foreign investment laws in service of enabling FDI, innovation, and economic growth. In the late 2010s and accelerating after 2020, the PRC government began to reassert its control over both domestic founders and foreign investors in response to what it saw as a threatening growth in autonomous domestic economic and social power concentrated among a small number of individuals like Alibaba founder Jack Ma. Recent government actions to shut down Ant Group's planned 2020 IPO, levy penalties against Alibaba and Ant, force major restructurings of both companies, and assert personal control over Ma evidence the PRC's backlash against successful and autonomous private-sector leaders.

The PRC now sits in a bind of its own making. Through its recent regulatory crackdown, the PRC government showed a willingness to rattle the fragile VIE structures that foreign investors and domestic entrepreneurs have used to push the technical limits of foreign investment restrictions. By tacitly accepting VIE structures as the main method of directing foreign investment to critical sectors, the PRC government caused investors and entrepreneurs to rely heavily on VIEs to finance many of the country's most successful businesses. Upsetting the apple cart by invalidating VIEs may allow temporary economic gain for the PRC, but will do so at the expense of continued critical foreign investment, a consequence that is already playing out to a limited extent in the PRC economy today. Because they rely on loopholes, VIEs are inherently unstable. The only long-term solution to encourage sustainable FDI would be to reform foreign investment laws to create a white-market legal FDI regime that reflects current practices in the grey-market VIE investment regime. In tandem, reforms are needed to ensure respect for judicial independence, intellectual property, property, and contract law among others to address significant rule of law limitations in the PRC that hamper the country's ability to attract foreign investment. Given that such reforms are highly unlikely and run counter to the PRC government's increasingly interventionist approach to foreign investment, investors and founders need to be wary when making investments and seek to align their interests with the PRC government wherever possible to avoid regulatory backlash.

# Historical Background: Deng Xiaoping to Alibaba's Founding (1978-1999)

## Liberalizing China: Deng Initiates Market Reforms

The story of Alibaba and Ant Group begins around 20 years before Alibaba's founding with the ascension of Deng Xiaoping to leadership of the PRC in 1978. Deng assumed power two years after Mao Zedong's death and set the PRC on a path towards a market economy and openness to the larger global economy. As Ross Garnaut describes, with the 1978 election of Deng to the leadership "there was [a pragmatic] acceptance that domestic and international exchange through markets was a necessary and acceptable component of a national development strategy" on the basis that market "institutions and policies... raised national economic output."<sup>1</sup> Indeed, the rise in China's economy from 1978 to 1999 was nothing short of astounding:

China's economy has expanded by five times, and its foreign trade by twelve. It has greatly increased consumption levels of what had been about half of the world's people in poverty. Then an isolated, autarchic economy, China through the mid and late 1990s absorbed about half of the direct foreign investment flows to developing economies. From having no trade or investment ties with Taiwan and the Republic of Korea, it is now [in 1999] the first or second export destination of one and the third of the other.<sup>2</sup>

The PRC's evolution towards free markets was accompanied by an increasing openness towards and importance of FDI.<sup>3</sup> Between 1978 and 2021, over \$2 trillion of FDI flowed into nearly one million foreign-invested enterprises in China,<sup>4</sup> despite continued restrictions on what industries foreigners could invest in.<sup>5</sup>

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<sup>1</sup> Garnaut's book summarizes the 20 years of growth after Deng came to power and was written the same year that Alibaba was founded. ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC REFORM 3 (Ross Garnaut & Ligang Song eds., 1999). Although Deng undoubtedly was critical in enabling the PRC's market transition, his exact economic role and legacy is complicated. *See, e.g.,* Barry Naughton, *Deng Xiaoping: The Economist*, 1993 CHINA Q. 491 (1993) ("Under [Deng's] leadership, the government extricated itself from a legacy of massive economic problems and began a sustained programme of economic reform... Yet it is deeply paradoxical to credit Deng Xiaoping primarily with economic success, for he has never said anything original about economics or economic policy, and rarely displays any particular insight into the functioning of the economy.").

<sup>2</sup> ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC REFORM 1 (Ross Garnaut & Ligang Song eds., 1999).

<sup>3</sup> Stefan Kaiser et al., *Foreign Direct Investment in China: An Examination of the Literature*, in GREATER CHINA: POLITICAL ECONOMY, INWARD INVESTMENT, AND BUSINESS CULTURE 44 (Chris Rowley & Mark Lewis eds., 1996) ("Up to 1978, China's economy was largely closed off from the world economy. FDI was prohibited for historical, ideological and practical reasons... Chinese authorities also recognized that the only way to pursue [their] ambitious goal [of modernizing agriculture, industry, science, and national defense] was to attract FDI which would provide the capital, the management skills and the technology that was lacking."). Modern FDI in China began with the passage of the Law on Joint Ventures Using Chinese and Foreign Investment in July 1979. CHUNLAI CHEN, CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT: 1978–2018 596 (Ross Garnaut, Ligang Song, & Cai Fang eds., 2018).

<sup>4</sup> Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China's regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1 (2021).

<sup>5</sup> *See* Serena Y. Shi, Comment, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 Fordham Int'l L.J. 1265, 1273-1274 (2014); Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China's regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 2-3 (2021). PRC solicitation of foreign resources and expertise was not limited solely to FDI financial investments, *see* ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC

At the time of Alibaba's 1999 founding, the PRC economy looked very different than it had 20 years earlier. Structurally, the PRC economy had shifted from autarky and strict state planning and controls to internationalized markets, culminating with the PRC joining the World Trade Organization (WTO) in 2001.<sup>6</sup> Over the 20 years following 1978, private ownership grew from next to nothing to become nearly the largest segment of industrial output in 1997, while the contribution of state-owned enterprises to total industrial output dropped by more than fifty percentage points.<sup>7</sup>

## Parallel Emphasis on the Party and Markets

While Deng and his successors began to liberalize the PRC's economy, they maintained tight control on the country's politics and a stranglehold on power for the Chinese Communist Party (CCP).<sup>8</sup> In contrast to the Soviet Union, which liberalized both its politics and economics simultaneously in the late 1980s under Mikhail Gorbachev,<sup>9</sup> and despite pushback from students and other segments of the population, the PRC transitioned to a market economy without allowing significant political liberalization or experiencing instability that threatened the survival of the state.<sup>10</sup> Garnaut argues that this balance of illiberal political policies with liberalizing economic policies was a core part of Deng's appeal as a leader,<sup>11</sup> with Deng's CCP adopting the view that Mao was "70 percent right and 30 percent wrong:"

The 70 per cent was the contribution of the early Mao to building the supremacy of the Communist Party, a strong Chinese state, and the early policy which had been developed with the co-operation of Deng Xiaoping and the other, older leaders of the reform period. The excesses of the Great Leap Forward and the Cultural Revolution comprised much of

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REFORM 7 (Ross Garnaut & Ligang Song eds., 1999) (discussing a range of other reforms including allowing more Chinese students to study abroad).

<sup>6</sup> Serena Y. Shi, Comment, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 *Fordham Int'l L.J.* 1265, 1272 (2014). See also Wayne M. Morrison, *China's Economic Conditions* (Issue Brief for Congress, 2002-2003) (overview of PRC economic development).

<sup>7</sup> ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC REFORM 11, 96 (Ross Garnaut & Ligang Song eds., 1999) (Figure 1.2).

<sup>8</sup> An obituary for Deng's economic impact on his death described "the functional distinction between economics and politics, and preserving the supremacy of the party" as one of the "pillar[s] of Deng's economic legacy." See Jean-François Huchet, *The Economic Legacy of Deng Xiaoping*, 11 *CHINA PERSPECTIVES* 6, 15 (May/June 1997); Seth Faison, *Deng Xiaoping is Dead at 92, Architect of Modern China*, *THE NEW YORK TIMES*, Feb. 20, 1997, <https://www.nytimes.com/1997/02/20/world/deng-xiaoping-is-dead-at-92-architect-of-modern-china.html> ("An unyielding authoritarian, he left behind a Communist Party that still has absolute political authority and crushes all dissent...").

<sup>9</sup> See VLADISLAV M. ZUBOK, *COLLAPSE: THE FALL OF THE SOVIET UNION* (2021).

<sup>10</sup> Maintaining political supremacy remained a key focus of Deng despite economic liberalization, see ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC REFORM 6 (Ross Garnaut & Ligang Song eds., 1999) ("Deng eventually came to doubt the will or the capacity of each [of his two main lieutenants] to secure and enforce the authority of the Chinese Communist Party, causing the dismissal of [one] in early 1987 after the Shanghai student demonstrations, and of [the second] in the Party crisis over the management of the Beijing student demonstrations in May 1989.").

<sup>11</sup> ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC REFORM 4 (Ross Garnaut & Ligang Song eds., 1999) ("Deng Xiaoping's political control of the Chinese Communist party and the People's Liberation Army was strong but not unconditional. It was built partly on others' confidence that he stood firmly for continued Communist Party political dominance, and commitment to some undefined minimum core of socialist principles and objectives.").

the 30 per cent, *including the elevation of ideological purity above the requirements of economic development.* [emphasis added]<sup>12</sup>

In addition to the political policies' Maoist legacy, Deng also viewed freer political discourse as potentially distracting to the party's primary job of "economic construction."<sup>13</sup>

Much of the tension that underlies the Alibaba and Ant story stems from the inability to resolve conflicting desires for economic growth while maintaining a monopoly of political power in the state. Growth of the economic and political power of individuals, whether through foreign investment or entrepreneurial wealth creation, presents a threat to the state's goals and thus tests the extent of liberalization that PRC leaders tolerate.

## Variable Interest Entities (VIEs)

### Regulation of FDI in China and the Origins of VIEs

As part of the PRC's post 1978 market liberalization, Chinese private sector companies and the PRC government began to welcome significant FDI as a way of overcoming the PRC's "underdeveloped capital markets" and "fuel[ing] their growth."<sup>14</sup> Foreign investment was a necessity for achieving the PRC's aggressive growth goals.<sup>15</sup> However, regulations have limited foreign investment in firms in a significant (though declining) number of "restricted" or "prohibited" industries.<sup>16</sup> These regulated industries include some of those that are most important to economic growth, that are most exciting to foreign investors, and "that the Chinese government regards as strategically sensitive, such as internet platforms, financial services, telecommunications, energy, agriculture, transportation, and education."<sup>17</sup> Both foreign investors and PRC companies in regulated industries seeking additional investment had incentives to work around regulations to enable investment, and Variable Interest Entities (VIEs) are the result of these attempts to avoid FDI rules.

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<sup>12</sup> ROSS GARNAUT, CHINA: TWENTY YEARS OF ECONOMIC REFORM 8 (Ross Garnaut & Ligang Song eds., 1999).

<sup>13</sup> See Barry Naughton, *Deng Xiaoping: The Economist*, 1993 CHINA Q. 491, 502 (1993) (Deng reportedly told George H.W. Bush: "There are so many Chinese people, and each has his own viewpoint. If there's a demonstration by this one today, and that one tomorrow, there'd be a demonstration every day, 365 days a year. In that case, economic construction would be entirely out of the question."). Naughton sees the focus on economic construction and clamp down on politics as a reflection of Deng's failure to provide an "affirmative vision" for success for the PRC.

<sup>14</sup> Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 3 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf).

<sup>15</sup> See, e.g., discussion of China Unicom's attempted use of the CCF structure to finance significant communications infrastructure projects, *infra* \_\_\_\_.

<sup>16</sup> See Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China's regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 2-3 (2021) (Table 1).

<sup>17</sup> Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 3 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf) (FDI rules are usually enforced by MOFCOM issuance of business licenses which is conditional on the company being "owned and controlled by Chinese owners," making it particularly difficult for direct equity investors to avoid these restrictions.).

The China-China-Foreign (CCF) structure, a precursor to VIE structures, was proposed in the late 1990s as a way of enabling foreign investment in restricted industries. CCF was an attempt to work around ownership restrictions by using multiple layers of subsidiaries, with the direct ownership over sensitive operating companies entirely in the hands of PRC-domiciled (and thus nominally not foreign) artificial entities. Initially, this workaround was “tacitly permitted,” and China Unicom was able to raise \$1.4 billion through its CCF structure over three years.<sup>18</sup> However, CCF PRC-domiciled direct owner entities were themselves partly owned by foreign investors, thus leading regulators to invalidate the structure in 1998 as violating foreign ownership laws.<sup>19</sup> After CCF was invalidated, investors in CCF structures were largely unable to recover their investments, a cautionary tale that hangs over VIE structures to this day.<sup>20</sup>

Despite the failure of CCF, the success of FDI in other areas of the Chinese economy continued to make the idea of enabling foreign investment in restricted sectors appealing if a workaround to restrictions could be found. Sina (owner of Weibo, China’s Twitter) identified the current consensus solution to this problem when it created the world’s first VIE in 2000.<sup>21</sup>

## Variable Interest Entity (VIE) Structure

At its most basic, the design of the VIE is intended to give foreign “owners” of the VIE the traditional benefits of corporate ownership of the underlying business (including economic rewards and, in some cases, control), while the business is able to operate without restrictions in the PRC as if it were fully owned by PRC nationals.<sup>22</sup> VIE structures usually attempt to accomplish this by using networks of contracts and ownership among at least three entities (see Figure XX):<sup>23</sup>

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<sup>18</sup> Samuel Farrell Ziegler, Note, *China’s Variable Interest Entity Problem: How Americans Have Illegally Invested Billions in China and How to Fix It*, 84 GEO. WASH. L.R. 539, 552 (2014).

<sup>19</sup> Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China’s regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 6-7 (2021) (similar structures were again rejected by PRC courts in 2013).

<sup>20</sup> Samuel Farrell Ziegler, Note, *China’s Variable Interest Entity Problem: How Americans Have Illegally Invested Billions in China and How to Fix It*, 84 GEO. WASH. L.R. 539, 553 (2014). Foreign investors also see a cautionary tale in CCF investors’ reliance on the PRC’s “tacit approval” of CCF structures between 1994 and 1998, which parallels similar arguments in favor of VIE validity. *See infra* \_\_\_\_\_.

<sup>21</sup> Notably, Sina operated in a difference sector than China Unicom (Class II rather than Class I telecommunications), where the PRC seems to have slightly more openness to FDI. *See* Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 1, 3 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf); Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 1 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>.

<sup>22</sup> Although VIE operators all make claims that they believe that the structure complies with applicable law in their securities disclosures, at best this position is formalistic and tenuous, relying on a lack of serious government scrutiny and pushback. *See* Sina Co., Registration Statement (Form S-3) 10 (Oct. 2, 2003) (“Although we believe we are in compliance with current PRC regulations, we cannot be sure that the PRC government would view these operating arrangements to be in compliance with PRC licensing, registration or other regulatory requirements, with existing policies or with requirements or policies that may be adopted in the future.”); discussion of uncertain legal status of VIEs *infra* \_\_\_\_\_.

<sup>23</sup> Some models of the VIE structure also include a fourth “conduit” entity registered in Hong Kong as a subsidiary tier between the ListCo and WFOE to improve tax treatment, *see* Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China’s regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 3-5 (2021).

- **Listed Company (ListCo)** – An entity incorporated outside of the PRC, usually in the Cayman Islands or another jurisdiction with limited investor protections. For public companies, ListCo’s shares are the ones traded on an international exchange.
- **Wholly Foreign-Owned Enterprise (WFOE)** – An entity incorporated inside the PRC that is usually a wholly owned or controlled subsidiary of ListCo.
- **Chinese Operating Company (OpCo or VIE)** – An entity incorporated inside the PRC that owns the assets of the business including any relevant licenses (usually the critical assets for businesses operating in highly regulated VIE industries).<sup>24</sup>

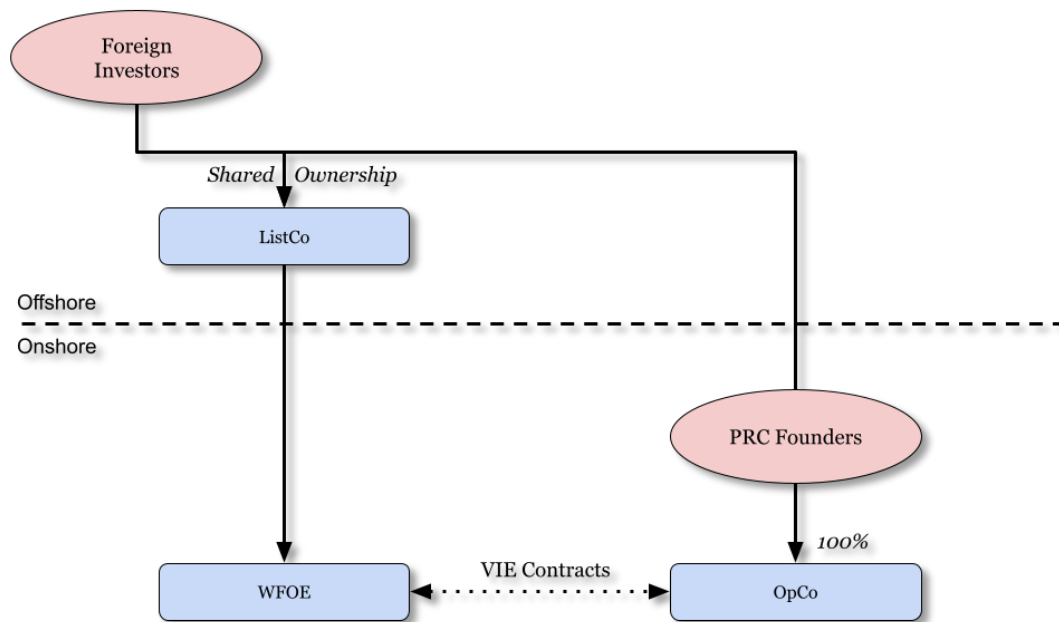


Figure 1: Diagram of key entities that make up VIE structure with connecting contracts and ownership (adapted from Cadwalader memo).<sup>25</sup>

Superficially, the equity ownership of these companies is relatively simple: ListCo equity is owned by shareholders (usually a combination of domestic investors and those purchasing shares on an international exchange), WFOE equity is owned by ListCo, and OpCo equity is owned by PRC

<sup>24</sup> Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 2-3 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>; Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 4-6 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf); Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 577-578 (2014).

<sup>25</sup> See Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 2 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>.

shareholders (usually the business’s founders). The VIE structure uses contracts to attempt to allocate many of the benefits of ownership in the underlying business (OpCo) to the WFOE and thereby to the ListCo and foreign investors. The common arrangements include:

- An **interest-free loan** from the WFOE to the VIE to capitalize the VIE. This loan is secured by the equity and assets of the VIE.
- **Call options** that allow the WFOE to purchase the VIE and its assets, usually for the amount of the loan agreement. These options cannot be exercised under current FDI laws by the WFOE but can be assigned to PRC residents who could exercise them.<sup>26</sup>
- An **irrevocable proxy** or **power of attorney** granted by the VIE’s equity holders to the WFOE giving it the rights of an equity holder.
- An exclusive **technical services agreement** between the entities that transfers substantially all VIE profits to the WFOE in exchange for certain services.<sup>27</sup>

When functioning correctly, this combination of contracts gives shareholders in ListCo essentially the same economic and governance rights they would have if they were direct equity shareholders in OpCo, making the structure appealing to foreign investors interested in investing in restricted Chinese industries.<sup>28</sup> One important byproduct of the VIE arrangement is to enable the ListCo to “consolidate” the financial statements of the OpCo into its financial statements, thus reporting operating revenues and profits as if they are earned by the ListCo.<sup>29</sup>

## Risky Legal Status

Although VIEs have been a critical legal and economic tool for directing FDI to the PRC over the last quarter century, commentators have raised persistent and unresolved concerns since the structure was invented, and there are many reasons to conclude that ListCo ownership is riskier

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<sup>26</sup> “[T]he option is more for comfort than actual protection since it underscores the very reason why the WFOE cannot own the OpCo, i.e. because the OpCo lies in an industry that prohibits or restricts foreign investment.” Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 579 (2014).

<sup>27</sup> Jesse M. Fried & EHUD KAMAR, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 294-295 fn. 87 (2021); Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 4-6 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf); Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 578-579 (2014). *see also* Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China’s regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 4 (2021).

<sup>28</sup> In the 2011 Cadwalader memo on VIE structures, the firm portrayed as the upside case that VIE ownership might someday be as good as equity ownership, arguing that “if regulations [on FDI] continue to ease, foreign investors may one day be able to exercise the equity [call] option in their VIE Contracts and legally acquire equity interests in the [OpCos] in their VIE Structures.” Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 3 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>. As this paper will show, the opposite has occurred over the last ten years, with VIE owners seemingly further from being able to achieve full equity ownership.

<sup>29</sup> For more discussion of the accounting roots of VIE structures and the mechanisms for consolidation, *see* Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 571-573 (2014). *See also id.* at 579 (“[T]he viability of the listing depends on the fundamental requirement that the OpCo’s financials are consolidated with that of the ListCo; this requirement allows the ListCo to generate interest in its listing.”).

than direct equity investment would be.<sup>30</sup> In particular, critics have focused on risks related to VIE enforceability in PRC courts, owner expropriation, and corporate governance.<sup>31</sup>

Despite nearly a quarter century of experience for the structure, it remains unclear whether VIE structures would be enforced by the PRC government if challenged. While the question of enforceability is critical, as “a VIE investment is only as good as the validity of its underlying contracts,”<sup>32</sup> the PRC continues to maintain a posture of “strategic ambiguity” with respect to the legality of the VIE structure, and the issue has never been directly tested in PRC courts.<sup>33</sup> Despite investor optimism that VIEs will continue to be recognized by the PRC,<sup>34</sup> concerns about the status of the form are real, and the risk of derecognition by the PRC is plausible. In addition to the historical example of the 1998 crackdown on CCF entities, which had also received tacit permission from the PRC for a period,<sup>35</sup> PRC authorities have repeatedly proposed rules that would limit or eliminate VIEs, though these proposals have been unsuccessful so far.<sup>36</sup> A 2015 Draft of the Foreign Investment Law (FIL) of 2020 (a significant revision of PRC restrictions on FDI) included proposals that would have provided much broader definitions for “foreign” investors that would have explicitly covered WFOEs and directly outlawed VIE structures by targeting

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<sup>30</sup> See, e.g., Serena Y. Shi, Comment, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 FORDHAM INT'L L.J. 1265 (2014).

<sup>31</sup> More broadly, investor disclosures seem to point towards a kind of *sovereign risk* of investing in VIE entities, indicating uncertainty about legal instability and PRC respect for business agreements. See, e.g., Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 96 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> (“The legal protections available to you under the PRC legal system may be limited.”). See also *id.* at V-1 (summarizing the PRC legal system).

<sup>32</sup> “Validity” in this quote has essentially the same meaning as “enforceability.” Serena Y. Shi, Comment, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 FORDHAM INT'L L.J. 1265, 1266-1267 (2014).

<sup>33</sup> See Fa Chen, *China's recent regulation of variable interest entity structures has led to a drop in Chinese companies' US listings*, OXFORD BUSINESS LAW BLOG (Apr. 19, 2022), <https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/chinas-recent-regulation-variable-interest-entity-structures-has-led> (“Notwithstanding its broad use since 2000, the VIE structure has been neither recognised nor denied by Chinese authorities in the general sense. Instead, cases challenging the VIE structure have repeatedly revealed that Chinese authorities are reluctant to clarify the legality of the VIE structure. The strategic ambiguity can help Chinese authorities maintain regulatory flexibility while funnelling foreign investment into the Chinese capital markets to leverage economic developments.”).

<sup>34</sup> This optimism came in part from very real interests the PRC government had in retaining the benefits that VIE structures provide to the PRC economy by enabling FDI and accelerated growth in crucial industries otherwise inaccessible to foreign investors due to the “negative list.” Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 3 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf> (“Leading industry practitioners, however, look to the success of Sina.com’s VIE Structure, as well as many other thriving VIE Structures in the heavily regulated internet, information, and technology sectors in China as evidence of the PRC regulators’ tacit approvals.”).

<sup>35</sup> See *supra* note \_\_\_\_.

<sup>36</sup> See Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 8 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf). See also, e.g., Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 5-6 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf> (discussing 2006 M&A Rules and SAFE 75 regulation and implications for VIEs); Serena Y. Shi, Comment, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 FORDHAM INT'L L.J. 1265, 1282 (2014) (discussing 2011 M&A Regulations).

contractual control and determining which ListCo investors had actual control in the OpCo.<sup>37</sup> Legislative and regulatory changes are not the only threats to the VIE structure. In 2017, Baosheng Steel (an OpCo) planned to go public in the United States as Buddha Steel (a ListCo) before the process was disrupted by “local authorities in Hebei province [who] determined that [Baosheng Steel’s] VIE Structure ‘contravenes current Chinese management policies related to foreign-invested enterprises and are against public policy.’”<sup>38</sup> Comparable action against an already-trading public ListCo would result in investors potentially losing their entire investments, and a similar decision against the structure writ large could be devastating for foreign investors.<sup>39</sup> Government refusal to enforce VIE contracts would also open the door to abuse and expropriation by PRC founders and operators (discussed further in the following paragraph on corporate governance risks).<sup>40</sup> The government might also refuse to recognize VIE structures as maintaining domestic ownership over an OpCo, denying the OpCo the licenses it needs to achieve its purpose of operating within a restricted industry.<sup>41</sup> VIEs have also come under regulatory threat from the US Securities and Exchange Commission (SEC) for lack of accessibility to accounting materials in the PRC, giving foreign regulators less oversight of the companies’ economics.<sup>42</sup> These audit concerns seem to be largely mitigated by an agreement on information access in 2022, but the potential for governments outside the PRC to disrupt the VIE structure remains.<sup>43</sup>

A particular area of concern for foreign investors is expropriation of underlying OpCo assets by PRC founders and owners. Unless incentives are aligned between PRC owners and foreign investors, the instability of the VIE structure and potentially large economic gains for expropriators make expropriation a significant risk. Although foreign investors have some protections from corporate law in ListCo’s jurisdiction (often Cayman law), exchange rules, and US securities law (if ListCo is listed on a US exchange), if PRC owners decide to breach OpCo’s contracts and seize assets for themselves, foreign investors will be forced to seek remedies and

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<sup>37</sup> See Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China’s regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 11 (2021).

<sup>38</sup> Additionally, some analysts saw this as a sign that the PRC might be taking a broader stance against VIEs though this has not materialized. Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 9 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>.

<sup>39</sup> Fa Chen, *China’s recent regulation of variable interest entity structures has led to a drop in Chinese companies’ US listings*, OXFORD BUSINESS LAW BLOG (Apr. 19, 2022), <https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/chinas-recent-regulation-variable-interest-entity-structures-has-led> (“In the event of invalidation of VIE structures, involved foreign investors could find themselves lacking effective remedies at both local and international levels.”).

<sup>40</sup> See *infra* \_\_\_\_.

<sup>41</sup> Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 7 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>. This is also the argument that Jack Ma used in justifying his decision to spin off Alipay in 2011, see *infra* note \_\_\_\_\_. See also Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 580-584 (2014) (more detailed discussion of historical regulatory risks).

<sup>42</sup> See Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 599 (2014). See also *id.* at 597-599 (discussing SEC approach to VIEs more broadly).

<sup>43</sup> See *Fact Sheet: China Agreement*, PCAOB (Aug. 26, 2022), <https://pcaobus.org/news-events/news-releases/news-release-detail/fact-sheet-china-agreement>; Gary Gensler, *Statement on PCAOB’s Determinations Regarding Public Accounting Firms in China*, SEC (Dec. 15, 2022), <https://www.sec.gov/news/statement/gensler-determination-statement-20221215>.

enforcement in PRC courts given the concentration of insiders and valuable assets in the PRC.<sup>44</sup> In general, Western commentators have not been optimistic about the likelihood of recovery in such a situation.<sup>45</sup> Such a move would require a direct ruling from PRC courts on VIE enforceability, and even if PRC courts were interested in maintaining VIE structures in the abstract, politics and the complexity of contractual ownership might make PRC courts unwilling to side with foreign owners against PRC owners or allow enforcement of a judgment in a specific case.<sup>46</sup> In just one example of VIE expropriation, Gigamedia PRC executive Wang Ji seized an OpCo's business license and fundamental documents upon learning he was going to be dismissed, essentially removing all ListCo control over the OpCo. The ListCo was devalued because of the loss and was ultimately unable to regain control over the rogue executive and OpCo.<sup>47</sup> VIEs also risk more subtle forms of expropriation, such as where some assets are removed from the OpCo for compensation, but where such compensation does not represent fair value.<sup>48</sup>

The attenuated VIE structure also reduces governance controls that traditional equity shareholders often have over their investments. As the Council of Institutional Investors (CII) notes in their brief on VIEs, ListCos are often incorporated in “management-friendly

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<sup>44</sup> See Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 302-306 (2021); see also Jesse M. Fried & Ehud Kamar, *China and the Rise of Law-Proof Insiders* 7-8 (Eur. Corp. Governance Inst., Working Paper No. 557, 2020).

<sup>45</sup> 2023 *Investment Climate Statements: China*, UNITED STATES DEPARTMENT OF STATE (2023), <https://www.state.gov/reports/2023-investment-climate-statements/china/> (“The PRC’s constitution and laws are clear that PRC courts cannot exercise power independent of the Party. Further, in practice, influential businesses, local governments, and regulators routinely influence courts. Outside of the IP space, U.S. companies often hesitate in challenging administrative decisions or bringing commercial disputes before local courts due to perceptions of futility or fear of government retaliation.”). This makes it important that VIEs create structures that try to avoid incentives for expropriation, see Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 3 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf> (“It is critical that the VIE Structure and its constituent agreements effectively align the interests of the investors... and those of the PRC Founders... [to] minimize the temptation for the legal domestic owners... to seize or transfer the operating licenses and other valuable assets.”); Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 601-602 (2014) (“The foremost priority is to ensure that the Chinese legal owner of the OpCo would maintain a sufficient stake in the success of the ListCo... Binding the participating parties by establishing mutual interest and fiduciary duty would reduce the incentives for Chinese founders to walk away or even steal and sabotage the arrangement.”). For additional discussion of difficulties enforcing judgments against PRC entities and persons, see Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 305-306 (2021) (see fn. 95, 96).

<sup>46</sup> Samuel Farrell Ziegler, Note, *China’s Variable Interest Entity Problem: How Americans Have Illegally Invested Billions in China and How to Fix It*, 84 GEO. WASH. L.R. 539, 549 (2014). (“Because, in a VIE structure, foreign investors actually own stock in [ListCo] while the valuable assets of the operating company reside in the distant [OpCo], there is essentially nothing a foreign investor can do about it if an insider misappropriates the [OpCo’s] assets.”). *C.f.* *Corwin v. KKR Financial Holdings, LLC*, 125 A.3d 304 (Del. 2015) (rejecting contractual control as inequivalent to equitable ownership rights of governance).

<sup>47</sup> Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 9 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf). See also, discussion of Jack Ma’s 2011 expropriation of Alipay assets without the approval of foreign investors, *infra* \_\_\_\_; Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT’L L.J. 569, 584-591 (2014) (discussion of additional expropriation cases).

<sup>48</sup> See, e.g., discussion of Alipay spinout and associated compensation via Framework Agreement, *infra* \_\_\_\_

jurisdictions... free[ing] these companies to pursue actions that investors would generally regard as unacceptable for U.S.-domiciled companies.”<sup>49</sup> More generally, the complexities of

the VIE structures themselves create significant management conflicts of interest, complicating, if not foreclosing, the ability of outside shareholders to challenge executives for poor decision-making, weak management, or equity-eroding actions. VIEs lead foreign investors to believe that they can meaningfully participate in China’s emerging companies, but such participation is precarious and may ultimately prove illusory.<sup>50</sup>

Indeed, VIEs are designed entirely with a “fundamentally contradictory purpose” to maintaining corporate accountability to shareholders, as the structure requires sufficient separation of foreign ownership to satisfy PRC regulators that the OpCo should be allowed to operate in a restricted industry.<sup>51</sup> In practice, many of the most prominent VIEs offer only an illusion of governance and control for foreign investors, with PRC investors or founders retaining voting control of the ListCo in the presence of FDI, as is the case for Alibaba.<sup>52</sup>

While some similar economic risks exist in a traditional foreign investment, risks are potentially magnified in the context of VIEs. In particular, the multi-entity and cross-border nature of the VIE structure puts VIE corporations at risk of “punitive” tax liability depending on how the PRC chooses to interpret payments between entities within the structure.<sup>53</sup> Courts have yet to face questions of tax treatment head on due to the lack of VIE dividends to foreign shareholders, but it is plausible that PRC courts would interpret tax provisions broadly if investors attempted to withdraw VIE profits from the PRC. The reduced liquidity of VIEs due to difficulties paying dividends, tax risks, and lack of direct ownership also places the investments of ListCo owners

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<sup>49</sup> Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 14 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf). (“For example, Cayman Islands and BVI law neither requires companies to hold annual meetings nor provides shareholders a right to submit proposals.”).

<sup>50</sup> Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 3 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf).

<sup>51</sup> Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 15 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf) (CII notes elsewhere in their brief that one of the goals of MOFCOM FDI regulations is to maintain Chinese control of companies operating in strategic industries).

<sup>52</sup> See *infra* \_\_\_\_\_.

<sup>53</sup> One interpretation of PRC laws might allow the government to apply around 50% effective tax rates on VIE profits that a company attempts to pay out to foreign investors. Most VIE filings assume much lower expected tax rates, e.g., only an 8.5% VAT in CII’s 2017 report. Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 10 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf). See also Fa Chen, *Variable interest entity structures in China: are legal uncertainties and risks to foreign investors part of China’s regulatory policy?*, 29 ASIA PACIFIC LAW REVIEW 1, 5 (2021); Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 303, F-39 (Sep. 18, 2014) (discussing Alibaba potential punitive tax liability and pre-IPO applied tax rates).

more at risk of adverse movements in exchange rates than traditional investors in foreign markets, who have a broader menu of options for exit.<sup>54</sup>

In general, the source of value for foreign investors in VIE shares is relatively unclear without significant regulatory changes. Given tax implications, regulations, and VIE companies' positions in high-growth industries, most VIE companies seem unlikely to pay a dividend.<sup>55</sup> Investors also do not directly own the underlying assets or licenses that make the business valuable, with their best claim on ownership being an option to purchase the business that is unexercisable under current law due to the restrictions on foreign ownership that necessitated the VIE structure in the first place. Additionally, the relatively weak control that foreign ListCo owners have over corporate governance (whether because of super-voting mechanisms favoring PRC owners, the reduced control that contractual ownership provides, or the tendency of ListCos to locate in jurisdictions with more lax corporate law) means that the control premium sometimes thought to be inherent in traditional equity ownership does not apply to ListCo stock. Finally, the possibility of a full buyout of ListCo stock by a PRC buyer who would exercise the option under current law is unlikely to be a realistic method for realizing gains or would require a steep discount, due both to the large enterprise values of the biggest VIEs (which may be prohibitive for a single buyer or group) and to the possibility of a PRC buyer trying to work directly with the OpCo's PRC owners rather than the ListCo's foreign investors. As CII notes in their report on VIEs, the combination of these limits on realizing value from ListCo shares means that "the VIE structure—while sidestepping" MOFCOM regulations meant to stop foreign investors from participating in regulated industries "—nonetheless *seems to ensure one-way capital flows into China.*" [emphasis added]<sup>56</sup> Despite all of these issues, foreign investors continue to invest in VIEs and likely will continue to do so unless there is a clear CCF-type decision from the PRC government that ends their viability.<sup>57</sup>

## Alibaba's VIE

Of the two key firms in our story, only Alibaba operates in a VIE structure, though both Alibaba and Ant are prohibited from accepting direct foreign investment because they operate in

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<sup>54</sup> PRC government and People's Bank of China (PBOC) control over exchange rates creates additional economic risk for investors, *see, e.g.*, Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) F-70 (Sep. 18, 2014) ("The Company's sales, purchase and expense transactions are generally denominated in RMB and a significant portion of the Company's assets and liabilities are denominated in RMB. The RMB is not freely convertible into foreign currencies. In the PRC, foreign exchange transactions are required by law to be transacted only by authorized financial institutions at exchange rates set by the PBOC.").

<sup>55</sup> *See* Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 12 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf) ("CII analysis has found that less than one fifth of U.S.-listed Chinese VIEs currently pay or intend to pay dividends to shareholders. While not uncommon in start-ups, indefinite reinvestment for at least some of these VIE-dependent companies appears more related to Chinese restrictions on moving money from the VIE to the WFOE and ListCo. In short, all the money made in China stays in China.").

<sup>56</sup> *See* Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 12 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf).

<sup>57</sup> *See Doing Business in China 2022*, BAKER MCKENZIE FENXUN 11 (2022), <https://www.bakermckenzie.com/-/media/files/insight/guides/2022/doing-business-in-china-guide-2022.pdf> ("Despite concerns about the legality of the VIE structure, we still see this structure being used in sectors where foreign investment is restricted.").

strategic industries that are on the PRC’s “Negative List” for foreign investment, which includes e-commerce, cloud, and payments.<sup>58</sup> While Ant has complied with foreign investment restrictions by not taking foreign investments since it was spun off of Alibaba in 2011, Alibaba has had a VIE structure and foreign investment since shortly after its inception.<sup>59</sup> Alibaba’s 2014 IPO Prospectus contains fairly broad risk disclosure language recognizing that the uncertainty inherent in VIE structures also hangs over any Alibaba ListCo investment.<sup>60</sup> Among other VIE-related risk factors, Alibaba’s ListCo and several of its high-level intermediaries are organized as Cayman Islands-domiciled entities, providing significantly more flexibility and management-favorable law than traditional Delaware corporate law most commonly governing US public companies.<sup>61</sup> This management-biased choice of law serves to reduce legally enforceable protections and rights for foreign investors in case of a conflict with PRC founders.

Alibaba’s VIE structure is complex and organized into several relatively independent groups along business lines, each owned by the Alibaba Group ListCo (Alibaba Group Holding Limited) and each with its own set of intermediaries, WFOEs, and OpCos that are only connected with the other business line VIE groups through parent company ownership. Alibaba consolidates the results of these business line VIE groups into its financial statements.<sup>62</sup> Figure XX below shows a simplified version of this corporate structure.<sup>63</sup>

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<sup>58</sup> See Lester Ross, Kenneth Zhou, & Tingting Liu, *China’s New Negative List for Foreign Direct Investment*, WILMERHALE, Jan. 11, 2022, <https://www.wilmerhale.com/insights/client-alerts/20220111-chinas-new-negative-list-for-foreign-direct-investment>; Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 295 (2021) (“Alibaba operates its China-based businesses through a series of WFOEs, each with a corresponding VIE, including four VIEs ‘material’ to its business: two for e-commerce, one for cloud computing, and one for digital media and entertainment. These sectors are categorized as ‘Value-Added Telecommunications Services (VATS)’ by China’s Ministry of Industry and Information Technology (MIIT) and are subject to restrictions on foreign investment, thus requiring the use of VIEs.”); *id.* at 296 and fn. 93 (discussion of important license ownership by Alibaba subsidiary VIEs and VIE restructuring).

<sup>59</sup> See *infra* \_\_\_\_\_. See also Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 284 (2021) (“Alibaba is a holding company: it has few assets other than shares of its wholly-owned off-shore (non-China) subsidiaries. These offshore subsidiaries, in turn, are themselves holding companies that directly or indirectly own shares in downstream subsidiaries.”).

<sup>60</sup> See, e.g., Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) F-69-F-70 (Sep. 18, 2014) (discussing enforceability and deconsolidation risks).

<sup>61</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 278-283 (Sep. 18, 2014).

<sup>62</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) F-87 (Sep. 18, 2014).

<sup>63</sup> Diagram is based on data from Alibaba Grp. Holding Ltd., Annual and transition report of foreign private issuers [Sections 13 or 15(d)] (Form 20-F) 70 (July 21, 2023) (discussing Alibaba Group’s “significant subsidiaries”). See also Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) F-88-F-89 (Sep. 18, 2014) (describing the legal structures of Alibaba’s VIE).

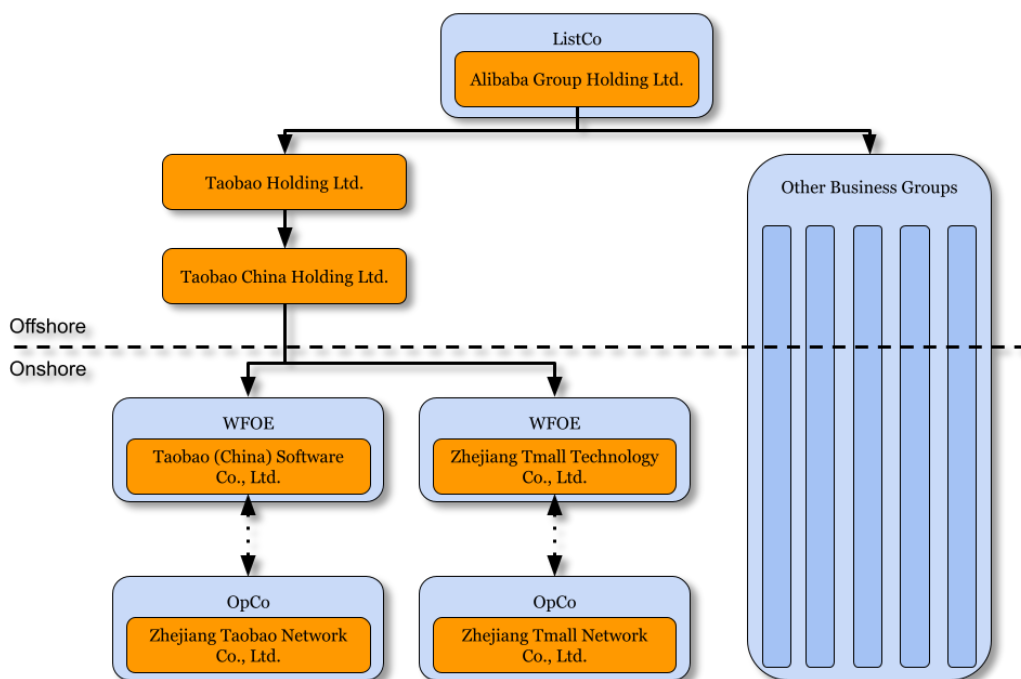


Figure 2: Simplified version of current Alibaba VIE structure for its domestic e-commerce group based on Alibaba securities filings and news reports. Some entities excluded for readability. Other business groups will each contain their own VIE structures.

In March 2023, Alibaba announced a restructuring it called “1+6+N,” where the previously unified Alibaba Group holding company (“1”) was split into “6” independent businesses, with each of the following having its own holding company structure under the top-level parent Alibaba Group:<sup>64</sup>

- Cloud Intelligence (cloud computing and artificial intelligence)
- Taobao and Tmall (domestic e-commerce)
- Local Services (Lazada and AliExpress international e-commerce businesses)
- Alibaba International Digital Commerce (Ele.me food delivery and Amap maps)
- Cainiao Smart Logistics (logistics)
- Digital Media and Entertainment (Youku online video and Alibaba Pictures)<sup>65</sup>

<sup>64</sup> The Taobao and Tmall domestic e-commerce group is represented in Figure 2. Each of the other five business groups has a similar VIE structure. See *Alibaba Reorganizes To Unlock Value*, ALIZILA: NEWS FROM ALIBABA, <https://www.alizila.com/alibaba-reorganizes-to-unlock-value/>. This restructuring was thought to be in response to the regulatory crackdown on PRC technology companies, discussed *infra* \_\_\_\_\_. See also Daisuke Wakabayashi, *Alibaba, China’s E-Commerce Giant, Will Split Into 6 Units*, THE NEW YORK TIMES, Mar. 28, 2023, <https://www.nytimes.com/2023/03/28/business/alibaba-china-e-commerce.html>.

<sup>65</sup> Alibaba Grp. Holding Ltd., Annual and transition report of foreign private issuers [Sections 13 or 15(d)] (Form 20-F) ii (July 21, 2023); Rita Liao, *Alibaba splits into six in biggest overhaul in 24 years*, TECHCRUNCH, Mar. 28, 2023, <https://techcrunch.com/2023/03/28/alibaba-splits-into-six-in-biggest-overhaul-in-24-years/>.

The “N” refers to assorted other businesses that may not fit cleanly into one of the six groups established by the reorganization. While the change does not significantly alter Alibaba’s VIE structure, after the restructuring, each of the business groups operates as a separate holding company with its own management, though management of all holding companies will continue to report to the Alibaba Group board. As part of the plan, the newly independent business groups (with the exception of the core Taobao and Tmall domestic e-commerce businesses) “retain the flexibility to raise outside capital and seek an initial public offering.”<sup>66</sup>

## Alibaba and Ant

This section summarizes the closely intertwined and parallel histories of Alibaba and Ant (which began as the Alipay subsidiary of Alibaba). Alibaba was founded in 1999 by Jack Ma and a group of associates, initially as an e-commerce B2B marketplace for PRC small businesses to export their wares globally (Alibaba.com) and shortly thereafter to engage in domestic sales (Alibaba.com.cn, now 1688.com).<sup>67</sup> Over approximately the next decade, Alibaba expanded into a range of other e-commerce marketplaces and adjacent products, including Taobao consumer-to-consumer marketplace (2003), commercial messaging (2004), marketing services for e-commerce sellers (2007), Tmall B2C online marketplace (2008), and AliExpress global marketplace (2010). Additionally, Alibaba launched two supporting businesses, which are important to our story: Alipay (2004, digital payments) and Alibaba Cloud Computing (2009).<sup>68</sup> Alipay and Alibaba Cloud reflect Alibaba branching out to become a market leader in new, strategically important industries. The holding company that acquired Alipay in 2011 eventually became Ant and grew its business from Alipay’s beginning as a Chinese version of PayPal to add many other fintech products including investment, advisory, insurance, credit, and banking products among others.<sup>69</sup> I refer to this holding company entity as “Ant” or “Ant Group,” even if the name at the time was different, while using Alipay to refer specifically to the digital payments subsidiary that was originally owned by Alibaba and transferred to the company now known as Ant in 2011. Together, Alipay and Ant form a crucial part of the legal and regulatory history of Alibaba and FDI in PRC technology companies. Alibaba Cloud is an important part of the story’s future as hosted, cloud-based applications and computer technologies have become standard. More recently, computing capacity for artificial intelligence has become an increasingly important part of global competition and security. The remainder of this section proceeds chronologically through several key moments in Alibaba’s and Ant’s histories, highlighting the ways that the companies have been shaped by foreign investment regulation, and their arc of dialogue with foreign investors and the PRC.

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<sup>66</sup> It seems as though the decision to retain the domestic e-commerce businesses as wholly owned subsidiaries is based on the idea that these are Alibaba’s “core” businesses and thus the logical residual after unrelated business lines are spun off. See *Alibaba Reorganizes To Unlock Value*, ALIZILA: NEWS FROM ALIBABA, <https://www.alizila.com/alibaba-reorganizes-to-unlock-value/> (Per Alibaba Group Chairman and CEO Daniel Zhang, “The market is the best litmus test, and each business group and company can pursue independent fundraising and IPOs when they are ready.”).

<sup>67</sup> Alibaba Grp. Holding Ltd., Registration Statement (Form F-1) 69-70 (May 6, 2014).

<sup>68</sup> *Id.*

<sup>69</sup> Ant Group’s primary corporate entity is Ant Group Co., Ltd. (since 2020), located in the PRC, which has been formerly known as Zhejiang Alibaba E-Commerce Co., Ltd. (2000-2014), Zhejiang Ant Small and Micro Financial Services Group Co., Ltd. (2014-2016), and Ant Small and Micro Financial Services Group Co., Ltd. (2016-2020). Chinese character names available in Ant Prospectus. See Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus VII-1 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

## Initial Investments and Growth: Yahoo! and SoftBank (1999-2009)

Alibaba's VIE structure goes back to its founding, with the Cayman ListCo (Alibaba Group Holding Limited) created on June 28, 1999.<sup>70</sup> Alibaba first received investment from foreign investors in October 1999, and two other small rounds (both including SoftBank) followed in 2000 and 2004.<sup>71</sup> Following these initial investments, founder ownership of Alibaba was around 47 percent.<sup>72</sup>

The first major foreign investment into Alibaba came in August 2005, when Yahoo! invested \$1 billion to take a 40 percent ownership stake in Alibaba (though they had slightly lower proportionate voting power relative to the PRC founders until October 2010).<sup>73</sup> This investment was in large part driven by the threat of competition from eBay, which had entered the PRC market in 2003.<sup>74</sup> As part of the transaction, Yahoo! bought out substantially all previous foreign investors (for a significant gain) except SoftBank, which restructured but retained its investment.<sup>75</sup> The initial Yahoo purchase and continued presence of SoftBank were critical to Alibaba's development, as from 2005 through 2011 or 2012, Yahoo was nominally the single largest and most powerful shareholder in the company, or at least at parity with Jack Ma and the other PRC founders.<sup>76</sup> Alibaba's size and the relative decline of Yahoo's other businesses made Alibaba's performance increasingly critical in determining Yahoo's success, and tensions between Yahoo and Alibaba leadership made Yahoo's large ownership and oversight frustrating for Alibaba's founders.<sup>77</sup>

## Evolution of Alibaba and Relationship with Ant

### AliPay Spinout and Yahoo! Controversy (2009-2012)

Over the course of 2009 through 2011, Alibaba restructured and ultimately spun off its Alipay business (Alibaba's digital payments unit) into the ownership of Jack Ma and other PRC owners without approval or knowledge of Alibaba's board or foreign investors. In June 2009, Alibaba underwent an initial restructuring of its Alipay business, which had previously been a

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<sup>70</sup> Alibaba Grp. Holding Ltd., Registration Statement (Form F-1) 71 (May 6, 2014).

<sup>71</sup> Key investors from this period include Goldman Sachs, Investor AB, and SoftBank. RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 11 (2020).

<sup>72</sup> *Id.*

<sup>73</sup> YAHOO!, YAHOO! AND ALIBABA.COM FORM STRATEGIC PARTNERSHIP IN CHINA, (Aug. 10, 2005), <https://www.alibaba.com/static-files/13f9e1af-3030-4e40-a9b7-f1ac339362fa>; RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 13 (2020). *See also* Yahoo! Inc., Stock Purchase and Contribution Agreement (Form 8-K Ex. 2.1) (Aug. 10, 2005); Yahoo! Inc., Shareholders Agreement (Form 8-K Ex. 2.5) (Oct. 24, 2005).

<sup>74</sup> LIN ET AL., *supra* note \_\_\_\_, at 7.

<sup>75</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 12 (2020).

<sup>76</sup> *See* RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 12-13 (2020) (discussing founders' reaction to Yahoo's October 2010 acquisition of a second board seat, previously Yahoo and SoftBank each had one board seat while Alibaba founders retained two).

<sup>77</sup> Note also the 2007 Hong Kong IPO of one of Alibaba's subsidiaries. *Id.*

wholly owned subsidiary of Alibaba's top-level VIE OpCo.<sup>78</sup> As part of the restructuring, Alipay (Alipay.com Co., Ltd.) was moved to a separate VIE structure with its own top-level OpCo (Zhejiang Alibaba E-Commerce Co., Ltd.) with equity directly owned by Jack Ma and another Alibaba cofounder, Xie Shihuang.<sup>79</sup> For a period of time after the initial restructuring, Zhejiang Alibaba E-Commerce Co., Ltd. remained subject to agreements that allowed Alibaba's ListCo and WFOE to retain effective control of Alipay within its own VIE model. However, in early 2011, Jack Ma and Xie Shihuang repaid the VIE loans to Zhejiang Alibaba E-Commerce Co., Ltd. and terminated the "control agreements" between Zhejiang Alibaba E-Commerce Co., Ltd. and Alibaba's ListCo, effectively removing Alipay from Alibaba's sphere of ownership and control and terminating its VIE structure.<sup>80</sup> Per Yahoo's later communications with the SEC, "this restructuring occurred without the knowledge or approval of [Yahoo] or the Alibaba Board of Directors."<sup>81</sup> After completing the transaction to unwind Alipay and remove it from Alibaba's ownership, Ma and Alibaba notified Yahoo and SoftBank on March 31, 2011 that Alipay's financial results were no longer consolidated.<sup>82</sup>

The primary rationale given for the spinoff was the threat of new PRC regulations to Alipay's payments business. In June 2010, the People's Bank of China (PBOC) issued a decree requiring that non-financial institutions operating in the payments business (including Alipay) obtain licenses from the PBOC.<sup>83</sup> These regulations implicitly placed tighter restrictions on foreign ownership of firms in the payments industry, as the PBOC offered no guidance for how firms with any foreign ownership could obtain payments licenses, and payments firms that were unable to obtain a license would be forced to stop operating by September 2011.<sup>84</sup> Multiple sources claim that Jack Ma made the decision to spin out Alipay from Alibaba and break its VIE structure because of these regulations.<sup>85</sup> However, it is unclear to what extent this was the sole or

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<sup>78</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 12, 39 (2020) (Fig. 2.1).

<sup>79</sup> Note that Alipay.com Co., Ltd. is the OpCo subsidiary containing Alipay while Zhejiang Alibaba E-Commerce Co., Ltd. is the HoldCo OpCo within the stylized VIE model we have been discussing. Yahoo! Inc., Framework Agreement (Form 8-K Ex. 10.1) A-1 (July 29, 2011) ("Pursuant to agreements dated June 1, 2009 and August 6, 2010, the legal ownership of [Alipay.com Co., Ltd.] was restructured so that 100% of its registered capital was transferred from a subsidiary of [Alibaba Group Holding Limited] to [Zhejiang Alibaba E-Commerce Co., Ltd.], for an aggregate amount of RMB 332 million."); RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 39 (2020).

<sup>80</sup> See generally Yahoo! Inc., Framework Agreement (Form 8-K Ex. 10.1) A-1-A-2 (July 29, 2011) (laying out timeline for spinoff and severance of Alibaba and Alipay).

<sup>81</sup> Yahoo! Inc., Letter to Mr. Patrick Gilmore (Correspondence) 2 (Aug. 11, 2011).

<sup>82</sup> Yahoo! Inc., Framework Agreement (Form 8-K Ex. 10.1) A-1-A-2 (July 29, 2011). See discussion of the importance of financial statement consolidation in VIE structures, *supra note* \_\_\_\_.

<sup>83</sup> See Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus IV-9-IV-10 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>84</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 28 (Sep. 18, 2014).

<sup>85</sup> Bonato v. Yahoo Inc. (In re Yahoo! Inc. Sec. Litig.), 2012 U.S. Dist. LEXIS 113036, \*9-10 (N.D. Ca. Aug. 10, 2012) (complaint alleges that "Ma terminated the control agreements between Alibaba Group and Zhejiang after receiving two letters from the BoC asking the Alibaba Group to declare whether it had control agreements connected to Alipay."); Yahoo! Inc., Letter to Mr. Patrick Gilmore (Correspondence) 3 (Aug. 11, 2011) ("The March 31 Letter [from Alibaba to Yahoo announcing the separation of Alipay] states that Alibaba had 'conversations with the relevant authorities' and undertook the restructuring in light of Alibaba management's understanding of the regulatory environment 'to enable Alipay to qualify for the licensing requirements under the [existing] Payment Measures' and 'to protect Alipay' from 'a significant risk that Alipay would have to cease operations.'"); Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 6 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>

predominant reason for the spinoff. While Alipay did have a relatively smooth process of obtaining its payment license, which it received in May 2011,<sup>86</sup> it is not certain that the PBOC would have blocked Alipay's license if it had retained its VIE structure, and "some commentators speculate that Jack Ma used the statements from the PBOC as a pretext to take control of one of Alibaba's most valuable assets, [Alipay,] to the detriment of the foreign investors."<sup>87</sup> The concealment of the Alipay spinoff transactions (particularly the supporting loans and termination of the control provisions) from foreign investors until after the transactions were complete tends to support this pretextual reading of Ma's motivations, as do the tensions between Ma and Yahoo leadership at the time. As a *TechCrunch* article from September 2010 noted, "in short, Jack Ma want[ed] Yahoo out of his company" because of an increasingly fractious relationship with new Yahoo CEO Carol Bartz and an investment deal with Yahoo that increasingly appeared to be one-sided.<sup>88</sup> Additionally, regulatory approval of the 2014 SAPA Agreement between Alibaba, and Small and Micro Financial Services Company (a successor name of Alipay and predecessor name of Ant), which allowed Alibaba to take a substantial ownership stake in Alipay, cast doubt on whether the hard line for PRC licensing suggested by Ma really existed.<sup>89</sup> Yahoo's shareholder agreement from its 2005 purchase required that "any single transaction involving the transfer of assets, including subsidiaries, of Alibaba Group worth more than \$10 million must be approved by the company's board or shareholders," seems to have been designed precisely to provide oversight and restrict transactions like the Alipay spinoff.<sup>90</sup> Had Ma and Alibaba's PRC affiliates truly been concerned

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(In particular, Ma "claimed that the spin-off was necessary because of the PBOC's requirement to disclose the use of a VIE Structure when applying for a Payment Business Permit, and the relevant government officials have allegedly stated that they will not issue Payment Business Permits to online payment companies that have foreign ownership, whether directly through equity interests or indirectly through the use of the VIE Structure"); see also RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 39 (2020) ("[I]n the first quarter of 2011, Jack Ma unilaterally decided to break between Alipay and Alibaba Group on the grounds that the agreement could not obtain a third-party payment license and protocol control relations endangered national economic security."); Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 28 (Sep. 18, 2014) ("In light of the uncertainties relating to the license qualification and application process for a foreign-invested payment company, our management determined that it was necessary to restructure Alipay as a company wholly-owned by PRC nationals in order to avail Alipay of the specific licensing guidelines applicable only to domestic PRC-owned entities.").

<sup>86</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 28 (Sep. 18, 2014).

<sup>87</sup> Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 7 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>.

<sup>88</sup> Ma's relationship was with Jerry Yang who orchestrated Yahoo's initial investment and remained on Alibaba's board after his departure from Yahoo. See Sarah Lacy, *Bartz in a China Shop: Has Yahoo's CEO Wrecked the Valley's Most Valuable Chinese Relationship?*, TECHCRUNCH, Sept. 12, 2010, <https://techcrunch.com/2010/09/12/bartz-in-a-china-shop-has-yahoos-ceo-wrecked-the-valley%E2%80%99s-most-valuable-chinese-relationship/> ("Sources close to Yahoo and Alibaba say that when Bartz entered the job two years ago, she didn't reach out to Ma or Wei and when Ma finally came to Sunnyvale to meet with her, she dressed him down in front of his management team criticizing what Alibaba had done with Yahoo's China portal. Said one person close to the Alibaba side of things, 'She displayed the diplomatic skills of a donkey.'... It's led to an ugly marriage between the two—which has become more evident as Alibaba's team continues to speak out about the lack of strategic value to the relationship. It's clear Ma wants the relationship severed... The more Bartz angers the Alibaba team and criticizes the Chinese government, the more ammo she gives Ma to drive a wedge between the two and even potentially force a sale if it's deemed to be a poisoned relationship."). See also discussion of Yahoo influence on Alibaba's governance, *infra* \_\_\_\_.

<sup>89</sup> See discussion of SAPA and ongoing relationship between Alibaba and Ant, *infra* \_\_\_\_.

<sup>90</sup> Loretta Chao & Amir Efrati, *Yahoo's China Feud Turns Ugly, Stock Falls*, THE WALL STREET JOURNAL, May 14, 2011, <https://www.wsj.com/articles/SB10001424052748703730804576321030705428022>; see Yahoo! Inc., Shareholders Agreement (Form 8-K Ex. 2.5) (Oct. 24, 2005); Yahoo! Inc., Letter to Mr. Patrick Gilmore

about the impacts of foreign ownership on PBOC licensing, Alipay's ownership was likely an issue that they could have negotiated with foreign investors (particularly given that foreign investors on the Alibaba ListCo's board were willing to allow the initial restructuring of Alipay into a separate OpCo). Instead, by concealing the transaction until it was too late to reverse, Ma and Xie placed themselves in a stronger position with respect to negotiating compensation for removing foreign ownership from Alipay, leveraging weaknesses in the VIE structure and difficulties enforcing judgments against PRC participants to expropriate value from foreign investors.

Although the initial plan to restructure Alipay from an Alibaba OpCo subsidiary to a standalone, top-level OpCo controlled through Alibaba's VIE structure was approved by Alibaba's ListCo board (including foreign investors), the separation of Alipay and termination of the VIE structure came as a shock to Alibaba's foreign investors. Upon discovery of the spinoff, foreign investors experienced immediate and substantial financial losses. Although Yahoo attempted to downplay the importance of deconsolidation of Alipay's financial statements to Yahoo's financials as of 2010, this failed to convince other investors.<sup>91</sup> In the first week after Yahoo announced the removal of Alipay, Yahoo's \$10 billion stake in Alipay fell by over 25 percent,<sup>92</sup> and Yahoo's stock, with a valuation substantially reliant on its Alipay ownership, fell 9.8 percent.<sup>93</sup> The longer-run effects of losing Alipay were even more extreme: Yahoo was sold in 2016 for around \$4.8 billion, while Alipay successor Ant Group was valued as high as \$315 billion prior to its proposed 2020 IPO (discussed below) and around \$79 billion in 2023.<sup>94</sup>

Although Yahoo and SoftBank were not able to enforce their initial contractual rights (laid out in the 2005 Shareholders' Agreement) to block the Alipay split, the foreign investors and PRC entities negotiated a settlement of the issue that provided some compensation for losses to the investors. A comparison of the settlement agreement (called the "Framework Agreement") and the investors' hypothetical rights were they full equity holders with enforceable rights helps shed light on the relative weakness of their positions as foreign VIE investors. The Framework Agreement required Alipay's new owners to partially compensate Alibaba (and thereby foreign investors) on

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(Correspondence) 2 (Aug. 11, 2011) ("The restructuring was not undertaken in compliance with Alibaba's governing documents, which... require, among other things, the following approvals of the restructuring, none of which were sought or obtained: prior approval by a majority of the Alibaba Board of Directors; prior approval by a majority of disinterested Alibaba Directors in connection with any transaction entered into between Alibaba and any of its subsidiaries, on the one hand, and any shareholder or other related parties, on the other hand; and prior approval of the Company (and SoftBank), as shareholders, of any transaction involving the disposition, sale, or transfer of assets relating to a core business, which includes Alipay.").

<sup>91</sup> Yahoo! Inc., Letter to Mr. Patrick Gilmore (Correspondence) 5 (Aug. 11, 2011); *In re Yahoo! Inc. Shareholder Derivative Litig.*, 153 F. Supp. 3d 1107, 1113-1114 (N.D. Cal. 2015) (quotes complaint noting that By 2011, some analysts estimated that the Alibaba investment was worth \$11.45 per share—97% of Yahoo's August 10, 2011 closing price—while others concluded that it exceeded 'Yahoo's entire current market value.'").

<sup>92</sup> Loretta Chao & Amir Efrati, *Yahoo's China Feud Turns Ugly, Stock Falls*, THE WALL STREET JOURNAL, May 14, 2011, <https://www.wsj.com/articles/SB10001424052748703730804576321030705428022>.

<sup>93</sup> Fa Chen, *China's recent regulation of variable interest entity structures has led to a drop in Chinese companies' US listings*, OXFORD BUSINESS LAW BLOG (Apr. 19, 2022), <https://blogs.law.ox.ac.uk/business-law-blog/blog/2022/04/chinas-recent-regulation-variable-interest-entity-structures-has-led>.

<sup>94</sup> These valuations would put a 40 percent stake in Ant Group at between 6- and 27-times as valuable as all of Yahoo at the time of sale. See Vindu Goel and Michael J. de la Merced, *Yahoo's Sale to Verizon Ends an Era for a Web Pioneer*, THE NEW YORK TIMES, July 24, 2016, <https://www.nytimes.com/2016/07/25/business/yahoo-sale.html>; Julie Zhu & Josh Ye, *Ant's surprise share buyback values firm at steep 75% discount to IPO*, REUTERS, July 8, 2023, <https://www.reuters.com/technology/ants-share-repurchase-plan-values-firm-nearly-79-bln-2023-07-08/>.

an ongoing basis and in the case of a liquidity event.<sup>95</sup> The key terms of the Framework Agreement were (with some additional complexity not represented here):

- An **interest-free loan** and corresponding **technical services and licensing agreements** requiring that Alipay pay approximately 50 percent of pre-tax income to Alibaba for a temporary period.<sup>96</sup>
- A **capped liquidity event payment** to Alibaba if Alipay has an IPO, sells a large enough block of stock, or sells substantially all of its assets. In a liquidity event, Alibaba would be entitled to receive 37.5 percent of the equity value of Alipay up to a maximum of \$6 billion.
- A long-term **preferential payment services agreement** allowing Alibaba to continue to rely on Alipay payments products in enabling its e-commerce platforms.<sup>97</sup>

In exchange for these concessions, the foreign investors on Alibaba's board agreed to ratify the Alipay spinout transactions and release all parties from liability for the transactions. Although Yahoo and SoftBank were able to extract some value and concessions in exchange for ratification and release from liability, these concessions placed Alibaba and foreign investors in a substantially worse position than they were before the spinoff, with Ma, other PRC owners, and Alipay as the primary beneficiaries.<sup>98</sup> Prior to the spinoff, Alibaba investors would have expected to share pro rata in 100 percent of the financial value of Alipay and any related financial and payments businesses that grew under the Alibaba umbrella. Afterwards, Alibaba shareholders would expect only to share in up to 37.5 percent of Alipay's value with that number diminishing if Alipay was liquidated for more than \$16 billion. Had Ant Group's \$315 billion IPO succeeded in 2020 and the Framework Agreement with the \$6 billion cap remained in place, Alibaba would have only received less than 2 percent of the equity value of Alipay in a liquidity event payment. Additionally, compensation under the framework agreement was limited to the Alipay subsidiary rather than the range of businesses that might be (and eventually were) owned by the Zhejiang Alibaba E-Commerce Co., Ltd. holding company.<sup>99</sup> Given the significant decrease in the value of Alibaba's (and therefore foreign investors') claims on future value of Alipay, it is not surprising that "analysts [were] not convinced that [the Framework Agreement] settlement is enough to compensate Yahoo for the loss of Alipay's value to Alibaba's portfolio."<sup>100</sup>

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<sup>95</sup> Yahoo! Inc., Annual Report (Form 10-K) 83 (Feb. 29, 2012).

<sup>96</sup> This is similar to a VIE loan and services agreement between an OpCo and WFOE but in this case Alipay does not transfer all its income to the lender. *See* Yahoo! Inc., Annual Report (Form 10-K) 83-84 (Feb. 29, 2012).

<sup>97</sup> *Id.*; *see also* Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 260-261 (Sep. 18, 2014) (50-year contract term, renewable for additional 50 years at Alibaba option).

<sup>98</sup> Several lawsuits were later filed to challenge the Alipay spinoff, Framework Agreement, and related securities disclosures and fallout from the transaction also included the firing of Yahoo CEO Carol Bartz and resignation of Yahoo co-founder and Alibaba Group board member Jerry Yang in January 2012. *See* Bonato v. Yahoo Inc. (In re Yahoo! Inc. Sec. Litig.), 2012 U.S. Dist. LEXIS 113036 (N.D. Ca. Aug. 10, 2012); In re Yahoo! Inc. Shareholder Derivative Litig., 153 F. Supp. 3d 1107 (N.D. Cal. 2015).

<sup>99</sup> *See, e.g.*, Yahoo! Inc., Framework Agreement (Form 8-K Ex. 10.1) 24-25 (July 29, 2011) ("The royalty and the software technology services fee consist of an expense reimbursement and a 49.9% share of the consolidated pre-tax income of OpCo [Alipay.com Co., Ltd. rather than 'HoldCo' Zhejiang Alibaba E-Commerce Co., Ltd.] and its Subsidiaries.')

<sup>100</sup> Rocky T. Lee, *Understanding the VIE Structure: Necessary Elements for Success and the Legal Risks Involved*, CADWALADER, WICKERSHAM & TAFT LLP 7 (Aug. 10, 2011), <https://www.martindale.com/matter/asr-1328576.Understanding.pdf>.

Within the broader narrative of Alibaba and Ant, the split of Alipay represents an inflection point along at least three key narratives. First, the spinoff reflects a turning point in Alibaba's (and Ant's) governance away from a significant role for foreign investors and a return to the domination of Ma and other PRC founders of Alibaba. Around the time of the Alipay spinoff, Ma and the other PRC founders began to assert greater control over Alibaba, both through concerted efforts to reduce Yahoo's power (including a buyout of half of Yahoo's ownership in Alibaba in 2012, removing Yahoo's right to a second board seat)<sup>101</sup> and through the Alibaba Partnership, which began to dominate Alibaba's board.<sup>102</sup> For Alipay, the split meant an immediate and complete exclusion of foreign investors from participation in governance or investment. As of 2020, most of the equity in the main Ant Group entity (Ant Group Co., Ltd.) was held by PRC investors.<sup>103</sup> Second, the Alipay spinoff has also had profound long-term impacts on the businesses of both Alibaba and Ant, with close relationships, overlapping ownership, and associated potential conflicts of interest being disclosed as significant risk factors in both Alibaba's 2014 IPO filings and Ant's Prospectus for its failed 2020 IPO.<sup>104</sup> Third, Alipay's spinoff represented a huge windfall for the PRC founders who gained equity in the new entity, particularly given the relatively one-sided terms of the Framework Agreement. Separating Alipay was a convenient way to exclude foreign investors from a profitable and high-potential part of the business once their capital was no longer essential for its success.<sup>105</sup> Finally, Alipay's separation highlights the legal instability of the underlying VIE structure that both Alibaba (and now Ant) are built on, with analysts regularly using the separation of Alipay to highlight the risks of owner expropriation and corporate governance for VIEs and more broadly the challenges foreign investors face when trying to operate in a country and industry where regulatory headwinds make it impossible to engage in traditional business arrangements.<sup>106</sup>

#### Alibaba-Ant SAPA and Minority Stake (2014-2019)

Shortly prior to Alibaba's 2014 IPO, Alibaba and Ant agreed to a Share and Asset Purchase Agreement ("SAPA"). The SAPA replaced and superseded the 2011 Framework Agreement as the

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<sup>101</sup> See, e.g., Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 256-257 (Sep. 18, 2014) (discussing share repurchase and sale agreements for Yahoo's equity stake between 2012 and Alibaba's 2014 IPO); *Alibaba buys back stake held by Yahoo for US\$7.1-billion*, FINANCIAL POST, May 21, 2012, <https://financialpost.com/technology/alibaba-buys-back-stake-held-by-yahoo-for-us7-1-billion>; RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 13-14 (2020).

<sup>102</sup> See *infra* \_\_\_\_.

<sup>103</sup> See Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 160 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>104</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 31 (Sep. 18, 2014); Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 56-57 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>105</sup> The decision to remove significant upside from foreign investors may have reflected the notion that foreign investors had received a more than sufficient share of returns for their investments in Alibaba and that more of the residual gains should accrue to founders, particularly with foreign investors no longer contributing incremental value to the business's success.

<sup>106</sup> See, e.g., RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 39 (2020) ("Jack Ma's unilateral termination of the Alipay VIE led to a discussion of risk associated with the VIE resurfacing, and eventually to extensive discussions and concerns in the industry."); *How Alibaba's mistake damaged China's market*, MARKETWATCH, June 14, 2011, <https://www.marketwatch.com/story/how-alibabas-mistake-damaged-chinas-market-2011-06-14>.

primary mechanism governing the companies' relationship.<sup>107</sup> Recognizing the deficiencies that prevented the 2011 Framework Agreement from fully resolving conflicts between Alibaba and Ant, the SAPA attempted to create a steady-state solution to provide the guidance to navigate conflicts created by the companies' highly integrated business models and overlapping ownership and control. The biggest change in the SAPA was that it gave Alibaba the option to convert its revenue sharing and liquidity payment rights into an up to 33 percent ownership stake in Ant, opening up a partial reintegration of ownership after the full separation of 2011.<sup>108</sup> Alibaba ultimately exercised its SAPA rights to take a 33 percent stake in Ant in September 2019.<sup>109</sup>

In addition to making Alibaba's revenue sharing and liquidity payment rights convertible into equity ownership, the SAPA also significantly rationalized these pre-ownership rights. First, it adjusted Alibaba's claims on pre-ownership payments to be based on the Ant Group holding company rather than only the Alipay operating subsidiary.<sup>110</sup> In exchange for this broadening of coverage for the SAPA's revenue sharing payments, the SAPA lowered the pre-tax revenue sharing percentage from approximately 50 percent to 37.5 percent, bringing Alibaba's revenue share in line with its liquidity event payment (also set at 37.5 percent).<sup>111</sup> The SAPA also removed the \$6 billion cap on a liquidity event payment, which had eliminated nearly all upside that Alibaba might see if Ant was successful.<sup>112</sup> The SAPA and subsequent transactions (including Alibaba's 2019 acquisition of one-third of Ant under its SAPA rights) also rationalized allocation of various borderline assets that might have ended up with the wrong owner at the time of the spinoff, such as intellectual property,<sup>113</sup> while at the same time maintaining some of the business integrations that had been more successful in the years immediately following the spinoff (e.g., reciprocal or shared agreements to allocate corporate overhead service provision).<sup>114</sup> The SAPA additionally

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<sup>107</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) F-73 (Sep. 18, 2014).

<sup>108</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 229 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>. This 33 percent ownership right is subject to an anti-dilution provision in the case of an IPO or other equity dilution. *Id.* at 11.

<sup>109</sup> The delay in exercising this purchase option is because doing so terminated the profit sharing and liquidity event provisions of the SAPA, which seem to have given Alibaba slightly better economic rights but no governance rights. *See* Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 261 (Sep. 18, 2014) (“[I]n the event we acquire the full 33% equity interest, rights to profit sharing and a liquidity event payment will automatically terminate, or in the event of any equity interest less than 33%, such rights will reduce proportionately.”). Lulu Yilun Chen, *Alibaba Snags 33% of Jack Ma's Ant as Portfolio Tops \$83 Billion*, BLOOMBERG, Sept. 24, 2019, <https://www.bloomberg.com/news/articles/2019-09-24/alibaba-closes-acquisition-of-a-third-of-jack-ma-s-ant-financial>.

<sup>110</sup> *See* Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 260-261 (Sep. 18, 2014). *C.f.* Yahoo! Inc., Framework Agreement (Form 8-K Ex. 10.1) 24-25 (July 29, 2011), *supra* note \_\_\_\_.

<sup>111</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 261 (Sep. 18, 2014).

<sup>112</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) F-73 (Sep. 18, 2014) (“Pursuant to the terms of the SAPA, in the event of an initial public offering of Small and Micro Financial Services Company or Alipay at an implied equity value exceeding US\$25 billion which results in gross proceeds of at least US\$2 billion (a “Qualified IPO”), if [Alibaba’s] total ownership of equity interests in Small and Micro Financial Services Company has not reached 33%, [Alibaba] would be entitled at its election to receive a one-time payment equal to 37.5% of the equity value of Small and Micro Financial Services Company as determined immediately prior to such Qualified IPO. There is no cap on the maximum value of such liquidity event payment.”).

<sup>113</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 237 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> (“Following Alibaba’s receipt of a 33% equity interest in us, Alibaba transferred to us ownership of major trademarks and domain names that were licensed by Alibaba to us and used in our business.”).

<sup>114</sup> *See, e.g.*, Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 243 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> (discussing June 29, 2011

included sectoral non-compete terms, prohibiting Alibaba and Ant from infringing on the other's core business areas.<sup>115</sup>

## Corporate Governance

Starting around 2010, both Alibaba and Ant evolved systems of corporate governance that left PRC founders, particularly Jack Ma, with complete control over the enterprises, despite smaller economic ownership interests. The disproportionate governance rights that Ma and other PRC founders accumulated created tensions between Ma and the PRC government and raise questions about the wisdom of fully severing economic and governance interests, particularly in the already unstable environment of VIEs and foreign investment.

### Alibaba Partnership (2010-Present)

Since 2010, Alibaba's corporate governance has been controlled by the "Alibaba Partnership," which is a group of people given the rights to nominate and effectively elect a majority of Alibaba's board members.<sup>116</sup> The Partnership was (like the Alipay spinoff and Yahoo share repurchases) another response to the diminishing equity rights and control of Ma and other PRC founders based on Ma's past experience losing control of his first start up, China Pages.<sup>117</sup> The Partnership structure was designed to divorce economic ownership interests from voting rights and ultimate control over Alibaba's corporate governance.<sup>118</sup> A review of the composition of Alibaba's board bears out the dominant role that the Partnership plays in corporate governance:

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"Shared Services Agreement," part of the Framework Agreement, by which Ant or its "affiliates will provide certain administrative and supporting services to Alibaba or its affiliates" and "Alibaba will cause its affiliates to provide certain technical support and administrative and supporting services to [Ant] and [its] affiliates.").

<sup>115</sup> This non-compete agreement is limited somewhat to listed business areas in the SAPA, and appears to be based on the idea that controlling shareholders cannot compete with the companies that they own. *See* Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 298 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> ("[U]nder the SAPA, subject to certain limitations and unless both we and Alibaba agree, Alibaba is restricted from engaging in specified business activities within our scope of business... and we are restricted from engaging in business activities within the scope of business of Alibaba or logical extensions thereof."); Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 264-265 (Sep. 18, 2014).

<sup>116</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 9 (Sep. 18, 2014) ("The Alibaba Partnership will have the exclusive right to nominate for shareholder approval up to a simple majority of the members of our board of directors. If an Alibaba Partnership director nominee is not elected by our shareholders or departs our board of directors for any reason, the Alibaba Partnership has the right to appoint a different person to serve as an interim director until our next scheduled annual general meeting of shareholders."); *id.* at 230 (detailed discussion of provisions that enable ultimate Partnership control over the majority of Alibaba's board in a range of scenarios). RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 28 (2020).

<sup>117</sup> *See* discussion of tensions with Yahoo over Yahoo's second board seat, *supra* \_\_\_\_\_. Several of Ma's later cofounders at Alibaba (and future members of the Alibaba Partnership) worked with him at China Pages. *See* David Barboza, *The Jack Ma Way*, THE NEW YORK TIMES, Sept. 6, 2014, <https://www.nytimes.com/2014/09/07/business/international/at-alibaba-the-founder-is-squarely-in-charge.html> ("Then Mr. Ma lost control of his company. In 1996, China Pages was pressured into forming a joint venture with Hangzhou Telecom. The deal put the government firmly in charge... 'At that time, I felt it was too tiring doing e-commerce in the government,' Mr. Ma said in a 2005 interview. 'E-commerce should start with private enterprises.'"); *see also* RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 21 (2020).

<sup>118</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 27 (2020) (Fig. 2.4); Lucian Bebchuk, *Alibaba's Governance Leaves Investors at a*

As of early July 2020, Alibaba's board consisted of ten members, five of whom were Alibaba Partnership nominees... The remaining Alibaba directors also owe their positions to the Partnership, either directly or indirectly: they were nominated by either Alibaba insiders who were members of the Partnership before Alibaba's IPO, or were nominated by Ma and other members of the Alibaba board thereafter.<sup>119</sup>

Although partners are required to “maintain a meaningful level of equity interests” in Alibaba, in practice the partnership's main selection criteria are less focused on ownership interests and instead are designed to select successful long-time managers from Alibaba (and Ant).<sup>120</sup> By 2014, the Partnership was firmly entrenched as the guiding body for the company, as the Partnership's board “nomination rights and related provisions of [Alibaba's] articles of association may only be changed upon the vote of shareholders representing 95% of the votes present in person or by proxy at a general meeting of shareholders.”<sup>121</sup> With the Alibaba Partnership in place, Ma and Alibaba's management could raise outside capital that was needed to fund a fast-growing technology company without having to be concerned that they would lose control over the business.<sup>122</sup>

Whether the Partnership is a positive for Alibaba's governance is a subject of intense debate among commentators. Although the Partnership's control over Alibaba is “widely understood” and disclosed throughout Alibaba's securities filings, the lack of foreign investor governance protections is stark, even given limitations placed by the VIE structure and regulation, and particularly against the backdrop of historical concerns stemming from Alipay's spinout from Alibaba.<sup>123</sup> Alibaba and Ma have tried to rationalize the Partnership as reinforcing the company's culture and ensuring that Alibaba remains “more flexible and competitive in any future market,”

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*Disadvantage*, THE NEW YORK TIMES, Sept. 16, 2014, <https://archive.nytimes.com/dealbook.nytimes.com/2014/09/16/alibabas-governance-leaves-investors-at-a-disadvantage/> (“In the case of Alibaba, investors need to worry about the relatively small [equity] stake held by the members of the controlling Alibaba Partnership. After the I.P.O., Alibaba's executive chairman, Jack Ma, is expected to hold 7.8 percent of the shares and all the directors and executive officers will hold together 13.1 percent.”).

<sup>119</sup> Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 289 (2021).

<sup>120</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 234, 302 (Sep. 18, 2014) (“We require each partner of the Alibaba Partnership to maintain a meaningful level of equity interests in our company during such individual's tenure as a partner.”). In practice, the only strict requirement is that partners must maintain at least 60 percent of their initial equity stake for three years from the time they became a partner and at least 40 percent of their initial equity stake indefinitely as long as they remain a partner.

<sup>121</sup> Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 231, 273 (Sep. 18, 2014); RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 31, 41 (2020) (“The emergence of Alibaba's partner system is the product of Jack Ma and his team's institutionalization of power to guarantee absolute control.”).

<sup>122</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 24 (2020) (The Partnership system “ensures that management can retain control of the board with a small shareholding.”); Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 288 (2021) (“This power [to appoint a simple majority of Alibaba's directors] gives the Partnership perpetual control of the board regardless of the partners' collective equity ownership.”).

<sup>123</sup> Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 280 (2021); Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 231 (Sep. 18, 2014) (“The nomination rights of the Alibaba Partnership and the voting agreement will limit your ability to influence corporate matters”).

rather than simply creating an “interest group” that has captured management of the business.<sup>124</sup> Lin et al. suggest a different but also positive reading of the Partnership as rewarding the greater role that people play in the success of technology companies relative to capital (although this argument begs the question of why Alibaba’s corporate structure would recognize entrepreneurial value only through voting control and not a predominant equity stake).<sup>125</sup> Lin et al. also argue that the Partnership is not substantially different from the dual-class share structure that many technology and media companies like Google and Facebook have adopted in the United States to allow founders or key people to retain control as their capital ownership stake in a company diminishes.<sup>126</sup>

Other commentators take a more negative view of the Partnership. Lucian Bebchuk argues that “the Alibaba insiders [in the Alibaba Partnership] will have substantial incentives to divert value from Alibaba to other entities in which they own a substantial percentage of the equity,” referencing the Alipay spinoff as the type of PRC controller expropriation that he sees as a continued risk given the Partnership structure.<sup>127</sup> Additionally, Jesse Fried and Ehud Kamar paint a picture of the Alibaba Partnership as a self-perpetuating institutional structure designed to conceal Jack Ma’s ultimate control over Alibaba’s governance.<sup>128</sup> They argue that the Partnership’s governance “power is actually concentrated in the hands of several people, as the Partnership itself is effectively controlled by a small Partnership Committee, of which [Jack] Ma is a perpetual member.”<sup>129</sup> The risky legal status of the VIE structure reinforces the Partnership-based control that PRC founders have over Alibaba (and Ant) by creating a holdup risk where PRC

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<sup>124</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 28 (2020); *see also* Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 231, 273 (Sep. 18, 2014) (selection criteria for partners).

<sup>125</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 42 (2020) (“In the information technology era, the role of people is more prominent. The reason why the partner system can be implemented and accepted by investors is largely due to the fact that the team of partners such as Jack Ma is itself Alibaba Group.”). *See also* a similar argument in Yu-Hsin Lin & Thomas Mehaffy, *Open Sesame: The Myth of Alibaba’s Extreme Corporate Governance and Control*, 10 BROOK. J. CORP. FIN. & COM. L. 437, 464 (2016) (“Given Ma’s entrepreneurial vision, his close association with Alibaba’s values and actions, and his future commitments, Alibaba investors can reasonably expect that the value Ma will be able to create with stable control over Alibaba would be greater than the costs of expropriation if he were to extract private benefits for himself.”).

<sup>126</sup> RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 40-41 (2020); *see, e.g.*, Brad Stone, *Facebook Will Form 2 Classes of Stock*, THE NEW YORK TIMES, Nov. 24, 2009, <https://www.nytimes.com/2009/11/25/technology/internet/25facebook.html>.

<sup>127</sup> Lucian Bebchuk, *Alibaba’s Governance Leaves Investors at a Disadvantage*, THE NEW YORK TIMES, Sept. 16, 2014, <https://archive.nytimes.com/dealbook.nytimes.com/2014/09/16/alibabas-governance-leaves-investors-at-a-disadvantage/>. Bebchuk’s concern is not entirely dissimilar to the threats Elon Musk has made to divert opportunities from Tesla to other companies where he has more control and economic interests. *See, e.g.*, Chandni Shah & Hyunjoon Jin, *Musk wants 25% voting control at Tesla before fulfilling AI goal*, REUTERS, Jan. 17, 2024, <https://www.reuters.com/technology/musk-seeks-25-voting-share-tesla-2024-01-16/>.

<sup>128</sup> *See* Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279 (2021). Notably, Fried and Kamar published their article arguing for Jack Ma’s dominance of Alibaba *after* Ma had officially stepped down from his role as Alibaba’s chairman in 2020, *see* Lily Kuo, *Jack Ma, China’s richest man, steps down as chairman of Alibaba*, THE GUARDIAN, Sept. 10, 2019, <https://www.theguardian.com/business/2019/sep/10/jack-ma-chinas-richest-man-steps-down-as-chairman-of-alibaba>.

<sup>129</sup> Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 280 (2021).

controllers could seize licenses or break the VIE structure similar to the spinoff of Alipay to gain leverage over foreign investors.<sup>130</sup>

Fried and Kamar's critique of the Partnership and Partnership Committee lands with less force than it did when their article was published in 2021 due to their emphasis on the importance of Ma's voting control over Ant to control of the Partnership, Committee, and Alibaba.<sup>131</sup> Ma lost voting control of Ant in Jan. 2023 as discussed below,<sup>132</sup> removing much of the formal indirect power over the Partnership that Fried and Kamar ascribe to him.<sup>133</sup> However, even if the position of the Partnership and Ma has changed in the last few years, Fried and Kamar's portrayal of Alibaba's use of the Partnership to perpetuate individual control is emblematic of the governance and economic assertiveness that PRC founders had in the 2010s and is the type of individualization of power that ignited recent PRC government backlash.

### Ant Group Corporate Control (2011-2020)

Like Alibaba's top-level holding company (Alibaba Group Holding Limited), Ant Group Co., Ltd. serves as a top-level holding operating company for numerous subsidiaries across a range of sectors: digital payments, lending and credit, investment tech, and insurtech, though Ant does not have a VIE structure and directly owns its subsidiaries, both inside and outside the PRC (see Figure XX, taken from Ant's IPO Prospectus).

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<sup>130</sup> Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 281, 297-301 (2021).

<sup>131</sup> Fried and Kamar argued that a combination of Ma's perpetual membership on the Partnership Committee, his significant ownership stake and control over Ant, and the Partnership Committee's control over partner compensation gave Ma control over Alibaba's governance until he chose to relinquish it. With the end of Ma's control over Ant, Ma no longer has significantly greater nominal power in the Partnership than Joe Tsai, the only other perpetual member of the Partnership Committee. See Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 280 (2021) (Ma's perpetual membership); *id.* at 281 (importance of Ant ownership to Ma's control over Alibaba); *id.* at 291 (control over partner compensation); discussion of Ant's Jan. 2023 voting "Adjustment" removing Ma's control *infra* \_\_\_\_\_. Note that Ma has maintained his role in the Partnership and Partnership Committee despite government attacks on his other positions, see *infra* \_\_\_\_\_.

<sup>132</sup> See *infra* \_\_\_\_\_.

<sup>133</sup> Though it seems likely Ma retained much of his soft power and influence as the company's culture carrier and visionary. Additionally, he and Joe Tsai, the two permanent members of the Partnership Committee, likely still have outsized influence in the governance of Alibaba disproportionate to their distribution or voting rights or other positions.

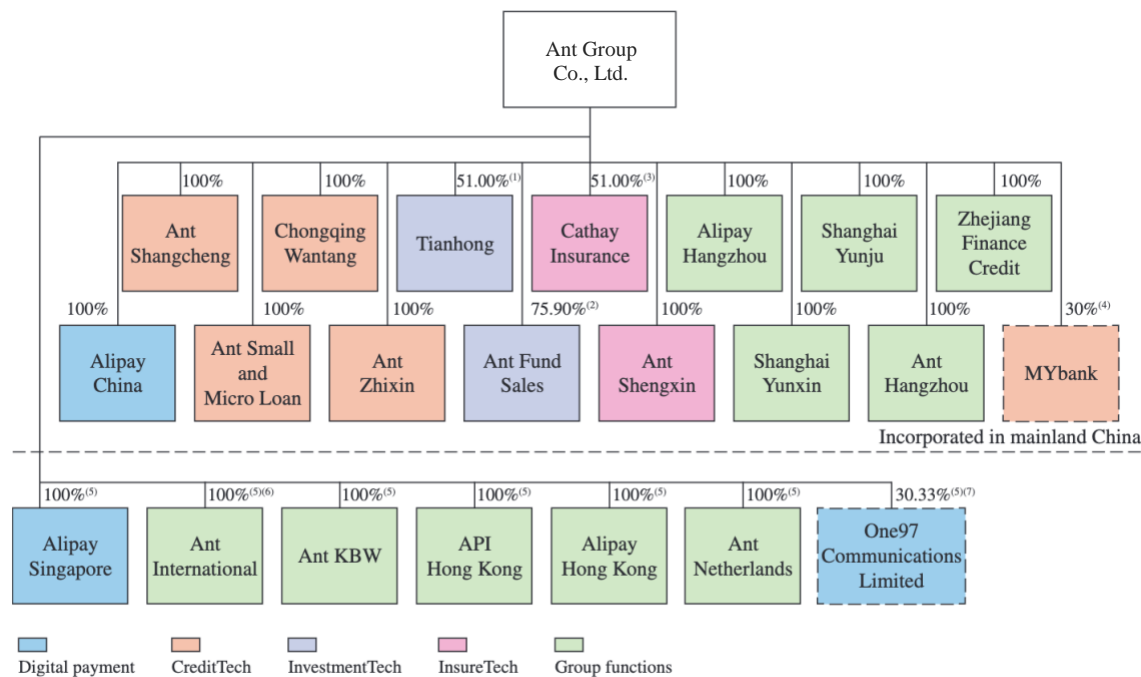


Figure 3: Important Ant Group subsidiaries organized by line of business and domicile with associated Ant Group ownership percentage.<sup>134</sup>

Like Alibaba, Ant originally had a system of pyramidal corporate control with Jack Ma as the ultimate controller, although Ant does not have any direct separation of economic and voting rights as is the case for the Alibaba Partnership. Prior to its planned IPO in 2020, Ant had three main groups of shareholders: (1) two limited partnerships (Hangzhou Junhan and Hangzhou Junao), which owned 50.52 percent of Ant, (2) Alibaba, which owned 32.65 percent, and (3) other PRC investors who owned 16.83 percent.<sup>135</sup> Because economic and voting rights travel together for Ant, the limited partnerships had voting control of Ant with their 50.52 percent stake. Voting control of the partnerships in turn is governed by a third entity, Hangzhou Yunbo, which is the executive and general partner of the two limited partnerships.<sup>136</sup> Although Ma only owns a 34 percent interest in Yunbo (three other associates each own 22 percent interests), a “Concert Party Agreement” among Yunbo’s owners gives him voting control over Yunbo and thereby over the limited partnerships and Ant (see Figure XX):

[The] ‘Concert Party Agreement’ provid[es] that all matters related to Ant Group-including the exercise of voting rights for all shares held by Junhan and Junao as well as the nomination of directors and supervisors to Ant Group's board-would be decided by a two-

<sup>134</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 156 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>. See also *id.* at 156-159 (summarizing the specific business done by each of these subsidiaries and relevant considerations).

<sup>135</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 160 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>136</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 160 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

thirds majority vote of the Yunbo shareholders. Ma’s 34% interest provides him with an effective veto over the decisions of Yunbo. More importantly, in the event of a disagreement among the shareholders, all votes will be cast ‘in accordance with the decision of’ Ma.<sup>137</sup>

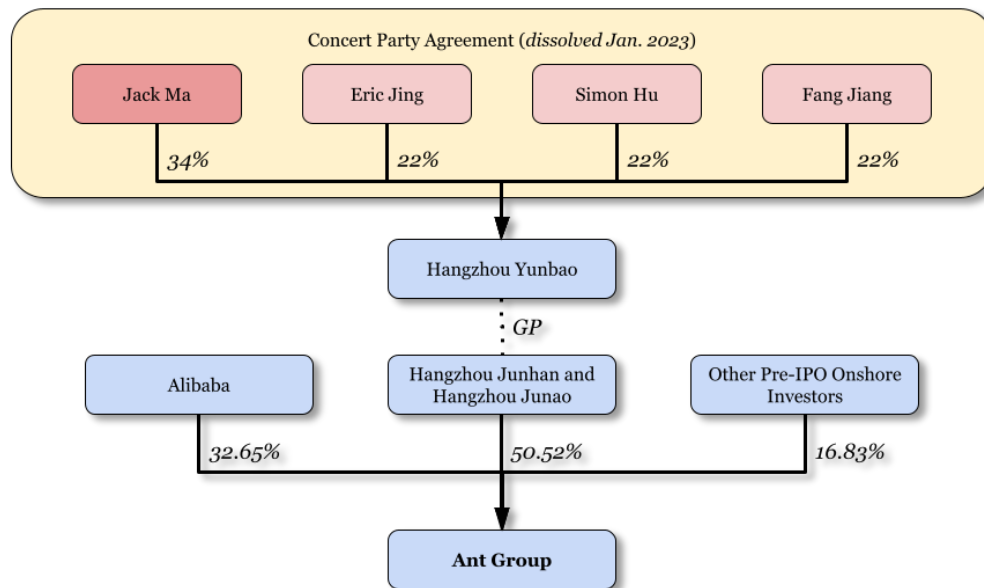


Figure 4: Ant Group’s ownership structure prior to its planned IPO in 2020. Jack Ma was able to control the votes of Hangzhou Junhan and Junao through voting agreements (shown) until the 2023 “Adjustment” dissolving these agreements.<sup>138</sup>

While this control agreement would no longer have provided direct majority control after Ant’s proposed IPO (as the limited partnerships were expected to only retain a 39.55 percent ownership stake after the offering),<sup>139</sup> together with Alibaba, the limited partnerships would have easily retained a voting majority of shares, and Ma would have been able to continue to control Ant to the extent he was able to exercise control over Alibaba’s votes.<sup>140</sup> However, as will be discussed below, the historical structure of control by Ma through the limited partnerships and Alibaba was

<sup>137</sup> Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 286 (2021).

<sup>138</sup> Adapted from Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 160 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>139</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 161 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>140</sup> See Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 285-287 (2021); Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 11 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> (“Pursuant to the Concert Party Agreement entered into between [Yunbo’s owners] and the articles of association of Hangzhou Yunbo, Mr. Jack Ma has ultimate control over our Company.”)

dissolved in early 2023 in response to Chinese government pressure, leaving control of Ant far more dispersed today.<sup>141</sup>

At the time of its proposed IPO, Ant also had policies that, in form if not in substance, attempted to reduce conflicts of interest in dealings with Alibaba. Five of Ant's nine directors including the chairman and the CEO, held offices or other management roles at Alibaba at the time of Ant's planned IPO.<sup>142</sup> Additionally, six of the company's nine directors were members of the Alibaba Partnership.<sup>143</sup> The five directors who hold offices or management roles at Alibaba agreed to "abstain from voting at the Board meetings in respect of matters involving transactions with Alibaba after the [IPO], for so long as they hold offices as directors and/or other management role[s] with Alibaba."<sup>144</sup> However, this protection against conflicts of interest is more limited than it appears. The sixth director, who is a partner of the Alibaba Partnership but not an officer or manager of Alibaba, retained the right to vote on issues related to Alibaba on the premise that "the Alibaba Partnership is not engaged in business operations and does not provide any financial support to Alibaba."<sup>145</sup> As discussed above,<sup>146</sup> describing the Alibaba Partnership as an unconflicted entity independent from Alibaba seems directly at odds with the entity's structure and mission of perpetuating and reinforcing Alibaba's culture and business success. Additionally, while conflicted directors must abstain from voting on connected transactions, they still appear to have been allowed to participate in discussion on these topics with the unconflicted directors who would vote on the issue.

## Public Offerings and Consequences

### Alibaba's Successful IPO (2014)

In 2014, Alibaba Group decided to list its stock publicly for the first time.<sup>147</sup> Alibaba chose to list through American Depositary Shares of Alibaba Group Holding Limited's Cayman corporate stock in New York after the Hong Kong Exchange rejected its listing because of the Alibaba Partnership and unequal voting power among shareholders.<sup>148</sup> Despite the rocky start,

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<sup>141</sup> See *infra* \_\_\_\_.

<sup>142</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 299 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>143</sup> *Id.*

<sup>144</sup> *Id.*

<sup>145</sup> Ant Grp. Co., Ltd., H Share IPO Hong Kong Prospectus 299-300 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> ("Mr. Xingjun Ni will not, by virtue of being a partner of the Alibaba Partnership, have conflict of interest which compromises his independence of judgment in exercising his responsibilities to the Board and therefore is not required to abstain from voting at the Board meetings in respect of matters involving transactions with Alibaba after the [IPO].").

<sup>146</sup> See discussion of the Alibaba Partnership *supra* \_\_\_\_.

<sup>147</sup> Alibaba had previously listed its Alibaba.com/1688.com subsidiary on the Hong Kong stock exchange from 2007-2012. RUNHUI LIN, JEAN JINGHAN CHEN, & LI XIE, CORPORATE GOVERNANCE OF CHINESE MULTINATIONAL CORPORATIONS: CASE STUDIES 6 (2020).

<sup>148</sup> See Enda Curran, *How Hong Kong Lost the Alibaba IPO*, THE WALL STREET JOURNAL, Mar. 15, 2014, <https://www.wsj.com/articles/SB10001424052702303546204579440820673013810> (at the time, the Hong Kong exchange and its regulator imposed "one shareholder, one vote" rules); Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 288 (Sep. 18, 2014). See also Jesse M. Fried & Ehud Kamar, *Alibaba: A Case Study of Synthetic Control*, 11 HARV. BUS. L. REV. 279, 283 fn. 22 (2021) (discussing why Alibaba chose to list on NYSE rather than originally preferred Hong Kong, Hong Kong's rejection of dual-class share arrangements and Alibaba partnership); Shen Wei & Angus Young, *Dual Share Plan in Context: Making Sense of Hong Kong's Decision Not to Embrace Alibaba's*

Alibaba’s IPO was a wild success. Although critics raised many of the same concerns about corporate governance and VIE enforceability discussed in this paper,<sup>149</sup> at the time Alibaba was the largest IPO in history, raising \$25 billion including oversubscriptions.<sup>150</sup> The company’s stock price increased 38 percent on the first day of trading, and the market assigned the company a value larger than that of Facebook or Amazon at the time.<sup>151</sup> The relatively smooth success of Alibaba’s IPO and significant economic benefits stand in stark contrast to Ant’s failed IPO six years later, discussed in the next section.

### Ant Group’s Unsuccessful IPO, Fallout, and Voting Reorganization (2020-2023)

In 2020, Ant planned a dual IPO listing its shares on both the Hong Kong and Shanghai stock exchanges.<sup>152</sup> Much like Alibaba’s record-breaking 2014 IPO, Ant’s planned 2020 IPO was expected to raise more money than any IPO up to that time (projecting to raise \$34 billion at a valuation of more than \$310 billion).<sup>153</sup> Its prospectus filing emphasized the company’s close relationship with Alibaba, describing how Ant “together with Alibaba, [is] building the digital infrastructure for commerce and services.”<sup>154</sup> Ant’s underlying performance supported its huge planned offering. Ant dwarfed comparable US payments companies in active users (730 million vs. 346 million Paypal accounts), payment volume (\$17 trillion vs. \$712 billion for PayPal), and payment infrastructure (459,000 payments per second vs. 65,000 for Visa).<sup>155</sup> However, the IPO was “dramatically suspended just two days before dealings were due to begin... a day after the

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*Listing*, 26 INT’L CO. & COM. L. REV. 4, 5 (2015). Alibaba would eventually also list shares on the Hong Kong exchange after the exchange changed its rules around control.

<sup>149</sup> See, e.g., Suzanne McGee, *Alibaba IPO Investors Should Be Careful What They Wish For*, THE FISCAL TIMES, Sept. 14, 2014, <https://www.thefiscaltimes.com/Columns/2014/09/16/Alibaba-IPO-Investors-Should-be-Careful-what-They-Wish>.

<sup>150</sup> Jonathan Shieber, *It’s Official: Alibaba Is The Biggest IPO Ever*, TECHCRUNCH, Sept. 22, 2014, <https://techcrunch.com/2014/09/22/its-official-alibaba-is-the-biggest-ipo-ever/>.

<sup>151</sup> Aimee Picchi, *Alibaba launches biggest IPO in U.S. history*, CBS NEWS, Sept. 19, 2014, <https://www.cbsnews.com/news/alibaba-ipo-trading-to-start-after-22-billion-sale/>.

<sup>152</sup> The Hong Kong listing is also described as the *H Share IPO* and the Shanghai listing is described as the *A Share IPO*. See Ant Grp. Co., Ltd., *H Share IPO Hong Kong Prospectus* 22-23 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>. See also *id.* at 160-161 (diagrams of Ant Group ownership structure before and after the dual IPOs); *id.* at 279-282 (describing specific share classes and IPO structure).

<sup>153</sup> Mark Sweney, *Jack Ma’s Ant set for world’s biggest share offering at £26bn*, THE GUARDIAN, Oct. 26, 2020, <https://www.theguardian.com/business/2020/oct/26/jack-mas-ant-set-for-worlds-biggest-flotation-at-26bn>; Sherisse Pham & Julie Horowitz, *Ant Group raises \$34 billion in world’s largest IPO*, CNN, Oct. 27, 2020, <https://www.cnn.com/2020/10/26/tech/ant-ipo-pricing-hnk-intl/index.html>; Ant Grp. Co., Ltd., *H Share IPO Hong Kong Prospectus* 377 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>154</sup> Altogether “Alibaba” is mentioned 828 times in Ant’s Hong Kong IPO Prospectus. Ant Grp. Co., Ltd., *H Share IPO Hong Kong Prospectus* 8 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf>.

<sup>155</sup> Raymond Zhong, *All About Ant Group, the Next Big Tech I.P.O.*, THE NEW YORK TIMES, Oct. 26, 2020, <https://www.nytimes.com/2020/10/26/technology/ant-group-ipo-explained.html>. See also Ant Grp. Co., Ltd., *H Share IPO Hong Kong Prospectus* I-5 (Oct. 27, 2020), <https://www1.hkexnews.hk/listedco/listconews/sehk/2020/1026/2020102600165.pdf> (financial statements); *id.* at 174-227 (summarizing other business metrics).

financial tech company's top executives including its founder... Jack Ma, were summoned to speak to [PRC] regulators."<sup>156</sup>

Most commentators linked the decision by regulators to pause the IPO with a speech that Ma had given criticizing financial regulators as having a "pawn shop mentality"<sup>157</sup> and stifling innovation.<sup>158</sup> Ma's willingness to challenge the PRC government was not new in 2020. In addition to being one of the most prominent users of the VIE structure, Ma has made numerous statements highlighting the questionable legality of his wildly successful technology businesses in a country that remains under the thumb of the state and party.<sup>159</sup> However, the decision to pause the IPO despite substantial collateral consequences for the global prestige of the PRC technology and financial sectors, and foreign investment suggests a desire by the PRC government to publicly reassert control over technology companies and leaders who have been increasingly willing to push back against the state.<sup>160</sup> As *Time* described in an article on Ma's withdrawal from the public eye and fall from grace following the "pawn shop mentality" speech:

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<sup>156</sup> Jasper Jolly, *Ant Group forced to suspend biggest share offering in history*, THE GUARDIAN, Nov. 3., 2020, <https://www.theguardian.com/business/2020/nov/03/biggest-share-offering-in-history-on-hold-as-ant-group-suspends-launch>.

<sup>157</sup> Charlie Campbell, *Where Is Alibaba Founder Jack Ma? What the Saga of One of the World's Richest Men Reveals About China Under Xi Jinping*, TIME, Jan. 4, 2021, <https://time.com/5926062/jack-ma/> (Ma "obliquely chided Chinese regulators for stifling innovation, and said that Chinese banks suffered from a 'pawnshop mentality' given that banks, like the informal lenders of yore, still relied on a system of 'pledges and collateral.' This wasn't all bad, Ma granted. 'In the old days,' he pointed out, 'a pawnshop was an advanced idea. Had it not been for innovations such as pledges and collateral, there would be no financial institutions today, and the Chinese economy would not have developed over the past 40 years to such a point now.'").

<sup>158</sup> Jasper Jolly, *Ant Group forced to suspend biggest share offering in history*, THE GUARDIAN, Nov. 3., 2020, <https://www.theguardian.com/business/2020/nov/03/biggest-share-offering-in-history-on-hold-as-ant-group-suspends-launch>; Cardiff Garcia & Emily Feng, *Ant's IPO Woes*, NPR, Nov. 12, 2020, <https://www.npr.org/2020/11/12/934251081/ants-ipo-woes>; Arjun Kharpal, *Alibaba shares dive 7% as Ant Group's record \$34.5 billion IPO is suspended*, CNBC, Nov. 3, 2020, <https://www.cnbc.com/2020/11/03/ant-group-ipo-in-shanghai-suspended.html> ("I don't think it served well (for) Jack Ma to criticize the entity that will demand the full cooperation of Ant Group on their ongoing reforms, moving forward,' [said a management consultant] who advises China's banking regulator.").

<sup>159</sup> See, e.g., Li Yuan, *Why China Turned Against Jack Ma*, THE NEW YORK TIMES, Dec. 24, 2020, <https://www.nytimes.com/2020/12/24/technology/china-jack-ma-alibaba.html> ("If someone needs to go to jail for Alipay, let it be me,' [Ma] told his colleagues at the time [of Alipay's founding]... He sometimes subtly dared the government to punish his defiance. Regarding Ant's business, he said on multiple occasions, 'If the government needs it, I can give it to the government.' His top lieutenants repeated the line, too.").

<sup>160</sup> See, e.g., Cardiff Garcia & Emily Feng, *Ant's IPO Woes*, NPR, Nov. 12, 2020, <https://www.npr.org/2020/11/12/934251081/ants-ipo-woes> ("The Ant IPO was such a big deal here in China because this was the chance for the Shanghai bourse and the Hong Kong bourse to really shine. Most Chinese tech companies, including Jack Ma's first successful venture, Alibaba, listed in New York. That's where most Chinese tech companies want to go. And the party in China decided that they were willing to sacrifice that moment in the spotlight to demonstrate their control. To them, that was worth it."); Li Yuan, *Why China Turned Against Jack Ma*, THE NEW YORK TIMES, Dec. 24, 2020, <https://www.nytimes.com/2020/12/24/technology/china-jack-ma-alibaba.html> ("The pressure on Mr. Ma signals a shift in how the Chinese government regulates the internet. It has long censored content, but in other ways it has adopted a laissez-faire approach. Regulations were spare."). The instability created by the sudden pause of Ant's IPO also served as a stark reminder of the rule-of-law concerns that surround FDI in the PRC and VIEs specifically. See Cardiff Garcia & Emily Feng, *Ant's IPO Woes*, NPR, Nov. 12, 2020, <https://www.npr.org/2020/11/12/934251081/ants-ipo-woes> ("There is still the facsimile of having rule of law. There are functioning court systems. There is extensive legislation out there protecting business interests. But the - at the end of the day, when push comes to shove, the party still calls the shots. And it can manipulate those legal processes to serve its desired outcome.").

[I]t's clear that the CCP under President Xi will not countenance any challenge to its authority. Given a slowing Chinese economy and mounting geopolitical headwinds, Beijing is nervous about systematic financial risks and rising debt. This is no time to be calling, as Ma did, for a loosening of the system. And just as seemingly unassailable titans of real estate, finance and show-biz previously discovered, China's tech champion is learning that loyalty comes first in Xi's China. "There is no so-called [Ma] era," read a recent headline in the CCP mouthpiece *People's Daily*, "but only an era that has [Ma] in it."<sup>161</sup>

*Time* framed the shutdown of Ant's IPO as not only a bid by the PRC for regulatory control but also as a reaction to the increasing personal prominence of the PRC's private sector leaders. Ma's glamorous lifestyle and eccentric behavior led him to be admired both with the PRC and internationally. Although initially tolerated by PRC authorities as a source of "soft power," Ma's prominence and outspoken behavior ultimately became a risk to the PRC, independent of his views on regulation.<sup>162</sup> One early sign of this pushback and desire to reassert personal control can be seen in the publicization of Ma's CCP membership, in small publications beginning in 2015 and then in a state run newspaper in 2018, shortly after Ma decided to step down as Alibaba chairman.<sup>163</sup> Ma's disappearance and loss of power following the "pawn shop" speech and Ant's failed IPO might be seen as a (largely successful) continuation of this attempt to wrest personal power and influence away from Ma for the CCP and President Xi Jinping. Although Jack Ma resurfaced in April 2024 to endorse the 1+6+N restructuring being undertaken by Alibaba, he has largely remained absent from Alibaba, Ant, and public view since 2020, and the loss of his vision and leadership has hurt both Alibaba and Ant.<sup>164</sup>

The most immediate fallout of Ant's failed IPO was economic. Alibaba's shares dropped 6 percent on the day the IPO was suspended, reflecting a combination of lost value from its 33 percent stake in Ant and broader investor concerns about market instability and government intervention, and Ant investors marked down their shares by around 25 percent in the months immediately following the pause.<sup>165</sup> Investors additionally lost the opportunity to liquidate any

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<sup>161</sup> Charlie Campbell, *Where Is Alibaba Founder Jack Ma? What the Saga of One of the World's Richest Men Reveals About China Under Xi Jinping*, TIME, Jan. 4, 2021, <https://time.com/5926062/jack-ma/>.

<sup>162</sup> Selina Wang, *Jack Ma was almost bigger than China. That's what got him into trouble*, CNN, Jan. 6, 2021, <https://www.cnn.com/2021/01/06/tech/jack-ma-china-tech-intl-hnk/index.html>. See also Charlie Campbell, *Where Is Alibaba Founder Jack Ma? What the Saga of One of the World's Richest Men Reveals About China Under Xi Jinping*, TIME, Jan. 4, 2021, <https://time.com/5926062/jack-ma/> ("Being something of a global business celebrity, he was tacitly entrusted by the Chinese Communist Party (CCP) to project a modern, go-ahead image for the country's entrepreneurs.").

<sup>163</sup> *Alibaba's Jack Ma is a Communist Party member, China state paper reveals*, CNBC, Nov. 26, 2018, <https://www.cnbc.com/2018/11/27/alibaba-founder-jack-ma-is-a-communist-party-member-china-state-media.html>; Arjun Kharpal, *Alibaba's Jack Ma has been a Communist Party member since the 1980s*, CNBC, Nov. 27, 2018, <https://www.cnbc.com/2018/11/27/alibabas-jack-ma-has-been-communist-party-member-since-1980s.html>. See also Robin Brant, *Why is Jack Ma a member of the Communist Party of China?*, BBC, Nov. 27, 2018, <https://www.bbc.com/news/business-46353767>.

<sup>164</sup> Arjun Kharpal, *Alibaba shares jump after founder Jack Ma reemerges with praise of Chinese giant's 'transformations'*, CNBC, Apr. 10, 2024, <https://www.cnbc.com/2024/04/10/alibaba-founder-jack-ma-re-emerges-with-praise-of-transformations.html>.

<sup>165</sup> Jasper Jolly, *Ant Group forced to suspend biggest share offering in history*, THE GUARDIAN, Nov. 3., 2020, <https://www.theguardian.com/business/2020/nov/03/biggest-share-offering-in-history-on-hold-as-ant-group-suspends-launch>; Xie Yu & Jing Yang, *Jack Ma's Ant Group Will End Some Practices That Helped Fuel Its Growth*, THE WALL STREET JOURNAL, Apr. 13, 2021, <https://www.wsj.com/articles/jack-mas-ant-group-will-end-some->

Ant shares on public markets, leaving them stuck holding the stock as the company's value cratered over the next few years with increasing PRC regulatory interventions. Short-term losses after the halted IPO were followed by a broader regulatory crackdown that created further losses for Ant, Alibaba, and other PRC companies.<sup>166</sup> For Ant, the most significant regulatory change was a decision to force it to become a financial holding company, meaning “the company [would] essentially be subject to regulations similar to those governing banks.”<sup>167</sup> Regulators also required a bevy of more specific changes to Ant's business, ranging from reducing cross-selling between various lines of business to restricting its marketing techniques and use of data.<sup>168</sup> When Ant finally revalued itself (in a private market tender offer with its IPO still paused) in July 2023, it did so at \$78.5 billion, a loss of around \$230 billion (75 percent) from the planned IPO valuation.<sup>169</sup>

In addition to economic losses, Ant's failed IPO and the PRC regulatory crackdown ultimately led Ant to significantly restructure its corporate control. Historically, Jack Ma maintained sole control of Ant through several limited liability companies and the voting arrangement that allowed him to wield effective majority control described above.<sup>170</sup> Between 2021 and 2023, Ant increased the number of independent directors on its board from three to four and made additional commitments to add a fifth independent director (thus establishing an independent majority).<sup>171</sup> Ant also took steps to attempt to increase its independence from Alibaba, including the removal of some Ant directors from their roles with the Alibaba Partnership.<sup>172</sup> However, the most significant change was an “Adjustment” of the Concert Agreement that had governed voting on Ant matters for the two limited partnerships that collectively owned a majority of Ant shares:

The main result of the Adjustment will be to change the exercise of voting rights of Ant Group's major shareholders, from Mr. Jack Ma exercising voting rights jointly with

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[practices-that-helped-fuel-its-growth-11618320015](#) (“Some Ant shareholders in recent months marked the value of their Ant stakes at prices that implied a company valuation of \$230 billion, according to regulatory filings.”).

<sup>166</sup> It is worth emphasizing that these losses were incurred not just by the domestic founders but also by foreign investors, leading to frayed trust and increasing concern about the the PRC government's approach to FDI. Between 2020 and 2021, increasing government intervention and regulation wiped out \$3 trillion of value from PRC companies. See Laura He, *China's 'revolution' cost investors \$3 trillion. So why aren't they running scared?*, CNN, Sept. 1, 2021, <https://www.cnn.com/2021/09/01/investing/china-investment-tech-crackdown-mic-intl-hnk/index.html>. See also Christine Wang, *China slaps Alibaba with \$2.8 billion fine in anti-monopoly probe*, CNBC, Apr. 9, 2021, <https://www.cnbc.com/2021/04/09/china-fines-alibaba-in-anti-monopoly-probe.html>.

<sup>167</sup> Jing Yang, *Jack Ma's Ant Group Bows to Beijing With Company Overhaul*, THE WALL STREET JOURNAL, Apr. 12, 2021, <https://www.wsj.com/articles/ant-group-to-become-a-financial-holding-company-overseen-by-central-bank-11618223482>.

<sup>168</sup> Note the headline for the article describing these regulatory changes as “end[ing] some practices that helped fuel [Ant's] growth.” Xie Yu & Jing Yang, *Jack Ma's Ant Group Will End Some Practices That Helped Fuel Its Growth*, THE WALL STREET JOURNAL, Apr. 13, 2021, <https://www.wsj.com/articles/jack-mas-ant-group-will-end-some-practices-that-helped-fuel-its-growth-11618320015>.

<sup>169</sup> Laura He, *How much did Jack Ma's speech cost Ant Group? About \$230 billion*, CNN, July 10, 2023, <https://www.cnn.com/2023/07/10/investing/china-ant-group-valuation-jack-ma-intl-hnk/index.html> (also noting Alibaba's stock declined 70 percent between Oct. 2020 and July 2023 – around \$645 billion).

<sup>170</sup> See *supra* \_\_\_\_, Figure XX.

<sup>171</sup> *Ant Group Announces Further Corporate Governance Optimization*, ANT GROUP CO., LTD., Jan. 7, 2023, <https://www.antgroup.com/en/notices/1>. I have been unable to find any news reports identifying a fifth independent director named to Ant's board as of March, 20 2024.

<sup>172</sup> *Id.* (“[T]o further enhance the transparency and effectiveness of our corporate governance and strengthen our independence from our shareholder, Alibaba Group, certain members of our management have exited the Alibaba Partnership.”).

persons acting in concert, to each of ten individuals (including the founder, representative of our management and employees) exercising their voting rights independently... Upon completion of the Adjustment, major shareholders of Ant Group, including [the limited partnerships], will independently exercise their voting rights in Ant Group. *No shareholder will, alone or jointly with another shareholder, have the power to control the outcome of Ant Group's general meetings. No shareholder will have the power to nominate the majority of Ant Group's board of directors. Therefore, no shareholder, alone or jointly with other parties, will have control over Ant Group.* [emphasis added]<sup>173</sup>

Although not changing economic rights, the Adjustment's reduction of Ma from sole controller to minority voting power (estimated to hold around 6.2 percent of voting rights after the Adjustment) was seen as additional evidence of PRC leadership's desire to assert its supremacy over prominent private citizens and businesses.<sup>174</sup> Notably, the Adjustment is another example (like the pause of the Ant IPO) where likely PRC pressure forced action that might in one way be seen as against the PRC's interests, as the change of control could further complicate plans to revive Ant's long-delayed IPO.<sup>175</sup> More recently, in March 2024, Ant further restructured several of its subsidiaries in response to continued regulatory friction and in preparation of a future relisting of its IPO.<sup>176</sup>

Ant's IPO and related fallout are illustrative of how the power hierarchy governing foreign investors in the PRC has evolved. In the 2000s, foreign investors like Yahoo and SoftBank played an important role in Alibaba's growth and governance, irking PRC founders and owners. In the 2010s, PRC founders reasserted their control through share repurchases, the Alipay spinoff, and governance mechanisms like the Alibaba Partnership and Ant's limited partnerships and Concert Agreement. However, since the late 2010s and exemplified by the regulatory crackdown following Ant's failed 2020 IPO, the PRC government and regulators have reasserted their dominance over both PRC founders and foreign investors at Ant and Alibaba and many other prominent companies, even showing a willingness to trade off economic goals in order to regain control over the PRC

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<sup>173</sup> *Ant Group Announces Further Corporate Governance Optimization*, ANT GROUP CO., LTD., Jan. 7, 2023, <https://www.antgroup.com/en/notices/1>.

<sup>174</sup> Tom Espiner, *Jack Ma to give up control of fintech giant Ant Group*, BBC, Jan. 8, 2023, <https://www.bbc.com/news/business-64192382> (“Jack Ma's departure from Ant Financial, a company he founded, shows the determination of the Chinese leadership to reduce the influence of large private investors,” said Andrew Collier, managing director of Orient Capital Research. “This trend will continue the erosion of the most productive parts of the Chinese economy.”). Note that while the Adjustment does not directly change economic rights, Alibaba filings from the previous year suggest that Ma has agreed to reduce his ownership in Ant over time and placed a cap on his stake in the company. See Lulu Yilun Chen & Bloomberg, *Chinese billionaire Jack Ma cedes control of fintech giant Ant Group*, FORTUNE, Jan. 7, 2023, <https://fortune.com/2023/01/07/jack-ma-cedes-control-of-fintech-giant-ant-group/>.

<sup>175</sup> See Lulu Yilun Chen & Bloomberg, *Chinese billionaire Jack Ma cedes control of fintech giant Ant Group*, FORTUNE, Jan. 7, 2023, <https://fortune.com/2023/01/07/jack-ma-cedes-control-of-fintech-giant-ant-group/> (“The change of control could mean that Ant will have to wait longer for a much anticipated resumption of its initial public offering. Companies can't list domestically on the country's so-called A-share market if they have had a controller change in the past three years — or in the past two years, if listing on Shanghai's STAR market. For Hong Kong's stock exchange, this waiting period is one year.”). Ant recommitted to an IPO in early 2021, but three years later, no IPO has taken place or appears imminent. See Arjun Kharpal, *Ant Group says it will help employees monetize shares and commits to listing after canceled IPO*, CNBC, Mar. 2, 2021, <https://www.cnbc.com/2021/03/02/ant-group-says-will-help-employees-monetize-shares-after-canceled-ipo.html>.

<sup>176</sup> KrAsia Connection, *Ant Group names new president and spins off three businesses in major restructuring*, KRASIA, Mar. 20, 2024, <https://kr-asia.com/ant-group-names-new-president-and-spins-off-three-businesses-in-major-restructuring>.

business landscape and rein in the prominence of private citizens.<sup>177</sup> The remainder of this paper reassesses Alibaba, Ant, and the PRC's FDI landscape within this new context of increased government and regulatory presence and looks towards the future.

## Implications for the Future

The position of Alibaba and Ant in the tug of war among foreign investors, domestic regulators, domestic founders, and at times foreign regulators casts a pall of uncertainty over the companies' futures, and over the future of the PRC economy. Uncertainty, particularly unnecessary uncertainty, causes friction and raises the price of investment and innovation. Although Alibaba and Ant have always been subject to legal and regulatory uncertainty, in part due to their VIE structures but in part due to variability in the PRC's regulatory regimes and legal system,<sup>178</sup> the recent move by the PRC to reassert its authority over private-sector businesses suggests reason for heightened concern. The PRC's decision to kill Ant's IPO not only destroyed value for the company but did damage to the Shanghai Stock Market and hurt the PRC's global prestige. Such previously rare value-destroying actions by the government make it riskier for investors to place their funds subject to PRC laws, not least because they suggest PRC regulators are becoming more unpredictable and less committed to economic growth.

Increasing PRC intervention has also turned Alibaba, Ant, and other leading Chinese technology companies from innovative market leaders with autonomous, domestically powerful, and visionary founders to state-adjacent corporations that are forced to toe the party line. The disappearance of Jack Ma and antitrust and regulatory actions against Alibaba and Ant are obvious examples of both personal and entity-level attempts to rein in the independence of PRC technology success stories. Authorities' decision to push private sector leaders to "increase[] donations to charity to align with President Xi Jinping's vision of achieving 'common prosperity'" asserts greater control over once-autonomous industry leaders but also makes the PRC's public and private sectors increasingly difficult to distinguish in the eyes of foreign regulators.<sup>179</sup> As Alibaba and Ant become more closely affiliated with the PRC, they have become pawns in the geopolitical competition between the United States and China and subject to additional scrutiny from US and foreign regulators, further decreasing their appeal as opportunities for foreign investment. For example, in April 2018, Jack Ma gave a speech advocating for greater PRC technological development and ownership in the semiconductor space as a defense against US control over the

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<sup>177</sup> Xi has framed economic intervention as explicitly trading off growth for national security interests, but there are reasons to be skeptical that this trade will succeed. For one, the PRC's weakening economic competitiveness has ripple effects that hurt its strategic position in other fields. See David Pierson, *In Xi's China, Economic Needs May Take a Back Seat to Security*, NEW YORK TIMES, May 12, 2023, <https://www.nytimes.com/2023/05/12/world/asia/china-xi-security-economy.html>.

<sup>178</sup> See, e.g., Prospectuses listing regulation as one of the major risks confronting both companies at the time of their (proposed) IPOs. Alibaba Grp. Holding Ltd., Prospectus (Form 424(b)(4)) 39-40 (Sep. 18, 2014); Ant Hong Kong Prospectus at 54-56, 61-62, 64, 65-66, 73, 75, 78-80, 93, 96 (listing more than ten different types of potential regulatory uncertainty impacting Ant's offering).

<sup>179</sup> Lulu Yilun Chen & Bloomberg, *Chinese billionaire Jack Ma cedes control of fintech giant Ant Group*, FORTUNE, Jan. 7, 2023, <https://fortune.com/2023/01/07/jack-ma-cedes-control-of-fintech-giant-ant-group/>; Jeanny Yu & Chloe Lo, *China Tech Stocks Drop as Alibaba's Donation Worries Investors*, BLOOMBERG, Sept. 2, 2021, <https://www.bloomberg.com/news/articles/2021-09-03/china-tech-stocks-drop-as-alibaba-s-donation-worries-investors>.

sector's output, posing a strategic threat to the United States.<sup>180</sup> In November 2023, Alibaba delayed its plans to spin off Alibaba Cloud<sup>181</sup> after the United States added export controls restricting the ability of PRC companies including Alibaba Cloud to purchase advanced semiconductors.<sup>182</sup>

These headwinds make it increasingly difficult for Alibaba or Ant to retain their status as national and global champion companies.<sup>183</sup> While protectionism may have helped the companies during their initial ascent,<sup>184</sup> an Alibaba or Ant so beholden to the PRC as to confine their primary business to the country will never be able to compete economically or in terms of international prestige with brands like Microsoft, Apple, Samsung, Nike, or Mercedes-Benz.<sup>185</sup> The threat of regulatory ruggpulling makes it increasingly challenging to attract foreign investors, both restricting the ability of existing companies like Alibaba and Ant to raise capital and hampering the growth efforts of the next potential Alibaba or Ant that needs foreign funding to spark its growth. More directly, these challenges and threats have led to major devaluations of both companies,<sup>186</sup> with no

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<sup>180</sup> Ma's statements echoed calls of other leading PRC founders for investment in domestic PRC semiconductor production, potentially suggesting coordination. Yuji Nakamura & Yuki Furukawa, *Jack Ma Says Nations Need Tech to Sidestep U.S. Grip*, BLOOMBERG, Apr. 25, 2018, <https://www.bloomberg.com/news/articles/2018-04-25/jack-ma-says-nations-need-own-tech-to-sidestep-u-s-control>.

<sup>181</sup> This spin off was originally begun because of PRC regulatory scrutiny. See Dave Sebastian, *Alibaba Outlines IPO Plans as It Splits Into Six Groups*, WALL ST. JOURNAL, May 18, 2023, <https://www.wsj.com/livecoverage/stock-market-today-dow-jones-05-18-2023/card/alibaba-outlines-units-ipo-plans-as-it-splits-into-six-groups-vGk4nN0gQyJt4gjOxsgq>; discussion of 1+6+N restructuring *supra* \_\_\_\_.

<sup>182</sup> Donny Kwok & Josh Ye, *Alibaba's U-turn on cloud unit spin-off lops \$20 billion off its market value*, REUTERS, Nov. 17, 2023, <https://www.reuters.com/technology/alibaba-shares-set-slide-8-after-it-shelves-cloud-unit-spin-off-2023-11-17/> (“The company believes the chip ban might materially and adversely affect its ability to offer products and services in the longer term. But (it) also points to the increasing importance of retaining the cloud unit given the surging demand for AI computing in China,” according to an analyst.); Alexandra Alper, Karen Freifeld & Stephen Nellis, *Biden cuts China off from more Nvidia chips, expands curbs to other countries*, REUTERS, Oct. 17, 2023, <https://www.reuters.com/technology/biden-cut-china-off-more-nvidia-chips-expand-curbs-more-countries-2023-10-17/>.

<sup>183</sup> See, e.g., Adam Minter, *What's Wrong With China's National Champions?*, BANGKOK POST, Mar. 5, 2019, <https://www.bangkokpost.com/opinion/opinion/1639294/whats-wrong-with-chinas-national-champions-> (describing Alibaba as “China’s most famous national champion”); Jeffrey Melnik, *China's “National Champions”: Alibaba, Tencent, and Huawei*, 24(2) EDUC. ABOUT ASIA 28, 30 (2019) (“While not state-owned, Alibaba still finds itself like other private Chinese tech companies deeply involved with the government as one of its national champions.”). See also U.S. CHAMBER OF COMMERCE, *MADE IN CHINA 2025: GLOBAL AMBITIONS BUILT ON LOCAL PROTECTIONS* (2017) (“MIC [Made In China] 2025 arguably represents the latest far-reaching industrial policy on a continuum of such policies to develop not only national champions but global champions.”); TOM WHEELER, *DIGITAL COMPETITION WITH CHINA STARTS WITH COMPETITION AT HOME* (2020), available at [https://www.brookings.edu/wp-content/uploads/2020/04/FP\\_20200427\\_digital\\_competition\\_china\\_wheeler\\_v3.pdf](https://www.brookings.edu/wp-content/uploads/2020/04/FP_20200427_digital_competition_china_wheeler_v3.pdf) (“The United States and China are engaged in a technology-based conflict to determine 21st-century international economic leadership. China’s approach is to identify and support the research and development efforts of a handful of ‘national champion’ companies.”).

<sup>184</sup> WING THYE WOO, *CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT: 1978–2018* 649 (Ross Garnaut, Ligang Song, & Cai Fang eds., 2018) (“Because learning-by-doing is an irrefutable phenomenon, it is often used to justify the use of import restrictions to induce the establishment of a targeted new industry. Such examples abound in China: China’s ban on Google created Baidu, its ban on Twitter created Weibo, its ban on WhatsApp created WeChat, its ban on PayPal created Taobao and its ban on eBay created Alibaba. While these bans are bad for those US companies, they could have increased consumer surplus worldwide because it is now commonly acknowledged that the services provided by WeChat and Alibaba are at least as good as those of WhatsApp and Amazon.”).

<sup>185</sup> See *Best Global Brands 2023*, INTERBRAND, 2023, <https://interbrand.com/best-brands/> (it appears that only two PRC companies made the Interbrand Top 100 brands list for 2023, Xiaomi (#87) and Huawei (#92)).

<sup>186</sup> See *supra* \_\_\_\_.

clear solution on the horizon. Without broader PRC reforms to cement the positions of both foreign investors and domestic founders, both groups are now aware that their success exists only at the whim of the PRC government, and thus even an apparent return to the treatment of the 2000s or 2010s may seem less stable and engender less trust than it did in those prior eras.

Compounding these issues, the PRC's broader regulatory crackdown comes at a problematic time for the Chinese economy. Following economic shocks from COVID and associated harsh government lockdowns, the Chinese economy continued to struggle after pandemic restrictions lifted as it confronted high levels of youth unemployment, a declining stock market, and debt and real estate crises.<sup>187</sup> The PRC's consumer confidence index dropped from the 120s at the start of 2022 to the 80s before the government stopped reporting it in 2023,<sup>188</sup> and the government has recently tried to crack down on public criticism and discussion of the country's economic woes.<sup>189</sup> New FDI could offer a lifeline that helps the PRC out of this economic quagmire, but with the many concerns about government intervention and hostility to foreign investors, 2023 saw the lowest foreign investment in the PRC since 1991.<sup>190</sup>

This sharp decline raises the question of whether the PRC can win back foreign investors, not only to Alibaba and Ant but to the PRC in general. Doing so certainly has value to the PRC and is a stated goal of the government,<sup>191</sup> but convincing investors would require a credible

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<sup>187</sup> Daisuke Wakabayashi & Claire Fu, *A Crisis of Confidence Is Gripping China's Economy*, NEW YORK TIMES, Aug. 25, 2023, <https://www.nytimes.com/2023/08/25/business/china-economy-confidence.html>. See CHUNLAI CHEN, CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT: 1978–2018 605 (Ross Garnaut, Ligang Song, & Cai Fang eds., 2018) (discussing the economic benefits of FDI for China: increased employment and labor demand, increased total output, increased capital formation, technology transfer and human capital augmentation, and increases in firm productivity and efficiency).

<sup>188</sup> See Daisuke Wakabayashi & Claire Fu, *A Crisis of Confidence Is Gripping China's Economy*, NEW YORK TIMES, Aug. 25, 2023, <https://www.nytimes.com/2023/08/25/business/china-economy-confidence.html>.

<sup>189</sup> Daisuke Wakabayashi & Claire Fu, *China's Censorship Dragnet Targets Critics of the Economy*, NEW YORK TIMES, Jan. 31, 2023, <https://www.nytimes.com/2024/01/31/business/china-censorship-economy-markets.html>.

<sup>190</sup> See Reuters, *Foreign investment flows into China shrink 19.9% in Jan-Feb*, REUTERS, Mar. 22, 2024, <https://www.reuters.com/markets/asia/foreign-investment-flows-into-china-shrink-199-jan-feb-2024-03-22/> (“A series of prolonged regulatory crackdowns on sectors from technology to education have also rattled domestic and foreign investors, adding to unease over policy transparency in China. U.S. Commerce Secretary Gina Raimondo said last year that American businesses had told her that China was becoming ‘uninvestible.’”); Ajay Shamdasani, *China: Foreign Direct Investment Hits 30-Year Low*, GLOBAL FINANCE, Apr. 2, 2024, <https://gfmag.com/economics-policy-regulation/china-foreign-direct-investment-hits-30-year-low/> (analyst described “‘long-run state planning’ as the culprit... ‘The collapse wasn’t a matter of ‘if’ but ‘when.’”). The timing of the FDI decline suggests that a worsening climate for foreign investors may only be part of the explanation for decreasing investment. Net foreign investment saw its most dramatic decline between 2022 and 2023 rather than following the initial crackdown in 2020, though investment had been declining for some time before that. See *Foreign direct investment, net inflows (% of GDP) – China*, WORLD BANK, <https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS?locations=CN>; *China Foreign Direct Investment*, CEIC, <https://www.ceicdata.com/en/indicator/china/foreign-direct-investment>.

<sup>191</sup> See Zhong Nan, *Country vows to create more opportunities for investors*, CHINADAILY.COM.CN, Mar. 27, 2024, <http://www.chinadaily.com.cn/a/202403/27/WS6602f3a1a31082fc043becbb.html> (senior government officials promise to “further shorten the negative list for foreign investment access and create a level playing field for domestic and foreign businesses” and make efforts to “resolve the concerns of global investors.”); Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS 16 (Dec. 2017), [https://www.cii.org/files/publications/misc/12\\_07\\_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf](https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies%20and%20the%20VIE%20Structure.pdf) (“Addressing the 19th Party Congress in Beijing in mid-October [2017], Chinese President Xi Jinping pledged to ‘protect the legitimate rights and interests of foreign investors’ as the country moves to open its markets. But this rhetoric does not match reality in the world’s second-largest economy as emerging Chinese companies construct this convoluted structure while the government looks the other way. Until China liberalizes its foreign investment restrictions and until the SEC achieves greater transparency for foreign investors, Chinese VIEs remain in the ‘buyer

commitment about the stability and future state of PRC law, which has always been challenging in the foreign investment space. Assuming that PRC leaders remain interested in the economic benefits of a return to higher levels of FDI,<sup>192</sup> the best path forward would be reducing uncertainty around the legality of foreign investments and the scope of regulatory intervention in invested companies and industries. Although Alibaba achieved one of the most successful IPOs in history using the VIE structure, Ant was treated less kindly, and it is time to retire the structure and associated uncertainty that come from violating the spirit of the PRC's FDI restrictions. The best way to do so is for the PRC to liberalize its foreign investment rules to allow for more direct investment in strategically important industries, or to significantly narrow its "Negative List" of restricted industries.<sup>193</sup> Instead, the PRC seems to have done the reverse, continually threatening VIE structures and intervening more in the technology sector, in part in response to parallel protectionism from America.<sup>194</sup> If the PRC does not want to engage in broad changes to its FDI regime, it could go part way to assuaging investor concerns by reinforcing status quo workarounds (like VIEs), either by explicitly endorsing them in at least one court decision (as the PRC legal system does not include binding precedent, such a decision would not be as strong as changing underlying laws but would certainly bolster investor confidence) or by restructuring supporting legal mechanisms such as allowing for international arbitration or asset seizures of unrelated PRC assets for contractual violations. Such actions could begin the process of rebuilding foreign investor trust in VIEs and PRC regulators but would not remove the risk of another government reinterpretation and crackdown.

In the absence of legal changes, investors will be forced to continue to rely on unofficial workarounds and self-help strategies to protect their investments as they have done since 1979. Actions like attempting to align ListCo and PRC founder incentives and crafting favorable dispute resolution and contract terms may help around the margins but can only go so far, as lost investment value and consequent declines in FDI show.<sup>195</sup> However, investors and founders who can be creative and align their interests with the government (who hold the ultimate trump card in disagreements between themselves, foreign investors, and founders) may be able to protect those

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beware' corner of global capital markets." Note that the PRC has changed its FDI laws since the time this was published but not in the way that CII wanted to make VIEs unnecessary. *C.f.* Abby Lemert & Eleanor Runde, *China Considers Ban on Overseas Tech IPOs*, LAWFARE, Sept. 10, 2021, <https://www.lawfaremedia.org/article/china-considers-ban-overseas-tech-ipos>.

<sup>192</sup> This is no guarantee, as PRC leadership may decide that trading off FDI and economic progress for control over private sector leaders and businesses is worth it, as seems to have happened in the last few years. Parallel discussions are occurring in the US over whether to ban TikTok (effectively restricting foreign investment in a major company operating in an industry that would be on the PRC's negative list). *But see supra note \_\_\_\_* highlighting ongoing government interest in reviving FDI.

<sup>193</sup> See CHUNLAI CHEN, CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT: 1978–2018 612 (Ross Garnaut, Ligang Song, & Cai Fang eds., 2018) ("[China's] current FDI policy can be... improved, particularly in respect to transparency, market access and the protection of intellectual property rights... In terms of market access, although [a 2017 reform] signals an attempt to build a friendlier investment environment for foreign investors in China, it does not remove as many restrictions as those investors had hoped.").

<sup>194</sup> See Sapna Maheshwari & Amanda Holpuch, *Why the U.S. Is Weighing Whether to Ban TikTok*, THE NEW YORK TIMES, Mar. 12, 2024, <https://www.nytimes.com/article/tiktok-ban.html>.

<sup>195</sup> See recommendations from Li Guo, *Chinese Style VIEs: Continuing to Sneak under Smog?*, 47 CORNELL INT'L L.J. 569, 601–606 (2014) (e.g., "Binding the participating parties by establishing mutual interest and fiduciary duty would reduce the incentives for Chinese founders to walk away or even steal and sabotage the arrangement. If the disagreement seems unavoidable, then it would also be helpful to ensure that there are WFOE-friendly provisions for resolving disputes.").

interests by making the costs of a policy change unpalatable to the government.<sup>196</sup> Doing so is usually challenging, but creative parties, like those that brought the PRC's sovereign wealth fund in as an investor in Alibaba's ListCo may be able to find solutions that tie their fates more closely to those of regulators.<sup>197</sup>

## Conclusion

The rise and downfall of Alibaba and Ant are representative of a broader conflict among PRC founders, PRC regulators, and foreign investors that governs the success or failure of FDI in China. Although each of the parties has seen periods of relative ascendancy since the beginning of modern Chinese FDI in 1979 and Alibaba's founding in 1999, the dominance by government regulators since 2020 poses significant risks to the PRC's ability to attract foreign investment. More so than other jurisdictions and sectors, foreign investment in PRC emerging technology companies like Alibaba and Ant is built on legal foundations of sand, as reliance on VIE loophole structures places investments at risk of invalidation and confiscation by a government reinterpretation of basic investment laws or expropriation by founders.<sup>198</sup> Although the VIE structure played a crucial role by enabling foreign investment to accelerate some of China's most important industries between 2000 and 2020, increasing instability means that it now serves to restrain rather than enable continued PRC growth. With the ongoing regulatory crackdown rattling the structures of foreign investment, in the absence of significant reform, the PRC's VIE foundations seem likely to crumble, leading to further flight of FDI (and potentially entrepreneurial talent) from China and causing enduring harm to its economy.

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<sup>196</sup> Though the best most parties can hope for is to slightly raise costs such that the likelihood of government intervention against the other parties' interests is reduced, not eliminated.

<sup>197</sup> See *China's CIC eyes up to \$2 bln stake in Alibaba Grp – sources*, REUTERS, May 24, 2012, <https://www.reuters.com/article/idUSL4E8GO0M4/>.

<sup>198</sup> This would not require a legal change, only an interpretive one.