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Foreword

This is the second of two issues of the *Berkeley Business Law Journal* which has published articles based on papers presented at the conferences organized by Berkeley Law School (Berkeley Law), the Faculty of Law, National University of Singapore (NUS Law), and the School of Law, Singapore Management University (SMU Law) on February 24-25, 2017 at Berkeley Law and on January 13-14, 2018 at NUS Law. These conferences were generously funded by the three universities and in particular: the Berkeley Center for Law and Business; the Centre for Asian Legal Studies (CALS) and EW Barker Centre for Law and Business (EWBCLB) at NUS Law; and, the Centre for Cross-Border Commercial Law in Asia at SMU Law. The first issue was published in the summer of 2018.

As was the case with the first issue, the articles in this issue address corporate law and governance issues from several of the world’s most important economies in the West and in Asia. An important perennial question relates to the appropriate balance of power between shareholders and directors in boards of companies, as discussed in three articles that explore specific Asian jurisdictions. Pearlie Koh in “Power Allocation and the Role of Shareholders - A Comparative Examination” argues that the allocation of power in a company between shareholders and directors is critical. In common law jurisdictions, while vesting general management power in the board of directors is usually the default position in theory and in practice, she argues that there are judicial decisions where the courts have placed limits on the shareholders to intervene in management matters, notwithstanding a constitutional provision that expressly preserves their right to intervene.

Kyung-Hoon Chun in “Multiple Derivative Actions: Debates in Korea and the Implications for a Comparative Study” discusses whether double or multiple derivative actions by shareholders is desirable in the context of Korea. Such actions could have a significant impact on the management of many unlisted subsidiaries of large corporate groups, given that many Korean *chaebols* use a multi-layered holding company structure. Derivative actions have been the subject matter of debate as a result of bills submitted to the National Assembly of Korea. Finally, Lee Pey Woan in “Dual-Class Shares in Singapore – Where Ideology Meets Pragmatism”, examines the desirability of Singapore adopting dual class shares among its listed companies on its stock exchange, with a review of the experiences of four common law jurisdictions with vibrant capital markets, viz., Canada, the United States, United Kingdom and Hong Kong, and argues whether the rationale applies to Singapore.
Further, the articles in this Issue that adopt a more comparative approach also discuss how significant Asian jurisdictions appear, at least at first glance, to have adopted corporate governance mechanisms from the United States (US), the United Kingdom (UK), or both. However, upon closer analysis these countries have made important adjustments to ensure the suitability of such mechanisms to their local contexts. Gen Goto in “The Logic and Limits of Stewardship Codes: The Case of Japan” discusses how Japan has ostensibly followed the trend in the UK by adopting a stewardship code. However, a more granular analysis reveals that the UK and Japanese codes have important differences in both their forms and functions: the UK Stewardship Code aims to restrain excessive risk-taking and short-termism by making institutional investors more responsible to the public; in contrast, the Japanese Stewardship Code aims to change the attitude of domestic institutional investors to orient Japanese corporate governance towards the interests of shareholders rather than non-shareholder stakeholders. Umakanth Varottil and Wai Yee Wan in “Hostile Takeover Regimes in Asia: A Comparative Approach” focus on the market for corporate control, which is an important corporate governance mechanism to discipline corporate managers. They argue that many of the Asian jurisdictions have drawn heavily from the US and the UK when framing their own takeover regulation. Yet, Asia differs significantly from the US and the UK, particularly in respect of the much higher concentration of shareholdings among their publicly listed companies, and their institutions supporting takeover regulation (i.e., the securities regulator, the stock exchange and the judiciary). They argue that takeover regulation in Asia must be viewed through a lens that is different from the Anglo-American approach, particularly taking into account the institutional factors that are at play when choices were (and are continuing to be) made. Christopher Chen, in “A One-Size-Fits-All Approach to Corporate Governance Codes and Compliance by Smaller Listed Firms: An Examination of Companies Listed in Hong Kong and Singapore” discusses Hong Kong’s and Singapore’s adoption of the corporate governance code, which is based on the UK Corporate Governance Code. He examines the impact of a “one-size-fits-all” corporate governance code and argues that it may not be suitable for smaller listed firms, which have fewer resources to hire more qualified independent directors for their boards and board committees.
We thank the *Berkeley Business Law Journal* for their superb editorial work. We hope you enjoy reading the articles as much as the authors enjoyed writing them.

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Hostile Takeover Regimes in Asia: A Comparative Approach

Umakanth Varottil*

Wai Yee Wan**

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The ideas in this article emanate from UMAKANTH VAROTIL & WAI YEE WAN, COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES (CAMBRIDGE UNIVERSITY PRESS 2017). We are grateful to our contributors from that project including Juan Chen, David Donald, Robin Huang, Masafumi Nakahigashi, Dan Puchniak and Hyeok-Joon Rho who provided valuable insights on six jurisdictions in Asia upon which we base our findings. We thank Xingxing Li and the participants at the US-Asia Comparative Corporate Governance Conference in February 2017 at the University of California, Berkeley School of Law, including Richard Buxbaum, Stavros Gadinis, Martin Gelter, Sang Yop Kang, Manabu Matsunaka, Holger Spamman and David Zaring for their helpful comments, and Bryan Ching and Jerrold Soh for excellent research assistance. Umakanth gratefully acknowledges funding from the E.W. Barker Centre for Law and Business and the Centre for Asian Legal Studies, both at the National University of Singapore, and Wai Yee from the Centre for Cross-Border Commercial Law in Asia at the Singapore Management University and the Lee Foundation through the Lee Kong Chian Fund for Excellence.

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Part I: Introduction

A key corporate governance mechanism that shareholders of a company can rely on as a tool to discipline management is the market for corporate control. Where the share price is depressed because of a company’s failure to maximize shareholder returns, prospective acquirers may unlock value by acquiring the company and replacing the company’s management. In both the United States (U.S.) and the United Kingdom (U.K.), public markets are characterized by dispersed shareholdings and active markets for corporate control. However, notwithstanding the similarities in shareholder structures and systems of corporate governance, the regulation of hostile takeovers differs remarkably between the U.S. and the U.K. The U.K. adopts a strict board neutrality rule in which shareholders are the primary arbiters of the success of a takeover offer. In contrast, in Delaware, where more than 50% of U.S.

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3. The board neutrality rule, also referred to as the “no frustration” rule, provides that when a target company becomes the subject matter of a takeover, the board of the target must not take any action that might frustrate the offer, without first obtaining the approval of the shareholders. See Marco Ventoruzzo, *Takeover Regulation as a Wolf in Sheep’s Clothing: Taking UK Rules to Continental Europe*, 11 U. PA. J. BUS. L. 135, 141 (2008).
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Publicly traded companies are incorporated, the state company law allows the board of the target a significant (though not exclusive) say in the outcome of the takeover offer.

A. Armour and Skeel’s Theory of Interest Group Politics

In their seminal work, Armour and Skeel argue that interest group politics is the reason behind the differences in takeover regulation in the U.S. and the U.K. The U.K. system, exemplified by the City Code on Takeovers and Mergers (the “UK Takeover Code”), prioritizes shareholder protection, and is attributable to the U.K.’s self-regulatory regime and aggressive lobbying by strong institutional shareholders. In contrast, U.S. courts serve as arbiters of takeover disputes—where the judgment of corporate boards and management is given greater leeway in the determination of the interests of the company. Armour and Skeel make an important contribution by explaining that the process of takeover regulation influences the outcome or substance of the regulation. U.K. takeover regulation is shaped by institutional shareholders preempting legislative intervention while U.S. regulation is derived from judge-made case law, largely from courts in Delaware.

B. Application of Armour and Skeel’s Theory in Asia

Influential as it is, can the theory of interest group politics, and its application to takeover regulation, be extended outside of the U.S. and the U.K., particularly to their legal transplants in Asia? From a theoretical perspective, the key determinants of the outcome of takeover regulation on legal transplants is an important issue because the U.S. and the U.K. have significantly influenced takeover regulation throughout the world, including in Asia. Six of the most significant economies in Asia (China, Hong Kong, Japan, India, Korea and Singapore), which also have the largest takeover

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5. For a discussion on the scope of the powers of the board vis-a-vis the shareholders in hostile takeovers pursuant to the company law in states other than Delaware, see Michal Barzuza, The State of State Antitakeover Law, 95 VIRGINIA LAW REVIEW 1973 (2009).
6. Armour & Skeel, supra note 2, at 1781.
8. Armour & Skeel, supra note 2, at 1730.
9. However, takeover regulation in the U.S. is in part governed by the Williams Act, a federal statute. See infra note 25 and accompanying text.
markets in the region, have adopted features of the U.S. model, the U.K. model, or both. This list of jurisdictions covers the emerging economies of China and India, the leading Asian financial centers of Singapore and Hong Kong, and the established economies of Korea and Japan. This combination also includes a balanced representation of both common law (India, Hong Kong and Singapore) and civil law (China, Japan and Korea) jurisdictions, enabling us to examine the influence of legal tradition on takeover regulation. A study of takeover regulation in these six jurisdiction provides a substantial and representative understanding of takeover regulation in Asia.

Although influenced by the U.S. and U.K. models for takeover regulation, Asian countries still differ significantly from them. In particular, while in the U.S. and the U.K., most companies have dispersed share ownership, the shareholder structures in Asia tend to be far more concentrated. Moreover, the legal institutions supporting Asian takeover regulation, such as securities regulators, stock exchanges, and the judiciaries, have different approaches from those in the U.S. or the U.K. in dealing with takeover regulation. Given these fundamental differences, would the considerations that shaped the mode of takeover regulation in the U.S. or the U.K. continue to be relevant in Asia? If not, what factors uniquely stimulated the design and implementation of takeover regulation in our Asian jurisdictions? Our exploration of these questions forms the crux of this article.

A strain of existing scholarship argues that, notwithstanding these differences, Armour and Skeel’s account of takeover regulation continues to be relevant in explaining the diversity of regulatory regimes in Europe, Japan and China (with modification). However, if Armour and Skeel’s theory is correct and comprehensive, at least two puzzles remain in explaining the development of takeover regulation in Asia: (1) how Asian jurisdictions prefer a board neutrality rule rather than an approach that would favor controlling shareholders; and (2) the existence of formal convergence of regulation without necessarily extending to functional convergence.

11. In addition to concentration of shareholding, cross-shareholdings or circular shareholdings as well as pyramid holding structures may also be present. For example, in Korea, see Hyeok-Joon Rho, M&A in Korea: Continuing Concern for Minority Shareholders; Umakanth Varottil & Wai Yee Wan, Comparative Takeover Regulation: Global and Asian Perspectives, 281-83 (2017); Stephen Choi, The Future Direction of Takeover Law in Korea, 7 JOURNAL OF KOREAN LAW 25, 34-35 (2007). For India, see Marianne Bertrand, Paras Mehta and Sendhil Mullainathan, Ferreting Out Tunneling: An Application to Indian Business Groups, 117 Q. J. ECON. 121, 121-22 (2002). Moreover, apart from holding absolute control, a dominant shareholder may, in certain circumstances, be able to exercise control while holding only a fraction of the equity, through the mechanism referred to as the “controlling-minority structure” (CMS). See Sang Yop Kang, Transplanting a Poison Pill to Controlling Shareholder Regimes—Why It Is So Difficult, 33 NW. J. INT’L L. & BUS. 619, 640 (2013).

12. Ventoruzzo, supra note 3.


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C. The Two Puzzles

First, with the (at least partial) exception of Japan, the other five Asian jurisdictions are dominated by public companies with concentrated shareholdings. Institutional minority shareholders do not have the kind of clout or influence in shaping takeover regulation that is otherwise present in jurisdictions with widely-held shareholders, such as in the U.K. Yet, even though concentrated shareholding is the norm, several Asian jurisdictions (such as India, Hong Kong and Singapore) nonetheless adopt the U.K.-inspired board neutrality rule. One would expect that the controlling shareholders in Asian jurisdictions would be indifferent or would prefer the U.S. approach that favors the incumbent management or controlling shareholders.

Second, we expect some degree of functional convergence in the substantive rules among the jurisdictions that have adopted the similar processes in takeover regulation. In particular, Armour and Skeel argue that the U.S. model of judge-made law results in managers and boards prevailing in the outcome of regulation of hostile takeovers. Using the U.K. example prior to the adoption of the UK Takeover Code, they argue that a similar result can be seen when the judiciary is the arbiter of takeover disputes in hostile takeovers. Thus, we would expect jurisdictions or legal transplants that have adopted the U.S. model of takeover dispute resolution would be likely to reach the same results. However, drawing from the evidence pertaining to Asian jurisdictions (Korea, China, and Japan) that have adopted the U.S. model of settling hostile takeover disputes by the courts, we find that the legal exportation of the takeover regulation has led only to somewhat superficial formal, but not functional, convergence of regulation.

D. Limitations of Armour and Skeel’s Theory?

In reflecting on these two puzzles, we seek to answer three questions. First, who are the relevant interest groups when choices regarding the initial takeover regulation are made in the Asian economies? Second, what explains the continued functional divergence of the recipient Asian jurisdictions’ takeover laws and regulations from the laws and regulations of the exporting country, in this case the U.S. and the U.K.? Third, are there any unintended consequences of legal transplantation of the U.S. and/or U.K. model of takeover regulation in the recipient jurisdictions (the Asian economies)?

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15. Interest groups could either be institutional shareholders (for example, in the U.K.), target management (for instance, in the U.S.), or controlling shareholders, including business families and the states (in several jurisdictions in continental Europe and Asia). The role of interest groups may vary from jurisdiction to jurisdiction, and in many cases it might be difficult to identify precisely the interest groups who have influenced the shape of takeover regulation. In other cases, regulation may be driven by policy makers and academics without being resisted by the business community.
Armour and Skeel’s theory of interest group politics in takeover regulation is helpful, yet incomplete, when it is extended to the Asian legal transplants.\textsuperscript{16} The beneficial aspect of the theory is that the broader narrative on the role of the various actors in the market for corporate control may explain why the takeover rules developed in advanced economies often operate quite differently in the recipient jurisdictions based on differences in the legal institutions supporting such regulation. In addition, the theory based on the roles of the various actors in the market has the potential of explaining the differences among jurisdictions that are recipients of transplants from the U.S. and the U.K. Thus, it provides an elegant framework to examine the factors that led to the design of takeover regulation in each of the Asian jurisdictions discussed.

At the same time, there are significant limitations in applying Armour and Skeel’s theory to our Asian jurisdictions. First, substantial differences are inherent in the manner in which takeover regulation emerged in the U.S. and the U.K. on one hand, and in our Asian jurisdictions on the other. Armour and Skeel are essentially concerned with indigenous development of takeover regulation purely based on local factors, without regard for cross-country diffusion of regulations. The narrative in Asia is rather different in that the jurisdictions therein are concerned with incorporation of takeover rules from other jurisdictions and adapting them to suit local circumstances. Here, the political economy implications are felt in choices such as which established jurisdiction should one borrow takeover regulation from, and what changes or modifications need to be made to implement them in an effective manner.

Second, Armour and Skeel’s theory is developed in the context of advanced economies with dispersed shareholdings. The theory disregards the potential influence of controlling shareholders found in economies with closely-held shares. We argue that controlling shareholders play an important role in shaping the outcome of takeover regulation, and this is true of all of our six Asian jurisdictions (with the partial exception of Japan, where most of its public companies are widely held). While controlling shareholders do not find a part in the Armour and Skeel story, they play a lead role in shaping takeover regulation in Asia.

Third, and related to the above, Armour and Skeel construct their theory around two of the most active takeover markets in the world. On the other hand, Asia has witnessed a sparse incidence of hostile takeovers. The usual explanation for this phenomenon relates to the presence of concentrated shoreholdings. But, matters are more complex. Hostile takeovers have not built up substantial momentum, even in Asian jurisdictions, such as Japan, where

\textsuperscript{16} One scholar notes a similar outcome in the context of European jurisdictions, finding that the evaluation of those jurisdictions is “both consistent with and contrary to Armour and Skeel’s analysis”. See Ventoruzzo, supra note 3, at 137.
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companies are widely held. The lack of hostile takeovers does not imply that discussions of such takeovers and the target board’s role in setting up defences are irrelevant (or even less relevant) in the Asian jurisdictions. Despite the fact that there is no uniform approach in the Asian jurisdictions, the analysis undertaken in this article is imperative given that there are still occasional instances of hostile takeovers in Asia that capture a great deal of attention.

Fourth, the differing roles of the state are also relevant in the development of takeover regulation between advanced and emerging economies. In advanced economies of the U.S. and the U.K., judicial decisions and the U.K. Takeover Code have, respectively, pre-empted the need for legislation governing hostile takeovers. However, in several economies, the state often has an interest in playing a far more active role: the selection (and subsequent adaptation) of a model of regulation serves as a signal of its commitment to a free market and open economy, and displays the importance of investor protection. At the same time, the adaptation of the U.S. and the U.K. models to different Asian jurisdictions not only causes divergence among jurisdictions, but is often driven by the need of the state to play to local influences—primarily those of controlling shareholders.

In this article, we argue that takeover regulation in Asia must be viewed through a different lens altogether. Asian regulators have cross-referred, arguably excessively, to the U.S. and the U.K. while framing their takeover regulation. But, a deeper analysis of the factors that were at play when choices were (and continue to be) made will enable a more informed appreciation of the manner in which such takeover regulation is likely to be implemented.

We contribute to the existing literature on comparative takeover regulation, corporate governance and comparative law in the following respects. First, we highlight the trends in the Asian jurisdictions’ adoption of U.S. and U.K.’s takeover regulation. Despite the presence of entirely different shareholding structures and legal institutions raising significant questions about the efficacy of the transplantation of such legal frameworks. Second, we seek to extend the scope of the comparative study of hostile takeover regimes and the influence of various interest groups in shaping takeover regulation, to a wider set of jurisdictions in Asia. Third, our study is relevant to emerging countries considering reforms to takeover regulation.

The rest of the article is organized as follows. Part II discusses the existing theoretical framework in comparative takeover regulation to establish where our study fits in the scholarship relating to the political economy of takeovers..

17. It might very well be that Asia as a whole cannot be viewed through a single lens, and that there needs to be “jurisdiction-specific lenses”. For further discussion on the power of shareholders in Asian jurisdictions, see Dan. W. Puchniak, Multiple faces of shareholder power in Asia: complexity revealed, in Jennifer G. Hill & Randall S. Thomas (eds.), RESEARCH HANDBOOK ON SHAREHOLDER POWER (2015).
Part III explains why hostile takeovers are important in Asia, despite the existence of concentrated shareholdings or (in the case of Japan) stable shareholdings. Part IV examines the evolution and design of takeover regulation in each of our Asian jurisdictions, with a focus on ascertaining the possible influences of various interest groups on regulatory outcomes. Part V explores the key lessons and implications that emerge from our study of six Asian jurisdictions. Finally, part VI offers a brief conclusion.

PART II: ESTABLISHING THE THEORETICAL FRAMEWORK FOR COMPARATIVE TAKEOVER REGULATION

A. The Theory of Interest Group Politics in Takeover Regulation in the U.S. and the U.K.

In their influential work, Armour and Skeel argue that the reasons for the differences in the regulation of hostile takeovers in the U.S. and the U.K. are based on interest group politics or political economy. Specifically, the differences arise from the varying influence of powerful lobbying groups, namely the institutional shareholders in the U.K. and the firm managers in the U.S., which affect the mode and the content of the regulation. Institutional shareholders in the U.K. opted for self-regulation and collectively acted together to write the U.K. Takeover Code, where the board neutrality rule is one of the most prominent features. In so doing, they pre-empted the possibility of state-imposed or legislative measures. The U.K. also had a closely-knit body of finance and legal professionals within the City of London who were receptive to the concept of self-regulation, which is essential for the operation of the U.K. Code. Their account of takeover regulation is broadly consistent with the existing scholarship on the influence of institutional shareholders on other aspects of corporate governance. This is similar to how shareholders in the 1970s were instrumental in procuring the listing rules of London Stock Exchange, which subject all large transactions to shareholder approval.
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In contrast, in the U.S., institutional shareholders neither had the same influence nor held the same levels of stock in the publicly listed companies as those in the U.K. Instead, as Armour and Skeel argue, corporate directors and managers exerted much greater influence on the development of takeover law. 24 For example, federal legislation, principally in the form of the Williams Act of 1968, which provides for shareholder disclosure requirements and prevents bidders from using unfair or coercive tactics, was ostensibly enacted to “level the playing field” between bidders and target managers. The Act had the effect of favoring target managers. 25 Additionally, with respect to Delaware state law, corporate directors and managers litigate before the courts against hostile bidders, and through repeat litigation, are able to convince the judiciary to lay down pro-managerial decisions. 26

Armour and Skeel consider the position in the U.K. prior to the emergence of the U.K. Takeover Code to demonstrate that the process of takeover regulation affects the shape of substantive rules. 27 Prior to the U.K. Takeover Code, when the Takeover Panel did not exist, all disputes relating to takeovers were resolved before the courts. The corpus of case law from the English courts of that era shows that the courts generally upheld management’s decisions that were entered into in good faith and with a legitimate business purpose, even if such decisions had the effect of frustrating a hostile bidder. 28 Thus, they argue that “using litigation to resolve such matters involves a structural bias in favor of the directors.” 29 Accordingly, in response to the case law, institutional shareholders in the U.K. chose to band together to write the Takeover Code. 30 Institutional shareholders in the U.S., however, could not replicate the U.K.’s transition because federal legislation precluded forming such links among the institutional shareholders and pre-empted self-regulation by the market players. 31 Here, the questions are 1) whether the experiences of the U.S. and the U.K. in takeover regulation are confined to their peculiar political economy and 2) whether they can be generalized outside these two jurisdictions and applied to Asia. The next part discusses the comparative takeover scholars’ works that seek to extend the theory of interest group politics in the context of takeover regulation outside of the U.S. and the U.K.

25. Id. at 1755.
26. Id. at 1781.
27. Id. at 1782-84.
28. Id. at 1782-84.
29. Id. at 1784.
30. Id.
31. Id.
B. The Extension of Interest Group Politics outside the U.S. and the U.K. to Asia

Following Armour and Skeel’s work, comparative takeover scholars have sought to extend their theory of interest group politics outside of the U.S. and the U.K. to other tools of takeover regulation (such as the mandatory bid rule) that are beyond the regulation of hostile takeovers. For example, Ventoruzzo argues that Armour and Skeel’s narrative of takeover regulation can be broadly applied to the rest of Europe (outside of the U.K.). However, not all application has been positive. Ventoruzzo argues that the effect of the U.K.-style takeover regulation (particularly the mandatory bid rule and the board neutrality rule) has led to unintended consequences in Italy due to the varied ownership structure in that jurisdiction.32 Armour, Jacobs and Milhaupt extended the theory of interest group politics to Japan, another advanced economy, and have broadly discussed the implications for China, India and Brazil.33 In the context of emerging economies, Xi argues that the theory of interest group politics may be extended to China with modifications.34 He has used the theory to analyze the mandatory bid rule in China, and argues that in such context, the theory applies but needs refinement to take into account the state regulator’s private interests.35

However, what is missing in the current scholarship is an updated discussion on whether the interest group politics theory, which developed in the context of advanced economies of the U.S. and the U.K., can be generalized in their application to their legal transplants in significant economies within Asia (in addition to Japan and China as discussed in the literature).36 Asia is fast becoming a significant player in the global M&A market,37 and the U.S. and the U.K. have been key exporters of their mode of takeover regulation. To test out this theory, we use the case studies of our six Asian jurisdictions (Japan, Korea, China, India, Hong Kong and Singapore).

As outlined in Section I above, there are two puzzles in using Armour and Skeel’s theory to fully account for the narrative of takeover regulation in our Asian economies. First, all of the Asian jurisdictions (except for Japan) are dominated by public companies with concentrated shareholdings. Yet, most of

32. Ventoruzzo, supra note 3, at 141.
33. Armour, Jacobs & Milhaupt, supra note 2.
34. Xi, supra note 14.
35. Id.
36. On a related note, given that a decade has elapsed since the publication of Armour and Skeel’s seminal work, this may be an opportune moment to take stock of the broader implications of their theoretical framework to understanding takeover regulation as well as its application to countries around the world, and more specifically in Asia.
37. See references in Umakanth Varottil & Wai Yee Wan, Comparative Takeover Regulation: The Background to Connecting Asia and the West, in UMAKANTH VAROTTIL & WAI YEE WAN (EDS.), COMPARATIVE TAKEOVER REGULATION: GLOBAL AND ASIAN PERSPECTIVES 6-9 (2017).
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the Asian jurisdictions adopt the UK-based board neutrality rule (India, Hong Kong and Singapore) or a weaker version thereof (China and Korea), where concentrated shareholdings are the norm. Second, there is no functional convergence in the substantive rules among the jurisdictions that have adopted the same types of processes of takeover regulation.

In reflecting upon the two puzzles, we examine the demand for, and supply of, takeover regulation. The demand comes from the interest groups, including the relevant shareholders of the publicly listed companies, corporate managers and directors. The supply side comes from the institutions responsible for the enactment of the law and regulation, such as legislature, judiciary, takeover panels (or their equivalents) and other agencies (such as self-regulatory bodies comprising market participants). 38

On the demand side, the interest group politics theory, as conceptualized by Armour and Skeel, was developed with reference to advanced economies and had dispersed shareholdings in mind. Thus, the developers’ focus is on the role that the institutional minority shareholders may (or may not have) played. They did not take into account the influence of controlling shareholders, which are not as relevant in the context of the U.S. and the U.K. Yet, as demonstrated in Part III below, the influence of the controlling shareholders needs to be given adequate attention due to the predominance of these shareholders in Asia. The absence of strong minority institutional shareholders may not necessarily lead to the choice of the U.S. model. Scholars have studied the influence of the controlling shareholders in the development of a separate, but closely related rule in takeover regulation: the mandatory bid rule. In relation to India and Singapore, each of us has separately argued that controlling shareholders, whether it is the state or the family, are influential in the selection and application of the mandatory bid rule which may ostensibly favour minority shareholders in the U.K., but actually operates to reinforce control by the controlling shareholders in both countries. 39 In the case of Japan, “stable shareholders” play a significant role in maintaining incumbency within firms. 40

Often considered to carry a shareholding pattern similar to that of the U.S. and

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38. See Armour, Jacobs & Milhaupt, supra note 2, at 223-24.
39. For India, see Umakanth Varottil, The Nature of the Market for Corporate Control in India, in VAROTTIL & WAN, supra note 37, at 378. For Singapore, see Wai Yee Wan, Legal Transplantation of UK-Style of Takeover Regulation in Singapore”, in VAROTTIL & WAN, supra note 37, at 431-433.
40. See e.g., Masao Nakamura, The Security Market and the Changing Government Role in Japan, 5 ASIAN EDUCATION AND DEVELOPMENT STUDIES 388, 397-99 (2016), and discussion in Part III(D) below. Although their presence is usually counted towards dispersed shareholding in companies, the stable shareholders enjoy financial and non-financial relationships with target firms that lead them to respond to a takeover by acting in favor of management. See Dan W. Puchniak & Masafumi Nakahigashi, The Enigma of Hostile Takeovers in Japan: Bidder Beware, in VAROTTIL & WAN, supra note 37, at 252-53 (a longer version of this chapter is in publication in the form of Dan W. Puchniak & Masafumi Nakahigashi, The Enigma of Hostile Takeovers in Japan: Bidder Beware, 14 BERKELEY BUS. L.J. (forthcoming), available at https://ssrn.com/abstract=2830286).
the U.K., scholars have predicted the rise of successful hostile takeovers in Japan.\textsuperscript{41} However, their prediction has not materialized, and it would appear that there are other factors at play, particularly the presence of stable shareholders.\textsuperscript{42} These stable shareholders have an important role in influencing the outcome of the takeover contests, often in favour of directors and management.\textsuperscript{43}

We then focus on the supply side of rule production: the role of the state and the legal institutions in takeover regulation. Armour and Skeel have argued that in the U.K. and the U.S., the U.K. Takeover Code and judicial lawmaking have respectively pre-empted the requirement for legislation. However, the relatively neutral positions adopted by the U.K. and the state governments in the U.S. (with the exception of some of the states which have anti-takeover statutes)\textsuperscript{44} does not necessarily exist in many Asian economies. One possibility is that in some economies the state has a special interest in signaling its commitment to an open economy and protecting its investors.

Again, with reference to the closely connected literature on the mandatory bid rule, we have seen that emerging countries are also influenced by other interests. In China, Chao Xi has argued that the interest group theory should take into account private interests of the Chinese securities regulator in driving state-led acquisitions, as evidenced from the shift in approach in the transition from a planned economy, which is administratively-driven, to a market economy, where the securities markets play a much more important role.\textsuperscript{45} Similarly, Huang and Chen have argued that the extensive and liberal exemptions to the mandatory bid rule granted by the China Securities Regulatory Commission (CSRC) demonstrates the compromise reached: the interest of the state in encouraging takeovers and the signal from the state of its commitment to protecting minority shareholders by ensuring they obtain control.\textsuperscript{46} In Korea, the mandatory bid rule received not only opposition from

\begin{thebibliography}{9}
\bibitem{42} See Puchniak & Nakahigashi, \textit{supra} note 40, at 243-45.
\bibitem{43} Id.
\bibitem{44} For evidence that states’ anti-takeover provisions do not affect firms’ decisions to incorporate, see Marcel Kahan, \textit{The Demand for Corporate Law: Statutory Flexibility, Judicial Quality, or Takeover Protection?}, 22(2) JLEO 340 (2006).
\bibitem{45} Xi, \textit{supra} note 14.
\bibitem{46} Robin Hui Huang & Juan Chen, \textit{Takeover Regulation in China: Striking a Balance Between Takeover Contestability and Shareholder Protection}, in \textit{VAROTTIL & WAN, supra} note 37, at 222-23. \textit{See also} Wei Cai, \textit{The Mandatory Bid Rule in China}, 12 EBOR 653, 665-68 (2011). However, at the same time, we note that the liberal granting of exemptions by CSRC may simply reflect the fact that the mandatory bid rule is not enforced in China and that such exemptions may ultimately harm minority shareholders. As such, these exemptions may not conclusively indicate that the CSRC is protective of shareholders’ interests. We are indebted to Xingxing Li for drawing our attention to the alternative interpretation of the grant of exemptions to the mandatory bid rule.
\end{thebibliography}
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Korean entrepreneurs, but also the International Monetary Fund and International Bank for Reconstruction and Development, for blocking takeover bids of financially distressed firms. As a result, the rule, which was enacted in 1997, was repealed soon after in 1998 in the wake of the Asian financial crisis.

Having considered the existing literature on comparative takeover regulation, we now explain how our study fits into and extends the same. First, our study contributes to the determinants of takeover regulation in Asia, which have, until recently, received very little attention from a broader comparative perspective. Second, our study offers a cautionary tale on the unintended consequences of legal transplantation. It is a truism that any choice of legal rule or reform must be sensitive to local conditions and should take account of different implementing environments. Legal concepts tend to behave differently in diverse jurisdictions and importing a new concept may have unintended consequences for law as a whole. Thus, we show that the adoption of one aspect of takeover regulation, hostile takeovers, may not actually have the intended effect because of the absence (or presence) of other legal institutions. Third, our study offers some lessons relating to the "legal origins" strain of literature, which proffers that the degree of investor rights are influenced by the legal tradition of the countries and outside interest group politics. We argue that at least in the context of takeover regulation, the legal origins hypothesis has no support given that countries do change their regulation over time.

47. Rho, supra note 11, at 293. See also Hwa-Jin Kim, The Market for Corporate Control in Korea, in HWA-JIN KIM (ED.), KOREAN BUSINESS LAW (2012).
48. See VAROTIL & WAN, supra note 37.
51. See generally, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, Legal Determinants of External Finance, 42 J. FIN. 1131 (1997); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, Law and Finance, 106 J. POL. ECON. 1113 (1998); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, Corporate Ownership Around the World, 54 J. FIN. 471 (1999); and Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert Vishny, Investor Protection and Corporate Governance, 58 J. FIN. ECON. 3 (2000) (attributing the scope of the capital market to the type of legal system used in a country and the level of legal protection for investors: common law countries have the strongest legal protections of investors, while civil law countries have the weakest protections).
PART III: WHY REGULATION OF HOSTILE TAKEOVERS MATTERS IN ASIA

A. Ownership Patterns and Hostile Takeovers

An active hostile takeover market can prevail only if two key elements are present: (1) a favourable shareholding structure and (2) depressed share prices relative to the asset values. The latter is largely a function of the markets and business cycles. While the shareholding structures of companies within Asian economies are largely concentrated, we argue that having an optimal takeover regulation matters for several reasons.

First, as the literature on shareholding structures in Asia points out, widely-held companies do exist in these jurisdictions and are vulnerable to hostile takeovers. In other words, it is not the overall concentration of shareholdings in a jurisdiction that matters, but the individual, granular, company-specific approach that is important. Even though shareholdings on average may be concentrated (particularly in comparison with the Anglo-American situation), individual companies may be dispersedly held, thereby exposing them to the specter of a hostile takeover. A regime on hostile takeovers will likely affect a non-trivial number of firms in Asia.

Second, even in the case of controlled companies, if there is more than one significant blockholder and no single blockholder controls a majority of the voting shares, the company continues be exposed to hostile takeovers. As shown in sub-part 2 below, the number of such companies is significant in Asia.

Third, there is some evidence of gradual diffusion of shareholdings, which makes it vital to attain the optimal balance of takeover regulation before the market players’ interests become too vested in a diffused shareholders’ model. Despite the lack of evidence of a vibrant market for corporate control in Asia and pessimism for such a market in the future, it would be imprudent for

52. See Armour, Jacobs & Milhaupt, supra note 2, at 222.
53. John C. Coffee, Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer’s Role in Corporate Governance, 84 COLUM. L. REV. 1162, 1163 (1984) (explaining the disciplinary hypothesis where bidder pays a premium over market price because the assets are not optimally utilised).
54. See e.g., Robin Huang Robin Huang & Juan Chen, The Rise of Hostile Takeovers and Defensive Measures in China: Comparative and Empirical Perspectives, EUROPEAN BUSINESS ORGANIZATION LAW REVIEW (forthcoming) (copy on file with the authors).
55. The literature on shareholding structures in all of our Asian jurisdictions in the context of takeover regulation can be found in VAROTTIL & WAN, supra note 37. For China, see Huang & Chen, supra note 46, at 214-16; for Japan, see Puchniak & Nakahigashi, supra note 40, at 250; for Korea, see Rho, supra note 11, at 281-83 (on the use of controlling minority shareholder structures among the chaebols or conglomerates owned by controlling family members); for India, see Varottil, supra note 39, at 373-77; for Hong Kong, see David C. Donald, Evolutionary Development in Hong Kong of Transplanted UK-Origin Takeover Rules, in VAROTTIL & WAN, supra note 39, at 391-93; for Singapore, see Wan, supra note 39, at 428-31.
56. Wan, supra note 39, at 420.
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policymakers and regulators to assume a continuation of the status quo. They must instead maintain a state of preparedness by designing a hostile takeover regime that bears clarity and certainty.

B. Widely-held Companies and Evidence of Ownership Dispersion

When ownership is dispersed in companies, they could become vulnerable to hostile takeovers.57 Although widely-held companies are not the norm in Asia, they do exist. In a study by Carney & Child of widely-held companies in East Asia (that excludes India and China),58 as of 2008, Japan has the largest number of widely-held corporations (57.4%) followed by Korea (28.9%).59 Singapore and Hong Kong have among the lowest number of widely-held corporations, at 8.4% and 6.3% respectively.60 Carney & Child’s findings are generally consistent with those presented in Comparative Takeover Regulation.61

We now turn to India and China. In India, Varottil has found there are companies within the three major indices—the CNX Nifty, the CNX 100, and the CNX 500—in which either the controlling shareholders hold less than 25% or they have no controlling shareholders and are thereby exposed to hostile takeovers.62 These companies comprise 16% of the companies in the CNX Nifty, 9% of companies in the CNX 100, and 6% of companies in the CNX 500.63 The larger companies in the CNX Nifty are more likely to be widely-held, as compared with the smaller companies. With the preliminary indications of some dispersion of shareholdings and greater participation by outside shareholders, this could render the issue of hostile bids more important.64

In China, the level of ownership concentration, which was predominantly held by the state, has been reduced ever since the 2005 Share Split Reform

57. Milhaupt, In the Shadow of Delaware?, supra note 41, at 2184, predicting the rise of hostile takeovers with the declining concentration of the shareholdings in Japanese listed companies (the shareholdings were previously concentrated in the hands of financial institutions).
58. Richard Carney & Travers Child, Changes to the ownership and control of East Asian corporations between 1996 and 2008: The primacy of politics, 107 J. FIN. ECON. 494 (2008). The study was performed with reference to the largest 200 companies in East Asian countries by market capitalization for which the ultimate ownership can be traced (and this study includes all of our Asian countries, except for India and China).
59. Id. at 505 (Table 4, Panel A (at the 10% cutoff level)). In their study, widely held companies are companies which have no controlling shareholders, defined at the levels of 10% or 20% of the voting rights. The number of companies for each country, however, differs as only the companies whose ultimate ownership can be traced are in the sample. For other studies on the dispersion of shareholdings in Japan, see Puchniak & Nakahigashi, supra note 40, footnote 2.
60. Id., at 505.
61. See supra note 55.
62. Varottil, supra note 39, at 376. The three indices represent the top 50, top 100 and top 500 companies respectively in terms of market capitalization among those listed on the National Stock Exchange of India Limited. Id.
63. Id.
64. Id. at 377.
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[Guquan Fenzhi Gaige].\(^{65}\) The average concentration of shareholding has reduced from over 40% in 2004 to 36% in 2014.\(^{66}\) Even in China, where hostile takeovers are thought to be difficult to achieve,\(^{67}\) the hostile battle for control of Vanke, the largest property developer in China, demonstrates the possibility of a widely-held company being targeted for hostile bids.\(^{68}\) The Vanke takeover contest is significant for several reasons: (1) it is the most recent high-profile case in Asia; (2) it demonstrates the peculiar nature of hostile takeovers in Asian jurisdictions; and (3) it draws attention to the somewhat unconventional defensive tools employed by companies to fend off raiders.

Prior to 2015, Vanke was a widely-held corporation, with a state-run conglomerate, China Resources, as its largest shareholder, holding 17%.\(^{69}\) However, by December 2015, the Baoneng group, a much lesser-known private firm, amassed shares in Vanke and increased its stake to 24.4%, surpassing the shares held by China Resources.\(^{70}\) Vanke’s management promptly declared the share acquisitions by Baoneng to be unwelcome.\(^{71}\) Vanke began undertaking defensive measures by calling for a trading suspension and declaring Anbang, an insurer that held 7.0%, to be a white knight.\(^{72}\) However, Anbang’s support was insufficient due to the limited number of shares it held.\(^{73}\) During the six-month trading suspension in the Vanke stock in the first half of 2016, the company found another white knight, Shenzhen Metro, a property conglomerate.\(^{74}\) Vanke proposed issuing shares to Shenzhen Metro in exchange for the injection of its assets to make Shenzhen Metro its largest shareholder, thereby massively diluting Baoneng and China Resources’ shares.\(^{75}\) Unsurprisingly, both Baoneng and China Resources opposed the transaction and Vanke ultimately withdrew its plans because of the strong shareholder opposition.\(^{76}\) Meanwhile, in June 2016, Baoneng openly demanded the removal

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\(^{65}\) Huang & Chen, supra note 46, at 215; Robin Huang Robin Huang & Juan Chen, The Rise of Hostile Takeovers and Defensive Measures in China: Comparative and Empirical Perspectives, EUROPEAN BUSINESS ORGANIZATION LAW REVIEW (forthcoming) (copy on file with the authors).

\(^{66}\) See id. at Table 1.

\(^{67}\) Id.


\(^{69}\) Tom Mitchell & Ben Bland, Vanke’s Tussel Points to China’s First Hostile Takeover Battle, FINANCIAL TIMES (Dec. 28 2015).

\(^{70}\) Id. (table showing Vanke’s largest shareholders as at Dec. 18, 2015 wherein China Resource’s shareholding was at 17.3%).

\(^{71}\) Zheng Yanping, Rivals Set to Boost Holdings in Vanke, SOUTH CHINA MORNING POST (Aug. 16, 2016).

\(^{72}\) Id.

\(^{73}\) Id.

\(^{74}\) The Five Things, supra note 68.

\(^{75}\) Id.

\(^{76}\) China Vanke Drops White Knight Rail Deal, FINANCIAL TIMES (Dec. 19, 2016).

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of the founder-director and other board members of Vanke because of over-compensation.\textsuperscript{77}

When Vanke shares’ trade suspension period ended, Baoneng raised its stake to 25%.\textsuperscript{78} In August 2016, a new player, Evergrande Group, joined in the potential takeover fray when it purchased a 4.7% stake in Vanke, which then increased to 14.1% in November 2016.\textsuperscript{79} Ultimately, the Chinese securities regulator stepped in and criticized the acquirers who had participated in highly leveraged takeover activities.\textsuperscript{80} In December 2016 and January 2017, Evergrande and Baoneng both declared that they had no intentions of taking over Vanke.\textsuperscript{81} The Chinese insurance regulator intervened as both Evergrande and Baoneng had utilized their insurance arms to finance highly leveraged takeovers.\textsuperscript{82} It banned Baoneng chairman Yao Zhenhua from the insurance industry for 10 years and Evergrande Life, Evergrande’s insurance arm, from investing in stocks. Consequently, in March 2017, Evergrande Group transferred the voting rights in Vanke to Shenzhen Metro for a year,\textsuperscript{83} and in June 2017, ultimately sold its shareholdings to Shenzhen Metro.\textsuperscript{84} Those voting rights, together with the sale of the shares by China Resources to Shenzhen Metro and other acquisitions, meant that Shenzhen Metro held 29.4% of Vanke, surpassing Baoneng’s shareholding.\textsuperscript{85}

While the takeover ended with regulatory intervention and without either Baoneng or Evergrande succeeding, the case illustrates how a widely-held company was vulnerable to takeovers. The company did not have any embedded takeover defenses in its constitution, and the only available defense was finding a white knight.\textsuperscript{86} Ultimately, unorthodox tools such as trading suspension,\textsuperscript{87} intervention by the Chinese regulators, and the assumption of control by a Chinese state-owned enterprise helped the target stave off a hostile

\textsuperscript{77} Id.
\textsuperscript{78} The Five Things, supra note 68.
\textsuperscript{79} Id.
\textsuperscript{80} Id.
\textsuperscript{81} Vanke’s Year at War, SCMP (Dec. 24, 2016); Vanke Sues Over ‘Invalid’ Baoneng Stake, SCMP (Feb. 8, 2017).
\textsuperscript{83} Shenzhen Metro Set to Become Vanke’s Largest Shareholder, SCMP (June 7, 2017).
\textsuperscript{84} Shenzhen Metro to Become Biggest China Vanke Shareholder as Evergrande Cashes Out, SCMP (Jun. 9, 2017).
\textsuperscript{85} Shenzhen Metro to Raise Stake in China Vanke to Nearly 30% with $4bn Share Purchase From Evergrande, FINANCIAL TIMES (Jun. 12, 2017).
\textsuperscript{86} Huang & Chen, supra, note 66.
acquirer. These are entirely incongruent with the classic scenarios played out in hostile takeovers in the U.S. and the U.K. 88

C. Presence of More than One Significant Shareholder

Majority-controlled companies and dispersedly held companies are not the only forms of companies. Other intermediate forms of shareholding exist as well. If there is more than one significant shareholder and no single shareholder controls a majority of the voting shares in a company, the presence of more than one blockholder will make it difficult for any single blockholder to control the board.

There is evidence that such companies exist in almost all of the Asian jurisdictions examined in this article. In India, the companies in the three major indices 89 show that there are a number of companies where the controlling shareholders hold less than a majority of shares, but outside shareholders or groups of shareholders hold at least 15% shares in the aggregate, with each individual shareholder or group holding at least 5%. 90 They constitute 12% of companies in the CNX Nifty, 15% of companies in the CNX 100 and 27% of companies in the CNX 500. 91 Despite the presence of controlling shareholders, such companies may be exposed to unwelcome acquirers.

In Singapore, the data from Carney & Child show that, as of 2008, 75.9% of the listed companies in Singapore have the presence of a single ultimate owner. 92 There still remains a significant proportion of companies with no single ultimate owner, for which an acquirer may still be able to succeed in a takeover offer that is opposed by some large shareholders. Thus, the board neutrality rule will limit the potential for these large shareholders to procure the board to prevent bona fide bids from succeeding; this fills a regulatory gap by benefitting non-controlling shareholders, even among companies not regarded as widely held.

88. While the U.K. takeover regulation constrains the ability of boards to maneuver around a hostile takeover offer, Delaware law offers target boards considerable wiggle room to fend off such an offer. See Armour & Skeel, supra note 2 at 1727. For instance, see KRAFT’S SUCCESSFUL TAKEOVER OF CADBURY IN THE U.K., DAVID KERSHAW, PRINCIPLES OF TAKEOVER REGULATION 117-20. For the U.S., courts have circumscribed the discretion available to target’s boards. See e.g., UNOCAL CORP. V. MESA PETROLEUM CO., 493 A.2d 946 (Del. 1985).

89. See supra note 62.

90. Varottil, supra note 39, at 377.

91. Id.

92. Carney & Child, supra note 58, at 508 (Table 8). Following Stijn Claessens, Simeon Djankov & Larry H.P. Lang, THE SEPARATION OF OWNERSHIP AND CONTROL IN EAST ASIAN CORPORATIONS, 58 J. FIN. ECON. 81, 93 (2000), companies with single ultimate owners are defined as companies where (a) there is a single owner who has majority control or (b) there is a single owner holding at least 10% of the voting rights and there is no second shareholder holding at least 10%. In the case of (b), if there is a second shareholder that holds at least 10%, it may be more difficult for the first owner to control the board.
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D. Ownership and Control in the Future

As we have seen, hostile takeovers are a distinct possibility in Asia if the shareholding changes continue to move in the direction of greater dispersion. While Hong Kong and Singapore have demonstrated greater concentration in the ownership of shares, China and India have seen greater shareholder dispersion in recent years. It would be critical to put in place an optimal takeover regulatory framework before shares become more widely dispersed and controllers begin to exercise their vested interests in retaining control. Because there are only a small of companies subject to hostile bids, regulators can have more leeway in determining the appropriate legal framework. A U.K.-based board neutrality rule or a rule that limits takeover defenses will be difficult to be put in place once a large number of companies are potentially subject to hostile bids and the insiders view the rule as a threat to their continued survival. The concern is not trivial. Huang and Chen report that after the attempted hostile attempt by Baoneng to acquire Vanke, up to 20 companies have put in place anti-takeover provisions in their constitutions by August 2016 to repel future hostile acquirers. Although it would be difficult to generalize in the broader Asian context, there could be a real threat real for a handful of companies that are exposed to hostile takeovers.

Other factors also play a role in determining the future of hostile takeovers and their regulation in Asia. Japan represents a unique case and serves as an illustration on the political force of labour and why timing may matter. Puchniak and Nakahigashi have demonstrated that labour is a powerful political force, and employee protection (not least in the form of the life-time employment phenomenon that marks the Japanese corporate landscape) has been an important force that influences the stable shareholders to be in their side. Thus, even for the rest of Asia, if hostile takeovers are seen as precursors for widespread layoff, it may be difficult for the regulators to implement a board neutrality rule that enables a free market for corporate control. While it can be argued that the protection of stakeholders, including employees, can be analytically separate from the regulation of hostile bids, Japan has shown that both facets of the policy are perceived as closely linked.

93. For Hong Kong, see Donald, supra note 55, at 392; for Singapore, see Wan, supra note 39, at 431-433.
94. For China, see Huang & Chen, supra note Error! Bookmark not defined., Figures 1 and 2; for India, see Varottil, supra note 39, at 375-76. At the same time, it is necessary to note that the available empirical evidence is not conclusive, nor does it suggest an irreversible trend that ownership will continue to become dispersed over time.
96. Puchniak & Nakahigashi, supra note 40, at 274-77.
together politically. In that sense, elements of corporate culture have an important role to play in the design and implementation of takeover regulation.  

In this section, we considered the shareholding structures in Asia and debated the possibility of hostile takeovers in the region. Now, we analyze the evolution of takeover regulation in our six Asian jurisdictions by examining various factors, including interest group dynamics, which have been responsible for giving shape to the regulation. This will enable us to analyze the broader trends in Asian takeover regulation.

**PART IV: EVOLUTION AND DESIGN OF HOSTILE TAKEOVER REGIMES IN ASIA**

In this Part, we analyze the broad contours of takeover regulation in Asian jurisdictions to identify patterns that may exist. In doing so, we also adopt the approach of Armour and Skeel in ascertaining the rule making process in each of the jurisdictions as a means to help explain the substantive regulatory outcomes. Such an analysis will also illuminate our understanding of the political economy of takeover regulation in those jurisdictions by studying the influence of various interest groups.

Interestingly, the legal transplants from the Anglo-American jurisdictions into Asia have followed a discernible pattern, as we seek to demonstrate in this Part. Our civil law jurisdictions in Asia, specifically, China, Japan and Korea, have adopted their regulations governing hostile takeovers either solely from the U.S. (Delaware) or through a combination of the U.S. and the U.K. modes of regulation (with greater emphasis on the U.S. approach). This not only includes granting freedom to the target boards to devise defensive mechanisms, at least to some extent, but it also relies heavily on the courts to monitor management conduct. On the other hand, our common law jurisdictions, particularly India, Hong Kong and Singapore, have largely embraced the U.K.’s strict board neutrality rule, which leaves the target’s board powerless in the wake of a hostile takeover offer. Instead, it confers the sole decision-making power upon the shareholders. Moreover, these jurisdictions drastically limit the role of the courts in resolving takeover disputes, and instead rely upon a takeover panel or the securities regulator to perform that role.

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97. For the role of culture in takeover regulation in specific Asian jurisdictions, see Huang & Cheng, supra note 46, at 225 (for China); Puchniak & Nakahigashi, supra note 40, at 274-77.
98. See also Ventoruzzo, supra note 3, at 136.
99. Somewhat similar trends have been found in relation to shareholder derivative actions. See Dan W. Puchniak, The Derivative Action in Asia: A Complex Reality, 9 BERKELEY BUS. L.J. 1 (2013).
100. Here, we seek to clarify that the civil law – common law dichotomy plays out somewhat differently in the context of takeovers. Although some countries in Asia are generally categorized to be under the civil law system and others under the common law heritage, the manner in which takeover laws are developed and implemented in these jurisdictions is somewhat ambiguous. For example, all jurisdictions in Asia (regardless of the lineage of their legal system) seem to have drawn to varying
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A study of the nature of regulation as well as the evolution of the takeover regimes in each of our jurisdictions will help explain the factors that led to these patterns and provide indications regarding the outcome of takeover regulation and the path that is likely to be taken in the future. We begin with our civil law jurisdictions, and then deal with the common law jurisdictions.

A. The Adoption of Hybrid Regulatory Mechanisms into Civil Law Asia

Our civil law Asian jurisdictions have substantially looked to the U.S. (Delaware) to draw inspiration for devising methods to deal with hostile takeovers. There is minimal cross-referencing to U.K. law. As a result, the incumbents (i.e., managers and controlling shareholders) are equipped with powers to overcome unwelcome raids on their companies. In these regimes, the incumbents have not simply relied on concentrated shareholdings or, in the case of Japan, the support of stable shareholders, but instead have preferred to incorporate explicit defensive mechanisms as well as board freedom (in some cases, subject to concurrence of shareholders) to respond to hostile offers. However, as we argue in this Part, our civil law jurisdictions have extracted their regulatory principles and mechanisms from the Anglo-American viewpoint only at a formal level, and that there has not been any form of convergence from a functional perspective. This is a result of the interplay of various dominant influences, not least from the controlling shareholders and managers. In developing our arguments further, we explore some key features of takeover regulation in China, Japan and Korea, examine the manner in which they are enforced, and then comment on their impact on interest groups, primarily controlling shareholders and managers.

1. Limited Applicability of the Board Neutrality Rule

As we have seen, the board neutrality rule is the staple ingredient in the regulation of hostile takeovers in the U.K., while it is absent in the U.S. Among our civil law jurisdictions in Asia, only China has imposed a form of board neutrality rule. China’s implementation of the rule has some superficial

degrees from the U.S. and the U.K., both of which are categorized as common law jurisdictions for purposes of corporate law. See La Porta, et. al., Law and Finance, supra note 51, at 1130. Hence, although we have made the civil law – common law distinction while discussing our jurisdictions in this Part, we draw readers’ attention to the fact that the division might amount to one that is more of convenience rather than strict principle.

101. This Part explores in detail the extent of power given to target’s boards, and how they are, in certain cases, circumscribed by the need to adhere to the will of the shareholders.

102. Supra Part IIA.

103. Shangshi Gongsi Shougou Guanli Banfa, Measures for Regulating Takeovers of Listed Companies, 2006 Takeover Measures (promulgated by the China Securities Regulatory Commission on 31 July 2006 and effective from 1 September 2006, amended in 2008, 2012, and 2014), art. 33. Some have argued that this is due to Chinese takeover regime’s historical links with the U.K. Takeover Code through Hong Kong, as several members of the drafting committee of the regulations looked to Hong
similarities to the U.K.’s position, but there are significant differences. For example, in China, a board’s defensive measure is proscribed only if it results in any significant effect on the assets, liabilities, entitlements or business performances of the company. Moreover, China’s rule only applies in scenarios where a takeover offer has been announced. The limited application of the rule provides greater leeway to the boards of Chinese companies to respond to preserve their position in the wake (or in anticipation) of a hostile takeover attempt. The Chinese version of the board neutrality rule is far more circumscribed compared to its U.K. equivalent, and such a selective adaptation will benefit state-owned enterprises and local Chinese interests. Japan and Korea have no such explicit rule. Target boards in all of these three jurisdictions are not bound to give the shareholders all the decision-making power in the wake of a hostile takeover, but can exercise some amount of leeway to affect the outcome.

2. Fiduciary Duties of Directors as the Main Prong

In all of our civil law jurisdictions in Asia, the conduct of the target’s board is judged against the duties of directors, which plays a major part in the regulation of hostile takeovers. Courts and regulatory authorities have sought to establish standards against which the board’s actions can be measured. This is similar to the approach adopted in Delaware. Although this aspect of civil law Asia bears a close comparison with Delaware law, we find that not only are there significant differences between the two systems, but target’s management and controlling shareholders in civil law Asia are arguably subject to less stringent regulation, thereby hindering successful hostile takeovers.

Kong for inspiration. See Wei, supra note 46, at 654-55 (2011). This is also due to Hong Kong’s proximity to mainland China and the Chinese regulators’ desire for Chinese companies to list in Hong Kong, due to which Hong Kong’s takeover regime became a natural example to follow. See Guanghui Yu, Does One Size Fit All? Transplanting English Takeover Law into China, in CHERYL R. LEHMAN, ET. AL. (EDS.), CORPORATE GOVERNANCE: DOES ANY SIZE FIT? 49 (2005)

104. Huang & Chen, supra note 46, at 228.
105. Id.
106. Id., at 233. The U.K. rule imposes a blanket ban on frustrating actions of target boards when a takeover offer is in the vicinity.
108. For Japan, see ENRICO COLCERA, THE MARKET FOR CORPORATE CONTROL IN JAPAN: M&AS, HOSTILE TAKEOVERS AND REGULATORY FRAMEWORK 215, 233 (2007) (noting that the law has not opted for a board neutrality rule). For Korea, see Rho, supra note 11, at 305 (indicating that some scholars have in fact argued for the introduction of a board neutrality rule similar to that of the U.K.). At the same time, courts in Japan have deferred to the ability of boards to intervene in takeover offers only in scenarios where shareholders have approved the action, thereby indicating the existence of a functional equivalent of the board neutrality rule, albeit imposed by court rulings. See infra, Part IVA2.
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Chinese law requires the target’s board to take decisions in the interests of the company and its shareholders. However, this provision is drafted in general terms and has caused a great deal of uncertainty, which has kept open the question of legitimacy of several takeover defenses. As we subsequently discuss, unlike Delaware, the courts and regulatory authorities have not had exposure to such a duty, which has added to the uncertainty, thereby benefiting the incumbents, such as controlling shareholders, rather than the acquirers.

Among the Asia jurisdictions, Japan has received the greatest amount of traction in the assessment of target responses to hostile takeovers using directors’ duties. Historically, when targets responded to hostile takeovers by issuing shares to friendly stable shareholders, the action was challenged before the Japanese courts, which developed the “primary purpose” rule. Under this doctrine, courts treat a share issuance to be valid if it was effected to raise capital rather than to maintain control. Puchniak and Nakahigashi argue that this is very different from the “proper purpose” duty imposed under English law, and that it set a very low bar for directors in Japanese companies.

This duty has been the subject matter of frenetic developments before both the courts and the regulators. In the much-discussed Livedoor case, the Tokyo High Court sought to explicitly recognize four circumstances where any issuance of shares or warrants by the target’s board in the event of a hostile takeover can be made for the “primary purpose” of maintaining control. Following this, the Japanese government issued a set of informal (non-binding) Takeover Guidelines, which provided for pre-bid takeover defenses that target boards were allowed to establish. This led to several companies issuing “pre-warming rights plans” (PRPs) as a defensive mechanism against hostile takeovers. The PRPs are not akin to the U.S.’s poison pills because, among

110. 2014 Takeover Measures, art. 8.
111. Huang & Chen, supra note 46, at 227.
112. Puchniak & Nakahigashi, supra note 40, at 263-64.
113. Id.
117. Puchniak & Nakahigashi, supra note 40, at 268. The circumstances include where the target is faced with a greenmail, asset stripping, and the like.
119. Puchniak & Nakahigashi, supra note 40, at 270. PRPs are press releases issued by the companies stating that if a takeover bid is commenced and the bidder acquires a specified threshold of
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other reasons, they can be activated only with the approval of the shareholders.\footnote{120} Defensive measures such as PRPs have also been litigated before the Japanese courts.\footnote{121} Despite the elaborate treatment by the Japanese courts to takeover defenses, several questions remain unanswered and “the events in the decade following Livedoor show that Japan has defied predictions that it would become something akin to Delaware.”\footnote{122} The lingering uncertainty in the hostile takeover regime in Japan could benefit incumbents and chill the market for corporate control.

Similarly, Korea has developed the “proper business purpose” test to enable target boards in case of a hostile takeover to issue shares in a manner that overcomes the statutory pre-emptive rights of shareholders.\footnote{123} In a somewhat restrictive interpretation, the Korean Supreme Court found that defending against a hostile takeover would not be considered “proper business purpose”.\footnote{124} While this might appear to go against the comparative freedom granted to Chinese and Japanese boards to defend themselves, managements and controlling shareholders of Korean companies have come up with a unique solution to extricate themselves from the risks of hostile takeovers: through the sale of treasury shares to friendly parties to protect against raiders.\footnote{125} Initially, the Korean courts issued contrasting rulings on the validity of treasury shares as a takeover defense. One approach found that issuing treasury shares was invalid unless there was a proper business purpose,\footnote{126} while the other, broader interpretation treated treasury shares to be different from the issue of new

the shareholdings, the target will set up a special committee which determines whether it is in the companies’ interests to issue warrants to shareholders other than the bidder.

\footnote{120}{
Id.

\footnote{121}{
Cases such as Nireco, Tōkyō Chihō Saibansho [Tokyo District Court], 1 June 2005, 1186 Hanrei TAIMUZU 274; Tōkyō Chihō Saibansho [Tokyo District Court], 9 June 2005, 1186 Hanrei TAIMUZU 265; Tōkyō Kōtō Saibansho [Tokyo High Court], 15 June 2005, 1186 Hanrei TAIMUZU 254 (Nireco), and the Bulldog Sauce, Saiōhō Saibansho [Supreme Court], 7 August 2007, 61 Minshū 2215; 1256 Hanrei TAIMUZU 125 (Bulldog Sauce); Oda, ‘Case No. 30’, supra note 116, at 323-330, have received extensive commentary. Puchniak & Nakahigashi, supra note 40, at 271-73; Milhaupt, Bulldog Sauce for the Japanese Soul?, supra note 118; Milhaupt, In the Shadow of Delaware?, supra note 41, at 2178-80; Armour, Jacobs & Milhaupt, supra note 2, at 25-51.

\footnote{122}{
Puchniak & Nakahigashi, supra note 40, at 273.

\footnote{123}{
Korea Commercial Code, § 418. See also Rho, supra note 11, at 300-01.

\footnote{124}{
Rho, supra note 11, at 300, referring to 2008Da50776, 30 January 2009 (Korea Supreme Court).

\footnote{125}{
Korea Commercial Code required all shares acquired by an issuer to be cancelled or disposed of shortly thereafter. However, by way of reforms introduced in 2011, companies are permitted to keep alive shares that they have acquired, so long as they do not carry voting rights during the period such shares are held by the company. Rho, supra note 11, at 283. Treasury shares are an elegant takeover defense mechanism as the pool of stock is available to management such that it can sell to friendly holders when a takeover offer is launched, thereby reinstating the voting rights associated with those shares and diluting the unwelcome acquirer. See Sang Gon Kim, South Korea: Treasury Shares as a Defence Mechanism Against Hostile Takeovers, MONDAL (Jan. 23, 2017), available at http://www.mondalq.com/x/53152/M+/A+Private%20equity/Treasury+Shares%20As%20A+Defence+Mechanism+Against+Hostile+Takeovers.

\footnote{126}{
Rho, supra note 11, at 301-02 (referring to the Daelim case, 2005Gahap8262 (Jun. 29, 2006, Seoul Western District Court)).}
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shares and conferred full discretion upon the target’s board to decide when and to whom treasury shares may be issued (thereby deferring to the business judgment of the directors). Since then, the Korean courts have begun adopting the permissive approach, which has become the prevalent norm. Although a more recent phenomenon, Korean boards are able to unleash their cache of treasury stock to disarm hostile acquirers.

It is clear that the development of fiduciary duties in the takeover context in all of our civil law Asian jurisdictions have conferred sufficient leeway to the target’s boards and controlling shareholders to stave off a hostile takeover. While comparisons can be made to Delaware law at one level, the takeover regimes in civil law Asia have proceeded on a different trajectory, although there is considerable diversity within each of those regimes.

3. Oversight and Monitoring by Courts

Given the reliance on fiduciary duties of directors as a tool to regulate board conduct during hostile takeovers, it is imperative that appropriate oversight and monitoring mechanisms are in place to effectively implement the takeover regime. Such mechanisms could include an independent board, a robust court system and developed capital markets. Similar to Delaware, the three civil law jurisdictions in Asia that we discuss have placed substantial reliance upon the courts to enforce the takeover measures. The similarity ends there. Unlike Delaware, which “has taken thirty years for [its] takeover jurisprudence to evolve to its present state”, the courts in civil law Asia do not possess the required expertise and sophistication to resolve disputes pertaining to complex takeover transactions.

In China, neither the courts nor the administrative regulators have had the occasion to enforce fiduciary duties in takeover situations. Apart from the fact that the dearth of hostile takeovers has resulted in this situation, it has also been attributed to the lack of qualified judges and an inadequate body of

127. Id. at 302 (referring to the Sovereign case, 2003 Kahap4145 (Dec. 23, 2003, Seoul Central District Court)).
128. Id. at 302-03. In a well-known decision involving the Samsung C&T merger case, the Seoul Higher Court allowed broad discretion of the board in selling treasury shares of Samsung C&T, 2015La20503 (Jul. 16, 2015).
129. Kim, supra note 47, at 240.
130. Gilson, supra note 41, at 39; Kang, supra note 11, at 662.
131. None of these legal systems place much reliance on independent directors to regulate hostile takeovers. For example, as to Japan, see Gilson, supra note 41, at 41.
133. Huang & Chen, supra note 46, at 227; CHEN, supra note 107, at 149. See also Li, supra note 87.
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precedents.\textsuperscript{135} Moreover, in China, shareholders are less likely to bring private actions to enforce fiduciary duties of boards. Even when actions are brought, shareholders are very unlikely to succeed.\textsuperscript{136}

Similarly, in Japan, the task of regulating takeovers has been thrust on to the court system, inspired largely by Delaware.\textsuperscript{137} It has been noted that “it would be a serious mistake to underestimate the weight of that burden”.\textsuperscript{138} Despite having created a relatively robust body of case law (in contrast to China and Korea), the takeover jurisprudence developed by the courts “leaves important questions unanswered”.\textsuperscript{139} The experience from Korea is no different. It does not have specialized courts to deal with complex takeover disputes, and it would be difficult to build up adequate expertise among the judges.\textsuperscript{140} Moreover, the practice of the Korean courts is to allow ample wiggle room to directors facing hostile takeovers.\textsuperscript{141}

Clearly, all of our civil law jurisdictions have gravitated towards a system wherein courts are a bulwark of takeover regulation. But, the application of legal principles and practice into the Asian jurisdictions has demonstrated varying results. China, Japan and Korea have witnessed very few cases in the takeover arena (arguably due to the low incidence of hostile takeovers), due to which the doctrine in the area has not been enriched. Moreover, courts in civil law Asia suffer from insufficient capabilities and resources, and they have failed to develop the requisite legal tradition and institutional capacity.\textsuperscript{142} Thus, in the absence of a robust court system, which is the primary driver for regulating target board’s conduct in case of a hostile takeover in civil law Asia, it would be imprudent to expect the expansion of a market for corporate control. Such a situation allows incumbents such as controlling shareholders and managers to entrench their positions further.

4. Effect of Transplanting Delaware Law

It is clear that China, Japan, and Korea have adopted a model (similar to Delaware) that places reliance on the courts (and, to a limited extent, U.K.

\begin{itemize}
\item \textsuperscript{135} CHEN, supra note 107, at 138.
\item \textsuperscript{136} Id. at 18. Although China has had a good number of cases brought by shareholders against directors by way of derivative action, with a high success rate, very few such cases have been initiated in the context of hostile takeovers. See Hui Huang, Shareholder Derivative Litigation in China: Empirical Findings and Comparative Analysis, 27 Banking and Finance Law Review 619 (2012).
\item \textsuperscript{137} Milhaupt, Bull-Dog Sauce for the Japanese Soul?, supra note 118, at 356.
\item \textsuperscript{138} Gilson, supra note 41, at 42.
\item \textsuperscript{139} Puchniak & Nakahigashi, supra note 40, at 263.
\item \textsuperscript{140} Choi, supra note 11, at 25. See also, Kang, supra note 11, at 624.
\item \textsuperscript{141} Rho, supra note 11, at 305.
\item \textsuperscript{142} See CHEN, supra note 107, at 27 (in the context of China).
\end{itemize}
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takeover jurisprudence) in order to keep up with global standards.\textsuperscript{143} As a result, they have paid short shrift to home-grown mechanisms of takeover regulation.\textsuperscript{144} However, any convergence with the Delaware model can only be said to be formal, and it is not substantial or functional. The application of Delaware law is bound to be inefficient unless local factors, socio-economic institutions and cultural implications are accounted for.\textsuperscript{145} In order to enable a market for control, it is not sufficient to introduce changes in the substantive law.\textsuperscript{146} There is a need to build an entire ecosystem that supports legislative or regulatory changes so as to achieve the desired results. The somewhat inchoate transplantation of Delaware law into our Asian civil law jurisdictions falls substantially short of that.

5. The Role of Interest Groups

In this context, it is worthwhile considering the interplay of various interests that led to the hybrid situation in our civil law jurisdictions. Although the role of interest groups varies according to each jurisdiction, a confluence of various factors has been at play that ultimately resulted in a rather incumbent-friendly takeover regime. Two examples are worth discussing.

First, in Japan, following the Livedoor saga,\textsuperscript{147} the Ministry of Economy, Trade and Industry (METI) established a Corporate Value Study Group that was the precursor to the Takeover Guidelines.\textsuperscript{148} The Working Group not only embraced Delaware doctrine on the ability of target companies to respond to hostile takeovers,\textsuperscript{149} but it also explicitly rejected the U.K.-based board neutrality rule.\textsuperscript{150} Apart from the conceptual slant of the Working Group towards the Delaware approach from a substantive perspective, its findings were largely driven by the fact that a substantial membership of the Working Group consisted of individual trained in the U.S., with lesser experience of U.K. law.\textsuperscript{151} Moreover, the influence of incumbents is demonstrated, albeit less starkly, as one scholar notes that “importantly for METI and the business constituency to which it responds, Delaware takeover jurisprudence is more

\textsuperscript{143} Milhaupt, \textit{In the Shadow of Delaware?}, supra note 41, at 2204. In the case of Japan, however, there is some level of disagreement as some argue that Japan has developed its own unique model that is most appropriate for its own circumstances. See Puchniak & Nakahigashi, \textit{supra} note 40, at 244.

\textsuperscript{144} Milhaupt, \textit{In the Shadow of Delaware?}, supra note 41, at 2204.


\textsuperscript{146} Id.

\textsuperscript{147} \textit{See text accompanying supra} note 116.

\textsuperscript{148} \textit{See supra} note 118. \textit{See also}, Milhaupt, \textit{In the Shadow of Delaware?}, supra note 41, at 2195-97.


\textsuperscript{150} Jacobs, \textit{supra} note 109, at 325.

\textsuperscript{151} Alger, \textit{supra} note 145, at 325.
protective of management than the [U.K. Takeover] Code. The domestic business interests have been vocal in asserting their opposition to hostile takeovers, as “Keidanren (a powerful Japanese business lobby) called for developing defensive measures to prevent “foreign predators” from taking control in Japan”. The end result is a regime that is flexible enough to suit the interests of various Japanese actors.

The second example relates to Korea wherein corporate boards have comparatively limited flexibility to outmaneuver hostile acquirers. The Korean business community has lobbied with the government to enable companies to adopt additional takeover defenses, including the U.S.-style poison pills. However, this move was not successful due to the concern that it may seek to benefit the incumbent business elites. Nevertheless, due to the circular and pyramid shareholdings, as well as wide discretion granted to target boards, hostile takeovers have failed to gain momentum. In any event, as discussed earlier, the use of treasury shares has more recently come to occupy a prominent defensive mechanism that could arguably obviate the need for a poison pill.

In all, there is some evidence of local business elites within our civil law jurisdictions in Asia expressing their concern over the possibility of hostile takeovers. Since hostile takeovers could have a broader impact on the economy (e.g., through layoff of employees), particularly when the acquirer is a foreign entity, governments cannot but afford to have regard to the incumbents in designing the scope and content of takeover regulation.

B. Transplant of the U.K. Model into Common Law Asia

Moving to the common law jurisdictions in Asia, specifically India, Hong Kong, and Singapore, anecdotal evidence indicates that these jurisdictions have been subject to fewer hostile takeovers compared to the civil law jurisdictions under study. Their takeover regimes have closely followed the U.K. model, where the board neutrality rule is the centerpiece. There is a great deal of homogeneity in the manner in which the three common law jurisdictions in Asia deal with hostile takeovers.

154. Rho, supra note 11, at 305.
155. *Id.* See also Kim, supra note 47, at 254.
156. Rho, supra note 11, at 305.
157. See text accompanying *supra* notes 125 to 129.
158. Another tool that is often used to address this concern is a national security review of takeovers by foreign acquirers, particularly in sensitive industries. See Andreas Heinemann, *Government Control of Cross-Border M&A: Legitimate Regulation or Protectionism?*, 15 J. INT’L ECON. L. 843 (2012).
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Target boards in these jurisdictions are powerless because they do not have access to a wide array of takeover defenses. Instead, they must submit to the decisions of the shareholders, who possess primary decision-making powers regarding the outcome of all kinds of takeovers, including hostile ones. Moreover, unlike the civil law jurisdictions under study, the resolution of takeover disputes takes place outside the court system, through the intervention of a takeover panel or the securities regulator. Although one might expect that a regulatory set up which immobilizes target boards to facilitate a market for corporate control, there has not been a frequent flow of hostile takeovers. Among other factors, this is largely because the U.K. model, devised in the dispersed shareholding context where takeovers are seen as a method of shifting control of a target from its board to the acquirer, is inapplicable to the goals of the Asian corporations, where the role of takeover regulation is to facilitate control shifts between a selling controlling shareholder and an acquirer. Because of the different ways that takeovers are perceived in the U.K. and Asia, the transplantation of the U.K. model into the Asian corporate sphere can have unintended consequences. In developing these arguments further, we explore the key features of takeover regulation in India, Hong Kong and Singapore, examine the manner in which they are enforced, and comment on their impact on interest groups, primarily controlling shareholders (being business families or the state).

1. Board Neutrality Rule as the Pivot of Hostile Takeover Regulation

In what amounts to a direct transplant of the mainstay of the U.K. model of regulating hostile takeovers, India, Hong Kong and Singapore display a steadfast adherence to the board neutrality rule. By virtue of this rule, target boards are immobilized from undertaking any defensive action once a takeover offer is imminent or has been made. Target boards may try to stop the takeover by issuing new shares or convertible securities, selling or disposing of material assets, or entering into contract otherwise than in the ordinary course of business, only if they have the prior approval of the shareholders. The inability of the target managements to fend off a hostile acquirer without referring back

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160. It is noteworthy, however, that China’s regulator, the China Securities Regulatory Commission, has established a special internal committee comprised of professionals and experts in the field of takeovers to provide opinions to the Commission on specific matters. However, this body’s role is different from that of the Takeover Panel in the U.K. (as is also the case in Hong Kong and Singapore) in that it is not an independent body (as it is established as part of the regulator) and has no power to make a final decision. See Hui Huang, The New Takeover Regulation in China: Evolution and Enhancement, 42 INT’L LAW. 153, 159, 173 (2008).
161. Varottil & Wan, supra note 37, at 25.
162. Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, § 26(1), (2) (for India); The Singapore Code on Take-Overs and Mergers, § 5 (for Singapore); The Codes on Takeovers and Mergers and Share Buy-backs, r. 4 (for Hong Kong). The origin for these rules is the U.K. Takeover Code, § 21.
to shareholders operates as a significant impediment. Despite the incapacity of
target boards to defend themselves, why are there relatively few takeovers in
our common law jurisdictions? We argue this is because the board neutrality
rule is a hollow notion in the Asian context that is misleading and points
towards erroneous results. We support our argument in two ways.

First, as asserted by several scholars, the board neutrality rule is merely
illusory in light of the fact that the corporate law in the common law
jurisdictions in Asia under study (as it is in the U.K.) requires shareholders to
approve transactions that constitute customary takeover defences.\textsuperscript{163} For
instance, issuance of shares or convertible instruments (such as warrants) that
dilute existing shareholders are to be authorized by a shareholder approval,
although in certain cases general or omnibus approvals are possible.\textsuperscript{164}
Similarly, the board cannot undertake a sale of substantial assets of the
company without the prior approval of the board.\textsuperscript{165} In addition, listing rules of
stock exchanges also impose restrictions on the ability of boards to carry out
actions without shareholder authorization. Hence, the board neutrality rule
arguably does very little to alter the dynamics in the context of a hostile
takeover, and can at best be described to be a policy statement of sorts.

Second, and more importantly, the board neutrality rule is an empty notion
in jurisdictions where concentrated shareholding is dominant, as is the case in
Asia. The rule originated in the dispersed shareholding context where
withdrawing the decision-making power of the target’s board (that is
effectively conflicted) in a hostile takeover and transferring it to the
shareholders can be effective. These shareholders then are able to ultimately
decide the fate of the takeover. However, when such a rule is juxtaposed to the
Asian context, unintended results ensue, given that the principal agency
problem is one between the controlling shareholders and the minority
shareholders.\textsuperscript{166} The managers do not play a significant role in the takeover
context as they are essentially within the influence of the controlling
shareholders. In such a scenario, the transfer of decision-making powers from
managers to the shareholders makes no difference as the two constituencies’
interests are aligned and arguably often counter the interests of the minority
shareholders. Instead, the board neutrality rule has the function of further
emboldening the controlling shareholders who are already well entrenched in
the target.

\textsuperscript{163} This point was first elucidated in David Kershaw, \textit{The Illusion of Importance: Reconsidering
the UK’s Takeover Defence Prohibition}, 56 \textit{Int’l & Comp. L.Q.} 267 (2007). \textit{See also} Ventoruzzo, supra
note 3, at 159; Wan, supra note 39, at 420.

\textsuperscript{164} Companies Act, 2013, § 62(1)(c) (for India); Companies Ordinance (Cap. 622),§ 141 (for
Hong Kong); Companies Act (Cap. 50), § 161 (for Singapore).

\textsuperscript{165} Companies Act, 2013, § 180 (for India); Companies Ordinance (Cap. 622), Companies Act
(Cap. 50), § 160 (for Singapore).

\textsuperscript{166} \textit{See} Ventoruzzo, supra note 3, at 141.
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Hence, the board neutrality rule, which was created to serve a distinct purpose in the U.K., i.e. to protect shareholders from managers, has a completely different effect altogether when transplanted to jurisdictions in Asia where concentrated shareholding is the norm. In Asia, it has the unintended effect of further bolstering the position of controlling shareholders. Hence, the inability of managers or controlling shareholders in the common law Asian jurisdictions under study to invoke conventional takeover defenses, such as poison pills and scorched earth tactics, does not matter.

2. The Relative Non-Use of Directors’ Duties to Resolve Takeover Disputes

In all of our common law jurisdictions in Asia, directors are fiduciaries and are required to act in the interests of the company, including in the context of takeovers. These include the duty of care, skill and diligence and the duty to act for proper purpose. Some of these duties have been developed substantially under English law, in particular the duty to act for proper purpose, which is usually triggered when the target undertakes actions to prefer a shareholder or investor in a manner that dilutes the interests of the acquirer. However, to the knowledge of the authors, there are no significant cases in India, Hong Kong or Singapore that expound on the scope and import of directors’ duties as a tool to resolve dispute relating to takeover regulation, let alone in the context of hostile situations. This is attributable to two factors. First, because of the lack of hostile takeovers in these jurisdictions, the courts have not had the opportunity to clarify directors’ duties. Second, takeover disputes in these jurisdictions are resolved outside the court system, a matter that will be discussed next.

3. Oversight and Monitoring by Regulatory Bodies

The civil law and common law jurisdictions in Asia follow divergent approaches when dealing with the oversight and monitoring of parties’ conducts in a hostile takeover. The civil law jurisdictions draw their inspiration from the U.S., which focuses on litigation as a means of resolving takeover disputes in an ex post fashion. In contrast, the common law jurisdictions not only regulate takeovers through ex ante rules, but resolve disputes either by a takeover panel or by the securities regulator. In these common law jurisdictions, similar to the U.K., the involvement of courts is limited in resolving takeover disputes.

Hong Kong and Singapore have established both the Takeovers and Mergers Panel and the Securities Industry Council (SIC) to make decisions regarding takeover matters. They follow the Panel on Takeovers and Mergers in the U.K., which has constituted the model for such a regulatory mechanism.

167. For the leading cases law, see supra note 114.
Membership of these takeover panels is represented by a wide range of interests, including participation from the industry, investor community and professionals. The idea behind establishing such panels is to ensure speed, flexibility and certainty. Courts only have limited oversight in respect of decisions of the panel.

In contrast, India has not adopted a panel-like approach towards the enforcement of takeover regulation. Instead, the Securities and Exchange Board of India (SEBI), the securities regulator, performs the function of regulating takeovers. However, even here, courts are generally kept outside the purview of takeover disputes. The resolution of takeover disputes outside the court system has implications in the political economy, as we discuss in the next subpart.

4. The Role of Interest Groups

In each of the common law jurisdictions in Asia under study, there is evidence that incumbents, such as controlling shareholders, have acted to preserve the status quo in the design and implementation of the legal regime pertaining to hostile takeovers. In India, controlling shareholders of Indian companies have a great deal of influence in shaping the takeover regulation in a manner that militates against a market for corporate control.

In the context of Singapore, Wan has argued that the adoption of the U.K.-style of takeover regulation is the result of interaction among the relevant interest groups, namely significant shareholders (such as business families or the state) and the regulator. One example that demonstrates this phenomenon is a consultation exercise conducted by the SIC where it sought the views of market participants on whether Singapore should adopt the U.S. model of takeover regulation (with discretion to directors to determine the fate of a takeover) or to retain the current U.K. model (where shareholder decisions are

169. For a detailed discussion of the performance of takeover panels on a comparative basis judged by these criteria, see Emma Armon, Assessing the Performance of Takeover Panels: A Comparative Study, in VAROTILL & WAN, supra note 37, at 134-62.
171. This is because sections §§ 15Y and 20A of the Securities and Exchange Board of India Act, 1992 bar the jurisdiction of civil courts to entertain a suit or proceedings on matters in which SEBI is empowered to take action (e.g., securities law violations). This exclusion of civil jurisdiction has been interpreted widely with respect to SEBI. Kesha Appliances P Ltd v Royal Holdings Services Ltd [2006] 130 Comp. Cas. 227 (Bom).
172. See text accompanying infra notes 183-184.
173. Varotili, supra note 39, at 378. For a more detailed discussion on India, see text accompanying infra notes 183-184.
174. Wan, supra note 39, at 408.
Hostile Takeover Regimes in Asia

The overwhelming response from market practitioners was to retain the U.K.’s board neutrality rule. This is perhaps attributable, at least in part, to the fact that in a concentrated shareholding scenario, the incumbents who are the controlling shareholders are better positioned to hold the decision-making power at the shareholder level where they can exercise significant influence, rather than to grant it to boards. Even if controlling shareholders do not have holdings that are large enough to influence the directors of the target as to the fate of the takeover, an exercise of powers through shareholder decision-making could enable them to decide the outcome of a hostile takeover.

In Hong Kong, the influence of controlling blockholders is evidenced in the manner, rather than design, of the implementation of takeover regulation. Given that the market for corporate control essentially relates to “the jockeying among blockholders for control of their corporate groups and the economy generally”, the entire slew of takeover regulation adopted from the U.K. is hardly used, barring certain specific provisions that relate to matters pertaining to controlling shareholders attempting to enhance their control over the target. Donald has argued that the U.K.-oriented takeover regulation has been “applied essentially as a ‘code of responsible corporate ownership’” and that the U.K. transplant that is focused on dispersed shareholding scenarios may, in the context of Hong Kong, “be a distraction from the main problem on which regulators should focus”.

The lawmaking, oversight, and monitoring process in takeover regulation plays an important role in how interest groups exert their influence. Armour, Jacobs and Milhaupt have noted that, unlike the judiciary, regulators and market actors tend to become the focus of interest groups while introducing new rules. Regulators appear to be somewhat responsive to such interest groups. Often, the effort to preempt a legislative outcome ends up conforming to the preferences of the dominant interest groups. For example, in India, SEBI usually creates takeover regulation by appointing a committee of experts.

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176. Id. at 8.
177. But, a significant constraint with the U.K. rule is that it is costly, both in terms of time and money, to hold a shareholder meeting to approve the use of defences. It is likely that defences may not be applied quickly enough to stave off a takeover that the controlling shareholder does not accept. See Huang, supra note 134, at 192-93.
179. Donald, supra note 55, at 383.
180. Id. at 403.
182. Id. at 232.
to examine the issues and make recommendations.\textsuperscript{183} Such committees tend to strongly represent domestic Indian business interests and include leading corporate lawyers.\textsuperscript{184} Through this, the Indian legal industry has maintained a strong voice in the shaping of takeover regulation, which explains the nature of regulation that emboldens controlling shareholders and impedes a free market for corporate control. Similar public consultation exercises tend to provide avenues for dominant market participants to forcefully put forward their positions, as seen in the case of Singapore.\textsuperscript{185} Moreover, the market-facing membership of the takeover panels in both Singapore and Hong Kong will likely attract local business elites, such as controlling shareholders, to assuage concerns that would make the design and implementation of takeover regulation in these jurisdictions vastly different from the origin country of the U.K.

\textbf{PART V: IMPLICATIONS FROM THE STUDY OF TAKEOVER REGULATION IN ASIA}

Our analysis of the six Asian jurisdictions indicates that they have adopted a dichotomous approach towards takeover regulation. While the civil law jurisdictions of China, Japan and Korea are aligned more closely to the U.S., particularly Delaware’s, position which confers significant freedom to target boards, the common law jurisdictions of India, Hong Kong and Singapore cling to the U.K.-based board neutrality approach that passes on decision-making powers to the shareholders. Despite the different approaches adopted by these jurisdictions, there is one important commonality. No matter how the takeover regulation is designed or implemented, the controlling or dominant shareholders have been the focus of the rulemaking process. This is not at all surprising given that all of these jurisdictions witness concentrated (or, in the case of Japan, stable) shareholding. But, as we have seen, the controlling shareholders have not simply rested in the comfort of their shareholding power, but instead have sought to bolster their position in the company. Here, we consider some of the key lessons and implications that emerge from the study, and close with some normative observations regarding the possible direction that takeover regulation in Asia might take.

\textit{A. (In)consistency with the Theoretical Framework}

Juxtaposing our findings with the theoretical framework set out by Armour and Skeel, it is clear that the Asian scenario relating to takeover regulation supports their theory. For instance, the evolution of the takeover regime is important in understanding the substantive nature of the rules, and interest
Hostile Takeover Regimes in Asia

groups tend to exert significant influence in the process its regulatory outcomes. However, divergences with Armour and Skeel do exist. Their analysis of the origin country rules demonstrates differences in hostile takeover regimes (i.e., manager-oriented in the U.S. and shareholder-oriented in the U.K.) and the interest groups that were influential in the process (i.e., managers in the U.S. and institutional investors in the U.K.). When this framework is applied to the recipient jurisdictions in Asia, a different position ensues. This difference can be seen with the bifurcation that exists in Asia as well as the bifurcation between the U.S. and the U.K., as shown in Armour and Skeel’s framework. For instance, while the civil law jurisdictions in Asia have drawn their inspiration from the U.S., and the common law jurisdictions from the U.K., ultimately the interest group that has been dominant in the process is the controlling shareholders, who are the business elite in these jurisdictions comprising either business families or the state. Armour and Skeel’s account understandably does not account for controlling shareholders. While Armour and Skeel note that differences in the evolution of takeover regulation could result in different outcomes as regards dominant interest groups (e.g., managers versus shareholders), our analysis demonstrates that radically different regimes in hostile takeover regulation could nevertheless inure to the benefit of a single constituency, namely controlling shareholders.

For the aforesaid reasons, we argue that it would be unwise to draw inferences from theories based on takeover regulation emanating from the U.S. and the U.K. A direct application of these theories to our Asian jurisdictions is bound to result in incongruences due to the prevalence of local factors. Such factors are likely to be idiosyncratic not only in relation to the U.S. and the U.K., but even relative to other Asian jurisdictions. Unless these factors are duly accounted for, “the same takeover rules might have different or even opposite effects in different markets”.

B. Pro-Incumbency: A Controlling Shareholder-Centric Approach

As we have seen, takeover regulation in the Asian jurisdictions mentioned has adopted an incumbent-friendly approach, regardless of the specific model in play. Controlling shareholders tend to play a central role in entrenching themselves further in the companies they already control. Any rulemaking process by the regulators or lawmakers cannot afford to ignore the interests and

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186. See Puchniak & Nakahigashi, supra note 40, at 244.
187. Ventoruzzo, supra note 3, at 141 (noting a similar result in the context of takeover regulation in continental Europe).
188. Even though controlling shareholders may not fear an imminent battle for control over their company due comfort of their significant shareholding, they nevertheless have an interest in ensuring the protection of their position in the future when their holdings might be diluted due to additional capital raising efforts.
concerns of controlling shareholders due to the political power that they wield. Here, the civil law jurisdictions in Asia follow a predictable pattern consistent with the interest group analysis of takeover regulation. The focus of the law and its implementation is on providing greater power to the incumbents to protect themselves against hostile takeovers, including allowing controlling shareholders to erect defenses. In these jurisdictions, while the board has been conferred these powers, the scenario is very different from the Anglo-American approach where there is a difference between ownership and management control. In Asia, given the concentrated shareholder structures, boards operate under the shadow of controlling shareholders’ influence, as the directors owe their election and continuation in office to the the shareholders (which the controllers strongly influence). Hence, we argue that any benefits conferred upon the board in the Asian context have to be viewed differently than the Anglo-American approach. In Asia, conferring freedom to the boards to resist hostile takeover not only protects incumbent management, but also helps bolster the controlling shareholders’ position in the company.

Moving on to our common law jurisdictions in Asia, the position is even more complex. We come back to a question we have raised before: why have the incumbents rested easy with the board neutrality rule that takes away the powers of the board to defend against hostile takeovers? Why have they not protested against the limitations on corporate boards in common law Asia to establish takeover defenses such as poison pills and scorched earth tactics? We proffer some explanation in seeking to respond to these questions.

At the outset, if we were to apply the Armour and Skeel analysis, the board neutrality rule in common law Asia ought to be present in full force due to the influence of institutional investors, as it did in the U.K. But institutional investors do not appear to have played much of a role in the rulemaking process in common law Asia. The Armour and Skeel analysis fails to shed light on this conundrum.

We offer an alternative explanation. We argue that the adoption and continuation of the board neutrality rule may signify a level of inertia on the part of the regulators and the market participants. We offer several reasons why. First, takeovers are yet to capture sufficient attention in common law Asia to warrant a paradigm shift in their regulation. Due to the high concentration of shareholdings, the threat perception from hostile takeovers is not yet material. Second, the board neutrality rule results in opposite and unintended consequences in common law Asia when compared with the U.K. model. The rule shifts power over the outcome of a hostile takeover from the board to the shareholders. Instead of disarming the power of the incumbents (e.g. managers in the U.K.), it has the effect emboldening them (e.g. controlling shareholders)

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189. See supra Part I.
Hostile Takeover Regimes in Asia

in common law Asia). It is little wonder that the business elites in the Asian jurisdictions see no reason to disturb the status quo. Third, a mere change to the board neutrality rule that is situated within takeover regulation is insufficient to strengthen the controlling shareholders’ position. Given the illusory nature of the rule, there is a need to introduce reforms to company law to enable the use of takeover defenses such as poison pills. Applying interest group theory, we find the legislature is usually less responsive to interest group influences in the takeover arena in the absence of a scandal. In that sense, addressing the board neutrality rule or bringing about other changes to the takeover codes in common law Asia must be accompanied by reforms to corporate law, which might be harder to come by.

This leads us to some key questions. Given the peculiar nature of application of the Anglo-American rules to the Asian context, why have our Asian jurisdictions chosen to transplant them? What factors have motivated them to exercise that choice? We now turn to address these.

C. Role of the State in Influencing the Outcome of Transplantation

Our analysis of the individual jurisdictions in Asia indicates various reasons why they decided to borrow extensively from the Anglo-American approaches. Asian jurisdictions find it attractive to adopt “global standards”, which are easy to justify, especially when reforms need to be introduced in a time-bound manner. Moreover, the state has reasons to prefer well-tested approaches to takeover regulation, especially from developed economies, since they signal signs of development. For instance, imposing a board neutrality rule might be a sign that the economy is open to foreign acquisitions and foreign investment, which are means towards deepening the capital markets, reducing reliance on domestic investment, and enhancing economic growth. Due to these reasons, all of the Asian jurisdictions have shunned a purely homegrown approach in developing takeover regulation. This is partly attributable to the fact that takeovers, in particular the hostile variety, is a relatively novel phenomenon in Asia compared to the West.

Competing interests have pulled individual Asian jurisdictions to varying degrees resulting in different outcomes from the same process. Since the state places importance on ensuring minority investor protection in order to promote deep and liquid capital markets, our Asian jurisdictions have sought to create a balance between protecting shareholder interests, for instance by the outright

190. See supra notes 163 to 165, and accompanying text.
191. See Armour, Jacobs & Milhaupt, supra note 2, at 229-32.
192. See supra Part IV.
prohibition on certain defensive measures), and the promotion of corporate
objectives and local business interests. This can be a difficult task due to the
operation of several local factors, which explains why several of the Asian
jurisdictions that follow similar approaches towards takeover regulation
demonstrate differing outcomes. As we have seen,194 such a move triggered by
globalization without accounting for local peculiarities would at most result in
formal convergence.

D. Broader Implications of the Findings

As is evident, it is myopic to view takeover regulation in Asia merely
through the lens of the Anglo-American approach.195 Due regard must be given
to the local factors and idiosyncrasies that map the Asian corporate landscape.
Even the theoretical literature on takeover regulation has been steeped in the
Anglo-American context and has only recently began to gain ground in other
regions, such as Asia. In the end, the specific circumstances and factors present
in each individual jurisdiction may explain the regulatory choice it makes in
determining takeover regulation.

Broadening the discussion to the sphere of corporate governance, it would
be imprudent for Asian jurisdictions to rely heavily on the market for corporate
control as a governance-enhancing mechanism, especially given the
concentration in shareholdings. Policy-makers and scholars may very well
divert their attention to other mechanisms that are appropriate in the Asian
context. The focus of takeover regulation in Asia is hence narrowed to
facilitating organized changes of control between parties in a manner that does
not undermine the interests of minority shareholders.

Lastly, our research also reveals some lessons relating to the operation of
legal systems. The ‘legal origins’ strain of literature posits that, in common law
countries, the judiciary plays an important role in defining and enforcing
investor rights.196 Hence, minority investor protection is an important tool for
the development of deep capital markets. On the other hand, civil law countries
tend to rely heavily on governmental intervention in protecting minority
shareholder interests. The legal origins analysis gives rise to curious outcomes
in takeover regulation pertaining to our Asian jurisdictions. First, the
originating countries for the diffusion of takeover regulation (i.e., the U.K. and
the U.S.) are both common law jurisdictions. However, their regulations have
been transplanted to Asian jurisdictions that follow common law as well as
civil law. In other words, our Asian civil law jurisdictions have found it
appropriate to look to the U.K. and the U.S. (as leading takeover markets)
Hostile Takeover Regimes in Asia

rather than to other civil law jurisdictions. Second, and more intriguingly, the diffusion of legal norms has occurred in rather counterintuitive ways. All the common law jurisdictions in Asia under study have preferred not to use the court system to resolve takeover disputes.197 While the use of a takeover panel-like arrangement by Hong Kong and Singapore is understandable, given the preference displayed by the UK, the exclusion of courts from takeover regulation in India is less clear. Our Asian jurisdictions following civil law have, instead, embraced the use of ex post determination through courts as a means of regulating takeovers, especially through fiduciary duties of the target’s board. This phenomenon undermines the applicability of the ‘legal origins’ thesis, as it receives no support in takeover regulation.

PART VI: CONCLUSION

Takeover regulation plays an essential role in the market for corporate control, which is an important mechanism of corporate governance. The origin of regulatory mechanisms as well as substantial literature in the field have hitherto taken on a strong Anglo-American flavor. In this article, we undertake a broader comparative approach by which we study the importation into Asia from the U.S. and the U.K. of the modes of regulating hostile takeovers. Our comparison extends in two ways: one, to compare the U.S. and the U.K. with the six Asian jurisdictions that have high volumes of takeover activity, and the second, to compare among these Asian jurisdictions themselves.

As we seek to demonstrate, the transplant of the U.S. and the U.K. takeover regulation to the Asian jurisdictions results in unintended consequences, attributable largely to differences in local factors, including shareholder pattern, capacity, sophistication of the regulators and courts, as well as cultural traits. The evolution, design, and enforcement of takeover regulation has tend to benefit the incumbents, who are usually the controlling shareholders, such as business families and the state. These groups are ubiquitous in the Asian corporate sphere. Ultimately, it is our case that Asian takeover regulation (specifically, each individual jurisdiction) must be viewed on its own terms rather than through an Anglo-American perspective.

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197. Similar findings regarding the use of courts can be found in the context of shareholder derivative actions. See Puchniak, supra note 99, at 10-11, 14.
Multiple Derivative Actions: Debates in Korea and the Implications for a Comparative Study

Kyung-Hoon Chun*

A double or multiple derivative action has attracted little academic attention in US for decades. In Korea, after the Korean Supreme Court dismissed a double derivative action in 2004 on the ground that a shareholder in a parent company lacked standing to sue on behalf of its subsidiary, this issue has attracted much interest both academically and politically. Since many large business groups, or chaebols, in Korea now use a multi-layered holding company structure, multiple derivative actions are perceived as a means to regulate the management of unlisted subsidiaries which is insulated from the pressure of stock market. In 2016 and 2017, a number of bills that attempt to allow double or multiple derivative actions in varying scopes were submitted to the National Assembly of Korea. After an analysis of those bills and a comparative review of the laws of a few jurisdictions, this article presents a few questions to be considered before legislation and provides some answers to those questions.

First, a double or multiple derivative action is justified because it may compensate harmed shareholders and deter possible wrongdoing to subsidiaries. It is irrelevant to resort to the doctrine of “piercing the corporate veil” to justify it. Second, a standard derivative action against the directors of a parent company for failure to monitor a subsidiary’s management or for failure to seek proper remedies cannot be a satisfactory alternative to a double or multiple derivative action, considering the difficulty of proving causes of action and assessing the damages. Third, double or multiple derivative actions need not be limited to situations in which the subsidiary is wholly owned or in which there is no one else who can sue. Fourth, before bringing an action, it would be sufficient to first demand that the subsidiary bring a suit, without needing to demand that the parent bring a standard derivative suit.

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Multiple Derivative Actions

Considering the increasing use of a multi-layered holding company structure, double or multiple derivative actions will be more and more important to recover the losses of a subsidiary and deter wrongdoing that may be committed at the level of subsidiaries.

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PART I: INTRODUCTION

A derivative action is a lawsuit brought by the shareholder on behalf of the corporation in order to enforce causes of action belonging to the corporation. The increasing use of a multi-layered group structure gives rise to the issue of whether a shareholder of a parent company may bring a derivative action against the directors and officers of subsidiaries on behalf of the subsidiaries. An action by a shareholder of a parent company on behalf of a subsidiary is called a double derivative action and an action by a shareholder of a grandparent company on behalf of its second-tier subsidiary (i.e., a grandson company or sub-subsidiary) is called a triple derivative action, as illustrated in [Figure 1]. Collectively, such actions are referred to as multiple derivative actions. In any of these multiple derivative actions, the cause of action belongs to the company which directly suffered damage from the misconducts of the defendants.

Multiple Derivative Actions

For several decades, multiple derivative actions have received little academic attention. In the US, while a number of state courts have addressed multiple derivation actions throughout the 20th century based on various theories, such as the fiduciary theory, the doctrine of “piercing the corporate veil”, the “instrumentality” test, and the “common control” theory, academics have largely ignored the issue. UK courts admitted double derivative actions in the case of a wholly-owned subsidiary, but it remains uncertain whether such a ruling will hold true when partially owned subsidiaries are concerned. In Japan, new provisions were added in its corporate law in 2014 to allow multiple derivative actions, but only for wholly-owned subsidiaries in very limited occasions. All in all, even in jurisdictions known for relatively active derivative suits, multiple derivative actions have not been studied in depth as to whether they should be allowed at all, and if so, under what conditions and to what degree.

In the Republic of Korea, debates began after the Korean Supreme Court dismissed a double derivative action in 2004 on the grounds that a shareholder of a parent company lacked standing to derivatively sue directors of the subsidiary. Many experts including some shareholder activists argued for amending the Korean Commercial Code (“KCC”) to explicitly allow multiple derivative actions. They argued that a multiple derivative action would be a useful tool to regulate tunneling by controlling shareholders taking place at the level of unlisted subsidiaries in the form of related party transactions. Others were skeptical or even hostile to the idea of introducing multiple derivative actions by a statute.

In 2016 and 2017, a number of bills that attempt to allow multiple derivative actions in varying scopes were submitted to the National Assembly of Korea, which are still pending as of August 2018. The lively debates among scholars and the various bills submitted to the legislature in Korea give a unique comparative perspective, considering the scarcity of academic attention on this issue in other jurisdictions, and thus, this topic deserves further review. Focusing on comparative legal research, this article attempts to explore the background of such debates, compare various bills, and analyze the key issues to be determined when making a statute on multiple derivative actions. This article begins by first summarizing in Section II the current Korean law on derivative actions in comparison to the US corporate law. Next, Section III analyzes the 2004 Supreme Court ruling, related debates, and recent bills

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2. For a classic explanation of these “theories,” see William H. Painter, Double Derivative Suits and Other Remedies with Regard to Damaged Subsidiaries, 36 Ind. L. J. 143, 146-155 (1961).
5. Also known as the South Korea. Throughout this paper, it is referred to as simply “Korea.”
involving multiple derivative actions. Then, Section IV provides a brief sketch of this issue from a comparative law perspective, and Section V analyzes a few key issues to be considered for legislation.

PART II: DERIVATIVE ACTIONS IN KOREA

A. Overview

Since its enactment in 1962, the KCC included detailed provisions on shareholder derivative actions. Theoretically, derivative actions were supposed to play a crucial role in protecting minority shareholders from abusive and wrongful conduct by the management. In reality, however, this remedy was dormant until the first derivative action in Korean history was filed in 1997, which then led to the first Korean Supreme Court case on derivative actions in 2002. Since then, Korean courts have encountered around sixty derivative suits.

A few features of derivative actions in Korea are noteworthy. First, NGOs such as the People’s Solidarity for Participatory Democracy and the Solidarity for Economic Reform played quite an important role in organizing and initiating actions against the directors of Korean conglomerates. Their main goal was improving the rigged governance of Korean companies as a part of social reform, rather than maximizing shareholder value per se. Such sociopolitical motives made them bring a number of derivative actions against the directors of a few large and famous firms in Korea, even when there was little economic incentive to do so. Second, derivative actions frequently followed criminal prosecutions or administrative inspection proceedings, based on the facts investigated and verified by such proceedings. For example, after a director is found guilty of embezzlement or ‘criminal breach of trust’ under the Korean Criminal Code, shareholders of the company tend to file derivative actions against the director. Absent a US-style discovery process, this is the most convenient, and almost the only possible way, to collect evidence for a derivative action.

B. Statutory Requirements

1. Company’s Claim against Directors

In order to bring a valid derivative action, there must be a substantive claim that belongs to the company against a director, statutory auditor, or executive
Multiple Derivative Actions

officer of the company. In other words, a director or other potential defendants of the derivative action must be liable to the company. Such liability typically arises when a director causes harm to the company by breach of fiduciary duty or violation of the law. For example, an underlying claim for a derivative action was recognized when (i) directors misused corporate funds for bribery, (ii) directors sold corporate assets to a related party at a price far lower than fair market value, or (iii) directors invested corporate funds in a distressed affiliate company even though there was little hope of survival.

2. Demand on the Company to Bring an Action

Before filing a derivative action, the plaintiff shareholder must first demand that the company bring a suit against the relevant director. The shareholder must submit to the statutory auditor (or the audit committee, if the company has an audit committee instead of a statutory auditor) of the company a written demand for filing a lawsuit. If the statutory auditor fails to bring a suit within 30 days from the date of the demand (either by ignoring the demand or refusing to honor the demand), the shareholder may immediately bring a suit on behalf of the company. If any irreparable damage is likely to arise during the demand period, the shareholder may bring a suit immediately without first making such a demand.

Such a demand requirement under Korean law is different from the “demand on board requirement” under many U.S. state laws. Under the laws of the States of Delaware and New York, for example, a written demand must be submitted to the board of directors unless the case meets the “demand futility tests.” Further, the board of directors has broad discretion in determining whether or not to bring a suit. In the “demand required” cases, a decision by the board of directors not to bring, or terminate, a suit would be almost impossible for a shareholder to successfully challenge. Even in the “demand excused”

8. Article 399 of the KCC.
12. Article 403(1) of the KCC.
13. Articles 403(2) and 394 of the KCC.
14. Article 403(3) of the KCC.
15. Article 403(4) of the KCC.
16. If the board refuses the demand, the shareholder may seek judicial review of that refusal, but the plaintiff bears the burden of proving that the refusal was wrongful. In addition, the relevant standard of review is the business judgement rule, and the plaintiff is not entitled to discovery. STEPHEN M. BAINBRIDGE, CORPORATE LAW (3rd ED.) 233-234 (2015).
cases where a demand on board requirement is excused, the company usually sets up a Special Litigation Committee (“SLC”) composed mainly of independent directors to determine the position of the company regarding the litigation. Although states have developed varying standards, generally speaking, the SLC’s decision to terminate the lawsuit is given quite strong deference by the court.\footnote{17. Auerbach v. Bennett, 419 N.Y.S.2d 920 (1979) for New York law (the challenged misconduct is not subject to a substantive review by the court so long as the SLC was independent and used proper procedures in reaching its decision); Zapata Corp. v. Maldonado, 430 A.2d 779 (Del.1981) for Delaware law (the court should inquire into the independence and good faith of the SLC, reviewing not only the procedural matters but also the bases supporting the SLC’s recommendations); Joy v. North, 692 F.2d 880 (2d Cir.1982) for a diversity case arising under Connecticut law (the court should examine whether the litigation is in the best interests of the corporation by reviewing both procedural and substantive matters).} If the SLC was independent and disinterested, and had a reasonable basis in reaching the recommendation to terminate the action, then the derivative action will most likely be dismissed even under very shareholder-friendly state law.

Unlike US law, however, Korean law does not recognize the board’s or any special committee’s discretion not to bring or terminate a lawsuit. Once the 30-day demand period elapses, regardless of the board’s decision, the plaintiff shareholder may legitimately file a derivative lawsuit.\footnote{18. Article 403(3) of the KCC.} A demand requirement under Korean law is thus more similar to granting the company with a mere “right of first lawsuit,” not any further discretion to give up or terminate the lawsuit. In addition, the plaintiff shareholder does not need to wait 30 days when there is concern of irreparable harm to the company,\footnote{19. Article 403(4) of the KCC.} or when the company clearly rejects the demand before the elapse of 30-day period. Therefore, this requirement is not a significant barrier to filing a derivative action in Korea.

3. Requirements for Plaintiff Shareholders

Another important difference from the US law is that the KCC requires a minimum shareholding ratio to bring a derivative action while a person who owns only one share is entitled to a derivative remedy under the US law. For an unlisted company, a plaintiff shareholder must hold at least 1% of the total issued shares.\footnote{20. Article 403(1) of the KCC.} There is no holding period requirement for an unlisted company. For a listed company, the statutory minimum shareholding ratio is as low as 0.01%, but the plaintiff must have held the shares for at least 6 months.\footnote{21. Article 542-6(6) of the KCC.} The KCC allows a listed company to reduce the minimum
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shareholding ratio, or shorten the 6-month period, in its articles of incorporation.\(^{22}\) The 1% or 0.01% ratio can be satisfied in aggregate by multiple shareholders.

The minimum shareholding requirement is probably one of the main barriers to bringing a derivative action in Korea. But the KCC also has some rules which render this requirement not as strict as it first appears. Once the plaintiff meets the minimum shareholding ratio at the time the derivative action is filed, any reduction in the plaintiff’s shareholding ratio does not affect the plaintiff’s standing as long as the plaintiff holds at least one share.\(^{23}\) Moreover, unlike US law,\(^{24}\) the KCC does not have a contemporaneous share ownership requirement: the plaintiff need not have been a shareholder at the time of the challenged misconduct. The underlying rationale is that the plaintiff shareholder is enforcing the company’s cause of action as an agent, not as a principal, with any legal effects of the lawsuit vested with the company. Thus, it does not matter whether the plaintiff himself suffered any damage from the challenged misconduct at the time of such an event.

C. Other Procedural Aspects

Under Korean law, the company itself is neither a plaintiff nor a defendant in a derivative action. Only the shareholders are the plaintiffs,\(^{25}\) and the persons who are liable to the company (usually directors who breached their fiduciary duty and caused harm to the company) are the defendants. The company is merely allowed to participate in the proceedings on the plaintiff’s side if and only if it desires to.\(^{26}\) Plaintiffs must notify the company of their suit without delay so that the company may participate in the proceedings.\(^{27}\) This is strikingly different from US law where the company is usually named as one of the defendants.\(^{28}\)

To prevent abuse of derivative actions, the KCC has a few mechanisms in place. First, the plaintiff is not allowed to withdraw or settle the case without
court approval once the derivative action is filed. Second, when a defendant director submits evidence of bad faith on the part of a plaintiff shareholder, the court may order the plaintiff shareholder to post a reasonable bond. Third, if the plaintiff loses the case and it is found that the suit was filed in bad faith, then the plaintiff is liable to the company for the losses suffered by the company due to the derivative action.

If the plaintiff wins the case, any proceeds collected from the defendants go to the company, not to the plaintiff, because the course of action belongs to the company. The plaintiff can demand that the company reimburse him for reasonable expenses as well as litigation costs. The courts, however, have sometimes denied full reimbursement of expenses on the grounds that the attorney fees requested by the plaintiff were unreasonably high. Restrictions on the reimbursable amount of attorney fees have negative impacts on the incentive of lawyers to be actively engaged in the derivative actions, and work as a deterrent for bringing a derivative action, together with the minimum shareholding ratio requirement discussed above.

PART III: MULTIPLE DERIVATIVE ACTIONS IN KOREA

A. Corporate Group Structure

It is worthwhile to take a glance at a few distinctive features of Korean corporate governance to understand why a multiple derivative action became an issue. In Korea, a number of large business groups, commonly known as chaebol, dominate the corporate scene. Chaebol is usually defined as a large group of related corporations engaged in diverse lines of business under highly concentrated family or individual control. Member companies of these business groups are legally independent but tied together by cross shareholdings, circular shareholdings, and pyramidal structures. Among these structural devices, cross shareholdings and circular shareholdings are no longer allowed for a business group whose total assets exceed 10 trillion Won (approximately 9 billion USD), and thus, many groups are using holding company structures that often have multi-layered, highly leveraged pyramidal

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29. Article 403(6) of the KCC.
30. Article 403(7) of the KCC.
31. Article 405(2) of the KCC.
32. Article 405(1) of the KCC.
33. E.g., Seoul Central District Court, June 20, 2008, 2007gahap43745.
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structures. Another noteworthy feature of Korean corporate governance is that even listed companies tend to have controlling shareholders, most of them being controlling minority shareholders.  

[Figure 2-1] shows ownership structures of a few key companies of LG Group, which converted into a holding company structure from a circular ownership structure. Other large business groups of Korea such as SK, CJ, GS and Hanwha Groups adopted similar structures, while Samsung, Hyundai Motors, and Hyundai Heavy Industry Groups are still maintaining circular ownership structures. [Figure 2-2] shows ownership structures of Hana Financial Group, one of the largest financial groups in Korea. Other large financial groups in Korea such as KB and Shinhan adopted similar structures where each member companies are wholly or almost wholly owned by a holding company, which is owned by dispersed shareholders.  

[Figure 2-1]

(*: non-listed companies)  
[Figure 2-2]

In these business groups, tunneling or other types of breach of fiduciary duty may take place at the level of unlisted subsidiaries by their directors while dispersed shareholders own shares in the holding company or listed subsidiaries. For example, a chaebol family member may set up a separate corporate vehicle and have it enter into transactions with unlisted subsidiaries of the group as a means of asset diversion from such subsidiaries. The directors of these unlisted subsidiaries are out of the reach of disciplinary power of the capital market or monitoring by the active shareholders. Nor do they have any fear of losing control of the subsidiary through a hostile takeover or a proxy fight. In this context, multiple derivative actions were regarded, at least by some experts and activists, as tools for regulating the directors and officers of the unlisted subsidiaries. Without multiple derivative actions, directors and managers could insulate themselves from liability simply by adding another corporate layer.

B. Supreme Court Case in 2004

The issue of a double or multiple derivative action began to attract the attention of certain shareholder activists in Korea in the early 2000s. They were in the midst of preparing to file derivative actions against controlling shareholders (who were usually board members as well) of certain chaebol companies because of committed crimes such as bribery or accounting fraud. In some instances, such wrongdoings were proved in a series of preceding criminal actions, and it was quite evident that such wrongdoings caused losses to the companies where the potential defendants were directors. In some cases, however, the direct victim of such misconducts was an unlisted subsidiary

38. Locascio, supra note 1, at 757.
39. Id.
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rather than the listed parent company for which the activists could mobilize to-be-plaintiff shareholders. It raised the necessity of double or multiple derivative actions.

In 2004, while the activists were preparing to file a double derivative action against the directors of SK Shipping, an unlisted subsidiary of the SK Group, for using corporate funds for bribery, the Supreme Court ruled in another case that a double derivative action is not allowed under Korean law. This ruling itself involved a small private company which was not a part of a chaebol or large business group, but its effect was strong enough to dissuade the activists from seeking double derivative remedies against chaebol family members and management in other cases such as SK Shipping.

Details of this 2004 Supreme Court case warrant a review. The defendant was a director of both a parent company and its subsidiary (the parent company held 80.55% of the issued voting stock of the subsidiary and both companies were unlisted ones). At the trial court, the plaintiff, who owned a 29.24% stake of the parent company, brought a standard derivative suit on the grounds that the defendant, as a director of the parent company, breached the fiduciary duty owed to the parent company and caused harm to the parent company. After this claim was dismissed by the trial court for lack of evidence, the plaintiff added a new cause of action in front of the appellate court by arguing that the defendant, as a director of the subsidiary, breached his fiduciary duty owed to the subsidiary and caused harm to the subsidiary (he allegedly embezzled assets of the subsidiary). This added portion was a double derivative action because the plaintiff was a “shareholder of a shareholder of” the subsidiary that suffered alleged damage.

The appellate court held that a double derivative action was legitimate. It stated that, “...it is difficult to prevent the indirect damage of the parent company caused by the wrongdoings of the subsidiary’s director only by demanding that the parent company file a derivative action or by filing a derivative action against the directors of the parent company...” and further noted that “...a double derivative action may deter the wrongdoings of a subsidiary’s directors, and indirectly reduces the losses of the parent company and its shareholders.” It clearly took a practical approach by highlighting the

40. Jooyoung Kim, Meaning of Introducing Double Derivative Actions Observed through Real Cases, 25(4) COMMERCIAL LAW REVIEW 62, at 63 (2007) (in Korean). Jooyoung Kim, a famous litigation attorney practicing in Seoul, was the key member of People’s Solidarity of Participatory Democracy, the NGO that organized and brought many derivative actions against chaebol companies.
42. Jooyoung Kim, supra note 40, at 64.
43. This new addition of a cause of action was neither time barred nor otherwise procedurally barred under Korean law.
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purposes of a derivative action, namely “deterrence of wrongdoing” and “recovery of loss.”

The Supreme Court, however, reversed the appellate court’s decision. The court’s logic was very simple and even blunt, as it stated, “. . .since the Article 403 of the KCC limits the standing of a derivative action to the shareholders of the company where the defendant is a director, the shareholder of a parent company lacks standing to bring a derivative action against the director of a subsidiary.” While the appellate court took a functional approach by focusing on policy issues, the Supreme Court stuck to a literal interpretation of the KCC. It is one of many examples of the formalistic and faithful-to-the-letter attitudes of the Korean Supreme Court that is often witnessed in the field of corporate law.

C. Debates

Debates on this case were two-folds. The first issue was whether the ruling of the Supreme Court was proper interpretation of the KCC. The second issue was whether the KCC should be amended to allow multiple derivative actions. With regards to the first issue, while certain commentators supported the appellate court decision, more commentators in Korea agreed with the holding of the Supreme Court. The majority believed that, at least as a matter of interpreting current statutes, a double derivative action could not be allowed because the KCC limited the standing of a derivative action to the shareholders of the harmed company.

However, even among those who agreed with the Supreme Court’s decision, many were in favor of the idea that the KCC should be amended to explicitly allow double or multiple derivative actions. These commentators generally relied on policy arguments. Just as the appellate court of the 2004 case did, they pointed out the practical necessity of allowing multiple derivative


47. Tae-Jong Lee, Double Derivative Actions under US Corporate Law, 2 COURT PRACTICE RESEARCH 497, 510 (Suwon District Court, 1997) (in Korean) (stating that the concept of ‘shareholder’ can be interpreted to include ‘shareholder of shareholder’); Ok-Rial Song, Whether Double Derivative Actions are Allowed Under Current Korean Commercial Code, 28 JOURNAL OF PRIVATE CASE LAW STUDIES 529, 543-551 (2006) (in Korean) (stating that the shareholder of a parent company falls under the concept of the shareholder of the company so long as their interests are aligned).

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Of course, certain commentators, as well as members of business community, were strongly against this “new statute” idea. They relied on a few arguments: (i) it will increase the number of frivolous lawsuits like in US and will create too many burdens and inefficiencies for the companies; (ii) it is against the doctrine of separate legal entities and unduly demurs the distinction between the parent and the subsidiary; (iii) a standard derivative action is sufficient because the parent’s shareholders may demand the director of the parent file a derivative suit against the subsidiary’s wrongdoing director, and if he doesn’t follow that demand, then he can be sued derivatively by the parent’s shareholders;\footnote{For example, Jae-Yeol Kwon, A Review of 2016 Proposed Amendments to Articles Regarding Derivative Actions under the Korean Commercial Code : In Comparison With Delaware Law and Cases, 27(1) JOURNAL OF BUSINESS ADMINISTRATION & LAW 135, 156-158 (2016) (in Korean) (stating that multiple derivative action is not compatible with Korean law because it disregards distinction of legal personality between the parent company and the subsidiary); Jeong-Ho Kim, A Study on the Path to Introduce the Multiple Derivative Suit in Korea, 23(4) JOURNAL OF BUSINESS ADMINISTRATION & LAW 209, 248-250 (2013) (in Korean) (opposing to the idea of new legislation because it is better to wait case laws to evolve for fact patterns such as wholly-owned subsidiaries and piercing corporate veil); Wan-Jin Choi, A Legal Study on the Double Derivative Suit, 18(2) JOURNAL OF BUSINESS ADMINISTRATION & LAW 255, 271 (2008) (in Korean) (preferring case laws to evolve for specific fact patterns); June-Sun Choi, Double Derivative Action, 18(3) SUNGKYUNKWAN LAW REVIEW 433, 462 (2006) (in Korean) (opposing to the idea of new legislation because it can be acknowledged by piercing corporate veil).} and (iv) allowing double derivative actions is inconsistent with the policy of the Korean government for the last 15 years, which recommended “a holding company structure” instead of “a circular ownership structure.”\footnote{It is true that for the last 15 to 20 years the Korean government has recommended chaebol groups to deconstruct circular ownership structures and adopt holding company structures because the latter is generally more transparent and less problematic (in terms of the gap between cash flow rights and control) than the former. However, if double/multiple derivative actions are allowed, business groups that converted into a holding company structure will be more vulnerable to those actions.}

Such a debate was not just academic or theoretical. In 2006, the Ministry of Justice of the Republic of Korea (“MOJ”) released a draft KCC reform bill that
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included a new provision explicitly allowing double/multiple derivative actions.\(^{52}\) It provided that shareholders who own at least 1% (0.01% in the case of a listed company) of the issued shares of the parent company may bring a suit against the director of the subsidiary, after submitting a written demand to sue to the subsidiary and waiting 30 days. It also granted a right to inspect books and records of the subsidiary to the shareholders who own at least 3% of the issued shares of the parent company. Since a subsidiary of a subsidiary is defined as a “subsidiary” of the parent company under the KCC,\(^ {53}\) the proposed draft in effect also allowed multiple derivative actions not only double derivative actions. The MOJ’s bill faced strong criticism from the business community, especially the Federation of Korean Industries, a main trade association for large business groups.\(^ {54}\) As a result, it was omitted from the final bill submitted by the MOJ to the National Assembly in late 2006.\(^ {55}\)

In 2012, the issue of double and multiple derivative actions arose again because of the so-called “Economic Democratization,”\(^ {56}\) the main campaign agenda of Presidential Candidate Park Geun-Hye. The “Economic Democratization” included various proposals for corporate governance reform. “Allowing multiple derivative actions” was one of Park’s campaign promises and was even contained in a campaign leaflet of Park’s camp as an item of economic democratization. After Park won the presidential election in 2012, the MOJ once again proposed an amendment to the corporate law chapter of the KCC that included multiple derivative actions pursuant to Park’s campaign promises.\(^ {57}\) Apparently in the face of organized resistance from the business community, however, the MOJ stopped the entire process of amending the KCC.\(^ {58}\)


\(^{53}\) Article 342-2(3) of the KCC.

\(^{54}\) Kon-Sik Kim, supra note 46, at 127.

\(^{55}\) Hyeok-Joon Rho and Kon-Sik Kim, Invigorating Shareholder Derivative Actions in South Korea, in THE DERIVATIVE ACTION IN ASIA (Dan Puchniak, Harald Baum, Michael Ewing-Chow Eds.), 199 (Cambridge University Press, 2012).

\(^{56}\) Its exact meaning is still (maybe inherently) unclear, but it generally encompassed various “progressive” smaller agenda items such as stronger regulation of conglomerates, distribution of market power, protection of minority shareholders, assistance to small and medium enterprises, and so on. Ironically, this agenda was preempted and fully utilized by Park Geun-Hye, the candidate of the conservative party, in 2012 presidential election.

\(^{57}\) Ministry of Justice, Public Notice 2013–162 (Jul. 17, 2013). Other items for proposed changes included mandatory cumulative votes, mandatory electronic votes, separation of the board chair and the CEO, and separate election of directors who will be audit committee members. All of these changes were proposed for the large listed firms exceeding certain size thresholds.

\(^{58}\) After the MOJ’s announcement of the draft amendment on July 17, 2013, major newspapers in Korea opposed the amendment through editorials. On August 27, 2013, the chairmen (controlling shareholders) of the top ten Korean chaebols were invited to a meeting with the President, and the President was reported to have said that, “I understand your concerns about the amendment of the KCC and the government will be more cautious in proceeding.” After that meeting, the MOJ did not take any further action for the amendment of the KCC until a new President was elected in 2017.

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In 2016 and 2017, the debate surfaced again when dozens of bills were submitted to the National Assembly to amend the corporate law chapter of the KCC. This time, dozens of congressmen submitted various bills on corporate governance issues, and at least six bills specifically included double/multiple derivative actions. They are still pending at the National Assembly as of August 2018.

D. Bills of 2016 and 2017

Bill No. 645, submitted by Congressman Jong-In Kim, was the initial bill that proposed to amend the KCC. It states that, “…a shareholder who owns at least 1% (0.01% in the case of a listed company) of the issued shares of the parent company may demand the subsidiary bring a suit against the director of the subsidiary…” and, if the demand period of 30 days elapses, a shareholder can file a double derivative action against the subsidiary’s director on behalf of the subsidiary. Here, the subsidiary is defined as a company in which the parent company holds more than 50% of the total number of issued shares pursuant to the KCC.

Bill No. 3254, submitted by Congressman Jong-Geol Lee, has two additional features on top of the foregoing bill. First, shareholders who own 1% or more of the issued shares of the parent company have a right to inspect the books and records of a subsidiary (“double inspection right”). Second, those shareholders of a parent company may ask the court to appoint an examiner who is authorized to examine the business affairs and assets of the subsidiary when there is suspicion of a material violation of the law or the articles of incorporation by the management of a subsidiary.

Bill No. 1463, submitted by Congressman I-Bae Chae, recognizes double/multiple derivative actions when one company has more than 30% (as opposed to 50% in the bills of Jong-in Kim and Jong-Geol Lee) of the issued shares of the other company. It also lowers the minimum shareholding requirement for a listed company to 0.001% (for six months) and acknowledges inspection rights of the parent company’s shareholders into the books and records of the subsidiaries.

60. Article 342-2(1) of the KCC.
62. Bill No. 1463, amendment to the KCC (Sangbeon-ilbu-gaejeong-beobryul-an), dated August 8, 2016.
Bill No. 2091, submitted by Congressman Hoe-Chan Roh, proposes the most shareholder-friendly scheme. It proposes to abolish the minimum shareholding ratio requirement for derivative actions in general. Thus, any shareholder holding at least one share (as opposed to 1% or 0.01%, as the current law says) of a company for 6 months may bring a derivative action. Also, it recognizes a “parent-subsidiary” relationship when a company has more than 30% of the issued shares of the other company, or otherwise has “de facto control” over the other company. Thus, if Company A has “de facto control” over Company B, then a person who has held one share of Company A for at least 6 months may bring a double derivative action against a director of Company B.

In contrast to the shareholder-friendly schemes proposed by the other bills, Bill No. 7863, submitted by Congressman Sang-Jik Yoon, reflects the opinions of the business community. It allows double derivative actions only for wholly-owned subsidiaries (similar to Japanese law as discussed below in IV.2) and requires court approval before bringing a suit. Thus, if the subsidiary has any shareholder other than the parent company, then a shareholder of the parent company is barred from bringing a double derivative action against the directors of the subsidiary. The minimum shareholding requirement for double derivative actions is 1% for both listed and unlisted companies, the highest ratio among the bills.

The key features of these five bills can be summarized as below:

<table>
<thead>
<tr>
<th>Plaintiff Requirement</th>
<th>Kim’s Bill</th>
<th>Lee’s Bill</th>
<th>Chae’s Bill</th>
<th>Roh’s Bill</th>
<th>Yoon’s Bill</th>
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<tbody>
<tr>
<td>Requirement</td>
<td>1% (unlisted); 0.01% + 6 months (listed)</td>
<td>1% (unlisted); 0.001% + 6 months (listed)</td>
<td>1 share + 6 months (listed and unlisted)</td>
<td>1% (listed and unlisted) + court approval</td>
<td></td>
</tr>
<tr>
<td>Parent-Subsidiary Requirement</td>
<td>more than 50%</td>
<td>more than 50%</td>
<td>more than 30%</td>
<td>more than 30% or de facto</td>
<td>100%</td>
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63. He is a member of Justice Party, currently the most progressive party in the National Assembly.
64. Bill No. 2091, amendment to the KCC (Sangbeon-ilbu-gaejeong-beohryul-an), dated September 2, 2016.
65. He is a member of Liberty Korea Party, currently the most conservative party in the National Assembly.
67. In addition to the five bills discussed above, Bill No. 5633, amendment to the KCC (Sangbeon-ilbu-gaejeong-beohryul-an), dated February 14, 2017 was submitted by Congressman Shin-Hwan Oh. However, so long as the multiple derivative action is concerned, this bill is almost same as the bill submitted by Jong-In Kim.
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<table>
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<tr>
<th>Control</th>
<th>Multiple Inspection Right</th>
<th>Court Appointed Examiner</th>
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<tr>
<td>No</td>
<td>Yes</td>
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A glance at these bills reveals that, despite the quite technical nature of multiple derivative actions, dynamic debates are being conducted on a political, rather than theoretical, dimension. Congressmen from a progressive party propose bringing down the hurdle as low as possible, while congressmen from a conservative party propose stricter requirements. To find benchmarks beyond mere reflection of political stances, we need to look at the laws of other major jurisdictions for reference.

PART IV: A COMPARATIVE SKETCH

A. United States

The courts of many states in US have allowed double or multiple derivative suits since the late 19th century without any statutory grounds. A double or multiple derivative action has “met with nearly universal acceptance” and “has not been judicially challenged since [its recognition].” Although the

68. “The double derivative action is a long-standing doctrine of equity jurisprudence, having been woven into the quiltwork of equitable principles covering shareholder-corporate relations over a century ago.” Brown v. Tenney, 125 Ill. 2d 348, 359 (Supreme Court of Illinois, 1988). Earlier literatures on this subject include: Note, Remedies of Stockholder of Parent Corporation for Injuries to Subsidiaries, 50 HARV. L. REV. 963 (1937); Note, Suits by a Shareholder in a Parent Corporation to Redress Injuries to the Subsidiary, 64 HARV. L. REV. 1313 (1951); Note, Corporations - Triple Derivative Suit Allowed in Absence of Controlling Interest, 25 FORDHAM L. REV. 140 (1956); Comment, Corporation – A Multiple Derivative Action is Valid in Certain Instances Though the Corporation in Which Plaintiff Holds Shares Does Not Own a Controlling Interest in the Corporation Which Controls the Corporation in Whose Behalf Plaintiff Sues, 44 GEO. L.J. 334 (1956); Note, Corporations – An Examination of the Multiple Derivative Suit and Some Problems Involved Therein in Light of the Theory of the Single Derivative Suit, 31 N.Y.U.L. REV. 932 (1956).

69. Brown v. Tenney, Id., at 359 (adding that “[cases] which assertedly have not recognized the double derivative cause of action do not involve a holding company-subsidiary company context; rather, they involve survival of actions after a corporate merger”).

70. BLUMBERG, STRASSER, GEORGAKOPOULOS, AND GOUVIN, BLUMBERG ON CORPORATE GROUPS (SECOND EDITION), Wolters Kluwer (supplemented in 2013), §44.02 (44-4). Contrary to this firm statement, a ruling of Southern District Court of New York is cited as a case that disallowed a double or multiple derivative action (Locascio, supra note 1, at 730-734). It held that a shareholder of a corporation which owned all of the stocks of an issuer did not have standing to bring a suit on behalf of the issuer to recover short-swing profits based on section 16(b) of the Securities Exchange Act of 1934. However, at issue in this ruling was how to interpret the statutory requirements under section 16(b) rather than whether to allow a multiple derivative action in general. The court also said that “[t]he
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doctrine itself was firmly established, the underlying theory was neither clear nor consistent.

In the early 20th century, certain courts have justified double derivative suits by relying on the theory of “piercing the corporate veil” – in other words, by treating the parent company and subsidiary as one entity. However, the veil-piercing theory severely limits the application of double derivative suits, because courts tend to pierce the corporate veil only in exceptional circumstances where (i) the corporation and its owners are so commingled that they cannot be regarded as separate personalities and (ii) continued separate corporate existence would result in a fraud or injustice. Also, there is no logical basis for double derivative suits being only allowed when the parent company and the subsidiary are so commingled that their respective corporate entities are disregarded. Therefore, for the past several decades, it appears that US courts have no more required “piercing the corporate veil” as a precondition for allowing a double derivative suit.

Certain other courts justified double derivative actions by a theory of common control. In United States Lines, the second circuit court found the justification to be the control exercised by the alleged wrongdoers over both the parent and the subsidiary. It stated that “the justification for allowing a double derivative suit [...] is that both the original corporation that is said to have suffered wrong and its shareholder corporation which had the right to bring a derivative suit were in the control of those charged with inflicting the corporate injury.” Under such circumstances, “it would be naïve to expect those on the board of directors of either corporation to vote in favor of either a direct or a simple derivative action.” However, while the court seriously considered the situation where both a parent and a subsidiary were under the control of the wrongdoer, it is questionable whether the court strictly required such a situation as a prerequisite for allowing a double derivative action. Subsequent court rulings focused on the practical necessity of a double derivative action instead of the specific standing requirements.

71. For example, Hirshhorn v. Mine Safety Appliances Co., 54 F. Supp. 588, 592 (W.D. Pa. 1944); Martin v. D.B. Martin Co., 10 Del. Ch. 211, 88 A. 612, 614 (1913). However, as to Hirshhorn, Professor Painter commented that “[it relied] on the concept of disregard of the corporate entity [...] as an alternative ground for the holding rather than an exclusive test of the right to bring a double derivative action.” Painter, supra note 2, at 149.
72. Painter, supra note 2, at 147-150; Locascio, supra note 1, at 744-745.
73. BLUMBERG ET. AL., supra note 70, at §44.02 [D] (44-7) (“[i]t is plain today that the basis of the multiple derivative action does not rest on the lack of a separate and distinct existence of the subsidiary”).
75. Id. at 151.
76. Painter, supra note 2, at 151.
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of requiring a “theory” that would justify it such as veil piercing or common control.77

Another issue is how much ownership the parent company must have over the subsidiary in order to justify double derivative suits. Many courts have allowed double derivative suits when the parent company had less than complete ownership over the subsidiary.78 One court clearly stated that “[s]uit by the stockholder of a parent corporation need not be limited only to situations in which the subsidiary is wholly owned or in which there is no one else who can sue.”79 However, no court dared to specify the parent’s ownership threshold as a number, and certain courts explicitly declined to specify a minimum stock ownership ratio required for bringing a double derivative suit.80

Cases and theories of US discussed thus far are rather old, but courts have continued to acknowledge double or multiple derivative actions. In the 2010s, for example, a double derivative suit (the Lambrecht case)81 and a triple derivative suit (the Sagarra case)82 were allowed for wholly owned subsidiaries in Delaware. The Lambrecht case deserves a closer review.

It involved actions brought by the shareholders of a company which was later acquired by another company by way of a stock-for-stock merger.83 The

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77. For example, “... realities have brought recognition of the right of the stockholder to bring suit not only for wrongs inflicted directly on the corporation in which he holds stock, but for wrongs done to that corporation’s subsidiaries which make indirect, but nonetheless real, impact upon the parent corporation and its stockholders.” Kaufman v. Wolfson, 1 A.D.2d 555, 556-557 (1956); “Unexamined observance to rigid and outmoded theories may result in inequitable decisions that fail to comport with the realities of corporate structure. For these reasons, we believe that double derivative suits should become part of the law of this State.” Brown v. Tenney, 155 Ill. App.3d 605, 609 (1987).


80. Painter, supra note 2, at 150; Saltzman v. Birrell, 78 F. Supp. 778, 784 (S.D.N.Y. 1948) (stating “nor does it appear a wise course to establish [...] a minimum requisite stock ownership by the parent in the subsidiary for institution of a multiple derivative suit”).

81. Lambrecht v. O’Neal, 3 A.3d 277 (Del. 2010).


83. Lambrecht v. O’Neal, 3 A.3d 277, 280-281 (Del. 2010). Originally, shareholders of Merrill Lynch filed standard derivative actions against the senior management and directors of Merrill Lynch for breach of their fiduciary duties to recover losses Merrill Lynch suffered. While the actions were pending, Merrill Lynch became a wholly-owned subsidiary of Bank of America through a stock-for-stock merger and the plaintiffs’ Merrill Lynch shares were converted to shares of Bank of America. The US District Court for the Southern District of New York (“S.D.N.Y.”) dismissed the standard derivative actions because the plaintiffs were no longer shareholders of Merrill Lynch, but without prejudice to plaintiffs’ repleading their actions as double derivative actions. After the dismissal, one of the original plaintiffs filed a claim to be double derivative, and the other plaintiffs filed a new lawsuit that took the form of a double derivative action. Since the Merrill Lynch was a Delaware corporation, the S.D.N.Y. certified a question of law to the Supreme Court of Delaware. Id. at 279. The main holding of
court categorized double derivative actions into two distinct groups. The first are lawsuits that are brought originally as double-derivative actions from the beginning, where the parent company has a pre-existing subsidiary at the time of the alleged wrongful conduct at the subsidiary level. The second category involves cases where the action is brought originally as a standard derivative action on behalf of a company, but the company is later acquired by another corporation by way of a stock-for-stock merger. In the second category, the plaintiff was a shareholder of the company at the time of filing a suit, but becomes a shareholder of the parent of the company after the stock-for-stock merger. The Lambrecht case fell under the second category (which is not a main concern of this article), but it did, in dictum, summarize the nature and reason for a double derivative action in the first category:

[Mismanagement and breaches of fiduciary duty by the directors of the subsidiary [...] resulted in harm to the subsidiary and, consequently, to the parent as the subsidiary’s only shareholder. In these circumstances, our law recognizes a right to proceed double derivatively. Otherwise, there would be no procedural vehicle to remedy the claimed wrongdoing in cases where the parent company board’s decision not to enforce the subsidiary’s claim is unprotected by the business judgment rule.]

Although courts in other states such as California, New York, and Pennsylvania have allowed double or multiple derivative suits to be brought and maintained when the parent company owns less than 100% shares of the subsidiary, the Delaware court has not opined as to whether this is allowed. In Lambrecht, the court intentionally avoided this issue:

Within this first category there is a subset of cases where the parent owns a controlling – but not 100% – of the subsidiary. In those cases a minority shareholder of the subsidiary [...] could bring a standard derivative action on the subsidiary’s behalf. In that scenario, a question that logically arises is whether, in addition to the standard remedy, a shareholder of the parent company could assert a double derivative claim. [Courts of some states recognize such right.] To date, the Delaware courts have not addressed this specific question nor do we purport to do so, expressly or implicitly, in this Opinion.

B. Japan

In Japan, the need for double or multiple derivative actions was generally recognized as a means to control the directors and officers of the unlisted

the Lambrecht decision was that, in the cases falling under the second category, “the shareholders were not required to demonstrate that they owned stock in acquiring corporation and that acquiring corporation owned stock in acquired corporation at the time of alleged wrongdoing.” Id. at 277. In other words, the contemporaneous ownership requirement is not strictly applied in the second category cases.

84. Id. at 282.
85. Id.
86. Id. at 282-283.
87. Supra note 78.
88. 3 A.3d 277, at 283.
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subsidiaries of listed firms. After a long process of review and discussion, the Japanese Corporate Law (kaishaho) was amended on June 20, 2014 with, among others, a complicated new provision (Article 847-3) on multiple derivative actions. However, its scope is very limited.

First, a shareholder bringing a claim must be part of a “final complete parent company (FCP).”\textsuperscript{89} For example, if Company A owns 100% of Company B, and Company B owns 100% of Company C, then Company A is the FCP of Company C. If Company B owns 100% minus one share of Company C, then Company A is not the FCP of Company C and a shareholder of Company A cannot bring a multiple derivative suit on behalf of Company C. FCP can be recognized by aggregating intermediary subsidiaries’ shareholdings. For example, if Company A wholly owns Company B and Company C, and each of Company B and Company C owns 50% of Company D, then Company A is the FCP of Company D.\textsuperscript{90} Again, if one single share of Company D is owned by an outsider, Company A ceases to be the FCP of Company D.

Second, the plaintiff must have owned at least 1% of the total voting rights, or 1% of the total issued shares, of the FCP for at least 6 months.\textsuperscript{91} Japanese corporate law, unlike Korean law, allows a shareholder who has owned any share of the company for at least 6 months to bring a standard derivative action without requiring a minimum shareholding ratio.\textsuperscript{92} However, in a double or multiple derivative action setting, Japanese law requires the minimum shareholding ratio.

Third, only those subsidiaries which are “material” in size compared to the size of the FCP are subject to the multiple derivative actions. Materiality or size of the subsidiary is measured by the book value of its shares. That is, multiple derivative actions are allowed only when the book value of the shares of the relevant subsidiary exceeds 20% of the total assets of the FCP at the time when the cause of action occurred.\textsuperscript{93} Thus, even if a director of Subsidiary A willfully caused serious damage to Subsidiary A (and indirectly harmed the FCP), if the book value of the shares of Subsidiary A is less than 20% of the

\textsuperscript{89.} Article 847-3(1) of the Company Act of Japan (\textit{Kaishaho}).
\textsuperscript{90.} Article 847-3(2)(ii) of \textit{Kaishaho}.
\textsuperscript{91.} Article 847-3(1) of \textit{Kaishaho}. The six-month holding period is not required when the FCP is a “closed company,” meaning that transfer of the shares of the FCP requires FCP’s approval in accordance with its articles of incorporation. Articles 847-3(6) and 2(v).
\textsuperscript{92.} Article 847(1) of \textit{Kaishaho}. The six-month holding period is not required when the company is a “closed company,” meaning that transfer of the shares of the company requires the company’s approval in accordance with its articles of incorporation. Articles 847(2) and 2(v).
\textsuperscript{93.} Article 847-3(4) of \textit{Kaishaho}.
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total assets of the FCP, then the shareholders of the FCP are barred from bringing a multiple derivative suit against such a director.94

There are further details to note in this Japanese version of multiple derivative suits,95 but the foregoing three requirements are already quite restrictive and criticized by some commentators.96 In Korea, those who oppose the idea of adopting multiple derivative actions by statute highly praise the Japanese law as a “considerate and careful approach.”

C. United Kingdom

In the UK, derivative claims were originally developed by the common law as an exception to the rule in Foss v Harbottle97 that only the company itself has standing to pursue a claim for its losses. In 1990s, the Law Commission reviewed whether a multiple derivative action should be recognized as a remedy for shareholders in addition to a standard derivative action. While it noted that double derivative actions are available in Canada under the Canada Business Corporations Act of 1985 and multiple derivative actions are available in New Zealand,98 the Law Commission decided not to include multiple derivative actions in developing the Companies Act of 2006 on the ground that situations calling for its use would be “extremely rare” and that it would not be helpful or practical to include such a provision.99 Although the Company Law Review Steering Group suggested that “rules for a double derivative action should be devised,”100 the Companies Act of 2006 (“Act”) has no provisions on

94. This “materiality” requirement was introduced to balance the liability of subsidiaries’ directors and that of the senior employees of the parent company. In terms of hierarchy within a corporate group, directors of small subsidiaries are often in a status corresponding to, or even lower than, the senior employees of the parent company. If the former is exposed to the risk of being sued while the latter is not, the balance would be impaired. It was the reason for introducing “materiality” requirement. YOICHI TAKAHASHI, IDEAL MODEL OF MULTIPLE DERIVATIVE ACTION SYSTEM 269 (Shojihomu, 2015) (in Japanese).

95. For example, the shareholders of the FCP have to first demand the relevant subsidiary to file a suit against the wrongdoing directors, and if the subsidiary fails to file a suit within 60 days, then the demanding shareholders of the FCP are allowed to file a suit on behalf of the relevant subsidiary. Article 847-3(7) of Kaishaho.

96. For example, a monograph on this issue written in Japanese opposes such a restrictive approach. Yoichi Takahashi, supra note 94, at 266 (criticizing restriction to “completely owned subsidiaries”), at 271 (criticizing “size of subsidiary” requirement), at 276 (arguing that a holder of one share should be allowed to bring a suit).

97. Foss v Harbottle (1843) 2 Hare 461.

98. Law Commission, Shareholder Remedies (Consultation Paper No. 142, 1996), Appendix F para 2.6 and 4.3.


100. Company Law Review Steering Group, Modern Company Law for a Competitive Economy: Developing the Framework (URN 00/656) (March 2000), para. 4.133.
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double or multiple derivative actions. Silence of the Act on this issue was criticized by some commentators.

Contrary to the Law Commission’s projection, such situations were far from “extremely rare.” In Fort Gilkicker, the High Court had to determine two issues: whether the English common law recognized double derivative actions prior to the enactment of the Act and, if it did, whether the common law double derivative actions were abolished upon the introduction of the Act. As for the first issue, the court noted that common law derivative actions typically involved conferral of locus standi upon members of the wronged company and that there were reported examples where locus standi was conferred upon a member of its holding company, when the holding company was itself subject to the same wrongdoer control as the company. As for the second issue, the court found that the Act did not abolish common law double derivative actions. Two years later, in Bhullar, the High Court reaffirmed that the Act has not taken away the power of shareholders to bring a double derivative action and recognized one brought by a shareholder of a parent company against a director of a wholly owned subsidiary.

These decisions in UK affected a famous multiple derivative action in Hong Kong, brought by a minority shareholder in a parent company for wrongs allegedly done to the parent company’s sub-subsidiary. The parent company was a Bermuda company and the subsidiary and the sub-subsidiary were incorporated under the law of the British Virgin Island (“BVI”). The defendant raised a defense that the BVI law should govern the case and that the multiple derivative action is not maintainable under the BVI law. The Court of Appeal ruled that such defense was too late to be raised, and further ruled that, even if such a defense was not time-barred, the merit of the case would not change because the BVI court would most probably acknowledge a multiple derivative

101. Chapter 1 of Part 11 of the Act prescribes the conditions for bringing a derivative claim. Section 260 of the Act provides that the Chapter applies to proceedings “by a member of a company” seeking relief on behalf of the company in respect of a cause of action vested in the company.

102. ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE 202 (Oxford University Press, 2007) states that such silence of the 2006 Company Act is “regrettable” and argues for acknowledging multiple derivative actions. Lord Millett, writing in an extra-judicial capacity, wrote that abolition of double derivative claims would give potential fraudsters a simple moral, “choose an English company and be careful to defraud its subsidiary and not the company itself” (Millett, Multiple Derivative Actions, THE GORE-BROWNE BULLETIN, July 2010, pp. 1-4).


104. Statute will be construed as taking away common law rights only if it does so expressly or by necessary implication (Islington Borough Council v Uckac [2006] 1 WLR 1303). In this case, according to the court, while the Act abolished common law rights in relation to the derivative claims by members, the abolition was neither express nor a necessary implication in relation to the double derivative claims by members of the holding company.


action at common law. The Fort Gilkicker decision was cited as an important authority.

Thus, like the US, the UK courts acknowledged double derivative actions as a matter of common law without statutory grounds. It is not certain, however, whether such a ruling will be valid when the parent owns less than 100% of the shares issued by the subsidiary.

PART V: ISSUES TO BE CONSIDERED FOR LEGISLATION

Based on the above comparative review, we note that there are a few issues to be considered and addressed when preparing a law on multiple derivative actions. The first issue would be whether any statute is necessary at all — whether the doctrine of “piercing the corporate veil” is sufficient to protect the shareholders of a parent company from wrongdoings done at the level of subsidiaries. Arguments that a standard derivative action against the parent company’s directors is sufficient also warrant a review. The question of whether multiple derivative actions should be allowed when the parent has less than complete ownership of the subsidiaries is still an open question, as considered in many US cases. Whether the subsidiary must be “material” in size as required under Japanese law is another point to consider.

A. Is “Piercing the Corporate Veil” Sufficient?

A number of Korean scholars still argue that multiple derivative actions can and should be allowed only when the corporate personality of a subsidiary is disregarded in accordance with the doctrine of “piercing the corporate veil.”107 They argue that there is no need to explicitly allow multiple derivative actions by statute. A few US cases based on such a doctrine108 are cited to support their arguments.

This is based on a misunderstanding of the nature of multiple derivative actions. When a subsidiary suffers losses due to a breach of fiduciary duty by its director or officer, the claim (or cause of action) belongs to the subsidiary. Whether (i) the subsidiary itself enforces the cause of action, (ii) the parent company derivatively enforces the cause of action, or (iii) a shareholder of the parent company double-derivatively enforces the cause of action, the intended result is the same: transfer of wealth from the defendant to the subsidiary for the recovery of the losses incurred by the subsidiary. The difference among these three instances is merely who brings the case to the court as a plaintiff, and the derivative or double-derivative plaintiff is more like an agent than a principal because the substantive claims, or causes of action, are not vested

107. Supra note 50.
108. Supra note 71.
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with the plaintiff. Thus, if a standard derivative action does not pierce the corporate veil of the company, neither does a multiple derivative action.

We pierce the corporate veil of the subsidiary when we attempt to pursue the liability of someone standing behind the veil. In the context of a multiple derivative action, however, we are not seeking payment from behind the veil, but authorizing someone higher up in the ownership chain to enforce the subsidiary’s claim. There will be many situations where multiple derivative actions are necessary to protect the shareholders of the parent company even though the corporate veil of the subsidiary cannot be pierced under the doctrine. Therefore, resorting to the doctrine of “piercing the corporate veil” to justify a double derivative suit is simply irrelevant.109

B. Is a Standard Derivative Action Sufficient?

There are also arguments that a standard derivative action is sufficient to address wrongdoings done at the subsidiary level. According to this argument, the shareholders of a parent company may pursue the liability of the directors of the parent company for failure to monitor the subsidiary’s management or for failure to seek proper remedies against such wrongdoers on behalf of the relevant subsidiary.110

Theoretically, this argument could have merit given that it is the directors of a parent company who owe a fiduciary duty to the shareholders of the parent company. The fiduciary duty of the directors of a parent company include monitoring the directors of a subsidiary and, if the directors of a subsidiary commit wrongdoing, seeking proper remedies such as filing a standard derivative action on behalf of the subsidiary.

Practically speaking, however, seeking the liability of a parent’s directors for the wrongdoings of a subsidiary’s directors would be very difficult, and almost impossible under the current civil practices of Korea. In order to seek the liability of a parent’s directors for the wrongdoings of a subsidiary’s directors by way of a standard derivative action, the plaintiff shareholder must prove (i) that the parent’s directors breached their fiduciary duty by failing to monitor the subsidiary’s directors or by failing to seek proper remedies, (ii) that the parent incurred losses, and (iii) causation between the parent’s losses and the breach of fiduciary duty by the parent’s directors. On the contrary, in order to seek the liability of a subsidiary’s directors by way of a double derivative action, the plaintiff shareholder must prove (i) that the subsidiary’s directors breached their fiduciary duty through the wrongdoings in question, (ii) that the

109. See also supra note 73.
110. See Locascio, supra note 1, at 735-739 (focusing on the failure to take remedies to protect a parent’s investment in a subsidiary). Locascio’s article introduces such an argument, but does not support it.
subsidiary incurred losses, and (iii) causation between the subsidiary’s losses and the wrongdoings of the subsidiary’s directors. The latter is much easier to prove than the former.

For example, when a director of a subsidiary embezzles its money, a plaintiff who is double-derivatively bringing an action has only to prove that the defendant (director of the subsidiary) embezzled the subsidiary’s money and that this caused harm to the subsidiary. In other words, in a double derivative action, the defendant and the initial wrongdoer is the same person, so the plaintiff has only to prove the wrongdoing and its monetary impact on the subsidiary. On the other hand, a plaintiff who is seeking the liability of a parent’s directors has to prove that the defendants (parent’s directors) failed to properly monitor, or to take proper actions against, the subsidiary’s director and that the parent incurred losses due to such failure. Here, the defendants and the initial wrongdoer are different, so the plaintiff must prove the wrongdoing of the subsidiary’s director, the defendants’ breach of fiduciary duty in preventing or taking actions against the wrongdoing, and its monetary impact on the parent company.

When a plaintiff relies on a standard derivative suit, the defendants (directors of the parent company) may argue that they could not detect and prevent the wrongdoings of the subsidiary’s director even though they performed their fiduciary duty. Or the defendants may argue that only a portion of the embezzled money can be attributable to the breach of fiduciary duty of the parent’s directors. Another difficult problem is measuring damages – because the subsidiary and not the parent actually suffers the direct injury, valuation of the indirect harm to the parent is more difficult than assessing the direct harm to the subsidiary.111 It would be very difficult to overcome these arguments and finally prove that the parent’s losses were caused by a breach of fiduciary duty of the directors of the parent with respect to the wrongdoings committed by the subsidiary’s directors.

Considering such difficulties, double or multiple derivative actions are necessary to recover the losses of a subsidiary (which will indirectly benefit the parent, and then the parent’s shareholders)112 and deter wrongdoings that may be committed at the level of subsidiaries.113 A standard derivative action against the parent’s directors cannot be a satisfactory alternative.

111. Locascio, supra note 1, at 735-736.
112. Locascio, supra note 1, at 755-756.
113. Locascio, supra note 1, at 756-758.
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C. Must There Be Complete Ownership?

It is true that multiple derivative actions are easier to justify when there is no other shareholder of the subsidiary. If there is a shareholder of a subsidiary other than its parent company, then such a shareholder may exercise a derivative remedy against the subsidiary’s director, in which case the need for a double derivative remedy decreases.

Such an argument, however, cannot form reasonable grounds to require complete ownership by the parent company over the subsidiary, such as in Japanese law. First, it is only a possibility that such an outside shareholder would exercise a derivative remedy. If that outside shareholder does not enforce the subsidiary’s claim derivatively, then the need for a multiple derivative remedy still exists. In particular, if such an outside shareholder is a related party to the controlling shareholder of the parent company or the potential defendants, the existence of such an outside shareholder does not affect the need for a multiple derivative action. In addition, since Korean law requires a 1% shareholding ratio for filing a derivative action regarding an unlisted company, the outside shareholders must own at least 1% to bring a derivative action. Second, if we allow multiple derivative actions only for wholly owned subsidiaries, companies can easily circumvent the risk of litigation by selling just one share to a party other than the parent company.

Therefore, as cited above, “[s]uit by the stockholder of a parent corporation need not be limited only to situations in which the subsidiary is wholly owned or in which there is no one else who can sue.” Then, the next issue is how to define a parent-subsidiary relationship where multiple derivative actions are allowed. There could be a few legislative alternatives: (i) clearly providing a shareholding ratio number, or (ii) providing a flexible standard such as “de facto control” or “complete control.” In this regard, the KCC already defines a “Subsidiary” as a company where another company (“Parent”) owns more than 50% of the issued shares. Although this definition in the KCC does not by itself anticipate double or multiple derivative actions, it would be reasonable to allow double or multiple derivative actions when the parent-subsidiary relation as defined under the KCC exists.

However, even if such a relationship exists, double or multiple derivative actions need not be allowed for a listed subsidiary whose shares are publicly traded on the stock exchange, because there are a number of non-related shareholders of the subsidiary who can bring standard derivative actions. Also, the directors and management of listed subsidiaries are under the disciplinary

115. Article 342-2(1) of the KCC, which prohibits a Subsidiary from acquiring the shares of a Parent. Also, under Article 342-2(3), if Company A’s Subsidiary (Company B) is a Parent of Company C, then Company C is deemed a Subsidiary of Company A.
pressures of the stock market and the monitoring of shareholders, including active institutional investors, which makes the deterrence effect of the double or multiple derivative actions less critical.

D. Should It Be Limited to Material Subsidiaries?

The “size” or “materiality” requirement for a subsidiary, as adopted in Japan, has no corresponding concept or precedent in other jurisdictions. Whether or not the book value of a subsidiary exceeds 20% of the total assets of the ultimate parent company has no relevance at all to the question of whether to allow the shareholders of a parent company to enforce a subsidiary’s claim. The necessity of standard/double/multiple derivative actions depends on the importance of the claim that is derivatively enforced, rather than the size or importance of the subsidiary itself. A claim may be important even if a subsidiary is insignificant, and furthermore, a claim may be frivolous even if a subsidiary represents almost all of the parent company’s assets. Therefore, there are no reasonable grounds for limiting double or multiple derivative actions to subsidiaries exceeding certain size thresholds.

E. To Whom Should the Demand Be Directed?

Before filing a standard derivative action, the plaintiff shareholder must first demand that the company bring a suit against the relevant director. In double or multiple derivative actions, the same requirement should be applied. But there is a technical issue: to which entity should a plaintiff direct their demand for action?

There are three alternatives: the demand may be directed at the parent, the subsidiary, or both. Various bills in Korea\textsuperscript{116} and Japanese corporate law\textsuperscript{117} provide that the demand must be directed at the subsidiary. However, the Lambrecht ruling states that, “the plaintiff owns stock only in the parent. Therefore, [a] demand could only be made […] at the parent, not the subsidiary, level.”\textsuperscript{118} Some commentators in Korea argue that the demand must be directed at both parent and subsidiary, in order to urge the subsidiary to bring an action and the parent to bring a derivative action.\textsuperscript{119} This view is also found in some rulings of US courts.\textsuperscript{120}

\begin{table}[h]
\centering
\begin{tabular}{|c|c|}
\hline
\textbf{Table 1} & Description of various bills in Korea indicating the requirement for derivative action. \\
\hline
\textit{Article 406-2} & Demand must be directed at the subsidiary. \\
\textit{Article 847-3(1)} & Demand must be directed at both parent and subsidiary. \\
\hline
\end{tabular}
\end{table}

\textsuperscript{116} Article 406-2 of the various bills in Korea indicated in Table 1.
\textsuperscript{117} Article 847-3(1) of Kaishaho.
\textsuperscript{118} 3 A.3d 277, at 282.
\textsuperscript{119} Tae-Jong Lee, supra note 47, at 510; Young-Hoa Son, supra note 49, at 44; Mi-Kyung Yum, supra note 49, at 496; Jin-Hee Ryu, supra note 49, at 145; Hun-Jong Lee, supra note 49, at 1046.
\textsuperscript{120} Fischer v. CF & I Steel Corp., 599 F. Supp. 340, at 346 (S.D.N.Y. 1984) (holding that, when a shareholder of a parent company became a shareholder of a newly incorporated grandparent company as a result of a stock-for-stock merger between the parent company and a third party company, demand must be also made to the new grandparent company so that “the newly-constituted […] board should be
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Considering that a claim enforced via a double or multiple derivative action belongs to the subsidiary, any demand to bring a suit must be first directed at the subsidiary. In other words, the subsidiary must have the first opportunity to carry out the cause of action that it has. Then should a demand be also made at the parent? The parent is able to enforce the cause of action only derivatively because the cause of action belongs to the subsidiary. If a demand should be made at the parent to urge derivative enforcement of the cause of action before double-derivative enforcement, then logically, such a demand should be made at other shareholders of the subsidiary as well to urge their derivative enforcement before double-derivative enforcement. Such a procedural requirement would be cumbersome without any contribution to protecting shareholders or enhancing corporate value. Therefore, before bringing a double or multiple derivative action, it would be sufficient to first demand that the subsidiary bring a suit, without needing to demand that the parent bring a derivative suit as well.

PART VI: CONCLUDING REMARKS

Double or multiple derivative actions have attracted hardly any academic attention in US for decades, but have attracted much interest in Korea both academically and politically because it could have a significant impact on the management of many unlisted subsidiaries of large corporate groups. Since many Korean chaebols now use a multi-layered holding company structure, multiple derivative actions are perceived as a real threat to management. Based on a review of many bills submitted to the National Assembly of Korea and a comparative review of the laws of a few jurisdictions, this article presented a few questions to be considered before enacting legislation and provided some answers to those questions.

First, a double or multiple derivative action is justified because it may compensate harmed shareholders and deter possible wrongdoing to subsidiaries, and it is irrelevant to resort to the doctrine of “piercing the corporate veil” to justify it. Second, a standard derivative action against the directors of a parent company for failure to monitor a subsidiary’s management or for failure to seek proper remedies cannot be a satisfactory alternative to a double or multiple derivative action, considering the difficulty of proving causes of action and assessing the damages. Third, double or multiple derivative actions need not be limited to situations in which the subsidiary is given the opportunity to take a fresh look at the issues raised by plaintiffs and to decide whether or not it wishes to pursue the claims”; Brown v. Tenney, supra note 69, at 361 (“a double derivative action may be maintained by a shareholder of record in a holding company, on behalf of a subsidiary controlled or dominated by the holding company, after due demand is made to, and rejected by, the subsidiary and the holding company”).
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wholly owned or in which there is no one else who can sue. Fourth, before bringing an action, it would be sufficient to first demand that the subsidiary bring a suit, without needing to demand that the parent bring a standard derivative suit.

In addition to the issues discussed above, there are many other points that need to be reviewed. Should there be a minimum shareholding ratio and minimum shareholding period requirement for plaintiffs to bring a multiple derivative action? Should there be any limit to the number of layers downward when allowing a multiple derivative action? Should the shareholder of a parent have a right to inspect or access the records of a subsidiary in order to make a multiple derivative action meaningful? Should the shareholder of a parent be given a right to an injunction to stop wrongdoing by the directors of a subsidiary?

It is not the purpose of this article to make a thorough list of questions and answers. Each of these questions will open up different arguments and reveal the need for comparative and empirical research. Regardless of what would happen in Korea as a result of the debates at the National Assembly, it will provide another interesting source for comparative studies in the field of corporate law.
A One-Size-Fits-All Approach to Corporate Governance Codes and Compliance by Smaller Listed Firms: An Examination of Companies Listed in Hong Kong and Singapore

Christopher Chen1

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ABSTRACT

This article examines the impact of a “one-size-fits-all” corporate governance code on smaller listed firms, which should have fewer resources to hire more qualified independent directors for their boards and board committees. After examining data from a sample of companies listed in Hong Kong and Singapore, we find some limited support for these resources-based arguments. While smaller firms do not necessarily have a lower proportion of independent directors, some evidence suggests that smaller firms do pay less to independent directors and that these directors have to serve on multiple board committees. Although many larger firms also share the problem of overloading

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their independent directors, the ability to find and attract qualified candidates certainly differs with the availability of resources. Therefore, this article suggests that policymakers consider the merit of raising board independence standards and increasing board committee requirements and find ways to assist smaller firms in hiring qualified (but less expensive) independent directors.

I. INTRODUCTION

Should corporate governance rules for publicly-traded companies be “one-size-fits-all”? In other words, should the same rules apply to firms of all sizes, industries, ownership, and business models? When people talk about corporate governance, they often focus on larger corporations, which hold a significant proportion of market capitalization and have more shareholders and more economic significance in the market and economy. The impact of any governance failure or scandal will be more pronounced in larger corporations with more shareholders, as it will affect more investors or have a larger effect on the market as a whole.

However, most companies on a stock exchange are not large corporations. For example, daily data that NASDAQ\textsuperscript{2} released about 3,249 observations on October 17, 2017 showed that 2,004 firms (about 61.68\%) had market capitalization lower than US$500 million. In contrast, 414 firms (about 12.74\%) had market capitalization over US$3 billion on the same day. The disparity in power between larger and smaller firms is obvious. In Asian markets, for example, the benchmark Hang Seng LargeCap Index covering the top 80\% of the total market capitalization\textsuperscript{3} contained merely 106 firms\textsuperscript{4} out of a total of 1,802 firms listed on the Mainboard of the Stock Exchange of Hong Kong as of January 17, 2018.\textsuperscript{5}

Smaller firms, however, form the majority of the market. Although they are relatively small, they “are the most dynamic, innovative and risk-taking sector of the economy in most developed countries . . .”\textsuperscript{6} Despite their prevalence on the market, “[t]he board[s] of directors in small firms have had little

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\textsuperscript{1} The author thanks Singapore Ministry of Education (MOE) Academic Research Fund Tier 2 grant with the MOE’s official grant number MOE2015-T2-1-142 for this project.

\textsuperscript{2} The daily data was extracted from the NASDAQ website, in http://www.nasdaq.com/screening/companies-by-


\textsuperscript{3} See Selection Criteria of Hang Seng Composite Size Indexes, in https://www.hsi.com.hk/HSI-


\textsuperscript{4} See Constituents of Hang Seng Composite LargeCap Index, in http://www.hsi.com.hk/HSI-


\textsuperscript{6} Christina Atanasova et al., The corporate governance and financing of small-cap firms in Canada, 42 MANAGERIAL FINANCE 244, 244 (2016).
A One-Size-Fits-All Approach to Corporate Governance Codes

attention.” One author argued that the Sarbanes-Oxley Act in the U.S. “ignores the special needs and concerns of small publicly held companies in the economy . . . .” Similarly, Gerard Hertig noted that “it seems at least plausible that submitting smaller firms to governance principles designed for larger firms will prove inefficient.” The then chairman and chief executive officer of the former American Stock Exchange testified that the Sarbanes-Oxley Act “made it extremely difficult for smaller companies to compete in this regulatory environment” because it made “no distinction between a billion-dollar large-cap company and a $75-million small-cap one.”

One common argument to explain why a one-size-fits-all corporate governance regime may be inefficient or inappropriate for smaller firms is that smaller firms may lack sufficient financial or human resources to comply with corporate governance codes. For example, it could be expensive for smaller firms to hire a sufficient number of candidates who are not only independent from management and controlling shareholders but also possess adequate competence and expertise. If this is the case, a one-size-fits-all approach may not actually improve the corporate governance of smaller firms because they may only aim to satisfy minimum requirements or to comply “on paper.” Thus, smaller firms’ lack of resources to comply might negatively influence the quality of corporate governance. It offers justifications to treating smaller firms differently from larger ones.

It is not that there are no examples of differential treatment. Policymakers sometimes identify certain industries as having more corporate governance requirements. For example, banks or insurers are often subject to higher corporate governance standards. In Singapore, the Insurance (Corporate Governance) Regulations 2013 require large insurers to have at least a majority of directors who are independent from a management business relationship with the insurer if a single substantial shareholder holds 50% or more of the share capital or voting power. In the U.S., the New York Stock Exchange (NYSE) exempts firms with a majority controlling owner from some corporate governance requirements (such as having a majority of independent directors). The NYSE also exempts the board of “smaller reporting

11 Insurance (Corporate Governance) Regulations 2013 (No. S 197) reg. 7(2) (Singapore).
The purpose of this article is to examine whether a one-size-fits-all corporate governance code is appropriate. This article discusses whether the rules should have more flexibility in terms of design and application and whether there should be different minimum standards for firms with different characteristics. A normative question from a comparative law angle is whether Hong Kong and/or Singapore should follow the UK Code in having some exemptions for smaller firms. Alternatively, if a one-size-fits-all corporate governance is appropriate, one may challenge whether any exemption for smaller firms is necessary.

To evaluate the appropriateness of a one-size-fits-all code, we must first understand how companies comply with corporate governance rules. However, we do not have a direct measure of compliance costs that listed companies bear. Regulators and exchanges in the markets did not publish any analyses of regulatory impact or potential costs in consultation or policy papers before or after revisions of corporate governance rules. Therefore, this article will explore the corporate governance practices of listed firms in Hong Kong and Singapore, the two leading international financial centers in the Asia-Pacific region, to examine the impact of corporate governance codes on smaller firms in terms of compliance records and remuneration.

13 In general, a smaller reporting company means “an issuer that is not an investment company, an asset-backed issuer (as defined in §229.1101 of this chapter), or a majority-owned subsidiary of a parent that is not a smaller reporting company” with a public float of less than US$ 75 million. 17 C.F.R. 240.12b-1.
15 The FTSE 350 is a market-capitalization-weighted index for the 350 largest companies listed on the London Stock Exchange.
17 UK Code B.1.2.
18 UK Code C.3.1.
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For simplicity, this article will focus on whether the size of a listed company makes any difference in terms of compliance with corporate governance codes. We recognize, however, that other firm characteristics, such as industry and nature of the firm or controlling owners (e.g., state or financial institutions), may affect how firms comply with corporate governance codes. The results will offer us valuable insights on how corporate governance rules might affect smaller players, and what potential consequences might be for shareholders and other market participants.

The remainder of this article is structured as follows: Part II explores current corporate governance regimes in Hong Kong and Singapore and the pros and cons of the one-size-fits-all approach to corporate governance. Part III introduces data from Hong Kong and Singapore that demonstrates how smaller listed firms comply with corporate governance codes, in contrast with larger firms. Part IV provides some policy reflections, and Part V concludes the article.

II. A ONE-SIZE-FITS-ALL APPROACH TO CORPORATE GOVERNANCE OF LISTED FIRMS

This section first gives the background of the one-size-fits-all approach in Singapore and Hong Kong. We then present two contrasting arguments on how these rules may affect small and medium listed firms in the market.

A. Corporate Governance Regimes in Singapore and Hong Kong in a Nutshell

This section briefly introduces the corporate governance regimes in Hong Kong and Singapore. In general, both markets follow the Anglo-American model of corporate governance, particularly the U.K.’s 1993 Cadbury Report. In Hong Kong, the Stock Exchange of Hong Kong (SEHK) required a minimum of two independent directors on a board in 1993, before raising the requirement to three in 2004. The SEHK published the first version of the Code on Corporate Governance Practices in 2005 before a major revision after the global financial crisis, resulting in the Code on Corporate Governance

19 For the background of the Cadbury Report and its impact on corporate governance reforms in other countries, see generally Cally Jordan, Cadbury Twenty Years On, 58 VILL. L. REV. 1 (2013).
21 Hong Kong Exchange, Mainboard Listing Rules, rule 3.10.
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Practices 2012. In Singapore, the Monetary Authority of Singapore (MAS), the financial regulator, issued the first edition of the Code of Corporate Governance in 2001, which it amended in 2005 and 2012. This section will quickly summarize the key regimes contained in the corporate governance codes in Singapore and Hong Kong as they stand in 2017.

Overall, the most essential regime is the independence of a board. In both markets, policymakers recognize that a company should have an effective board to lead and control the company. Companies should have a strong and independent board that can exercise objective judgment on corporate affairs with a balance of skill and experience. For this purpose, Singapore requires a minimum of one-third of a board to be independent. This threshold is raised to at least half of the board under certain situations, e.g., when the chairman and chief executive officer (CEO) are the same person or close family members or when the chairman is also part of the management team or otherwise not independent. In Hong Kong, the Code of Corporate Governance Practices only makes the minimum one-third threshold a “recommended best practice,” but the same requirement also appears in the exchange rules, which are mandatory in nature.

In terms of board members, Singapore generally defines independence as having no relationship with the company (or related companies) or having more than 10% of shareholders and officers (including directors and senior executives). However, this definition of independence is not absolute. The nomination committee, which should consist of mostly independent directors, determines whether a candidate qualifies as an independent director.

Hong Kong’s definition of independence is similar. A candidate may lose independence if he has over 1% of outstanding shares; has received an interest in securities that the company issued to him as a gift; or has other connections arising from employment, common business interests or family relationships. Like in Singapore, the nomination committee is responsible for assessing

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23 Hong Kong Exchange, Mainboard Listing Rules, Appendix 14. (HK Code)
26 Singapore Code Principle 2; HK Code A.3.
27 Singapore Code Guideline 2.1.
28 Singapore Code Guidelines 2.2.
29 HK Code A.3.2.
30 Hong Kong Exchange, Mainboard Listing Rules, rule 3.10A.
31 Singapore Code Guidelines 2.3.
32 Id.
33 Hong Kong Exchange, Mainboard Listing Rules, rule 3.13.

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whether a candidate is independent.\(^3^4\) A listed company must demonstrate to the exchange how a candidate is independent.\(^3^5\)

To support the board independence regime, both Hong Kong and Singapore clarify the role of the chairman of the board. Ideally, the same person should not be both the chairman and CEO.\(^3^6\) The chairman is the leader of the board and ensures the board’s effectiveness, while the CEO is the chief of the management team.\(^3^7\) Thus, it is best to separate the roles of the chairman and CEO with different persons.

Both markets require listed firms to establish subcommittees at the board level. The most important is the audit committee, which is responsible for making recommendations regarding the firm’s external auditor (including appointment, removal and remuneration) and review the company’s financial condition, reporting and internal control system.\(^3^8\) The audit committee may also be responsible for the firm’s whistle-blowing policy.\(^3^9\) In Singapore, the audit committee should comprise mostly independent directors with a minimum of three members,\(^4^0\) and in Hong Kong, the SEHK requires the audit committee to be comprised of only non-executive directors.\(^4^1\)

Apart from audit committees, both markets require remuneration and nomination (or nominating) committees, both of which should comprise mostly independent directors.\(^4^2\) The nomination committee is in charge of making recommendations to the board regarding the company’s succession plan, evaluating the board’s performance, and appointing and training directors.\(^4^3\) The remuneration committee is responsible for reviewing the company’s procedure and policy for remunerating executives and directors.\(^4^4\) In Hong Kong, a significant proportion of executive directors’ compensation should be linked to corporate and individual performance.\(^4^5\) In contrast, in Singapore, the MAS makes clear that the level and structure of remuneration should be aligned with the long-term interests and risk policy of the firm to motivate good stewardship and successful management of the company.\(^4^6\) Both markets

\(^{34}\) HK Code A.4.5(c).
\(^{35}\) Hong Kong Exchange, Mainboard Listing Rules, rule 3.14.
\(^{36}\) Singapore Code Guidelines 3.1; HK Code A.2.1.
\(^{37}\) Singapore Code Guidelines 3.2; HK Code A.2.4.
\(^{38}\) Singapore Code Guidelines 12.4; HK Code C3.3.
\(^{39}\) Singapore Code Guidelines 12.7.
\(^{40}\) Singapore Code Guidelines 12.1.
\(^{41}\) Hong Kong Exchange, Mainboard Listing Rules, rule 3.21.
\(^{42}\) Singapore Code Guidelines 4.1 and 7.1; HK Code A.4.4 and B.1.1.
\(^{43}\) Singapore Code Guidelines 4.2; HK Code A.4.5.
\(^{44}\) Singapore Code Guidelines 7.2; HK Code B.1.3.
\(^{45}\) HK Code B.1.6.
\(^{46}\) Singapore Code Principle 8.
require companies to disclose details of executives’ remuneration in annual reports.47

There are two other features worth noting. First, both markets have improved corporate governance on an incremental basis. For example, as mentioned earlier, Hong Kong first imposed the minimum requirement of 2 independent directors in 1993 before raising the number in 2004 and imposing the minimum one-third threshold in 2012. In Singapore, the Code of Corporate Governance first required the minimum one-third board independence threshold in 2001 and later raised the standard to one-half under certain circumstances in 2012. Second, both markets have adopted minimum corporate governance standards without differentiating between different kinds of firms. All firms, regardless of size, industry or other characteristics, are expected to comply with the same standards.

Thus, both Hong Kong and Singapore have created one-size-fits-all corporate governance codes. Although both markets generally transplanted regimes from the U.K., neither of the markets’ policymakers followed the U.K.’s approach of differentiating the application of some provisions in corporate governance codes based on the size of the firm. In Hong Kong, the SEHK has recognized that a smaller percentage of medium-cap or small-cap issuers have fully complied with the Code of Corporate Governance Practices.48 Many smaller companies did not have a corporate governance committee.49 In the 2010 consultation paper, the exchange also recognized that the same standard (the one-third threshold) is potentially costly, and some may argue that it should not apply to both large and small issuers.50 Some respondents to the consultation paper suggested that SEHK consider “the cost implications of the proposal for issuers with smaller market capitalizations.”51 Nonetheless, the exchange did not implement different rules for smaller firms.

In Singapore, none of the consultation papers leading up to the Code of Corporate Governance in 2001 or the 2005 and 2012 revisions examined whether provisions in the code were appropriate for smaller firms. In 2001, most discussions relating to small businesses were about rules for private companies.52 During the later rounds of consultation on the reform of the corporate governance code, there was no discussion of its application to smaller firms.53

47 Singapore Code Guidelines 9.1; HK Code B.1.7.
48 Hong Kong Exchange, supra note 22, at para. 22.
49 Id., at para. 136.
50 Id., at para. 71.
51 Id., at para. 116.
52 REPORT OF THE COMPANY LEGISLATION AND REGULATORY FRAMEWORK COMMITTEE (2001), paras. 3.1-3.10.
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B. Pros and Cons of the One-Size-Fits-All Approach

There are pros and cons as to whether the one-size-fits-all approach good or bad for smaller firms. This section first lays out arguments in favor of a one-size-fits-all approach to corporate governance before examining counter-arguments, which center around the notion that smaller firms lack financial and human resources to fully comply with the spirit of corporate governance codes.

There are reasons that uniform corporate governance standards are preferable. First, the agency problem exists when there is a separation of ownership from control.54 This should not change whether a firm is large or small. Larger corporations may have more shareholders, but the degrees of concentration of ownership do not necessarily differ. As long as there are minority shareholders, there is a need for corporate governance—this should not change merely because a firm is smaller. In addition, there is no particular reason or proof showing that controlling shareholders or managers of smaller firms are less likely to tunnel, which generally means activities to ‘transfer of assets and profits out of firms for the benefit of those who control them’ .55

Second, corporate governance standards are often laid down as minimum standards (e.g., a minimum one-third of a board being independent directors). Unless the law requires a super-majority of a board to be independent, or a very high standard (e.g., hypothetically, an audit committee with five members all with accounting or financial expertise), minimum standards should not cause hardship in terms of compliance for smaller firms, as they represent the minimum requirements that market participants are expected to have. A firm may voluntarily choose to have more independent directors at its own cost. Exchange or trade associations might help smaller firms find independent directors by having a register of potential candidates, such as the one operated by the Australian Institute of Corporate Directors.56

Third, in places where corporate governance codes “comply or explain” in nature, a firm may disclose the reasons behind any failure to comply with a standard and let the market decide. In a way, the “comply or explain” principle has been seen as “a practical means of establishing a single code of corporate

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55 S Johnson et al., Tunnelling, 90 AMERICAN ECONOMIC REVIEW 22, 22 (2000).
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governance whilst avoiding an inflexible ‘one size fits all’ approach.’’
Considering the flexible approach, minimum corporate governance standards
should not generate excessive burden on these firms if they can properly
explain their noncompliance.

Fourth, it is easier for market participants to compare and regulators to
supervise compliance if there is a uniform benchmark to measure companies. If
the law imposes a lower standard for smaller firms (e.g., 20% of the board
being independent instead of one-third), policymakers need to first decide how
to define large and/or small firms (depending on how the law is drafted). As a
company’s fortune may fluctuate, there could be difficulties in continuous
monitoring and classification of a firm, thereby increasing regulatory and
enforcement costs. Having different regulatory requirements based on the size
of a firm might also raise the chance of regulatory arbitrage.

Fifth, one might also argue for a one-size-fits-all approach on the ground of
equality. Having differential treatment that favors smaller firms might penalize
those who happen to become more successful (and henceforth becoming larger).
If a firm really prefers to evade corporate governance requirements, it
may choose to go private. Since corporate governance codes apply mainly to
listed companies in stock exchanges (at least in the cases of Hong Kong and
Singapore), there seems to be no need to have further differential treatment,
provided that even small listed firms are larger than most other firms if we
examine the whole spectrum of business entities in a market.

Last, there are some arguments that more rigorous corporate governance
may benefit smaller companies. For example, Bruninge argued that for closely
held small or medium enterprises, changing board composition by introducing
more outside directors might facilitate more strategic changes. Minichilli
suggested that board diversity is important during a crisis and independent
directors may provide the CEO and the firm better access to a more diverse
pool of competence and experience. Switzer argued that small-caps firms that
were subject to the Sarbanes-Oxley Act experienced an incremental increase in
market valuation by comparing firms that are subject to the Act and those that
are not.

There are also contrary views against a one-size-fits-all approach to
corporate governance. First, good corporate governance comes with costs. If

57 David Seidl et al., Appyling the “comply-or-explain” principle: discursive legitimacy tactics with regard to codes of corporate governance, 17 JOURNAL OF MANAGEMENT & GOVERNANCE 791, 792 (2013).
58 Bruninge et al., Corporate governance and strategic change in SMEs: The effects of ownership, board composition and top management team, 29 SMALL BUSINESS ECONOMICS 295, 304 (2007).
60 See generally Lorne N. Switzer, Corporate governance, Sarbanes-Oxley, and small-cap firm performance, 47 QUARTERLY REVIEW OF ECONOMICS AND FINANCE 651 (2007).
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we accept that hiring good and qualified people tends to cost more money (including remuneration, cost for directors’ insurance, and other benefits), it disadvantages smaller firms compared with their larger counterparts, who are presumed to have more financial resources for such expenditure. In other words, smaller firms could face resource constraints that limit their choices.61

In the U.S., some argue that the Sarbanes-Oxley Act imposed disproportionately high compliance costs on smaller firms.62 The cost of registration alone could range from US$200,000 to $500,000, as reported in a paper published in 2005.63 Another paper showed that the projected expenditures to comply with the Sarbanes-Oxley Act was US$2.9 million per company for companies with annual revenue over US$5 million, compared with a projection of US$222,200 by companies with annual revenues under US$25 million,64 showing that the magnitude of impact (as a proportion of revenue) on smaller firms is bigger than larger ones.65 Another report in 2008 estimated that the average cost of compliance with Sarbanes-Oxley Act for companies with under US$1 billion in annual revenue has increased more than US$1.7 million to US$2.8 million since 2001.66 It is also costly to prepare a report assessing a firm’s internal control system.67 Even in Singapore, one report suggests that smaller companies might comply with the code in form rather than in substance, though there is no further empirical evidence provided68

Second, unless a smaller firm has a well-known brand, it may not have a sufficient reputation to attract good candidates. The lack of good candidates may affect the quality and expertise of board members. Eisenberg et al. argued that “[o]utside directors thus bear a reputation cost if projects fail and the firm encounters financial difficulties, [in] which their share of the gains is limited.”69 The argument is based on an assumption that independent directors

61 See generally Irene M. Gordon et al., Corporate governance in publicly traded small firms: A study of Canadian venture exchange companies, 55 BUSINESS HORIZONS 583 (2012) (suggesting that smaller firms might face resource constraints on choices after studying some publicly traded smaller firms listed in Canada).
63 Castelluccio, supra note 8, 445 (2005).
65 Id., at 1588.
66 Nikki Swartz, SOX Costs Sock Small Firms, 42(2) INTERNATIONAL MANAGEMENT JOURNAL 14 (2008).
67 Sarbanes-Oxley Act, Pub. L. 107-204, s 404; Castelluccio, supra note 8, at 457.
68 Mak, supra note 56, at 23.
of smaller firms own only negligible equity stakes in the firms.\textsuperscript{70} It may also mean that independent directors have a bias against projects that increase the probability of bankruptcy.\textsuperscript{71} In the end, board independence regime might not benefit shareholders of smaller firms.

Third, if a smaller firm can only hire the required number of independent directors to meet the minimum regulatory requirement, the same independent directors might be required to be members of all relevant committees (including audit, remuneration and nomination committees). If this is the case, it increases the workload and responsibility of the independent directors, compared with in a larger firm, which should be able to afford to have more independent directors on the board and to have more variety of expertise. This in turn could reduce the chance of a smaller firm hiring a highly qualified candidate if the person is conscious of responsibility and potential liability.

Fourth, if a smaller firm is a family-owned business with a controlling shareholder, the company might have a certain amount of closeness among the controllers and management. In such a situation, independent directors may not be as effective if they cannot acquire information from the insiders. If an independent director comes from a small network of controlling shareholders of a small firm, this could further undermine the board’s effectiveness, as the director might not be truly “independent.”

In extreme situations, high compliance costs might prevent smaller firms from going public. As Holmstrom and Kaplan argued,

“\textit{[B]ecause some of the additional costs of comply[ing] with [the Sarbanes-Oxley Act] are fixed rather than variable, the effects will be more negative for smaller companies than for larger ones. At the margin, this may lead some public companies to go private and deter some private companies from going public.}”\textsuperscript{72}

There has been some empirical evidence of this effect. For example, Chhaochharia et al. found that small firms that are less compliant earn negative abnormal returns, suggesting that some provisions might be detrimental to small firms.\textsuperscript{73} Eisenberg et al. found a negative correlation between board size and profitability in small and mid-size Finnish firms.\textsuperscript{74} Moreover, Gordon et al. found that larger firms have better corporate governance practices and larger board sizes than smaller firms in a sample of over 700 companies listed in Toronto.\textsuperscript{75} Further, in a study of Norwegian companies published in 1990,

\begin{itemize}
    \item \textsuperscript{70} \textit{Id.}, at 37.
    \item \textsuperscript{71} \textit{Id.}, at 38.
    \item \textsuperscript{72} Bengt Holmstrom and Steven Kaplan, \textit{The state of U.S. corporate governance: What’s right and what’s wrong?} 15 \textit{JOURNAL OF APPLIED CORPORATE FINANCE} 8, 17 (2003).
    \item \textsuperscript{74} Eisenberg, \textit{supra} note 69, at 53.
    \item \textsuperscript{75} Gordon, \textit{supra} note 61, at 589.
\end{itemize}

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Huse found that board composition in small firms is a function of company size and ownership structure and varies with industry. If smaller firms have smaller boards, independent directors may be less likely to resist the influence of executive officers.

Last, even if a corporate governance code is “comply or explain” in nature, there could be some standardization effect to the point that smaller firms are still expected to comply by investors market analysts. Therefore, smaller firms may still be compelled to comply with rules that may not be optimal for them.

In sum, there are arguments that support or oppose the application of a one-size-fits-all corporate governance code. In relation to smaller firms, the key opposition is based on restraint of resources that smaller firms might face. On a grander level, it is also arguable whether or not a one-size-fits-all corporate governance practice based on the Anglo-Saxon model is suitable in the global context. Another scholar argues that there could be multiple governance paths leading to high firm performance, but these practices do not always belong to the same national governance tradition. However, this is beyond the scope of this article. To better evaluate the impact of a one-size-fits-all approach of corporate governance to smaller firms, we must first acquire a better idea on how firms comply with corporate governance codes. For this purpose, the next part will use data to examine whether the resources-based arguments still stand with empirical evidence collected in Hong Kong and Singapore. Before then, there is a preliminary question: who should define firm size?

C. Defining Firm Size

Our question is this: which argument better reflects the state of compliance by smaller firms? Before we illustrate our data in Part III, we must define “smaller firms.” The easiest reference is the definition of small and medium-sized enterprises (SMEs). However, we must note that smaller listed corporations are probably larger than most unlisted SMEs.

The definition of an SME varies by country. The Organization for Economic Cooperation and Development (OECD) generally defines SMEs as

76 Huse, supra note 7, at 372.
77 Eisenberg, supra note 69, at 37.
78 Hertig, supra note 9, at 10.
79 See generally Marlene Davies and Bernadette Schlitzer, The impracticality of an international “one size fits all” corporate governance code of best practice, 23 MANAGERIAL AUDITING JOURNAL2 532–544 (finding that the Anglo-Saxon model is not necessarily the right approach from a global perspective); Ann-Marie Anderson & Parveen P. Gupta, Corporate governance: Does one size fit all? 24 JOURNAL OF CORPORATE ACCOUNTING & FINANCE 51–64 (2013) (arguing that mandating corporate governance practices based on the Anglo-Saxon model may lead to sub-optimal firm performance.
“non-subsidiary, independent firms which employ fewer than a given number of employees [which may vary across countries].” The OECD also recognizes that some jurisdictions use the size of financial assets as benchmarks. In the U.S., the definition of an SME may vary by industry, pursuant to standards laid down by the North American Industry Classification System or the U.S. Small Business Administration (SBA). Pursuant to the SBA standards, the size standards for small businesses depend on either the average annual receipts or the average number of employees of a firm, varying by industry and subsector. For example, the size standard for timber tract operations is US$11 million, but for the logging sector, the standard is 500 employees. The European Commission defines SMEs as enterprises “which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million and/or an annual balance sheet total not exceeding EUR 43 million.” In Asia, taking Singapore as an example, a firm would qualify as an SME if either its annual turnover is no more than SS100 million (about US$71 million) or it has no more than 200 workers. In sum, the definition of SMEs usually includes either the number of employees or the size of a firm (by asset or by revenue), or both, as benchmarks, although the actual standards vary by country.

How can we differentiate between large and smaller firms in the case of listed companies? Drawing from the definitions of SMEs, we may consider using assets, revenue or number of employees as benchmarks. The former two factors could be acquired from public databases or financial statements. However, listed companies do not always report their numbers of employees, so we have only limited information for this factor.

Another benchmark is market capitalization, which generally refers to the total market value of company shares, illustrating the market’s perception of the company’s value. The market generally classifies firms into large-cap, medium-cap, small-cap or even micro- or nano-cap companies, depending on the figures of their market capitalization. Nonetheless, there is no universal standard for classifying market capitalization. For example, NASDAQ defines “large-cap” as “a stock with high level of market capitalization, usually at least $5 billion market value,” while it defines a mid-cap firm as a firm with

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83 Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises, 2003/361/EC, article 2(1).
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capitalization between $1 billion and $5 billion.\textsuperscript{86} In Hong Kong, the Hong Kong Exchange defines a company as large-cap if its market capitalization is at least HK$1,000 million (about $130 million USD) or more, with the threshold for mid-cap between HK$400 million (about $52 million USD) and HK$1,000 million, and companies below HK$400 million constituting small-cap.\textsuperscript{87}

This article will mainly adopt total assets and market capitalization as benchmarks. The value of total assets of a company refers to the left side of the firm’s balance sheet and is a raw indicator of how large a company is. For simplicity, this article uses the end of fiscal year as the cut-off day for the value of total assets (as reported in financial statements) and market capitalization. For clarification, this article does not propose to use annual revenue as a benchmark to define smaller firms. This is in part because some companies suffer losses in some years, which may result in negative annual revenue figures.

From our total sample of 354 firms and 2,499 firm-year observations, the mean of market capitalization converted to US dollars\textsuperscript{88} at the end of each fiscal year is $1,913.5 million USD ($2,340.6 million USD in Hong Kong and $846.7 million USD in Singapore). The difference in values between Hong Kong and Singapore is consistent with the size of each market.\textsuperscript{89} In addition, the data are highly skewed. In aggregate, the highest observation of end-of-year market capitalization is $139.84 billion USD, in contrast with $0.53 million USD in the smallest case, demonstrating the breadth of the divide.

In terms of total assets by the end of the fiscal year for each firm, we find a similar pattern, with the mean of observations of total assets $6,175.6 million USD (largest $873.72 billion USD and smallest merely $0.18 million USD). Between Hong Kong and Singapore, the results are also consistent with market capitalization; Hong Kong is larger in means of total assets ($7,380.4 million USD vs $3121.2 million USD) and total revenue ($2,872.8 million USD vs $1,183.1 million USD), with the difference in means significant at the 1% level for both measures. This could be a result of the gigantic Chinese firms listed in Hong Kong, as there are no Chinese firms in our Singapore sample. Just looking at the Hong Kong sample, the mean of Chinese firms ($7955.7 million

\textsuperscript{86} Nasdaq, Financial Glossary (Mid cap) in http://www.nasdaq.com/investing/glossary/m/mid-cap (last visited December 1, 2017).
\textsuperscript{88} This research converts all financial and RPT data into USD by calculating the annual average of the exchange rate between USD and the reporting currency based on the daily exchange rate reported by the Board of Governors of the Federal Reserve System. See the Federal Reserve website: https://www.federalreserve.gov/releases/h10/Hist (last visited December 1, 2017).
\textsuperscript{89} According to the World Bank, the total market capitalization of listed companies in 2016 was US$3,193.235 billion in Hong Kong and US$640.428 billion in Singapore. World Bank, Market capitalization of listed domestic companies (current US$) in https://data.worldbank.org/indicator/CM.MKT.LCAP.CD (last visited December 1, 2017).
USD) is nearly five times larger than the mean of other firms ($1652.0 million USD), the difference in means being statistically significant at the 1% level.

As our main purpose is to distinguish small companies from their larger counterparts in order to observe characteristics and compliance records, this article will classify firms into two groups by market capitalization: larger firms and smaller firms. To avoid an arbitrary distinction, this article uses $150 million USD (inclusive) as the dividing line, as it is near the median of all of our observations and close to the criteria of SEHK’s definition for large-caps.90 As each of the sampled firms has data for 7 years (if there is no missing value), we treat a firm as a “smaller firm” if the average of its market capitalization for all 7 years is below $150 million USD. This approach ensures that we can analyze our data at the firm level, since a firm’s market capitalization may fluctuate above or below the threshold at times, depending on market movement. As the effect of corporate governance and company performance should be continuous, this approach is more suitable than classifying each firm-year observation separately. This classification leaves us with two groups of companies that this article will adopt for further analysis: larger companies (1,220 observations) and smaller companies (1,190 observations).91 If we classify them into the different markets, about 42.07% of observations in Hong Kong belong to the category of smaller companies, and 67.63% belong to the same category in Singapore.

Before we move on, we entertain a question regarding the connection between ownership and firm size. A two-sample t-test shows that smaller firms (collectively) have a lower mean of highest beneficial stakes than larger companies if we combine both markets (mean = 43.35% for smaller firms and 46.68% for larger firms, \( p < 0.001 \)), or in the Singapore market (mean = 39.27% for smaller firms and 45.80% for larger firms, \( p < 0.001 \)), but not for Hong Kong, although the differences in means are not very large. Moreover, we find that smaller firms are less likely to have 30% controlling ownership in both markets (\( \chi^2 = 27.16, p < 0.001 \)), for Hong Kong (\( \chi^2 = 10.98, p = 0.001 \)) and for Singapore (\( \chi^2 = 7.31, p = 0.007 \)). Combining both markets, 68.16% of smaller firms have a 30% controlling owner, in contrast to 77.61% for larger firms. In Hong Kong, 71.65% of smaller firms have a 30% controlling owner compared to 78.59% for larger firms. In Singapore, the percentage is 62.69% for smaller firms and 73.18% for larger firms.

In addition, it is clear that state-owned enterprises (SOEs) (notably those from China) are far larger than other businesses on average. In Hong Kong, the average market capitalization at the end of 7 fiscal years is about $8151.8 million USD for SOEs and $1118.7 million USD for others. The figures in

90 Supra note 87.
91 There are 89 observations of missing values due to inability to find end-of-year figures for market capitalization from public information or subscription-based databases.
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Singapore are $3,801.3 million USD for SOEs and $702.8 million USD for others. In contrast, very few smaller firms in our dataset are SOEs. Overall, fewer than 5% of smaller firms are SOEs, in contrast with 22.79% of larger firms. Therefore, smaller firms have far less implications from state ownership. In sum, our data show that smaller firms do not necessarily have a higher degree of concentration of ownership. As state ownership is probably not a significant factor for smaller firms, the main corporate governance issues for smaller firms arise from family ownership or a single controlling shareholder.

III. ASSESSING SMALLER FIRMS’ COMPLIANCE WITH CORPORATE GOVERNANCE CODES

To assess the suitability of corporate governance codes for smaller listed firms, we must first examine how firms of various sizes comply with corporate governance codes. The existing literature states lack of resources and high costs as the biggest concerns for smaller firms. If this is the case, we should expect smaller firms to have smaller boards and just enough independent directors to meet the minimum requirement if they choose to comply, resulting in the proportion of independent directors on the board being near or barely above the minimum threshold. Moreover, if the resource-based arguments are correct, smaller firms should have fewer resources to hire outside directors, and those independent directors would have heavy workloads. These factors combined may negatively affect the goals of the corporate governance rules, and they support the argument that one size does not fit all.

To this end, this article presents empirical data from a sample of companies listed in Hong Kong and Singapore to see how firms comply with corporate governance standards. We sampled 25% of all companies listed on the main boards of both the SEHK and the SGX as of January 1, 2009 (that were still listed at the end of 2015), resulting in a total of 254 companies from the SEHK and 103 from the SGX, with a total of 2,499 firm-year observations, to create panel data for 7 years. We collected a variety of corporate governance data, including board size, number of independent and executive directors, type of chairman, duality of chairman and CEO, number of members on board committees, remuneration paid to directors (where available), names of external auditors and fees paid to auditors, some firm characteristics (e.g., ownership and largest ownership stakes), and financial data for each firm-year observation.

In general, we present data from different analyses for each issue in order to have a complete picture. First, we seek to test any correlation between some corporate governance benchmarks (e.g., board size, board independence, remuneration for independent directors, etc.) and firm size (in terms of the amount of market capitalization or total assets) through a regression model.
clustered by firms, controlling year fixed effect for our panel dataset. As we aim to discover evidence rather than draw statistical inferences, this article refrains from adding complexity by controlling more factors in the regression model. Second, this article examines whether firms that we classify as small have certain characteristics (e.g., smaller boards) through two-sample t-tests or analysis (where appropriate). We also support our data with other analytical methods such as Wilcoxon-Mann-Whitney test where appropriate.

Overall, this article attempts to paint a picture of the effect of a one-size-fits-all corporate governance code on smaller listed firms in Hong Kong and Singapore. Because the spectrum of market capitalization or total assets for our sampled firms is very wide, we use logged figures for financial data and market capitalization for our analysis. On this basis, the following four sections will offer empirical evidence on the compliance of corporate governance codes by smaller firms. Due to some missing information, the total number of observations for each benchmark may differ.

A. Corporate Governance Practices and Compliance

This article first examines corporate governance compliance records to understand whether firm size may be a factor in shaping corporate governance practices. In terms of board size, the mean of all observations is 8.40 directors (8.97 in Hong Kong and 7.00 in Singapore). Regarding the total number of independent directors (as designated in annual reports), Hong Kong and Singapore are in the same band, with the mean being 3.53 independent board directors in Hong Kong, and 3.38 in Singapore. The size of the audit committee is also comparable between the two markets, with a mean of 3.37 directors in Hong Kong and 3.25 in Singapore. Regarding the proportion of independent directors on the board (i.e., the degree of board independence), with larger board sizes and similar numbers of independent directors, Hong Kong firms naturally have a lower degree of board independence (about 41%) than Singapore firms (48.86%).

In addition, 1,921 of 2,427 observations (79.15%) reveal the chairman as an executive director (84.65% in Hong Kong and 66.06% in Singapore). In contrast, only about 21.04% of observations in Singapore and barely 2.33% in Hong Kong have the chairman as an independent director. In terms of chairman–CEO duality (i.e., the chairman also being the CEO), 33.38% of observations in Singapore and 26.46% in Hong Kong (28.46% aggregated)

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92 This article does not present data with fixed effect regression with firm fixed effect. The underlying reason is that firms do not radically change ownership, size or corporate governance practices within 7 years (i.e. 2009 to 2015). As a result, the lack of variance in a number of variables would affect the outcome in fixed regression models with firm fixed effect. As the purpose to identify general patterns rather than to draw statistical inference, this article will present data with regression models clustered by firms and with year fixed effect.

93 See supra Section II.C.
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have chairman–CEO duality. Therefore, separating the roles of chairman and CEO or having an independent chairman is not overwhelmingly common, despite the recommendations of corporate governance codes in both markets.\textsuperscript{94} This contrasts with compliance with the minimum board independence requirement.

How do smaller firms comply with corporate governance codes in comparison with larger firms? First, we find that board size positively correlates with market capitalization ($p < 0.001$) or total assets ($p < 0.001$) if we use the combined data. We can replicate the positive correlation in both Hong Kong and Singapore for both market capitalization and total assets ($p < 0.001$ in all cases). In addition, we also note a positive correlation between the number of independent directors on the board and market capitalization or total assets, regardless of whether we look at combined data or each market separately ($p < 0.001$ in all cases).

Combining the two factors, we find a negative correlation between the degree of board independence and market capitalization ($p = 0.003$) for both the combined data and Hong Kong ($p < 0.001$) In Singapore, the correlation is only significant at 10% level ($p = 0.059$). Moreover, we see a negative correlation between the degree of board independence and total assets for combined data and in Hong Kong ($p < 0.001$ in both cases), but there is no statistically significant correlation between the two variables in Singapore. The results suggest that, in Hong Kong at least, larger firms are likely to have a lower proportion of independent directors on the board, though they might have more board members and independent directors. In Singapore, larger firms might also have more board members and independent directors, but the degree of board independence does not seem to differ judging by firm size.

We can support the findings with other analytical methods. Through two-sample t-tests, we find that smaller firms have smaller board sizes (7.22 vs 9.54, $p < 0.001$) and fewer independent directors (3.14 vs 3.82, $p < 0.001$) based on the combined data, although smaller firms have a higher mean degree of board independence (45.39% vs 41.36%, $p < 0.001$). We reach the same conclusion if we analyze each market separately; however, we note that the actual differences in means is not particularly great. Therefore, we have some mixed evidence on the correlation between firm size and the degree of board independence.

Second, regarding the nature of the chairman, we find that a supermajority of observations (1,450 out of 1,713, 84.6%) in Hong Kong and about two thirds of observations in Singapore (471 out of 713, 66.06%) have an executive chairman, contrary to recommendations by corporate governance codes in

\textsuperscript{94} See, for example, David J. Denis and Atulya Sarin, \textit{Ownership and board structures in publicly traded corporations}, 52 JOURNAL OF FINANCIAL ECONOMICS 187, 195 (1999).
either market. We find that the amount of market capitalization or total assets cannot predict the odds of a firm having an executive chairman for the combined data or the Hong Kong data. However, if we analyze the Singapore sample alone, we find that firms with bigger market capitalization (odds ratio = 0.735, \( p = 0.003 \)) or total assets (odds ratio = 0.757, \( p = 0.01 \)) are less likely to have an executive chairman. If we classify firms into two groups—smaller and larger firms—the results also show that, in Singapore, smaller firms tend to be more likely to have an executive chairman (\( \chi^2 = 28.48, p <0.001 \)), but this is not true for neither the combined nor Hong Kong data. In addition, applying Wilcoxon-Mann-Whitney rank-sum test also shows that, in Singapore, those companies with an executive chairman have lower market capitalization or total assets (\( p<0.001 \) in both cases).

Third, regarding chairman–CEO duality, the sample shows that about 26.46% of observations in Hong Kong (468 out of 1,769) and 33.38% in Singapore (240 out of 719) have chairman–CEO duality. In Singapore, firms with larger market capitalization (coefficient = -2.82, \( p = 0.01 \)) or total assets (coefficient = -0.237, \( p = 0.053 \)) are less likely to have chairman–CEO duality. However, we find no statistically significant relationship between firm size and the odds of chairman–CEO duality for neither the combined data nor the Hong Kong data. If we classify firms into “smaller” and “larger” groups, we find that smaller firms are more likely to have chairman–CEO duality for the combined data (\( \chi^2 = 4.64, p = 0.03 \)) but this is not the case if we analyze each market individually (\( p = 0.48 \) for Hong Kong and \( p = 0.12 \) for Singapore). Applying the Wilcoxon-Mann-Whitney rank-sum test, the data shows that in Singapore (but not in Hong Kong) firms with chairman–CEO duality have lower market capitalization or total assets (\( p<0.001 \) in both cases).

In sum, the data shows some evidence suggesting that smaller firms tend to have a smaller board with a fewer number of independent directors, though they do not necessarily have a lower proportion of independent directors. In addition, the data also shows that smaller firms seem to be more likely to have executive chairman in both markets, but chairman–CEO duality in Singapore alone. A further question may be the characteristics of those who serve as independent directors. This is subject to further studies in the future, as this research has not acquired data on personal characteristics of independent directors in our sample companies.

B. Board Committees

The next issue is the size of board committees and compliance by smaller firms. These aspects should shed some light on the potential workload and responsibility of independent directors in smaller firms.
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In general, companies in both Hong Kong and Singapore require at least three different committees: audit, remuneration and nomination committees. If we combine both markets, the mean size of an audit committee is about 3.34 directors (median = 3) with the maximum observation of 7 directors in the committee and the minimum 2. In fact, vast majority of companies have 3-5 audit committee members, covering a range from the 1st to the 99th percentile. The mean size of both remuneration and nomination committees is about 3.5 members per observation, with a median of 3. However, in the case of nomination committees, some companies listed in Hong Kong have only recently created their nomination committees. If we exclude companies without nomination committees, the mean size is 3.66 members with a median of 3. If we analyze each market separately, the mean and median are similar to the combined data, with the mean and median size of each board committee being between 3 and 4 members.

How do smaller firms fare in terms of board committees? For simplicity, this article reports only data on audit committees, which serve the important corporate function of reviewing financial accounts and related party transactions. We find that firm size does not correlate with the number of members of an audit committee, except in the Singapore only data, where market capitalization has a positive correlation ($p = 0.02$). If we apply two-sample t-tests by classifying firms into two groups, we find that smaller firms tend to have smaller audit committees ($p < 0.001$ for all cases). If we combine all observations, the mean size of an audit committee is 3.20 members in smaller firms, and 3.47 for larger firms, with a statistically significant difference in means (mean = 3.23 for smaller firms and mean = 3.42 for larger firms, $p < 0.001$). The same holds true if we analyze Hong Kong and Singapore separately ($p < 0.001$ in both cases). Considering that there is little variance in the size of the audit committees, the actual difference in audit committee composition between larger and smaller firms is too small to be meaningful.

A separate point is the workload of independent directors in board committees. Our dataset does not record the number of committee memberships held by each director. Hence, we do not have a direct measure of the workload of independent directors regarding board committee work. This article thus proposes an indirect measure for workload, by calculating the ratio between the total seats of the three board committees (audit, remuneration and nomination committees) divided by the total number of independent directors in a certain firm-year observation. As the corporate governance codes in either market generally expect more than half of these committee members to be

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95 See section II.A.
96 We treat the value as 0 if a firm does not have a remuneration or nomination committee in a certain year.
independent directors, it is very likely that independent directors have multiple board committee memberships and hence greater workloads and responsibility.

In general, the overall mean of the ratio between total board committee seats and number of independent directors is 3.01 (median = 3) if we combine both markets. If we analyze each market separately, the mean is 2.93 in Hong Kong and 3.22 in Singapore (median = 3 in both markets). This means that, on average, the total number of seats in board committees is three times the total number of independent directors. Considering that our sample companies have a mean of about 3.5 independent directors, it is likely that independent directors are required to serve on at least two or often all three board committees.

Is there any difference between larger and smaller firms? We find that the ratio negatively correlates with market capitalization or total assets in Singapore ($p<0.001$) in both cases and negatively correlates with total assets only in Hong Kong ($p=0.01$). If we apply two-sample t-tests to examine the means of the ratios between the groups of larger and smaller firms, we can repeat the same result with the means of the ratios for smaller firms being statistically significantly higher than those for larger firms for combined data (mean = 3.10 for smaller firms and 2.94 for larger firms, $p <0.001$) and in Singapore (mean = 3.37 for smaller firms and 2.88 for larger firms, $p <0.001$), although not in Hong Kong. Thus, we have limited evidence that smaller firms tend to have a higher ratio between the total number of board committees and independent directors. However, as the ratio is closer to three in both markets, it is perhaps a general problem where independent directors are required to serve on multiple (if not all) board committees regardless of the size of the firm.

C. Remuneration of Directors

Another angle is to examine directors’ remuneration, which represents the direct costs of complying with corporate governance codes. This also represents an indirect way to measure compliance costs. However, there were some difficulties in acquiring data on remuneration of directors in our sample, as there is no known database providing Asian data for analysis. Annual reports (including corporate governance reports) sometimes do not offer exact figures. This study acquires remuneration data from financial statements from two sources: key management remuneration listed under the disclosure of relation party transactions and emolument of board of directors. Nevertheless, there is a considerable number of missing values that might hinder inferential analysis. We have only 1,998 observations (out of 2,499) for key management compensation disclosed in the section of related party transactions in the notes to financial statements. Further, we have 2,351 observations for aggregate directors’ compensation disclosed in other parts of financial statements, including only 1,649 observations for remuneration of executive directors and
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only 1,285 observations for independent directors. Thus, there is a limit on the power of the data. On this basis, this article provides a descriptive account of the data on directors’ remuneration, notably for independent directors.

First, a general question is whether smaller firms tend to pay directors less. Combining both markets, a regression analysis shows that the amount of total remuneration paid to directors positively correlates with firm size ($p < 0.001$ for both market capitalization and total assets). We can replicate the correlation if we analyze each market separately ($p < 0.001$ in all cases). Thus, there is evidence showing that smaller firms generally pay their directors less.

Second, do smaller firms tend to pay independent directors less than large firms pay? From our limited data, we identify a similar pattern whereby smaller firms pay less to independent directors (mean = US$0.09 million for smaller firms and US$0.24 million for larger firms, $p < 0.001$) if we test the differences in means between smaller and larger firms. A regression analysis shows that the amount of market capitalization or total assets positively correlates with the amount of remuneration to independent directors ($p < 0.001$ in both cases) for the combined data or in Hong Kong only. By analysing the means from the combined data, the means of total remuneration to directors and total remuneration to independent directors are both higher for larger firms than smaller firms. However, for Singapore, there are too many missing values, resulting in a very small sample size of about 30 observations only. This prevents us from making a judgment for the Singapore sample.

Thus, our limited data show that smaller firms might pay less to independent directors (and the whole board generally) if we combine data from the two markets. This generally reflects the size of the firm and its financial resources. However, this conclusion is not very robust due to the significant amount of missing data.

D. Smaller Firms and Auditing

How do smaller firms and larger firms differ in terms of auditing? If smaller firms tend to have fewer resources, one may argue that they are less likely to hire more reputable auditing firms. If this is the case, it may reduce the quality of their audits and therefore their corporate governance. Commonly in finance studies, one benchmark is whether the auditing firm is one of the Big 4 in the industry.97

Our dataset lends some support to the above assertion. From the 2,407 observations where we can clearly identify the auditing firm, we find that larger firms are more likely to hire one of the Big 4 ($chi^2 = 215.16, p < 0.001$). For larger firms, 82.27% of observations were audited by one of the Big 4 auditing firms, while only 54.50% of the observations for smaller firms were audited by

97 The Big 4 are PricewaterhouseCoopers, KPMG, Deloitte & Touche, and Ernst & Young.
one of the Big 4. This is also holds true if we analyze Hong Kong and Singapore separately. In Hong Kong, the proportion of firms hiring one of the Big 4 is 82.81% for larger firms and 57.87% for smaller firms ($\chi^2 = 130.19$, $p < 0.001$), and in Singapore it is 79.82% for larger firms and 49.25% for smaller firms ($\chi^2 = 58.3$, $p < 0.001$). If we apply the Wiloxon-Mann-Whitney rank-sum test, we also find that in both Hong Kong and Singapore, firms that hire one of the Big 4 as the auditor are generally larger in size in terms of market capitalization or total assets for both Hong Kong and Singapore ($p < 0.001$). Therefore, we have some evidence showing that smaller firms are less likely to hire one of the Big 4 auditing firms as their external auditor.

Does this finding mean that smaller firms have lower quality audits? Among the smaller firms in both markets that did not hire a Big 4 firm for auditing services, more than 70% hired other large international auditing firms, such as BDO, HLB, Mazars, RSM, Grant Thornton, Baker Tilly, etc. There are indeed cases where smaller firms hired relatively unknown local auditing firms. However, without other evidence, it might be too harsh to accuse them of providing poorer auditing services in comparison with larger firms. Therefore, we find no substantial proof that smaller firms have poorer audit quality based on the audit firms they hire.

E. Summary

In summary, Part III examines the compliance of corporate governance codes in a sample of companies listed in Hong Kong and Singapore. First, we found evidence showing that smaller firms tend to have smaller boards and less independent directors. However, we do not have robust evidence showing that smaller firms have a lower degree of board independence in terms of the proportion of independent directors. Second, in Singapore only (not in Hong Kong), smaller firms are more likely to have executive chairman and chairman–CEO duality. Third, it appears problematic that independent directors are required to serve on multiple (and sometimes all three) board committees, but there is no strong evidence showing that the situation is worse in smaller firms than in larger ones. Fourth, there is limited evidence that smaller firms pay less remuneration to independent directors than larger firms, as our data are limited by missing values. Finally we find that smaller firms are less likely to use one of the Big 4 auditing firms, but this does not support questions of lesser audit quality because our data are inconclusive as to whether smaller firms have higher degrees of concentrated ownership.

IV. REFLECTION ON A ONE-SIZE-FITS-ALL CORPORATE GOVERNANCE CODE

The discussion in the previous part does to a certain extent support resource-based arguments that a one-size-fits-all approach to corporate
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governance does not favor smaller listed firms, though it seems that smaller firms have no obvious difficulty in meeting the minimum board independence requirement. What do our findings imply regarding a one-size-fits-all approach to corporate governance? Must it mean that Hong Kong or Singapore should have lower standards for smaller firms, like the U.K. does? As Romano suggests, provisions should enable firms to tailor their internal organization to their specific needs.98 From this light, this article makes the following suggestions.

First, meeting the minimum threshold of one-third of a board being independent directors in both markets, and the minimum number of three independent directors required by the SEHK, does not seem to be difficult for smaller firms, as most seem able to satisfy this requirement. All of the sampled companies in Singapore generally complied with the minimum threshold during the study period, and over 80% of the sampled firms in Hong Kong complied with the minimum threshold in 2009 even before the requirement was enacted in the corporate governance code. The high compliance rate (even before the official implementation of the rule in Hong Kong) lends support to a one-size-fits-all approach to impose some common minimum requirements. For this purpose, there seems to be no strong evidence demanding Hong Kong or Singapore to impose a lower board independence requirement for smaller firms. To push further, perhaps the UK could reconsider merits of having a lower board independence requirement for smaller companies after examining UK data.

However, a bigger question is whether it worth raising minimum board independence thresholds for all companies. For example, the Singapore code now requires firms to have at least half of their boards as independent directors if the chairman is part of the management team.99 As the Singapore sample shows that smaller firms are more likely to have an executive chairman, this will mean that many smaller listed firms may have to hire more independent directors if they want to comply with the code.

While hiring more independent directors might reduce some of the burden on serving board committees, it also means that firms must find good candidates and pay them more to attract people with a higher level of skills and experience and to compensate for their services. The former means that the pool of candidates will only get smaller if smaller firms all try to hire more independent directors at the same time and are limited only to more qualified candidates; the latter is certainly a financial constraint when smaller firms already pay less to independent directors and are now forced to only select from a more highly qualified pool of candidates that will likely seek more

98 Romano, supra note 64, at 1596.
99 Singapore Code, Guidelines 3.3.
reflective compensation. This might be less of a problem in larger countries such as the U.S. or China where there is an abundance of professionals or qualified candidates. However, it might be an issue in smaller markets like Singapore without assessing foreign candidates, who might cost more for smaller firms to hire if those firms do not have many international business connections and those firms that are largely domestic in their operation and transactions.

Shrinking board size may be another option to meet the minimum threshold if a firm does not want to, or finds it difficult to, hire more independent directors. There is some evidence from the compliance record of the 2012 code in Hong Kong that reducing board size is a common strategy to meet the minimum one-third threshold. However, it is unclear whether reducing board size is good or bad, especially when smaller firms already tend to have smaller boards. For example, Coles et al. find that the relationship between firm value and board size may not be linear, so very large or very small boards could both be optimal, while Yermack shows that smaller boards are more effective. Thus, policymakers should reconsider the merit of one-size-fits-all corporate governance standards for smaller firms, especially when they consider imposing higher standards. Otherwise, policymakers should assist firms to find good candidates that do not demand outstanding payment as compensation.

Second, regarding the nature of chairman and chairman–CEO duality, the relatively low compliance record perhaps shows that chairman–CEO duality is not an overwhelmingly popular idea among companies no matter whether they are big or small. This article suggests that policymakers could consider differentiating between larger and smaller companies. There are arguably more benefits in requiring larger firms to have an independent chairman and/or to separate the roles of chairman and CEO. It is likely that larger firms have many more shareholders and it may be more justifiable for them to have additional safeguards, such as an independent chairman, to ensure the board’s function. Nonetheless, the case may be weaker for smaller firms, which are often run by a family or a single founding owner. In light of the potential burden of hiring more independent directors (let alone designating one of them as the chairman), one may argue for a more flexible approach to respect certain features of family firms or sometimes to preserve the vision of founder of a smaller company.
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Third, this article does not propose exemptions for smaller firms from board committee requirements. However, assuming that there is no particular reason to believe that smaller firms would be willing to pay more to hire better independent directors, policymakers should perhaps do more to address potential concerns about overloading independent directors of smaller firms. This research does not prove that more responsibility (which might be translated into more liability) might mean that smaller firms hire lesser candidates, who have less full-time business separate from the firm. This is subject to future studies to examine characteristics and expertise of directors hired by listed companies. However, it is perhaps not an unreasonable expectation that an excellent candidate would think about workload and potential liability when considering a directorship. If a candidate is excellent, we should also assume that he probably has other full-time business to handle.

To make corporate governance regimes work, we must have good candidates for independent directors. Relaxing certain rules for smaller firms may be one way to reduce compliance costs and assist smaller firms in concentrating their resources on hiring good people. Policymakers should also do more to help match demand and supply. Creating a register or network of suitable candidates for independent directors may be a start. However, it will not address potential concerns around overload and responsibility.

V. CONCLUSION

In conclusion, this article examines the impact of a one-size-fits-all corporate governance code (as is the case in Hong Kong and Singapore) on smaller listed firms, which are supposed to have fewer resources to hire more qualified independent directors to serve on their boards and board committees. A one-size-fits-all approach is arguably not suitable for smaller listed firms. After examining data from a sample of companies listed in Hong Kong and Singapore, we find some limited support for the resources-based arguments, though there is no overwhelming evidence suggesting that smaller firms have difficulties meeting the minimum board independence requirements. While smaller firms seem to comply with the minimum one-third threshold quite well, evidence suggests that smaller firms might pay less to their independent directors and these directors are quite likely to be required to serve on multiple board committees. Although many larger firms also share the problem of overloading their independent directors, the ability to find and attract good candidates certainly differs with the availability of resources. Therefore, this article suggests that policymakers should rethink the merit of raising board independence standards to a higher level or board committee requirements and should find ways to assist smaller firms to hire good (and hopefully less expensive) candidates as independent directors in order to strengthen the board.
independence regime and to achieve the goals of promoting good corporate governance.
The Logic and Limits of Stewardship Codes: The Case of Japan

Gen Goto

A stewardship code is a set of principles on how institutional investors should act as shareholders of companies in which they invest. Since the first one was adopted by the Financial Reporting Council of the United Kingdom in July 2010, a significant number of countries, including Japan, have followed the lead of the United Kingdom in adopting their own stewardship codes. Although the contents of these codes are not identical, they generally are non-mandatory “comply or explain” rules urging institutional investors to engage more actively with their investee companies by exercising their rights as shareholders.

One might find the trend of jurisdictions adopting stewardship codes unsurprising considering the global increase in the ownership stake held by institutional investors in listed companies, and the growing expectation that these investors will play a role in the corporate governance of investee companies. However, if the goal of adopting stewardship codes is to promote better corporate governance in investee companies, then this uniform approach is rather puzzling since it is widely acknowledged that different countries have different share-ownership structures and often face different corporate governance challenges. It may well be the case that the true intention behind adopting a stewardship code could be highly contextual and, contingent on jurisdiction-specific factor).

From such viewpoint, this article investigates the true intention behind the adoption of stewardship codes in the United Kingdom and Japan by analyzing not only the text of their principles and guidance, but also the contexts in which they were adopted. The main finding is that there is a divergence between the basic goals and orientation of the Japanese and the UK Stewardship Codes that has been largely overlooked in the literature. Although the term “stewardship” suggests that stewardship codes are premised on the logic of

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fiduciary duties, which compels a fiduciary to forsake its own self-interest and act in the interest of its beneficiary, the goal of the UK Stewardship Code is different. It aims to restrain excessive risk-taking and short-termism by making institutional investors more responsible to the public. In contrast, the Japanese Stewardship Code aims to change the attitude of domestic institutional investors in order to orient Japanese corporate governance towards the interests of shareholders rather than stakeholders. This goal of the Japanese Code is more compatible with the logic of stewardship than that of the UK Code. At the same time, the Japanese Government considers this goal to be in the public interest of Japan.

Another finding of this article is that different stewardship codes have different goals and that this must be taken into consideration when assessing their effectiveness. The success of the Japanese Stewardship Code will primarily depend on how well domestic institutional investors are incentivized to act in the interest of their ultimate beneficiaries and to monitor entrenched management. Conversely, the success of the UK Stewardship Code will likely depend on the extent it can prompt institutional investors to consider the interest of the public and stakeholders other than shareholders. Regulatory interventions might be necessary in both cases, but for different reasons.
The Logic and Limits of Stewardship Codes

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PART I: INTRODUCTION: STEWARDSHIP CODES AND THE LOGIC OF “STEWARDSHIP”

A. Stewardship Codes as a Global Trend

A stewardship code is a set of principles on how institutional investors should act as shareholders of companies in which they invest. Since the first was adopted by the Financial Reporting Council of the United Kingdom in July 2010,1 a significant number of countries, including Japan,2 have followed the lead of the United Kingdom in adopting their own stewardship codes.3 Similar measures have also been taken by intergovernmental organizations, such as the Organization for Economic Co-operation and Development (OECD) and the European Union, to promote the concept of stewardship across jurisdictions.4

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3. Stewardship codes around the world can be classified into three groups: those adopted by or under auspices of relevant state authorities, those adopted by stock exchanges and industrial organization of finance companies, and those adopted by private groups of institutional investors. JENNIFER G. HILL, GOOD ACTIVIST/BAD ACTIVIST: THE RISE OF INTERNATIONAL STEWARDSHIP CODES, ECGI Law Working Paper No. 368/2017 (2017), at page 11-15 (available at http://ssrn.com/abstract=3036357). Among others, the first group includes stewardship codes of the United Kingdom (2010), Japan (2014), Malaysia (2014), Hong Kong (2016), and Taiwan (2016), the second group includes those of South Africa (2011), Singapore (2016) and South Korea (2016), and the third group includes those of Canada (2010), the Netherlands (2011), Switzerland (2013), International Corporate Governance Network (2016), and the United States of America (2017). Some of the stewardship codes in the second group, for example that of Singapore, could be classified in the first group if state authorities were the actual driving force behind the scene. Hill, supra at page 12 note 75. The author believes that this classification is valuable and essential as it is natural to think that the authorities adopting stewardship codes have some policy objectives, which private groups of investors may not necessarily share. In contrast, Professors Fenwick and Vermeulen, who also introduce a similar classification, do not seem to recognize the possible divergence of the goals of state authorities and private groups of investors as they simply compare “which approach is the best option”. See MARK FENWICK & ERIK P. M. VERMEULEN, INSTITUTIONAL INVESTOR ENGAGEMENT: HOW TO CREATE A ‘STEWARDSHIP CULTURE’, TILEC Discussion Paper DP 2018-006 (2018), at page 37-38 and page 43 (available at http://ssrn.com/abstract=3098235).

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Although the contents of these codes are not identical, they generally are non-mandatory “comply or explain” rules urging institutional investors to engage more actively with their investee companies by exercising their rights as shareholders.

The trend of jurisdictions adopting stewardship codes is unsurprising when considering the global increase in the ownership stake held by institutional investors in listed companies and the growing expectation that these investors will play a role in the corporate governance of investee companies. However, if the goal of adopting stewardship codes is to promote better corporate governance in investee companies, then this uniform approach is rather puzzling.

It is widely acknowledged that different countries have different share-ownership structures and thus often face different corporate governance challenges. From such a viewpoint, the assertion of two UK law professors that the transplantation of UK-Style stewardship codes “is likely to be driven by the common concerns shared by many jurisdictions” is surprising, as it may well be the case that the true intention behind adopting a stewardship code in a jurisdiction could be highly contextual and contingent upon jurisdiction-specific factors. Indeed, as explained in this article, this is the case in Japan.

B. The Logic of “Stewardship”

Another question arises from the term “stewardship”.

A “steward” means a “person employed to manage another’s property, especially a large house or estate” or a “person whose responsibility it is to take care of something”. In its original historical context, a “steward” was an “officer of the royal household, especially an administrator of Crown estates” in Britain. Without delving much into the British history, it would not be wrong to think of stewards in those days as being responsible to and required to
demonstrate loyalty to the British royal household, whose estate is entrusted to the stewards.

In the context of modern investment, institutional investors, such as mutual funds, pension funds, insurance companies, and investment advisors, are considered to be “stewards”, as they are entrusted with their clients’ money for investment purposes. The use of the term “stewardship” suggests that stewardship codes are based on the following logic produced by an analogy with the historical “steward”: Institutional investors must be loyal to their clients, who have entrusted their money to the institutions for investment purposes, and should exercise their rights as shareholders of investee companies in order to fulfill their responsibility as “stewards” of their clients.10

One would notice that this logic of “stewardship” is essentially that of fiduciary duties, which compels a fiduciary to forsake its own self-interest and act only in the interest of its beneficiary.11 Indeed, some of the relationships between institutional investors and their clients can be described as a fiduciary relationship. For example, an investment advisor hired by a public pension fund to manage a part of its fund is a fiduciary to the pension fund.12 By avoiding the use of the term “fiduciary”, which is a well-established legal term in the common-law world with a defined scope,13 stewardship codes have expanded the range of actors they cover, especially those that would not necessarily be considered fiduciaries.14

10. Those who are familiar with the UK Stewardship Code might argue that the logic of stewardship stipulated in the text above does not fit the UK Code, which considers institutional investors rather as stewards of investee companies. The author agrees. Indeed, the point of this article is to show that such framing of a stewardship code is UK-specific (or Europe-specific) and is not necessarily universally shared - at least not by the Japanese Stewardship Code. See infra, Part I, Section C and Part III, Section C.

11. See for example, Hiroyuki Kansaku, Koporeto gabansu koyo ni maketa naigai no doko – Suchuwadoshippu kodo wo chushin toshite [Developments towards the Improvement of Corporate Governance in Japan and Other Countries: With Focus on Stewardship Codes], 2030 SHOJIHOMU 11, at 13 (2014).

12. For example, OECD Principles recommends, without using the term “stewardship”, that institutional investors acting in a fiduciary capacity should disclose their corporate governance and voting policies with respect to their investments.


14. See Hiroyuki Kansaku, Nihon-ban suchuwadoshippu kodo no kihansei ni tsuite [On the Nature of the Japanese Stewardship Code as a Norm], in Etsuro Kuronuma & Tomotaka Fujita (eds.), Kigyoho no shinro – Egashira Kenjiro sensei koki kinen [Future Courses of Enterprise Law - In Celebration of the 70th Birthday of Professor Kenjiro Egashira] (Yuhikaku, 2017), 1005, at page 1014 (in Japanese). Of course, the binding power of stewardship codes taking the “comply or explain” approach is not as strong as that of fiduciary duties imposed by law.
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While the above logic of stewardship focuses on the interest of ultimate beneficiaries, scholarly debate on the role of institutional investors focuses on improving corporate governance of investee companies. This difference in focus raises a possibility that stewardship codes are not necessarily based on the logic of stewardship, but rather focus on corporate governance of investee companies.

C. The Japanese Code and the UK Code: Are they the same?

Are stewardship codes about the interests of ultimate beneficiaries, or are they about corporate governance of investee companies? Interestingly, there is an important difference between the Japanese Stewardship Code and the UK Stewardship Code on this point.

The preface of the Japanese Stewardship Code begins with the following definition of “stewardship responsibilities”:

In this Code, “stewardship responsibilities” refers to the responsibilities of institutional investors to enhance the medium- to long-term investment return for their clients and beneficiaries (including ultimate beneficiaries; the same shall apply hereafter) by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment.

In contrast, the preface of the current UK Stewardship Code as revised in 2012 states the aim of stewardship in its first paragraph as follows:

Stewardship aims to promote the long term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy as a whole.

These codes are ostensibly alike as they use similar wording on the same two issues. The first is the interest of ultimate beneficiaries (“the medium- to long-term investment return for their clients and beneficiaries” (Japan) or the prosperity of “the ultimate providers of capital” (UK)). The second is the growth of investee companies (“improving and fostering the investee companies’ corporate value and sustainable growth” (Japan) or “the long-term success of companies” (UK)).

Interestingly, the Financial Services Agency of Japan rather turned to the term “fiduciary duty”, which is an imported concept for Japan that does not share the common-law tradition, as a means to change the behavior of sellers of financial instruments, such as banks selling mutual fund or variable life insurance, to disclose more information to their customers. See Nobuko Matsumoto, Kinyu bunyu ni okeru “fidyushari”=dyushbi no yogoho ni tsuite no ichi koatsu [A Study on the Terminology of “Fiduciary Duty” in Financial Regulation], in Yoshihisa Nomi, Norio Higuchi & Hideki Kanda (eds.), Shintaku hosei no shin jidai: Shintaku no gendaiteki tenkai to shorai tenbou [The New Era of Trust Law: Modern Developments and Future Prospects of Trusts] (Kobundo, 2017) at 223.

15. In contrast, the question raised in Part I, Section A that countries facing different issues are somehow adopting a common measure would not be a problem here as the relationship between ultimate beneficiaries and fund managers may not be so different among countries.


17. The 2012 Revised UK Code, supra note 1 at page 1.
The two codes, however, are structured differently and thus seem to emphasize different points. By using the prepositions “to” and “by”, the Japanese Code seems to prioritize the enhancement of “the medium- to long-term investment return for [institutional investors’] clients and beneficiaries” as the goal of stewardship responsibility and consider sustainable growth of investee companies as a means to achieve this goal. In contrast, the UK 2012 Code seems to put emphasis on “the long-term success of [investee] companies”, which is brought first, and to subordinate the interest of ultimate providers of capital by using the words “in such a way” and “also”. Somewhat ironically, Japan seems to demonstrate greater fidelity to the logic of “stewardship”, as set out earlier, than the United Kingdom, the motherland of stewardship codes.

D. Research questions

From this divergence, which has been largely overlooked in the literature, a few questions arise. What is, or are, the intended goal(s) of stewardship codes? Why are countries pursuing different goals and trying to use the same measure to achieve them? How compatible are these goals with the logic of stewardship and can they be achieved by adopting stewardship codes?

This Article addresses these questions by drawing on the Japanese experience and by comparing it with the United Kingdom. Briefly stated, there is a divergence between the basic goals and orientation of the Japanese and the UK Stewardship Codes. Although the term “stewardship” suggests that stewardship codes are based on the logic of a fiduciary duty that compels a fiduciary to forsake its own self-interest and act in the interests of its beneficiary, the goal of the UK Stewardship Code is instead to restrain excessive risk-taking and short-termism by making institutional investors more responsible to the public. In contrast, the Japanese Stewardship Code aims to change the attitude of domestic institutional investors so as to make Japanese corporate governance more oriented towards the interests of shareholders rather than stakeholders.

18. In response to one of the comments received in the public comment procedure criticizing the inclusion of sustainable growth of investee companies in the scope of stewardship responsibility, the Council of Experts Concerning the Japanese Version of the Stewardship Code admitted that the final goal of institutional investors is to enhance the medium- to long-term investment return for their clients and beneficiaries, while asserting that it is important to improve and foster the investee companies’ corporate value and sustainable growth through constructive engagement. See THE COUNCIL OF EXPERTS CONCERNING THE JAPANESE VERSION OF THE STEWARDSHIP CODE, Wabun ni taisuru komento no gaiyo oyobi kensetsu no kango (“The Summary of the Comments to the Japanese Version of the Draft and the Council’s View on Then“) (April 22, 2014, available at http://www.fsa.go.jp/news/25/singi/20140422-2/01.pdf), Comment No.2 at page 1.

19. See infra note 152-158 and accompanying text.
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The remainder of this Article starts with a deeper look at the background and the contents of the UK Stewardship Code with a view to identify its intended goal (Part II). After a similar exercise with the Japanese Stewardship Code (Part III), this Article analyzes whether the intended goals of the UK and Japanese codes are compatible with the logic of stewardship, and whether these codes can achieve their respective goals (Part IV).

PART II: THE ORIGIN OF STEWARDSHIP CODES: THE CASE OF THE UNITED KINGDOM

A. Inconsistency within the 2012 UK Code

As discussed above, the preface to the current 2012 revised version of the UK Stewardship Code, lists two goals of stewardship: (1) “the long term success of companies”; and, (2) the prosperity of “the ultimate providers of capital”. However, the first goal appears to have priority over the second. Such a focus on the long-term success of investee companies is also reflected in the second paragraph of the preface, which states that “responsibility for stewardship is shared” in publicly listed companies; that “the primary responsibility rests with the board of the company”; and that investors “also play an important role in holding the board to account for the fulfilment of its responsibilities”. If, however, one takes the logic of stewardship discussed in Part I, Section B seriously, it should be institutional investors that bear the primary responsibility to their clients and ultimate beneficiaries.

In contrast, the principles of the 2012 Revised UK Stewardship Code, which are described as “the core of the Code”, are stipulated in the following manner:

So as to protect and enhance the value that accrues to the ultimate beneficiary, institutional investors should:
1. publicly disclose their policy on how they will discharge their stewardship responsibilities.
2. have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.
3. monitor their investee companies.
4. establish clear guidelines on when and how they will escalate their stewardship activities.
5. be willing to act collectively with other investors where appropriate.
6. have a clear policy on voting and disclosure of voting activity.
7. report periodically on their stewardship and voting activities.

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20. The 2012 Revised Code, supra note 1 at page 1.
21. The 2012 Revised Code, supra note 1 at page 4. Each principle is accompanied by detailed guidance. Ibid. at page 6-10.
22. The 2012 Revised UK Code, supra note 1 at page 5.
Clearly, the chapeau of these seven principles, which was added by the 2012 revision, emphasizes the interests of ultimate beneficiaries as the goal. It does not even refer to the interest of investee companies. There is thus a clear inconsistency between the preface and the principles of the 2012 Revised UK Stewardship Code on which aspect to emphasize, the interest of investee companies or that of ultimate beneficiaries. Unsurprisingly, the UK Stewardship Code has been criticized as “unclear as to whom shareholders are accountable to”. To understand the origin of this inconsistency, the following section will examine the background of the UK Stewardship Code.

B. The Background of the UK Stewardship Code

1. The Walker Review

In November 2009, in the aftermath of the global financial crisis in the preceding years, Sir David Walker submitted a report known as the “Walker Review” commissioned by the UK government. The task, as described by the UK government, was “to review corporate governance in UK banks in light of the experience of critical loss and failure throughout the banking system”, on the premise that “serious deficiencies in prudential oversight and financial regulation in the period before the crisis were accompanied by major governance failures within banks” and that these factors “contributed materially to excessive risk taking and to the breadth and depth of the crisis”.

In this review, Sir David recommended that the “remit of the FRC [Financial Reporting Council] should be explicitly extended to cover the development and encouragement of adherence to principles of best practice in stewardship by institutional investors and fund managers” and that the “Code on the Responsibilities of Institutional Investors, prepared by the Institutional Shareholders’ Committee, should be ratified by the FRC and become the Stewardship Code”.

The Walker Report focused on the role of institutional investors since there was “a widespread acquiescence by institutional investors and the market in the gearing up of the balance sheets of banks (and also of many other

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companies) as a means of boosting returns on equity”.27 Such an attitude “was not necessarily irrational from the standpoint of the immediate interests of shareholders who, in the leveraged limited liability business of a bank, receive all of the potential upside whereas their downside is limited to their equity stake, however much the bank loses overall in a catastrophe”.28 However, “while shareholders enjoy limited liability in respect of their investee companies, in the case of major banks the taxpayer has been obliged to assume effectively unlimited liability”.29 In another part, the Walker Review criticizes the “increased shareholder pressure on boards to perform in the short term” before the Financial Crisis, and regards “specific short-term initiative[s] such as increased leverage, spin-offs, acquisitions or share buybacks” as “opportunistic behavior” as they brought “a stronger stock price and higher short-term earnings” “at the expense of increased credit risk and potential erosion in credit quality to the detriment of bondholders and other creditors”.30

In this context the Walker Review emphasizes the importance of discharging the responsibilities of shareholders as owners, and asserts that “those who have significant rights of ownership and enjoy the very material advantage of limited liability should see these as complemented by a duty of stewardship”.31 The Walker Review states that this view “would be shared by the public, as well as those employees and suppliers who are less well-placed than an institutional shareholder to diversify their exposure to the management and performance risk of a limited liability company”.32

To summarize, the goal of the Walker Review was to make institutional investors who are shareholders of public companies more responsible to the general public and curtail excessive risk taking by monitoring the management of those companies.33 This goal is understandable given the context of the post-crisis climate.34

27. The Walker Review, supra note 24 at para.5.10 at page71. See also the Walker Review, supra note 24 at para.1.10 at page 26.
28. The Walker Review, supra note 24 at para.5.10 at page71. See also the Walker Review, supra note 24 at para.1.8 at page 25.
30. The Walker Review, supra note 24 at para.5.27 at page 78.
31. The Walker Review, supra note 24 at page 12 and para.5.7 at page 70.
32. The Walker Review, supra note 24 at para.5.7 at page 70.
34. Professor Reisberg describes the mood of the period as “Something had to be done quickly and, preferably, visibly”. Reisberg, supra note 23 at 221.
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It is not so clear, however, how the adoption of a stewardship code would help in achieving these public interest goals. While the Walker Review describes the responsibility of shareholders as “a duty of stewardship” without clarifying to whom such a duty is owed and expects that many “ultimate beneficiaries, trustees and other end investors would no doubt wish to be supportive of” it,35 the above goal would rather contradict with the logic of “stewardship” discussed in Part I, which focuses on maximizing the interests of ultimate beneficiaries of institutional investors.

2. The ISC Code

Interestingly, the Code on the Responsibilities of Institutional Investors (the ISC Code),36 which was drafted by the Institutional Shareholders’ Committee (ISC) and recommended by the Walker Review to the FRC for ratification, did not share the same goal as the Walker Review. In particular, the ISC Code declares that the “duty of institutional investors is to their end-beneficiaries and/or clients and not to the wider public”.37 Also, the paragraph describing the aim of the code places improving “long-term returns to shareholders” ahead of reducing “the risk of catastrophic outcomes due to bad strategic decisions” and “helping with the efficient exercise of governance responsibilities”.38

As the ISC is not a governmental agency but a private organization formed by trade associations of British institutional investors,39 it places the interests of clients and ultimate beneficiaries of institutional investors above that of the wider public. This stance, which the ISC has held since at least 2002,40 however, has apparently been ignored by the Walker Review.41

35. The Walker Review, supra note 24 at para.5.7 at page 70 and para.5.9 at page 71.
37. ISC Code, supra note 36 at page 2. The declaration in the text was made after stating that the amount of resources of institutional investors should be “sufficient to allow them to fulfill their responsibilities effectively” but be “commensurate with the benefits derived”.
38. ISC Code, supra note 36 at page 1.
39. The members of the ISC as of 2009 are the Association of British Insurers, the Association of Investment Trust Companies, the National Association of Pension Funds, and the Investment Management Association. ISC Code, supra note 36 at page 1, footnote 1.
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Why did the Walker Review recommend that the FRC ratify the ISC Code and grant it “quasi-official imprimatur” despite fundamental differences in their orientation and philosophy? The Walker Review seems to assume that investors who engage with investee companies “are likely to be relatively long-term holders for whom divestment in potential problem situations comes to be seen as a last rather than first resort” and thus that they would focus on long-term profits and not pursue “specific short-term initiative[s] such as increased leverage, spin-offs, acquisitions or share buybacks” that were seen in the period before the Financial Crisis. It is, however, difficult not to criticize this assumption as “naïve” given the behavior of institutional investors prior to the financial crisis.

3. The 2010 UK Code

In any event, the Financial Reporting Council followed the recommendation of the Walker Review and issued a consultation paper in January 2010 seeking public feedback on whether it should adopt the ISC Code as the UK Stewardship Code.

Although the FRC referred to the responsibility of institutional investors “to ensure that the asset managers act diligently and in the best interest of the ultimate owners”, improved governance and performance of investee companies, more efficient operation of capital markets and increased confidence in business were stated as the first potential benefits of more effective engagement. Upon the adoption of the ISC Code as the UK...
Stewardship Code in July 2010, the FRC replaced the introduction of the ISC Code with a new preface and deleted the declaration of the ISC Code that the “duty of institutional investors is to their end-beneficiaries and/or clients and not to the wider public”.49 Taken together, the 2010 UK Code appears to share the same goal as the Walker Review.50

This orientation of the 2010 UK Code is obscured, however, because the aim in the newly drafted preface is almost an exact copy of that of the ISC Code, stating that the “Stewardship Code aims to enhance the quality of engagement between institutional investors and companies to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities”.51 The principles and guidance stated in this 2010 UK Code are also essentially the same as those of the ISC Code,52 as the FRC “decided to adopt the Code in its current form” “with only limited amendments” in order “to build on the momentum generated by the Walker Review, the ISC’s initiative, and the debate on engagement stimulated by the changes to the UK Corporate Governance Code and the consultation of this Code”.53

4. The 2012 Revised UK Code

The FRC made it clear in 2010 that it would revise the UK Stewardship Code as necessary.54 One of the aims of this revision, which took place in 2012, was to clarify the meaning of the term “stewardship”.55 Consequently, the preface of the Code was substantially redrafted. As mentioned in Part I, Section C above, the 2012 Revised UK Code provides that stewardship “aims and asset owners and strengthened accountability of institutional shareholders to their clients will also strengthen trust in the financial system. A clear understanding of these responsibilities will also assist beneficial owners in setting the terms of their fund mandates and in holding asset managers accountable”.


50. Chiu, supra note 33 at 395, 416.

51. The 2010 UK Code, supra note 1 at page 1.

52. The formulation of the chapeau of the principles in the 2010 UK Code, which simply states “Institutional investors should”, differs from that of the 2012 Revised UK Code cited earlier,See supra note 22 and accompanying text.

53. FINANCIAL REPORTING COUNCIL, IMPLEMENTATION OF THE UK STEWARDSHIP CODE (July 2010), para.7 and 9 at page 2. Some commentators have criticized the FRC for not taking the opportunity to strengthen the standards of the ISC Code. See Lee Rouch, The UK Stewardship Code, 11 JOURNAL OF CORPORATE LAW STUDIES 463, 479-493.

54. The 2010 UK Code, supra note 1 at page 3.

55. FINANCIAL REPORTING COUNCIL, REVISIONS TO THE UK STEWARDSHIP CODE: CONSULTATION DOCUMENT (April 2, 2012) (available at https://www.frc.org.uk/consultation-list/2012/consultation-document-revisions-to-the-uk-steward), para.6 at page 1. The other aims were to clarify the respective roles and responsibilities of asset owners and managers, to address some issues identified in the initial consultation in 2010, to take into account lessons learned during the initial implementation of the Code and to update the Code to reflect developments in market practice. See ibid., para.6-8 at page 1-2.
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to promote the long term success of companies in such a way that the ultimate providers of capital also prosper”.56 When comparing this statement with the aim of the 2010 Code, which is “to help improve long-term returns to shareholders and the efficient exercise of governance responsibilities”, it is clear that the 2012 Revised Code placed more emphasis on “the long-term success of [investee] companies” as its goal over the interest of ultimate beneficiaries.

At the same time, the 2012 Revised UK Code created the inconsistency described in Part II, Section A by emphasizing the interest of ultimate beneficiaries with the phrase “So as to protect and enhance the value to the ultimate beneficiary,” in the chapeau of “The Principles of the Code”.57 Similar references to the interest of ultimate beneficiaries are also made in the new guidance to Principles 1 and 2.58

Unfortunately, the reason for these amendments is not fully explained in the consultation paper for the 2012 revision. On the subject of revisions to the preface and the guidance to Principle 1, the consultation paper only refers to the existence of “some confusion in the UK market and overseas as to what ‘stewardship’ means” such as “a perception in some quarters that the Stewardship Code is solely concerned with socially responsible investment”.59 As to the objectives provided in the chapeau of the principles, the consultation paper explains that this phrase was moved from Principle 4 of the original 2010 Code as it “relates to all the principles”.60 but does not explain how it relates to the statement of the aim of the Stewardship Code in the new preface.

5. The Kay Review

The 2012 revision of the UK Stewardship Code seems to be influenced by the position of the Kay Review,61 the first recommendation of which states that

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56. The 2012 Revised UK, supra note 1 at para.1 at page 1.
57. No change or addition is made to the content of the seven principles itself. FINANCIAL REPORTING COUNCIL, supra note 55 at para.4 at page 1.
58. The 2012 Revised UK Code, supra note 1 at the second paragraph of the guidance to Principle 1 (“The policy should disclose how the institutional investor applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client.”) and the third paragraph of the guidance to Principle 2 (“Institutional investors should put in place, maintain and publicly disclose a policy for identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first.”).
59. FINANCIAL REPORTING COUNCIL, supra note 55 at para.36 at page 11.
60. FINANCIAL REPORTING COUNCIL, supra note 55 at para.5 at page 5.
61. THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING: FINAL REPORT (July 2012) (hereinafter “the Kay Review: Final Report”), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf. To be precise, the Final Report of the Kay Review was published in July 2012 and thus was unable to be taken into consideration by the consultation paper of the FRC, which was published in April of that year. However, the Interim Report of the Kay Review, which was published in February 2012 and is referred to in the consultation paper, had already expressed the views that will be discussed in the following texts. See FINANCIAL REPORTING COUNCIL,
the “Stewardship Code should be developed to incorporate a more expansive form of stewardship, focusing on strategic issues as well as questions of corporate governance”.  

This “expansive form of stewardship” is premised on the Kay Review’s “belief that the investment chain will work best if those who invest funds in equity markets have trust and confidence in the agents with which they place the funds and if the companies which list on equity markets have respect for those who rely on their earnings and cash flow to generate returns on their savings and security in their retirement”. In other words, the Kay Review expects institutional investors to “trust” the management of investee companies upon engagement, “which is most commonly positive and supportive, and not merely critical”.  

The aim of the Kay Review in promoting this “expansive form of stewardship” is, as the official title of the Review suggests, to contribute to “good long-term decision making in British business and finance”. To put it differently, the Kay Review’s emphasis on stewardship of institutional investors was directed at combating short-termism, which is defined as “a tendency to under-investment, whether in physical assets or in intangibles such

supra note 55 at para.4 at page 1 (referring to the view expressed in the Interim Report of the Kay Review that the 2010 Stewardship Code “should be given time to settle”) and THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING: INTERIM REPORT (February 2012), available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31544/12-631-kay-review-of-equity-markets-interim-report.pdf (focusing on stewardship and engagement as essential means for equity markets to achieve the ends of “allowing companies to make long term decisions appropriate to their business and . . . allowing savers to make financial plans appropriate to their objectives” (at para.2.15 and 2.16 at page 8, para.2.21 at page 9 and para.2.23 at page 11); observing that asset managers concerned with stewardship “would be expected to engage with, and be committed to, the companies in which they held stock” and “normally be supportive of company management, but would be ready to engage in constructive criticism and, in the extreme cases, to act themselves or in conjunction with others to effect change” (para.2.20 at page 9); acknowledging the concern that “the time horizons adopted by savers . . . to judge their asset managers was significantly shorter than the time horizon over which the saver . . . was looking to maximise a return” and that this “emphasis . . . on short term performance investing influenced the style of asset management in ways that could disadvantage the beneficial owner” by emphasizing “trading rather than investing” (at para.6.32 at page 36); distinguishing asset managers “whose primary focus is on the activities of the company – its business, its strategy, and its likely future earnings and cash flow – and those whose primary focus is on the market for the shares of the company – the flow of buy and sell orders, the momentum in the share price, the short term correlations between the prices of different stocks” (para.6.6 at page 31)).  

63. The Kay Review: Final Report, supra note 61 at para.6.4 at page 45. See also Principle 1, ibid. at page 12.  
64. The Kay Review: Final Report, supra note 61 at para.6.3 at page 44-45. It must be noted that the word “trust” may not be used consistently in the Kay Review as para.6.2 refers to the trust on institutional investors by their clients (“The honest steward expects to be rewarded for the discharge of that trust, but on a basis of full disclosure and only on that basis.” (emphasis added by the author)).  
65. The Kay Review: Final Report, supra note 61 at para.6.27 at page 48. The Kay Review sets out the principles relevant to good long-term decision making so as “to focus the attention of directors on the success of the company in the long-term: to lengthen the time scale of measurement of investment performance by influencing the priorities of asset holders and asset managers: to shorten the time horizon of value discovery by placing greater emphasis on the relationship between the asset manager and the company”. The Kay Review: Final Report, supra note 61 at para.6.28 at page 48.
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as product development, employee skills and reputation with customers, and as hyperactive behaviour by executives whose corporate strategy focuses on restructuring, financial re-engineering or mergers and acquisitions at the expense of developing the fundamental operational capabilities of the business.  

In its foreword, the Kay Review expresses the view that such short-termism is detrimental to the competitive advantages of British companies in global markets and the prosperity of the United Kingdom. Although the Kay Review also refers to the interests of British savers and pension beneficiaries “to benefit from the activity of these businesses through returns to direct and indirect ownership of shares in UK companies”, its focus seems to be on the long-term profitability of UK companies rather than on the interest of UK ultimate beneficiaries. Thus, the Kay Review essentially shares the goal of the Walker Review, which is to restrain excessive risk-taking at the cost of stakeholders other than shareholders.

6. Summary: The Goal of the UK Stewardship Code

The above analysis of the background of the UK Stewardship Code illuminated the importance of distinguishing between the UK practice of engagement by traditional institutional investors and the Stewardship Code in conjunction with the Walker and the Kay Reviews. While the UK practice has been carried out for the interest of their beneficiaries as expressed by the ISC, the UK Code and the two Reviews as policy documents focus on public interest by restraining excessive risk-taking and short-termism. The reference to the interest of ultimate beneficiaries in the UK Stewardship Code, especially in the

66. The Kay Review: Final Report, supra note 61 at para.vi at page 10. See also para.1.1 and 1.2 at page 14.
67. The Kay Review: Final Report, supra note 61, Foreword at page 5 (“British business must invest and must develop its capacity for innovation, its brands and reputations, and the skills of its workforce. Only in this way can we create and sustain the competitive advantages in global markets which are necessary to maintain our prosperity.”). The Kay Review also seems to blame short-termism in the UK equity market as one of the reasons that no companies like Amazon, Apple or Google has emerged in Britain “to take the place of the financial institutions which failed in the recent crisis”. The Kay Review: Final Report, supra note 61 at para.1.27 at page 20.
68. The Kay Review: Final Report, supra note 61 at page 9. See also the Kay Review: Final Report, supra note 61, Foreword at page 5 (“Through success in world markets, British companies will earn the returns on investment which are necessary to pay our pensions and enable us to achieve our long-term financial goals.”).
69. The Kay Review emphasizes the importance of fiduciary duty and standards in investment chain, which “require that the client’s interests are put first”, but limits the type of the client’s interest to be taken into account to long-term and excludes short-term. The Kay Review: Final Report, supra note 61, Principle 5 at page 12, para.7.9 at page 51 and para.9.16 at page 68.
70. The difference between the orientations of the ISC Code and the UK Stewardship Code has been overlooked even by British commentators. See for example Chiu & Katelouzou, supra note 7 at 134-135 (“The Code evolved out of the Institutional Shareholders’ Committee’s similarly named Code of 2010, and therefore accords with market perceptions of the appropriate role for institutional investors.”).
2012 version, should be read restrictively as referring to an interest in long-term returns.

C. Academic Responses in the UK

Legal scholars in the UK generally seem to share the above orientation of the UK Stewardship Code, although commentators have been largely critical of the Code’s ability to achieve its intended goal.

For example, after correctly recognizing that the aim of the Walker Review is to impose a duty of stewardship on shareholders who enjoy limited liability, Professor Cheffins questions the effectiveness of the Code as foreign investors who presently own more than 40% of the shares of UK listed companies today are not “under any direct onus to commit to the Code’s terms”. Professor Davies also observes that “it is difficult to believe that the new regime” envisaged by the Kay Review “will achieve anything of substance in the absence of some amendment of the liberal UK regime for takeovers, which induces corporate management to focus on the current share price and provides episodic but substantial pay-offs to shareholders”. In this sense, Professor Davies states that the Kay Review “sits in the mainstream of the UK corporate governance tradition”. Professors Chiu and Katelouzou attempt to depart from this mainstream by pointing out that “even where institutions support shareholder engagement, such engagement is on the basis of a shareholder value ideology that exerts short-termist pressures upon their investee companies and has deleterious effects upon corporate culture, bringing in short-termism and less regard for stakeholders and wider social responsibility”. They criticize the UK Stewardship Code as “ideologically perplexed” for conceptualizing “investor-led governance within a public-interest framing” while continuing “to make overly optimistic assumptions about the motivations of different types of institutions and their alignment with socially beneficial effects in the long-

72. Cheffins, supra note 40 at 1011.
75. Ibid.
76. Chiu & Katelouzou, supra note 12 at 73-74.
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term”. 77 At the same time, “the Code, being soft law, does not provide adequately for the accountability and governance mechanisms that would check and balance shareholders’ enhanced engagement roles and powers”. 78 From such a viewpoint, Professors Chiu and Katelouzou propose imposing mandatory disclosure requirements on institutional investors regarding their engagement intentions, plans and outcomes to the public, and regulatory standards of conduct focusing on “the long-term well-being of the company taking into account of other shareholders’ and stakeholders’ interest” via securities and investment regulation. 79 In contrast, Professor Reisberg suggests providing financial incentives through weighted dividends or tax benefits to reward worthy stewardship by long-term investors. 80

Professors Chiu and Katelouzou go on to assert that other countries including Japan have adopted stewardship codes from “the common concern” about “minority shareholder activism, especially of the offensive variant” “especially due to its perceived short-term nature and its likely negative impact on corporate wealth in general”. 81 To ascertain whether this statement is correct, this Article next analyzes the text and the backgrounds of the Japanese Stewardship Code.

PART III: THE TRANSPANT OF STEWARDSHIP CODES: THE CASE OF JAPAN

A. How is the Japanese Stewardship Code Different from the UK Code?

Japan adopted its stewardship code in February 2014, and later revised it in May 2017. The framework of the Japanese Stewardship Code is heavily influenced by the UK Stewardship Code. It takes the form of soft law; it is not mandatory for institutional investors to sign up to the code. If an institutional investor chooses to sign up, it is only required to comply with the principles

77. Chiu & Katelouzou, supra note 12 at 87.
78. Chiu & Katelouzou, supra note 12 at 88.
79. Chiu & Katelouzou, supra note 12 at 90-92, 94-96. See also Chiu & Katelouzou, supra note 7 at 151-152 (discussing the then-proposed Shareholder Rights Directive of the European Union and calling for complete “hardening” of the soft law of shareholder stewardship” while pointing out that “policy-makers need to be more honest and open about the regulatory objectives and premises underlying such legalisation of institutional shareholder duties.”). For similar arguments in the United States, see Usha Rodrigues, Corporate Governance in an Age of Separation of Ownership from Ownership, 95 MINNESOTA LAW REVIEW 1822 (2011) (asserting that shareholder empowerment and disclosure requirements introduced by the Dodd-Frank Act cannot solve the issue of short-termism and that substantive governmental regulation such as limitation on executive compensation is a better choice).
80. Reisberg, supra note 23 at 249-250. See also, Sergakis, supra note 73 at 146-147.
81. Chiu & Katelouzou, supra note 7 at 135, 138. See also ibid. at 139 (stating that stewardship codes have been “further internationalised to address the need for constructive engagement by institutional investors for the purposes of supporting a long-term wealth-creating corporate sector and mitigating short-termism and trading-focused investment management, and the need to define the terms of engagement in order to rein in opportunistic activist behavior.”).
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and guidance of the Code, or to explain why it does not do so.82 The seven principles of the Japanese Code were also drafted by first translating those of the UK Code into Japanese and then considering one by one whether any modifications or additions were necessary to meet the circumstances in Japan.83

1. The Principles

The content of the Japanese Stewardship Code, however, is not identical to that of the UK Code. The principles of the Japanese Code are as follows:84
So as to promote sustainable growth of the investee company and enhance the medium- and long-term investment return of clients and beneficiaries,

1. Institutional investors should have a clear policy on how they fulfill their stewardship responsibilities, and publicly disclose it.
2. Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.
3. Institutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies.
4. Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.
5. Institutional investors should have a clear policy on voting and disclosure of voting activity. The policy on voting should not be comprised only of a mechanical checklist; it should be designed to contribute to the sustainable growth of investee companies.
6. Institutional investors in principle should report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.
7. To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the investee companies and their business environment and skills and resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities.

Principles 1, 2 and 6 of the Japanese Stewardship Code are substantially the same as Principles 1, 2 and 7 of the UK Code. However, the other parts of the Japanese Stewardship Code differ from the UK Code in that they appear to apply less investors’ pressure on investee companies.85

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82. The 2017 Revised Japanese Code, supra note 2 at para.11-12 at page 6.
85. The following paragraphs are based on the analysis of Wataru Tanaka, Nihon-ban suchowadoshippu codo no kento: Kikan-toshika no yakuwari nitsuite no anbivarento na mikata [An Analysis of the Japanese Stewardship Code: An Ambivalent View on the Role of Institutional Investors], 629 KANSAYAKU 66 at 68-69 (2014).
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To begin with, the chapeau of the Japanese principles puts sustainable growth of the investee company ahead of the enhancement of the medium- and long-term investment return of clients and beneficiaries; whereas the UK Code only refers to the interest of the ultimate beneficiaries.

Secondly, while Principles 4 and 5 of the UK Code refer to the possibility of escalating stewardship activities when necessary, and recommend that institutional investors act collectively with other investors, no such reference can be found in the Japanese principles. Instead, Principle 4 of the Japanese Code requests institutional investors to arrive at a common understanding with investee companies, and to work with them in solving problems. It must be noted that the FSA admitted that sometimes it would be necessary to take more aggressive measures than merely asking for explanation and such measures are not excluded as a way of solving problems. Still, the wording of Principle 4 may have the effect of giving Japanese companies room to argue that institutional investors requesting certain actions, such as an increase in payouts, are not making sufficient efforts to reach such a common understanding. In a similar vein, Principle 7 calls on institutional investors to have in-depth knowledge of investee companies and their business environment, as well as skills and resources necessary for appropriate engagement – again in order to contribute to the sustainable growth of investee companies.

Further, while Principle 3 of the English version of the Japanese Code requests institutional investors to “monitor” investee companies, as does that of the UK Code, the original Japanese document does not use the literal Japanese translation of the term “monitor”; instead it requests investors to “properly

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86. At the second meeting of the Council of Experts Concerning the Japanese Version of the Stewardship Code, Mr. Muneaki Tokunari of Mitsubishi UFJ Trust and Banking Corporation, as the representative of trust banks that are often in charge of management of private pension funds, stated that in the then-current practice his bank asks investee companies for more explanation in certain occasions but does not have a concrete guideline on escalating the level of stewardship activities and that the banks does not participate in collective engagement. Mr. Toshinao Matsushima of Daiwa Asset Management, as the representative of the mutual funds industry, also made a similar statement. See the Minutes of the 2nd Council of Experts Concerning the Japanese Version of the Stewardship Code, at pages 12-13 and 15-16 (available at http://www.fsa.go.jp/en/refer/councils/stewardship/material/20130918_3.pdf). Based on these presentations, FSA proposed to deviate from the UK Code in this regard. See the Minutes of the 3rd Council of Experts Concerning the Japanese Version of the Stewardship Code, at page 13 (available at http://www.fsa.go.jp/en/refer/councils/stewardship/material/20131018_2.pdf). While there was some support for making no reference to the possibility of escalating the level of stewardship activities as it would not fit the Japanese practice (ibid. at page 18), a few members of the Council expressed positive views on collective engagement and criticized the FSA’s proposal (ibid. at page 19-20). It must be noted that, as a partial response, FSA issued a document on its interpretation of Japanese law on “acting in concert” under the large shareholding report requirement and the tender offer rules to remove legal ambiguities that may hinder collective engagement. Financial Services Agency, Clarification of Legal Issues Related to the Development of the Japan’s Stewardship Code (February 26, 2014, available at http://www.fsa.go.jp/en/refer/councils/stewardship/20140226.pdf). For the 2017 revision of the Japanese Stewardship Code that added some reference to collective engagement in the guidance section, see infra note 130 and accompanying text.

grasp the circumstances of investee companies”. Together with the reference to “the sustainable growth of investee companies” in the same principle, the Japanese wording is milder and more nuanced — not encouraging institutional investors to take a tough stance against investee companies.

Overall, the Japanese principles can be described as being much friendlier to investee companies as compared to the UK principles. This divergence from the UK Code has been criticized by some academics, but welcomed by industries as reflecting the reality of Japanese corporate governance system, which traditionally focused on the interest of stakeholders, especially employees.

2. The Preface

Unlike the UK Code, the preface to the Japanese Stewardship Code prioritizes the enhancement of “the medium- to long-term investment return for...
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their clients and beneficiaries” as the goal of stewardship responsibility and regards sustainable growth of investee companies as its metric, as mentioned earlier in Part I, Section C. Thus, the Japanese Stewardship Code also harbors some inconsistency between its preface and principles, albeit in a different manner from the UK Code, the preface of which emphasizes the long-term success of investee companies to the contrary.

The question arising from this difference is, why the Japanese Stewardship Code is structured differently from the UK Code despite their apparent similarity. Let us now turn to the background of the Japanese Stewardship Code to examine its intended goal.

B. Background

1. Japan Revitalization Strategy: June 2013

As the background of establishing the Council of Experts Concerning the Japanese Version of the Stewardship Code, the preface of the Japanese Stewardship Code cites a document titled “the Japan Revitalization Strategy”. 93

This document was prepared by the Headquarters for Japan’s Economic Revitalization 94 as part of the Abe administration’s policies aimed at economic growth in the 2013 fiscal year. It claims that bold investment by private sector is necessary to promote innovation and that better corporate governance is required to support such “aggressive” management. 95 The adoption of a Japanese version of a stewardship code is listed as one of the representative measures that needs to be implemented swiftly. 96 In particular, the Japan Revitalization Strategy states as follows:

With the aim of promoting sustainable growth of companies, discuss and establish the principles for a wide range of institutional investors to appropriately discharge their stewardship responsibilities through constructive dialogues with invested companies by the end of this year while considering discussion of the Council on Economic and Fiscal Policy concerning the market economy system in Japan. 97

It should be noted that the phrase “sustainable growth of companies” had already appeared at this stage as “the aim” for adopting a stewardship code. The document itself, however, does not provide any explanation on the reason

93. The 2014 Japanese Code, supra note 2, paragraphs 2-3 at page 1-2. No change is made to these paragraphs in the 2017 version.
94. The Headquarters for Japan’s Economic Revitalization (Nihon Keizai Saisei Honbu) is a body established by the Abe administration by a cabinet decision on December 26, 2012, and consists of all ministers with the Prime Minister as its chief. Its mandate is to plan and to coordinate economic policies of the government as a whole. See, http://japan.kantei.go.jp/96_abe/decisions/2012/1226saiseihonbu_e.html.
96. JAPAN REVITALIZATION STRATEGY, supra note 95 at 14, 16.
97. JAPAN REVITALIZATION STRATEGY, supra note 95 at 37.
for such a mandate. 98 On the other hand, the adoption of a stewardship code is listed together with other measures such as the promotion of appointment of independent directors and the creation of a new stock index consisting of high-profile companies in terms of profitability and management, 99 making it difficult to ascertain the orientation of the document. The same problem applies to the order made by Prime Minister Abe on April 2, 2013 at the sixth meeting of the Headquarters for Japan’s Economic Revitalization. It calls on the Minister for Financial Services to “coordinate with other relevant ministers and consider, with the aim of promoting the sustainable growth of companies, principles for a wide range of institutional investors to appropriately discharge their stewardship responsibilities” .100

2. Industrial Competitiveness Council: March 2013

Interestingly, discussions held a few months earlier at the Industrial Competitiveness Council, 101 which is mentioned in the preface of the Japanese Stewardship Code as the basis of the order by Prime Minister Abe cited above, 102 were a little different.

On March 15, 2013, at the fourth meeting of the Industrial Competitiveness Council, the introduction of a Japanese version of the UK Stewardship Code was proposed by members of the Council from the private sector as one of the measures to promote the replacement of obsolete industries and businesses by new ones. 103 Here, the stewardship code was described as a mechanism to compel institutional investors to play an active role – but no additional details about its goals were provided (e.g., such as promoting sustainable growth of investee companies). 104

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98. The same problem applies to the order made by Prime Minister Abe at the 6th meeting of the Headquarters for Japan’s Economic Revitalization, which is also cited in the preface of the Japanese Stewardship Code. See the 2014 Japanese Code, paragraph 1 at page 1.
99. JAPAN REVITALIZATION STRATEGY, supra note 95 at 37-38.
100. As cited by the 2014 Japanese Code, supra note 2 at paragraph 1 at page 1.
101. The Industrial Competitiveness Council (Sangyo Kyosoryoku Kaigi) was established by the Headquarters for Japan’s Economic Revitalization on January 8, 2013 to consider specific measures for economic growth and consisted of the Prime Minister, the Vice Prime Minister, the Minister for Economic and Fiscal Policy, the Cabinet Secretary, the Minister of Economy, Trade and Industry, and members appointed from the industry and academics. See https://www.kantei.go.jp/jp/singi/keizaisaisei/skkkaigi/konkyo.html.
102. The 2014 Japanese Code, supra note 2 at paragraph 1 at page 1.
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On the contrary, Mr. Takeshi Niinami, the then-CEO of a major convenience store chain Lawson, emphasized the necessity of interventions by institutional investors. In particular, he stated as follows:

Mr. Niinami: It is important to have external discipline of the management by the stock market, namely by outspoken shareholders.105 Non-activist institutional investors as shareholders with a mid- to long-term perspective should properly intervene in management of companies to promote replacement of outdated industries and businesses by new ones. In this regard, the government should consider introducing a Japanese version of the UK’s Stewardship Code so that the private sector cannot make excuses for failing to act.106

The ministers at the meeting did not object to Mr. Niinami’s statement on the role of institutional investors.107 However, at a subgroup meeting of the Industrial Competitiveness Council held earlier on March 6, 2013, where Mr. Niinami proposed the introduction of a stewardship code for the first time, Mr. Akira Amari, then the Minister for Economic and Fiscal Policy and the Minister for Economic Revitalization disagreed with Mr. Niinami.108

Minister Amari: Investors have gradually become less patient and the period from their investment to exit is getting shorter and shorter. To respond to requests from activist shareholders to payout retained earnings, companies should, for example, be permitted to pay more dividends to shareholders that have held shares for a longer period of time. It would be impossible to attract long-term investment when investors that had only recently bought shares can easily pressure companies and make off with retained earnings that have been accrued over time. Although investors are becoming more and more short-term oriented across the world, Japan should establish a system that attracts long-term investment. Otherwise, R&D-intensive firms cannot prosper.109

Mr. Niinami responded with the assertion that return on equity of Japanese companies had not increased in the long term despite their allegedly long-term management approach, and that activist shareholders are necessary to some extent to improve corporate value by exerting pressure on companies to give

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105. The term “outspoken shareholders” is the literal English translation of the Japanese term used in Mr. Niinami’s remark, “mono iu kabunushi”. This term, which is often used in Japanese media, is usually translated as “shareholder activists”, but the author chose the term “outspoken shareholders” as the second sentence of Mr. Niinami’s remark seems to differentiate institutional investors from activists.


107. See, the Minutes of the Fourth Meeting of the Industrial Competitiveness Council, supra note 106 at page 5-10. In contrast, Professor Heizo Takenaka expressed his support for Mr. Niinami (ibid. at page 11).

108. The Summary of the Discussions at the Meeting on March 6, 2013 of the Subgroup of the Industrial Competitiveness Council on Specific Topics, at page 3 (available in Japanese at https://www.kantei.go.jp/jp/singi/keizaisaisei/kaigou/pdfh250306_gijiyousi.pdf) (Mr. Niinami arguing that “it is necessary to make rigorous systems, such as the UK Stewardship Code, in order to achieve higher productivity of firms” and to have “institutional investors such as Government Pension Investment Fund monitor corporate governance of companies more rigorously” and referring to a practice of General Electric that it “only pursues segments in which they can become the leader or the second in that market within a few years”).

reasonable explanations for the usage of cash they are hoarding. This view of Mr. Niinami, however, substantially differs from the basic orientation of the UK Stewardship Code, which focuses on public interest by restraining excessive risk-taking and short-termism. In contrast, Mr. Amari’s views appears to be largely congruent with the UK Code.

This interesting exchange suggests the following two points. First, Mr. Niinami’s true intention seems not to be in favor of adopting the UK Stewardship Code as such, but rather in importing the UK practice of engagement by institutional shareholders for effective discipline of management. Second, Minister Amari’s anti-activist view seems to be the background of the insertion of the phrase “with the aim of promoting sustainable growth of companies” into the Japan Revitalization Strategy.


Minister Amari’s anti-activist orientation is also reflected in the role he played in the Council on Economic Fiscal Policy. On April 18, 2013, about one month after the fourth meeting of the Industrial Competitiveness Council, Mr. Jyoji (George) Hara was invited to the eighth meeting of the Council on Economic Fiscal Policy to make a presentation on establishing “a market economy system that enables sustainable growth”. He criticized US-style corporate governance as focusing only on the interests of shareholders and management, and advocated that companies should be evaluated not by return on equity, but by its sustainability, distributive fairness and improvements in its business. He also made various proposals, such as the restriction of stock-

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110. The Summary of the Discussions at the Meeting on March 6, 2013 of the Subgroup of the Industrial Competitiveness Council on Specific Topics, supra note 108 at page 6. Mr. Yasuchika Hasegawa, then the president of Takeda Pharmaceutical Co., Ltd., also expressed a similar view that the management of a company is responsible to explain to its shareholders why the company is holding retained earnings. Ibid.

111. See Part II, Section B.

112. The Council on Economic and Fiscal Policy (Keizai Zaisei Shimon Kaigi) was originally established in 2001 pursuant to Article 18, paragraph 1 of the Act for Establishment of Cabinet Office (Act. No.89 of 1999). The core mission of this council is to discuss important issues regarding economic and fiscal policy as consulted by the Prime Minister or the Minister on Economic and Fiscal Policy. Article 19, paragraph 1, no.1 and paragraph 2, Act for Establishment of Cabinet Office. The Minister on Economic and Fiscal Policy is an ex officio member of the Council and is to chair the meeting of the Council when the Prime Minister is absent. Article 21, paragraph 4 and Article 22, paragraph 1, no.2, Act for Establishment of Cabinet Office.


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based compensation and share repurchases, together with the introduction of preferential treatment of mid- to long-term shareholders.  

Following the lines of Mr. Hara’s presentation, Minister Amari then proposed establishing an expert group under the Council to conduct research on a “desirable market economy system” that “enables sustainable growth through appropriate allocation of capital and distribution of profits”. Accordingly, the Expert Committee on Desirable Market Economy System (Mezasubeki shijyo keizai shisutemu ni kansuru senmon chosakai) was established, and the Japan Revitalization Strategy explicitly directed that the discussions of this committee must be taken into consideration when drafting the Japanese Stewardship Code.

The final report of the Expert Committee, which was published on November 1, 2013, emphasizes that “corporate governance prioritizing adjustments of the interests of various stakeholders” is necessary in order to “improve the overall corporate value from a medium- and long-term perspective”. It also asserts that institutional investors should “fulfill fiduciary responsibility by taking into account improvement of the overall corporate value in the medium and long terms, instead of leaning excessively toward maximization of short-term shareholder returns”. From such a perspective, this report calls for the adoption of the Japanese Stewardship Code based on “the circumstances in Japan, with a focus placed on the achievement of sustainable growth of companies through constructive communications between institutional investors and companies”.

When the Council of Experts Concerning the Japanese Version of the Stewardship Code heard this final report at its fourth meeting held on November 27, 2013, Professor Wataru Tanaka criticized the Final Report for not supporting its arguments with factual evidence necessary to convince “readers who may view such arguments as a means to give an excuse for the

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115. The Minutes of the 8th Meeting of 2013 of the Council on Economic and Fiscal Policy, supra note 114 at page 8.
118. See supra note 97 and accompanying text.
120. Ibid. The overall corporate value is defined as “a broad concept that does not merely refer to ordinary monetary value (so-called shareholder value) but also includes elements difficult to measure in numerical terms, such as value arising from external economies and diseconomies whose monetary value cannot be evaluated immediately (reduction of environmental burden, etc.) and value relating to uncertain future sustainability (measures concerning exhaustible resources, etc.)”. Ibid. at page 9-10.
121. Ibid. at page 14.
currently stagnant profitability.\textsuperscript{122} Mr. Masaya Sakuma, the Director of Economic, Fiscal and Social Structure of the Cabinet Office in charge of the secretariat of the Expert Committee on Desirable Market Economy System, responded that the report “does not intend to criticize short-term investment at all” as it also “refers to the need to maintain ‘liquidity’ in transactions” in the market, and that it is not the intention of the report “to use our argument about short-termism and the lack of medium to long-term funding as an excuse for the stagnant state of profitability.”\textsuperscript{123}

At the end of his remarks, however, Mr. Sakuma also stated that the “Committee was in a sense initiated by a concept similar to Public Interest Capitalism as noted by Mr. Hara, Deputy Chairman of the committee. In view of such background, I would appreciate your understanding as to the difficulty we faced in putting ideas together as the secretariat to the CEFP Committee.”\textsuperscript{124} This statement of Mr. Sakuma arguably suggests that the orientation of the Final Report was already determined by a political initiative of Minister Amari to promote Mr. Hara’s view from the Expert Committee’s inception, and thus that it was impossible to alter the final outcome of the discussions, even though the government officials in charge might not have been completely convinced.

4. Other Corporate Governance Reforms Around the Same Period

The above analysis depicts the existence of two camps with different views on the role of pressure from shareholders (i.e., one represented by Mr. Niinami and the other by Minister Amari) that led to the adoption of the Japanese Stewardship Code. This sub-section analyzes other corporate governance reforms around the same period as a way to illuminate which camp was ultimately more influential.\textsuperscript{125} To state the conclusion upfront, it appears from the recent corporate governance reforms that the camp promoting more shareholder pressure to discipline management has prevailed—supporting Mr. Niinami’s, not Minister Amari’s, point of view.


\textsuperscript{123} The Minutes of the Fourth Meeting of the Council of Experts on the Stewardship Code, supra note 122 at page 5.

\textsuperscript{124} Ibid.

\textsuperscript{125} See Kansaku, supra note 14 at 1012-1013 (stating that the Japanese Stewardship Code was adopted as part of the so-called “growth strategy” of the Abe administration which aims to improve corporate governance and to promote corporate value).

\textsuperscript{126} An earlier report published in 2009 by a study group established by the Financial Services Agency also emphasized the importance of exercise of voting rights based on fiduciary duty of institutional investors and disclosure of their voting results. At this time, there was no mention to the sustainable growth of investee companies. See, REPORT BY THE FINANCIAL SYSTEMS COUNCIL’S STUDY GROUP ON THE INTERNATIONALIZATION OF JAPANESE FINANCIAL AND CAPITAL MARKETS – TOWARD STRONGER CORPORATE GOVERNANCE OF PUBLICLY LISTED COMPANIES (June 17, 2009) at 15-16, available at https://www.fsa.go.jp/en/news/2009/20090618-1/01.pdf.
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First, it has been clarified through the public comment process that the Japanese Stewardship Code does not prohibit institutional investors from requesting investee companies to increase dividends. Institutional investors are expected to consider whether such a request fits within their overall stewardship responsibilities in the particular context. Further, the Japanese Stewardship Code was revised in 2017, placing more emphasis on the pressure of institutional investors on investee companies. For example, a paragraph on collective engagement, to which no reference was made in the original 2014 text, is added in the guidance section to Principle 4, stating that “it would be beneficial for institutional investors to engage with investee companies in collaboration with other institutional investors (collective engagement) as necessary.” Under the 2017 Revised Code, institutional investors are also required to disclose how they have voted on each agenda item at shareholders’ meetings of individual investee companies. In addition, the revision emphasizes the role of asset owners such as pension funds in stewardship activities, calls for effective control of conflicts of interest of asset managers, especially those belonging to financial conglomerates, and requires institutional investors which have a passive governance strategy to participate in engagement and voting more actively.

Second, the Japanese government has succeeded in nudging Japanese listed companies to appoint at least one or two outside/independent directors through measures such as the 2014 Reform of the Companies Act and the 2015 Japanese Corporate Governance Code, which introduced “comply or explain” rules regarding appointment of one outside director or two independent directors, respectively. One of the roles expected to be performed by these

127. The Council of Experts Concerning the Japanese Version of the Stewardship Code, supra note 18, Comment No.3 at page 1.
129. The 2017 revision has added “opportunities arising from social and environmental matters” as one of the factors that institutional investors should “monitor” or “grasp” at Guidance 3-3. In the author’s view, however, this amendment is not so meaningful as the original 2014 text already listed “risks arising from social and environmental matters” in the same paragraph.
131. The 2017 Revised Japanese Code, supra note 2, Guidance 5-3, at page 15. This individual disclosure requirement was not included in the original 2014 version due to the objections from the industry and some investors. Kansaku, supra note 11 at 19. The revised code, however, decided to override such objections and to introduce this requirement in order to enhance the transparency of the stewardship activities of asset managers and to eliminate concerns on conflicts of interest of asset managers who belong to financial conglomerates. See, the 2017 Revised Japanese Stewardship Code, at page 15, note 15.
135. For details of the recent Japanese reforms on board independence, see Gen Goto, Manabu Matsunaka & Souichirou Kozuka, Japan’s Gradual Reception of Independent Directors: An Empirical
outside and/or independent directors is to represent the interests of shareholders in the boardroom and to function as a barrier insulating the management from the interests of core employees.\textsuperscript{136}

Third, the Japanese government has also been trying to tackle the issue of “cross-shareholdings”.\textsuperscript{137} One characteristic of traditional Japanese listed companies is that a large proportion of their shares, often the majority, was held by “stable shareholders”, which consisted of the company’s banks and friendly business partners.\textsuperscript{138} Since such shareholders have an incentive to support the management of the company in order to maintain good business relationships, this ownership structure effectively insulated managers from the pressure of capital markets. Seeing such phenomenon as problematic as it arguably leads to inefficiency and managerial slack, the 2015 Japanese Corporate Governance Code provides that Japanese listed companies shall disclose their policy on cross-shareholding, and provide an annual detailed explanation on the objective and rationale behind major cross-shareholdings after examining their mid- to long-term economic rationale.\textsuperscript{139} The 2018 revision of the Japanese Corporate Governance Code further seeks to accelerate the reduction of cross-shareholdings by adding a supplementary principle calling on companies not to discourage their shareholders from divesting their shareholding by, for example, suggesting that such divestments would result in reduction of business transactions with them.\textsuperscript{140}

It is also worth noting that the so-called “Ito Review”, a report commissioned by the Ministry of Economy, Trade and Industry to Professor Kunio Ito under inspiration from the Kay Review,\textsuperscript{141} rather emphasizes the importance of Japanese companies achieving a level of return on equity that exceeds the cost of capital required by global investors, so that the Japanese
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market can attract capital to support investment for long-term innovation.\textsuperscript{142} Such an emphasis on return on equity clearly differs from Mr. Hara’s stakeholder-oriented view.\textsuperscript{143}

5. Summary: The Goal of the Japanese Stewardship Code

The above analysis shows that the adoption of the Japanese Stewardship Code was part of a recent trend of corporate governance reforms in Japan aimed at more effective discipline of management for the purpose of meeting shareholders’ interests – in line with Mr. Niinami’s initial rationale for proposing the code. In this context, it appears clear that the insertion of the phrase “with the aim of promoting sustainable growth of companies” was not the driving force behind the Code. Rather it was a compromise to appease those who resisted the trend towards a more shareholder-oriented system of corporate governance.

From this perspective, the goal of the Japanese Stewardship Code is to change the behavior of domestic institutional investors, in particular life insurance companies and some investment trust management companies which have been criticized for their reluctance to take a tough stance against management due to their business relationships with investee companies.\textsuperscript{144} In contrast, foreign institutional investors, who are often viewed in Japan as being free from conflict of interests and being unreluctant to exert pressure on the management of investee companies when necessary,\textsuperscript{145} are not the main target.


\textsuperscript{143} See supra note 113-114 and accompanying texts.

\textsuperscript{144} For example, Professor Kenjiro Egashira lists the inactivity of domestic institutional investors as one of the basic foundations of traditional Japanese corporate governance system and claims that the 2014 Reform of the Companies Act introducing the “comply or explain” rule on appointment of at least one outside director would fail to change the behavior of Japanese listed companies as long as domestic institutional investors stay the same. See Kenjiro Egashira, Kaishaho no kaisei ni yotte nihon no kaisha ha kawaranai [Japanese Companies Would Not Change Regardless of the Companies Act Reform], Vol.86, No.11 HORITSU JIBO 59, at 60 (2014). One recent empirical study reports that the ratio of shareholding by domestic institutional investors has a positive effect on the probability of hedge fund activism internationally, but a negative effect in Japan (both effects were statistically significant). Marco Becht, Julian Franks, Jeremy Grant & Hannes F. Wagner, Returns to Hedge Fund Activism: An International Study, 30 Review of Financial Studies 2933, at 2946-2948 (2017). It must be noted, however, that the unwillingness of investment managers to take actions that are disfavored by corporate managers is not unique to Japan. See Bebchuk, Cohen & Hirst, supra note 5 at 21-23 (describing the similar attitude of investment managers in the United States).

\textsuperscript{145} Professor Hideaki Miyajima and his colleagues report that, after controlling for reverse causality, higher shareholding by foreign investors in Japanese companies facilitates appointment of independent directors, affects corporate policy on investment, capital structure and payout, and has positive impact on ROA and Tobin’s Q of investee companies. See Hideaki Miyajima, Takaaki Hoda & Ryo Ogawa, Does Ownership Really Matter? The Role of Foreign Investors in Corporate Governance in Japan (2015, available at https://www.rieti.go.jp/jp/publications/wp/15e078.pdf); Hideaki Miyajima & Ryo Ogawa, Convergence or Emerging Diversity? Understanding the Impact of Foreign Investors on Corporate Governance in Japan (2016, available at...
of the Japanese Stewardship Code. Stated differently, the Japanese Stewardship Code aims to make domestic institutional investors act like foreign institutional investors. Reflecting such an orientation, the Japanese Stewardship Code has been criticized for not covering cross-shareholdings by banks and non-financial companies, whereas the UK Stewardship Code was criticized by Professor Cheffins for not including foreign investors in its scope.

C. The True Difference between the Japanese and the UK Codes

In summary, although the Japanese Stewardship Code and the UK Stewardship Code may bear superficial resemblance due to their broad focus on the same two core concepts, their fundamental policy rationales are almost diametrically opposed. The UK Stewardship Code aims to restrain excessive risk-taking and short-termism by making institutional investors more responsible to the public. Conversely, the Japanese Stewardship Code intends to champion shareholders’ interests by making domestic institutional investors more active shareholders who would exert pressure on entrenched management.

It is worth emphasizing, however, that the Japanese Stewardship Code “primarily targets institutional investors investing in Japanese listed shares”. This focus, which is similar to the UK Code’s, suggests that the Japanese Government’s objective in adopting the Stewardship Code was to improve the corporate governance of Japanese listed companies, rather than to promote the


147. See supra note 73 and accompanying text.

148. It must be noted that at the third meeting of the Council of Experts Concerning the Japanese Version of the Stewardship Code, the Financial Services Agency as the secretariat of the Council described that the statement of the Japan Revitalization Strategy referring to “the aim of promoting the sustainable growth of companies” and the language in the preface to the 2012 Revised UK Stewardship Code aiming to “promote the long-term success of companies in such a way that the ultimate providers of capital (managed by institutional investors) also prosper” “do not contradict each other”. See, Document No.3 of the Third Meeting of the Council of Experts Concerning the Japanese Version of the Stewardship Code, submitted by the Secretariat (available at https://www.fsa.go.jp/en/refer/councils/stewardship/material/20131018_1.pdf) at page 1. While this description does not conform perfectly with the view explained in the text, it does not preclude the possibility that the secretariat deliberately avoided pointing out the divergence between the UK Code and the Japan Revitalization Strategy, which might have provoked controversies over the goal to be aimed at.

149. The 2017 Revised Japanese Code, supra note 2, para.8 at page 5 (unchanged from the 2014 original Code).
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interests of Japan’s ultimate beneficiaries. This may sound superficially similar to the goal of the UK Code. Nevertheless, this goal of the Japanese Stewardship Code is still different than that of the UK Code, as the former aims to prioritize the interests of shareholders over other stakeholders, especially employees.

This difference in the basic orientations of the Japanese and the UK Stewardship Codes has been largely overlooked, even by Professor Hiroyuki Kansaku, who chaired the Council of Experts Concerning the Japanese Version of the Stewardship Code. Also, Professor Wataru Tanaka, who was a member of the Council, focused only on the principles of the Japanese and the UK Codes, and erroneously states that the concept of the sustainable growth of investee companies does not exist in the UK Code. In a similar vein, in the international discourse, Professors Bebchuk, Cohen and Hirst portrayed the

150. If the goal of the Japanese Stewardship Code were to promote the interests of Japanese ultimate beneficiaries, then it should target institutional investors funded by Japanese interest investing in non-Japanese listed shares as well.

151. In a separate piece on recent Japanese reforms on board independence, the author discusses that one of the various roles expected to be performed by outside/independent directors is to represent the interests of shareholders in the boardroom and to function as a barrier insulating the management from the interests of core employees who may oppose decisions such as divestment of non-core businesses. See Goto, supra note 135 at 50-51.

152. See for example, Yoko Manzawa, Suchuwadoshippu sekinin to jyutakusha sekinin – Eibe ni okeru kangeikata no hikaku no kokoromi [Stewardship Responsibility and Fiduciary Duty: A Comparison with the Anglo-American Way of Thinking], 2070 SHOHOMU 23, at 24, 32 note 6 (2015) (stating that the Japanese Code and the UK Code are the same as both codes require institutional investors to promote the growth of investee companies and the interest of their beneficiaries, although there is a slight difference in the wording) and Nakagawa, supra note 1 at 349 (stating that making institutional investors less speculative is “the whole intention of deploying the stewardship rules”).

A notable exception is the view of Mr. Sadakazu Osaki of Nomura Research Institute, who briefly but correctly observes the difference of the goals of the two stewardship codes. See Sadakazu Osaki, The New Stewardship Code in Japan: Comparison with the UK Code and its Implementation, in Hiroshi Oda (ed.), COMPARATIVE CORPORATE GOVERNANCE: THE CASE OF JAPAN, Journal of Japanese Law, Special Issue No.12 (Carl Heymanns/Wolters Kluwer, 2018) at 101, 102-103. Professor Mika Takahashi also states that “the Japanese Stewardship Code is not based on a radical criticism against the short-termism as in the United Kingdom” and “puts itself in line with fiduciary duty” as it aims to “enlarge the mid- to long-term investment return to the clients and beneficiaries of institutional investors”. Professor Takahashi, however, does not provide the background for such a difference between Japan and the UK. See Mika Takahashi, ‘Jyutakusha no chui gimu’ to suchuwadoshippu sekinin [‘Fiduciary’s Duty of Care’ and Stewardship Responsibility], 2 SHINTAKU FORAMU 45, at 49 (2014).

In the international discourse, Professor Jennifer Hill correctly notes that while the UK Stewardship Code seeks to meet “the need for effective risk control in the post-crisis era”, the Japanese Stewardship Code focuses “on arresting declining profitability, unlocking value and increasing investor returns” and deliberately creates “a ‘warmer climate’ for foreign investors and shareholder activists”. Hill, supra note 3 at 20, 22. She, however, fails to explain the whole picture underlying the Japanese Code as she views the reference to the concepts of “sustainable growth” and “medium to long-term corporate value” is a reflection of the above goal of the Japanese Code, and does not explain why the Japanese Code envisages relatively gentle kind of shareholder engagement. Ibid. at 22, 23. As noted earlier, these concepts and the relatively gentle stance were included in the Japanese Code rather as a compromise to appease those who resisted shareholder-oriented system. See supra Part III, Section B, 5.

153. See Kansaku, supra note 11 at 18-20 (listing characteristics of the Japanese Code in comparison with the UK Code).

154. Tanaka, supra note 85 at 69.
stewardship codes of the United Kingdom, Japan, and Canada as attempts to solve the agency problem of institutional investors, a conclusion that is correct in Japan’s case but not for the UK.

In contrast, Professor Chiu provides a UK-biased view by stating that the Japanese Stewardship Code “could be seen as providing an ex ante form of defence against more unpredictable forms of shareholder activism”, despite her recognition that the Japanese Code “is purportedly introduced as part of a package of measures to revitalize the Japanese economy and to improve the investment appeal of its listed sector”. Also, Professors Fenwick and Vermeulen, who have recently conducted a survey on the regulatory environment of engagement by institutional investors in various countries, state that “shareholders, particularly institutional investors, must be viewed as ‘stewards’ of the company” and observe that stewardship codes in general “attempt to create more responsible and purposeful investor engagement” and that the “Japanese Stewardship Code is modeled after the UK code”. The finding of this Article shows that the value of studies such as Fenwick and Vermeulen’s would be diminished unless enough attention is paid to the context behind the adoption of stewardship codes in each country.

PART IV: THE EFFECTS AND THE LIMITS OF STEWARDSHIP CODES

A. The Effects and the Limits of Stewardship Codes

1. Different Goals, Different Effects and Limits

When the goals of stewardship codes differ, as seen in the case of the UK Code and the Japanese Code, their effectiveness and limits could also differ. Thus, the effectiveness of each stewardship code must be evaluated individually, taking into consideration possible differences in the goals of each.

In the United Kingdom, the goal of a stewardship code is to advance the public interest by restraining excessive risk-taking and investor short-termism. There, the problem is that institutional investors acting as loyal “stewards” of

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155. Bebchuk, Cohen & Hirst, supra note 5 at 108.

156. In the same vein, the view of this article could be criticized as Japan-biased. The author’s point is not to discuss which one of the two is more appropriate or authentic but to emphasize the importance of recognizing a possible home-country bias of an observer.


158. Fenwick & Vermeulen, supra note 3 at 10, 36 (emphasis added by the author). It is also worth noting that Professors Fenwick and Vermeulen summarize the goal of the Japanese Stewardship Code somewhat roughly as “(1) to discharge its responsibility to facilitate the continuous growth of the invested company and (2) to try to increase the medium-term or long-term return of the beneficial owners and clients of the institutional investor”, thereby ignoring the priority provided in the preface of the Japanese Code. See ibid. at 36 and supra note 18 and accompanying text.

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their clients and ultimate beneficiaries would not act in furtherance of such public interest when doing so does not coincide with the interest of their clients and ultimate beneficiaries. In other words, this goal is incompatible with the logic of stewardship that requires institutional investors to be loyal to the interests of their ultimate beneficiaries.

It is from such a viewpoint that Professors Chiu and Katelouzou propose imposing disclosure requirements and regulatory standards of conduct on institutional investors instead of introducing a stewardship code; in similar vein, Professor Reisberg proposes to provide weighted dividends or tax benefits to long-term shareholders. While the desirability of some of these proposals remain debatable, they seem to be at least more consistent with their goal of restraining excessive risk-taking and investor short-termism when compared with the UK Stewardship Code.

In contrast, the goal of the Japanese Stewardship Code is more effective discipline of management from the viewpoint of shareholders’ interests by urging domestic institutional investors to act for the benefit of the ultimate beneficiaries. This goal is compatible with the logic of stewardship where institutional investors are the fiduciaries of ultimate beneficiaries. In this context, the key issue becomes the effective enforcement of fiduciary duties, in particular, the duties of loyalty and care. After taking a brief look at the current status of the adoption of the Japanese Stewardship Code by institutional investors, the remainder of this part will analyze the effect and limits of the Code from this perspective.

2. Signatories to the Japanese Stewardship Code

The Japanese Stewardship Code requests institutional investors who have adopted the Code to notify the Financial Services Agency (FSA) accordingly, and the FSA to publicize the list of such institutional investors (“signatories” to the Code). Table 1 below shows the composition of these signatories as of April 5, 2018.

Table 1: Signatories to the Japanese Stewardship Code as of April 5, 2018

159. See supra note 76-80 and accompanying texts.
160. The Kay Review states that the “core fiduciary duties are those of loyalty and prudence” and that “effective stewardship is possible only if . . . the steward proceeds on the basis of obligations of loyalty and prudence”. The Kay Review: Final Report, supra note 45, para.9.6-9.8 at 66. See also, the Myners Report, supra note 40 at 92-93 (asserting that all pension fund trustees and the UK law should incorporate the principle of the US Department of Labor’s Interpretative Bulletin, which states that the “fiduciary obligations of prudence and loyalty to plan participants and beneficiaries require the responsible fiduciary to vote proxies on issues that may affect the value of the plan’s investment”).
These signatories include most of Japan’s major domestic trust banks and insurance companies, whereas adoption by Japan’s private pension funds is limited.163

Out of the 162 investment managers (mutual funds and investment advisors), 48 are foreign institutions.164 Among them are several activist hedge funds including Brandes Investment Partners, Dalton Investments, Effissimo Capital Management, and Oasis Management Company. Some Japanese activists, such as SPARX Asset Management Co. and Strategic Capital, also have signed up. In addition, there are four foreign pension funds, namely, CalPERS, Fourth Swedish National Pension Fund, UK Railway Pension Trustee Company Limited, and the University of California.

While the number of signatories itself does not guarantee the effectiveness of the Stewardship Code in improving the quality of institutional investors’ engagement,165 it is still noteworthy that foreign institutional investors, especially activist hedge funds, took the trouble of signing up to the Japanese Stewardship Code, which features rather investee company-friendly principles and guidance.166 One possible reason for this move is that by signing up, these investors are trying to portray themselves as long-term investors supportive of the “sustainable growth of investee companies” and to dilute their image as hostile activists.167 This tactics, however, may not be that effective as

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<tr>
<th>Types of signatories</th>
<th>Number of signatories</th>
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<tr>
<td>Trust banks</td>
<td>6</td>
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<tr>
<td>Investment managers (mutual funds and investment advisors)</td>
<td>162</td>
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<tr>
<td>Pension funds</td>
<td>30</td>
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<tr>
<td>Insurance companies</td>
<td>22</td>
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<tr>
<td>Other institutions (including proxy advisors)</td>
<td>7</td>
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<td><strong>Total</strong></td>
<td><strong>227</strong></td>
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164. This is judged by their lack of corporate numbers assigned to legal persons established under Japanese law. Corporate numbers of signatories are only shown in the Japanese version of the list of signatories. See <https://www.fsa.go.jp/singi/stewardship/list/20180405/list_01.pdf>.

165. Reisberg, supra note 23 at 224-226. See also, Sergakis, supra note 73 at 136.

166. See supra note 84-89 and accompanying texts.

167. See Tanaka, supra note 90 at 37-38 (suggesting that, if the Japanese Stewardship Code had taken more adversarial stance, Japanese domestic institutions would have been more reluctant to sign up to the Code).
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companies are unlikely to be so naïve as to believe in a declaration of this sort that is not supported by formal sanctions.

B. Duty of Loyalty and Conflicts of Interest

1. Institutional Investors and Conflicts of Interest

Turning back to the analysis of the effects and limits of the Japanese Stewardship Code, the essence of the duty of loyalty of fiduciaries is that fiduciaries must put the interests of their beneficiaries ahead of their own. Thus, the core issue for a stewardship code from the duty-of-loyalty perspective is managing the effect of conflicts of interest between institutional investors and their ultimate beneficiaries. Accordingly, Principle 2 of the Japanese Stewardship Code, in conformity with Principle 2 of the UK Code, requests institutional investors to “have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.”

A conflict of interest is particularly likely to occur when an institutional investor offers financial services to its investee companies, or when it is affiliated with companies that offer financial services to investee companies. For example, a life insurance company may undertake management of an investee company’s pension fund, or an investment advisor could be a subsidiary of a bank making a loan to its subsidiary’s investee company. In such cases, institutional investors might face pressure not to vote against the management of investee companies so as to avoid losing valuable contracts for themselves or their affiliated companies’ other businesses.

On the assumption that institutional investors have not done enough to manage conflicts of interest, the 2017 revision of the Japanese Stewardship Code has added a few sentences to the Guidance to Principle 2 requesting institutional investors to make their policies on conflict of interest more specific and to establish governance structures to prevent conflict of interest, such as independent committees on voting of shares.

2. Disclosure of Voting Records on Individual Agenda of Each Investee Company

As voting of shares is an important aspect of stewardship activities by institutional investors, the Japanese Stewardship Code has a separate principle

168. See Guidance 2-1, the 2017 Revised Japanese Code, supra note 2 (stating that “institutional investors should put the interest of their client and beneficiary first”) and Guidance to Principle 2, the 2012 Revised UK Code, supra note 1 (“An institutional investor’s duty is to act in the interest of its clients and/or beneficiaries.”).

169. Black & Coffee, supra note 5 at 2059-2061.

on this issue, requesting institutional investors to “have a clear policy on voting and disclosure of voting activity”, again in line with the UK Code.\footnote{171}{The 2017 Revised Japanese Code, supra note 2, Principle 5.}

One of the most controversial issues that arose in the process of the 2017 revision was whether institutional investors should disclose how they have voted on the individual agenda of each investee company, or whether it is sufficient to disclose their voting records on an aggregate basis. In the end, disclosure of voting results on the level of individual agenda was adopted as Guidance 5-3 to address conflicts of interest in the Japanese market,\footnote{172}{The 2012 Revised UK Code, supra note 1, Principle 6, the 2012 UK Stewardship Code.} overriding oppositions from some institutional investors and listed companies arguing that such individual disclosure may encourage institutional investors to follow formalistic voting standards, which in turn may hinder meaningful dialogue between institutional investors and investee companies.\footnote{173}{The 2017 Revised Japanese Code, supra note 2, note 15 at page 15, Tahara et al., supra note 128 at 21. The UK Stewardship Code does not explicitly require disclosure of voting records on individual agenda, but it is reported that major institutional investors in the United Kingdom do so for the sake of better accountability and management of conflict of interest. Ibid.}

Major domestic trust banks and investment managers belonging to large financial conglomerates quickly accepted the request of Guidance 5-3 on individual disclosure, presumably in response to the criticism on the high-likelihood of conflict of interest in financial conglomerates.\footnote{175}{Osamu Hamada, Giketsuken koshi kekka no kaiji wo meguru giron to kikan toshika ni yoru giketsuken koshi no jyokyo – 2017-nen no kabunushi sokai wo farikaette [The Current State of Voting of Shares by Institutional Investors: Looking Back at Shareholders’ Meetings in 2017], 2150 SHOJI HOMU 13, at 14 (2017), Sanpei, supra note 174 at 23.} In contrast, two of the four largest life insurance companies have not decided to disclose individual voting results as of April 2018.\footnote{176}{It might be worth noting that these two life insurance companies, namely Nippon Life Insurance and Meiji Yasuda Life Insurance, take the form of mutual insurance company instead of stock corporation. In this case, profits of insurance company through services offered to investee companies substantially belong to insurance policyholders as the equity holders of a mutual insurance company. Thus, conflicts of interest between beneficiaries and insurance company would not be as strong as in the case of insurance companies taking the form of a stock corporation.} In lieu of individual disclosure, Nippon Life Insurance, the largest life insurer in Japan, has established an independent advisory council on stewardship activities, which is comprised of one independent director, two academics, and one lawyer, to oversee the voting process and how the company should vote on important cases.\footnote{177}{Nihon Seimei Sogo Gaisha, Suchuwadoshippu katsudo no kyoka ni muketa “Suchuwadoshippu shimon innkai” no shinsetsu oyobi kongo no katsudo hoshin ni tsuite [Establishment of “the Advisory Council on Stewardship” and Future Action Plans toward Improvement of Stewardship Activities], March 30, 2009, available at https://www.nissay.co.jp/news/2016/pdf/20170330.pdf.}

Such an independent committee is one possible solution for issues of conflicts of
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interest;\textsuperscript{178} whether it works effectively will in turn depend on whether the committee is adequately monitoring.

What then is the effect of the individual disclosure requirement by the 2017 revision? Although there is no systematic empirical study on this issue to the best of the author’s knowledge as of April 2018,\textsuperscript{179} there is some anecdotal evidence suggesting that such disclosure matters.\textsuperscript{180} For example, Mitsubishi UFJ Trust Bank disclosed that it had voted against the reelection of directors of Mitsubishi Motors in December 2016, which was surprising as both companies belong to Mitsubishi group, one of the six largest keiretsu known for its strong group unity.\textsuperscript{181} Also, in June 2017, Mizuho Trust Bank supported a shareholder’s proposal that was opposed by the management of its parent company, Mizuho Financial Group.\textsuperscript{182}

C. Duty of Care and Business Models of Investors

The duty of care requires institutional investors as fiduciaries to exercise reasonable care when they perform their task. The core task is of course to invest the fund they manage, and the investment strategy of institutional investors differ depending on their “business model”.

In the same vein, stewardship activities of these investors would also differ essentially depending of their business model and investment strategy.\textsuperscript{183} For

\textsuperscript{178} Simon CY Wong, \textit{How Conflicts of Interest Thwart Institutional Investor Stewardship}, BUTTERWORTHS JOURNAL OF INTERNATIONAL BANKING AND FINANCIAL LAW, September 2011, 481, at 482.

\textsuperscript{179} See Hamada, supra note 175 at 42, 43 note 22 (citing a descriptive statistic reporting that at shareholders’ meetings held of companies comprising Nikkei 225 index in June 2017, the amount of decrease of the average ratio of votes supporting proposals made by the management, except for those on anti-takeover measures, was less than one percentage point). See also, Yasutomo Tsukioka, \textit{The Impact of Japan’s Stewardship Code on Shareholder Voting} (2017, available at https://ssrn.com/abstract=3013999) (studying the effects of the original Japanese Stewardship Code using data of investee companies from 2010 to 2016 on the ratio of votes for and against for agenda on appointment of directors).

\textsuperscript{180} Hamada, supra note 175 at 41.

\textsuperscript{181} Nihon Keizai Shinbun, \textit{Mitsubishi UFJ Shintaku, Mitsubishi Jidosha no jinjian ni “no” Toshi no ronri zenmenni [Mitsubishi UFJ Trust votes against the nomination of directors in Mitsubishi Motors: The Logic of Investment Comes to Front]}, 2017/5/31 22:30JST. While the shareholders’ meeting in question was held before the revision of the Japanese Stewardship Code, disclosure of individual voting records had been already proposed by another council at the Financial Services Agency on November 30, 2016. See, the Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code Opinion Statement No. 3, Effective Stewardship Activities of Institutional Investors – To Enhance Constructive Dialogue toward Sustainable Corporate Growth, page 3–4 (November 30, 2016, available at https://www.fsa.go.jp/en/refer/councils/follow-up/statements_3.pdf).

\textsuperscript{182} Nihon Keizai Shinbun, Giketsuken koshi de oyagaisha ni “hanki” Asemane One nado [Rising in “Revolt” against the Parent Company in Voting of Shares: Asset Management One and Others], 2017/8/30 19:59 JST (https://www.nikkei.com/article/DX1LASGD30H5H_Q7A830C1EE9000/).

example, investors with a concentrated portfolio would actively engage with
the management to raise the firm value of their investee companies.\footnote{184}
However, active engagement is not a rational choice for a passive fund aiming
to fully replicate a certain market index, the business model of which is to
provide diversified investment at a low cost.\footnote{185}

As long as there is no conflict of interest, and as long as clients of
institutional investors have entrusted their funds knowing the latter’s business
model, such diversity of type and intensity is not problematic from the
viewpoint of the interest of ultimate beneficiaries. In other words, the type and
intensity of stewardship activities could and should be left to the discretion of
each institutional investor as part of their business model and investment
strategy, as long as conflict of interest is effectively managed.

However, from the perspective of the Japanese Government, whose aim is
to make Japanese companies to prioritize the interest of shareholders over that
of stakeholders by utilizing the pressure from institutional investors,\footnote{186}
passivity on stewardship activity of some institutional investors would be
problematic. Thus, the 2017 revision of the Japanese Stewardship Code has
added a new paragraph requesting passive funds “to actively take charge of
engagement and voting”.\footnote{187, 188} although such active engagement might not be in
the best interest of clients of such funds. In other words, the goal of the
Japanese Stewardship Code is not perfectly compatible with the logic of
stewardship as fiduciaries of ultimate beneficiaries.\footnote{188}

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\textit{in the Roles of Institutional Investors in Corporate Governance}, in Jennifer G. Hill & Randall S.
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184. Takaaki Eguchi, \textit{Tayo na toshika, tayo na gabanansu koka – Passibu unyo no kakudai ga
imisuru mono [Diverse Investors, Diverse Governance Effects: The Meaning of the Expansion of
Passive Investment], in Hiroyuki Kansaku (ed.), \textit{Kgyo hosei no shorai tenbo – Shihon shiyo
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Reforms of the Capital Market System, 2018 edition]} (Shihon Shijyo Kenkyukai, 2018), 415, at 422-
423.
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Investors and the Revaluation of Governance Rights}, 113 \textit{Columbia Law Review} 863, 866-869,
889-895, Bebchuk, Cohen \& Hirst, \textit{supra} note 5 at 97-98, 100-101, 108 and Curtis J. Milhaupt,
\textit{Evaluating Abe’s Third Arrow: How Significant Are Japan’s Recent Corporate Governance Reforms?},
in Hiroshi Oda (ed.), \textit{Comparative Corporate Governance: The Case of Japan, Journal of
Japanese Law, Special Issue No.12} (Carl Heymanns/Wolters Kluwer, 2018) at 65, 74. For a similar view
in Japan, see Takahito Kato, \textit{Suchuwadoshippu kodo no riron teki kousatsu – Kikan toshika no insenthibu
kozo no kanten kara [A Theoretical Analysis of the Stewardship Code: From the Perspective of the
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186. See \textit{supra} Part III, Section C.
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187. The 2017 Revised Japanese Code, \textit{supra} note 2, Guidance 4-2. See also Tahara et al., \textit{supra}
note 128 at 20.
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188. See also Celik \& Isaakson, \textit{supra} note 183 at 21 (“Before we discuss these different
determinants of shareholder engagement it is important to remind ourselves why the degree of
ownership engagement is a public policy concern. Why should policy makers care? From a public policy
perspective, ownership engagement is not a moral issue. Nor can it be seen as a general obligation or
fiduciary duty that would override other objectives, such as maximizing the return to the institution’s
ultimate beneficiaries. What is primarily matters for public policy is the role that ownership engagement
plays for effective capital allocation and the informed monitoring of corporate performance.”)
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The Logic and Limits of Stewardship Codes

Would then the Japanese Stewardship Code be effective? On one hand, there is a possibility that the Stewardship Code may be entirely ignored or result only in formalistic engagement that does not produce value. On the other hand, the Stewardship Code could “serve as a focal point for changing the norms about asset management and capital productivity in Japan.” While it is still too earlier to have definitive empirical evidence, the anecdotal evidence described in the previous section on voting behavior by large trust banks show that the latter effect may be more than a pipe dream.

D. Monitoring and Enforcement

The Japanese Stewardship Code takes the form of “comply or explain”. As signing up to the code does not guarantee either compliance or meaningful explanation, monitoring and enforcement from the viewpoint of ultimate beneficiaries is essential for the Stewardship Code to be effective. In particular, whether an institutional investor who declares compliance does comply, and whether an institutional investor who chooses to explain provides a persuasive explanation must be monitored.

The question is who would provide such monitoring. In this regard, the Japanese Stewardship Code follows the UK Code that divides institutional investors into two categories: asset managers, who are entrusted with the day-to-day management of funds provided by the other group; and asset owners such as pension funds and life insurance companies. Both codes expect asset

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189. Milhaupt, supra note 185 at 9 (noting that the Stewardship Code would be “practically useless” as many institutional investors “rationally do not engage”).


191. Milhaupt, supra note 185 at 9. See also Wataru Tanaka, Nihonban suchuwadoshippu kodo no kaitei [The Revision of the Japanese Stewardship Code], 398 SHIRYOBAN SHOJI HOMU 6, at 12 (2017) (asserting that by officially acknowledging the value of stewardship activities, the Stewardship Code might make coordination among institutional investors easier and thus solve the collective action problem).

192. One of the major concerns in Japan has been the weakness of the enforcement due to the Stewardship Code’s “comply or explain” approach and the lack of a specific enforcement mechanism. See Kansaku, supra note 14 at 1018-1019, Mayumi Takahashi, Suyuto ro to shiteno koporeto gabanansu kodo to suchuwadoshippu kodo [The Corporate Governance Code and the Stewardship Code as Soft Law], JIYU TO SEIGI, Vol.67, No.7, 41, at 45 (2016).


194. The 2012 Revised UK Code, supra note 1, para.6 at page 1, the 2017 Revised Japanese Code, supra note 2, para.7 at page 5.
owners to monitor stewardship activities of asset managers as their direct clients.\(^{195}\)

It has been observed, however, that private pension funds, have tended not to sign up to the Japanese Stewardship Code.\(^{196}\) As of April 5, 2018, there are 30 pension-fund signatories, which comprise of 12 public pensions, 14 private pensions, and 4 foreign pension funds.\(^{197}\) Out of the 14 private pension funds, 8 are of companies are under the supervision of the FSA, such as banks and insurance companies, and 3 are associations of private pension funds.\(^{198}\) This leaves only 3 signatories that are pension funds of individual companies, out of a total of 774 private pension funds as of April 1, 2018.\(^{199}\)

The reason for the low adoption rate by pension funds seems to be threefold. First, most of the private pension funds are small in size, holding less than 10 billion Yen, and cannot afford to hire sufficient staffs for stewardship activities.\(^{200}\) Second, as the beneficiaries of private pension funds are employees they cannot monitor such funds effectively due to collective action problems. And third, unlike trust banks or investment managers, private pension funds are not supervised by the Financial Services Agency and thus do not face regulatory pressure to sign up, except for those of financial companies which are regulated by the Agency.\(^{201}\)

Actually, the 2017 revision did take this issue into consideration, and added a few paragraphs in the guidance section to promote stewardship activities by

\(^{195}\) The 2012 Revised UK Code, supra note 1, para.7 at page 2 (“Since asset owners are the primary audience of asset managers’ public statements as well as client reports on stewardship, asset owners should seek to hold their managers to account for their stewardship activities. In so doing, they better fulfil their duty to their beneficiaries to exercise stewardship over their assets.”), the 2017 Revised Japanese Code, supra note 2, Guidance 1-3, 1-4 and 1-5. See also Reisberg, supra note 23 at 241.

\(^{196}\) Tahara et al., supra note 128 at 18. In contrast, public pension funds, in particular the Government Pension Investment Fund (GPIF), are very active on stewardship. See for example, GPIF, STEWARDSHIP PRINCIPLES & PROXY VOTING PRINCIPLES (June 1, 2017), available at http://www.gpif.go.jp/en/stewardship_and_esg/pdf/stewardship_principles_and_proxy_voting_principles.pdf.

\(^{197}\) For the list of signatories, see Financial Services Agency, supra note 162.

\(^{198}\) One of such association is the Pension Fund Association, which has been active in stewardship activities since early 2000s. See Bruce E. Aronson, A Japanese CalPERS or a New Model for Institutional Investor Activism? Japan’s Pension Fund Association and the Emergence of Shareholder Activism in Japan, 7 NYU JOURNAL OF LAW & BUSINESS 571 (2011).

\(^{199}\) The three signatories are the pension funds of Eisai, Panasonic and Secom. The total number of private pension funds (774) is derived from adding the 32 employees’ pension funds (kosei nenkin kikin) to the 742 fund-type defined-benefit corporate pensions (kikin-pata kakutei kyufu kigyo nenkin), which is 742. See Kigyo Nenkin Rengokai (Pension Fund Association), Kigyo nenkin no genkyo (Heisei 30-nen 4 gatsu 1 nichi genzai) [The Current State of Corporate Pensions (as of April 1, 2018)] (April 9, 2018), available at https://www.pfa.or.jp/activity/tokei/nenkin/files/genkyo.pdf.

\(^{200}\) Ryoko Ueda, Nihonban suchuwadoshippu kodo no kaiti ~ Kikantoshika no yakuwari to jikkosei to kyoka [The Revision of the Japanese Stewardship Code: The Role of Institutional Investors and Strengthening of Its Effectiveness], 382 SHIRON SHIYO 26 at 30 (2017).

\(^{201}\) Naoya Ariyoshi, Suchuwadoshippu kodo kaiti - heno jitsumu tao [Practical Issues in Response to the Revision of the Stewardship Code], 2141 SHIOI HOMU 84, at 91 (2017).
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asset owners.\textsuperscript{202} The number of pension fund signatories after the revision, however, did not increase by much,\textsuperscript{203} suggesting that the Revised Code is unlikely to address such collective action problems. To urge private pension funds to be more active, encouragement from their regulator, the Ministry of Health, Labor and Welfare,\textsuperscript{204} is crucial.\textsuperscript{205} This may call for additional regulations, but for a reason that is completely different from that in the UK.\textsuperscript{206}

PART V: CONCLUSION

This article has demonstrated that there is a divergence between the basic goals and orientation of the Japanese and the UK Stewardship Codes, which has been largely overlooked in the literature. Although the term “stewardship” suggests that stewardship codes are based on the logic of a fiduciary duty compelling a fiduciary to act in the interest of its beneficiary, the goal of the UK Stewardship Code is instead to restrain excessive risk-taking and short-termism by making institutional investors more responsible to the public.

In contrast, the Japanese Stewardship Code aims to change the attitude of domestic institutional investors in order to make Japanese corporate governance more oriented towards the interests of shareholders rather than those of stakeholders. This goal of the Japanese Code is more compatible with the logic of stewardship than that of the UK Code. At the same time, the Japanese Government considers this goal to be in the public interest of Japan.

Another finding of this article is that different stewardship codes have different goals and that this must be taken into consideration when assessing their effectiveness. The success of the Japanese Stewardship Code will primarily depend on how well domestic institutional investors are incentivized to act in the interest of their ultimate beneficiaries and to monitor entrenched management. Conversely, the success of the UK Stewardship Code will likely depend on how well it can make institutional investors consider the interests of the public and of stakeholders other than shareholders. Regulatory interventions might be necessary in both cases, but for different reasons.

\textsuperscript{202} Tahara et al., supra note 128 at 17-18.

\textsuperscript{203} The number of pension-fund signatories as of December 27, 2016, the year before the 2017 revision, was 26.


\textsuperscript{205} See also Ariyoshi, supra note 201 at 91 (asserting that it is not enough to rely on spontaneous adoption by private pension funds and suggesting that fiduciary duties of directors of such funds would call for adequate stewardship activities).

\textsuperscript{206} See supra note 159 and accompanying texts.
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The diversity in the goals and measures of effectiveness of stewardship codes is the consequence of the variety in the systems and primary issues of corporate governance in each jurisdiction. This suggests that, although stewardship codes are proliferating around the world, what seems like a move towards convergence may actually be an evidence of continued divergence – with “stewardship” having different meanings in different jurisdictions. Thus, inter-jurisdictional comparisons of stewardship codes must be undertaken with caution, with a comparison of the text of the principles and guidance being only the starting point – and not the end - of any analysis. Ultimately, the policies driving the adoption of such codes and the specific corporate governance context into which a stewardship code is implemented appear to be critical. As such, multiple jurisdiction-specific lenses are necessary when examining stewardship codes in a comparative context.
Power Allocation and the Role of Shareholders - A Comparative Examination

Pearlie M.C. Koh*

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In Meridian Global Funds Management Asia Ltd. v Securities Commission,1 Lord Hoffmann referred to the company as a “persona ficta... deemed... to have certain of the powers, rights and duties of a natural person.”2 This, undoubtedly, is a universal truth. However, the question, “with whom should the power to exercise these powers lie?” does not have a universally accepted response. The legislative scheme for companies in practically all jurisdictions is premised on a dichotomy between the shareholders as a collective group,3 and the board of directors. There are, it appears, two extant models for the allocation of decision-making powers in the common law world: (1) a “statutory” allocation of powers, and, (2) a “contractual” allocation of powers.

* Singapore Management University. I would like to thank Professor Kon Sik Kim and the participants at the Comparative Corporate Governance Conference 2018 Singapore for their constructive and helpful comments. All errors remain mine.

2. Id. at 506.
3. In this paper, the reference to “shareholders” is necessarily a reference to the shareholders as a collective whole, operating and acting by means of the processes stipulated by the companies legislation.
The paradigm example of the statutory model may be found in American corporation law statutes. These uniformly provide that the board of directors is the ultimate decision-maker. In contrast, the U.K. features a contractual model, with companies legislation being silent as to the functions of the board. Subject to certain matters expressly reserved to the shareholders in general meeting, the matter of power allocation is left to the company’s constitution. Under U.K. law, a company’s constitution is accorded contract-like status, as shareholders are bound by the document’s terms “to the same extent as if there were covenants on the part of the company and of each [shareholder] to observe” the constitution. And since the constitution may be amended by, and only by, the shareholders collectively, the originating power of the company is presumed to lie with the shareholders. Therefore, it should follow that any authority of the directors to manage the company must be ultimately derived from the shareholders. The necessary corollary of this conclusion is that with the contractual model, it should be permissible for the shareholders to confer general management powers on themselves by means of a suitably drafted provision in the constitution. Notwithstanding this seemingly logical position, arguments have been made to deny the shareholders their primary position in the company. There is judicial authority for this position, as the English courts

4. And also in Canada. All Canadian jurisdictions, with the exceptions of British Columbia and Nova Scotia, adopt the Canadian Business Corporations Act, R.S.C. 1985 c. C-44, § 102(1) of which provides:
   Subject to any unanimous shareholder agreement, the directors shall manage the business and affairs of a corporation.
   In the Alberta Court of Appeal decision of Canadian Jorex Ltd v. 477749 Alberta Ltd, 85 Alta. L.R. (2d) 313 (1991), the effect of § 102 was explained by Fraser J.A. as follows (at ¶¶ 8–9):
   Under the corporate model adopted by the [Canadian Business Corporations Act 1985], the residual power to manage the corporation’s affairs rests with the directors. This power is given by statute and is not derived from the delegation of powers by the shareholders. To suggest that the directors enjoy no specific power unless it has been expressly granted to them by the CBCA would effectively render the § 102 “basket clause” redundant. This result would run counter to the philosophy underlying the basket clause. The effect of this clause is that the directors’ powers to manage a corporation’s affairs are unlimited except to the extent these powers may have been circumscribed by the corporation’s by-laws or a unanimous shareholders’ agreement.


6. Companies Act (U.K.) 2006, c. 44, § 33 which provides that “the provisions of the company’s constitution bind the company and its members to the same extent as if there were covenants on the part of the company and of each member to observe it.” See also Corporations Act 2001 (Ch.), § 140(1) and Companies Act Cap. 50 (Singapore), § 39, which also provide for the constitution to have contractual effect.

7. Companies Act (U.K.), § 21: “A company may amend its articles by special resolution,” and “special resolution” is defined in § 283(1) as a resolution of the members passed by a majority of not less than 75%.


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have on occasion read down\(^\text{10}\) the power of the shareholders to intervene in management matters, notwithstanding a constitutional provision that expressly preserves their right to intervene. The dissonance between what the contractual model promises and the judicial limits placed on shareholder power may be discerned in Australia and in Singapore as well.

The allocation of power in a company is fundamental to the proper operation of the corporate form. In common law jurisdictions, vesting general management power in the board of directors is usually the default position in theory and in practice. But it is not a mandated legal position. The fact that there appears to be some dissonance between the legislation and the courts, as well as a general lack of consensus amongst commentators as to the role for the shareholders as a whole, indicate that the matter is far from settled. We examine the issue from Singapore’s perspective. We begin with a consideration of the extant governance scheme dictated by legislation in England, Australia, and Singapore. We then proceed to assess whether the courts’ treatment of power allocation provisions and their effect sits coherently against that legislative background. Finally, we traverse the various arguments for and against shareholder empowerment, and suggest the way forward.

**PART I: POWER ALLOCATION REGIMES COMPARED**

The question of whether corporate governance\(^\text{11}\) should be premised on the idea of shareholder primacy is the subject of much debate.\(^\text{12}\) The debate exposes the fundamental existential question for companies in general: do companies exist solely for the maximization of shareholder wealth, or do they exist for the betterment of a larger group of stakeholders, including employees, creditors, and the wider consumer community (i.e., the opposing “stakeholder” model of corporate governance)? This particular debate, which has been referred to as the “ends” question in the governance of companies,\(^\text{13}\) has little

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\(^\text{10}\) Elizabeth Boros, *How Does the Division of Power Between the Board and the General Meeting Operate?*, 31 Adelaide L. Rev. 169, 172 (2010).

\(^\text{11}\) This refers, in a broad sense, how companies are managed and controlled. The Cadbury Committee 1992 defined corporate governance as ‘the system by which companies are directed and controlled.’ *COMMITTEES ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, Report of the committee on the financial aspects of corporate governance*, at ¶ 2.5 (1992).


Essentially, all of these models [of corporate governance] are ways of thinking about the means and ends of corporate governance. They strive to answer two basic sets of questions: (1) as to the means of corporate governance, who holds ultimate decisionmaking power? and (2) as to the ends of corporate governance, whose interests should prevail?
impact on the question whether shareholders collectively should have a role in corporate decision-making. Instead, the latter question\textsuperscript{14} raises the issue of decision-making power allocation. In the U.S., this question is resolved mostly against the shareholders such that the shareholders are allocated only a limited role in decision-making. The Delaware General Corporation Law, for example, provides that “the business and affairs of every corporation organized\textsuperscript{15} under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.”\textsuperscript{16}

The effect of such provisions was explained by Judge Collins of the New York Courts of Appeal in \textit{Manson v. Curtis}\textsuperscript{17}:

In corporate bodies, the powers of the board of directors are, in a very important sense, original and undelegated. The stockholders do not confer, nor can they revoke those powers. They are derivative only in the sense of being received from the state in the act of incorporation. The directors convened as a board are the primary possessors of all the powers which the charter confers, and like private principals they may delegate to agents of their own appointment the performance of any acts which they themselves can perform. The recognition of this principle is absolutely necessary in the affairs of every corporation whose powers are vested in a board of directors. All powers directly conferred by statute, or impliedly granted, of necessity, must be exercised by the directors who are constituted by the law as the agency for the doing of corporate acts.\textsuperscript{18}

This shows that the U.S. model of power allocation is director-centric, with the board of directors controlling much of the decision-making in U.S. corporations.\textsuperscript{19} Shareholders do not have the power to dictate that the directors take a particular course of action. Instead, shareholder voting rights are limited to a number of specific actions,\textsuperscript{20} which usually require board approval before they can be brought to a shareholder vote. In contrast, the English approach to power allocation, as well as the extant legislative positions in Australia and in Singapore, is significantly more shareholder-centric in according the shareholders a larger role under the operative legislative regimes. Indeed, the U.K. position is often discussed as a comparative counterpoint to the U.S.

\textsuperscript{14} Id.
\textsuperscript{15} Del. Code Ann. Tit. 8, § 101, which provides that “[a]ny person, partnership, association or corporation, singly or jointly with others, and without regard to such person’s or entity’s residence, domicile or state of incorporation, may incorporate or organize a corporation under this chapter…”
\textsuperscript{16} Del. Code Ann. tit. 8, § 141.
\textsuperscript{17} 223 N.Y. 313 (1918).
\textsuperscript{18} Id. at 322–23 (references omitted).
\textsuperscript{19} As Professor Bainbridge explained, “The statutory decisionmaking model thus is one in which the board acts and the shareholders, at most, react.” Stephen M. Bainbridge, \textit{The Case for Limited Shareholder Voting Rights}, 53 UCLA L. REV. 601, 603 (2006).
\textsuperscript{20} These are the election of directors, and approval of charter or bylaw amendments, mergers, sales of substantially all of the corporation’s assets, and voluntary dissolution: see Stephen M. Bainbridge, \textit{Corporate Law} at ¶ 5.1 (3rd ed. 2015).
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regime. Typically, the shareholders in these jurisdictions are empowered to decide on the content of the constitution, a document that underpins the internal regulation of the company. The shareholders also have the power to decide on the composition of the board. In ensuing paragraphs, we consider the respective approaches towards power allocation in these three jurisdictions.

The U.K.

Under English law, shareholders, as contributors of capital, were traditionally treated as “owners” of the company. The board of directors, on the other hand, were seen as skilled managers, who received the authority to manage the business from the “owners.” With this perspective, it was not controversial if the shareholders were able to exercise supervisory powers over the directors’ management of the company, or step in to run the company should the board become incapacitated for any reason. As Professor Hill noted, “traditional corporate theory assumed that the role of directors was to carry out the will and implement the interests of shareholders, and that within standard principles of agency law, shareholders had a formal right to control their agents.” However, incorporation created a discrete legal entity. Because the company became its own individual entity, this insight made it difficult, as a matter of logic, to see the shareholder as the “owner” of the company. Indeed, Professor Bainbridge would consider this to be “deeply erroneous.” Nevertheless, English law adopted a shareholder-centric view of the company, reinforced by the provisions of successive companies Acts. This

22. Accordingly, as Sir James Wigram V.C. noted, the board was “always subject to the superior control of the proprietors assembled in general meetings.” Foss v. Harbottle 67 E.R. 189, 203 (Ch. 1843).
27. Hill, supra n. 25, at 42–43.
provided the basis for the shareholders’ central role in the control of corporate matters.

A shareholder-centric view that subjects the board of directors to the superior control of the shareholders collectively does not, however, necessarily mean that the board is an agent for the shareholders. On the contrary, it is trite that both the general meeting and the board of directors are organs of the company, each deriving directly from the company’s constitution, an original authority to commit the company to juristic acts that fall within designated spheres. As Greer LJ noted in *John Shaw & Sons (Salford) Ltd v Shaw*:31

A company is an entity distinct alike from its shareholders and its directors. Some of its powers may, according to its articles, be exercised by directors, certain other powers may be reserved for the shareholders in general meeting.32

The English Companies Act 2006, as well as its predecessors, does not dictate how corporate powers are to be divided between the organs. This is instead left to the relevant provisions of the company’s constitution, which all U.K. companies are required to have.33 Accordingly, the relative powers of the general meeting and the board is a matter for “the true construction of the articles.”34 The English approach to power allocation is referred to as a contractual allocation of power, essentially because the constitution is accorded contract-like status by the Companies Act 2006.35 While the constitution cannot be inconsistent with the Companies Act,36 its content, including the matter of power allocation, is largely a matter for the shareholders. What the legislation does provide, in subsidiary legislation, is a standard form constitution.37 The Model Articles,38 promulgated by the Secretary of State under authority conferred by the Companies Act of 2006,39 set forth the default position for both private and public companies, and may be adopted by

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30. Or perhaps more accurately, a majority of them. *see MacDougall v Gardiner*, 1 Ch. D. 13, 22–25 (1875) (C.A.), where the court equated the company with the majority of the shareholders.
32. Id. at 134.
33. These articles of association are closer in content to the “bylaws” of a U.S corporation, while the “articles of incorporation” of a U.S corporation are more akin the memorandum of association of a U.K. company.
34. *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch. 34, 38 (H.C.), *per* Warrington J., aff’d on appeal.
35. Section 33 of the Companies Act 2006, ch. 46 (U.K.) provides as follows:
38. Companies (Model Articles) Regulations 2008/3229
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companies in whole or in part. Article 3 of the Model Articles provides for the “general authority” of the directors in the following terms:

Subject to the articles, the directors are responsible for the management of the company’s business, for which purpose they may exercise all the powers of the company.

This general management authority of the board is, however, subject to Article 4 of the Model Articles, which expressly provides for the “reserve power” of the shareholders to “direct the directors to take, or refrain from taking, specified action” by special resolution. An earlier default version qualified the general grant of management powers to the board by making it “subject nevertheless . . . to such regulations . . . as may be prescribed by the company in general meeting.” Although the textual differences affect the scope and boundaries of the instruction power, it remains clear that both versions preserved the power of the shareholders to intervene in matters of management. On the other hand, once power is allocated, the allocation remains sacrosanct until such time as the constitution is validly altered. This is a necessary corollary of the “contractual” nature of the constitution. Nevertheless, except for limited constraints, the constitution may generally be amended as and how the shareholders deem fit. Ultimately, the shareholders remain statutorily in control of power allocation in the company. Such a regime clearly reinforces the “superior” position of the shareholders. It is therefore incontrovertible that the U.K. has resolved the “means” question in favor of the shareholders. Indeed, this is also the case in the “ends” question. In this regard, Section 172 of the Companies Act 2006 expressly stipulates that a director “must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole” when performing managerial functions.

Australia

The legislative position regarding power allocation in Australia is different in form, but similar in substance to the U.K. position. In form, Section 198A of the Corporations Act of 2001 states that “the business of a company is to be managed by or under the direction of the directors” and that “the directors may exercise all the powers of the company except any powers that

40. Companies Act (U.K.), § 20(1).
41. See Regulation 55 of Table A of the Companies Act 1862 (U.K.), and successor versions culminating in Article 80 of Table A of the Companies Act 1948 (U.K.), before the newer version was adopted.
42. Quin & Axstens Ltd. v. Salmon [1909] A.C. 442, 443 (H.L.) per Collins M.R.
43. The common law imposes a requirement that the power to alter the constitution shall be exercised bona fide for the benefit of the company as a whole. Greenhalgh v. Arderne Cinemas Ltd. [1951] Ch. 286, 290 (C.A.).
Corporations Act or the company’s constitution (if any) requires the company to exercise in general meeting.” While this appears to provide for a statutory allocation of power, Section 198A in fact does not dictate a mandatory position. It is instead designated as a replaceable rule. Under the regulatory scheme of the Corporations Act, a replaceable rule is a section or subsection of the Corporations Act that the corporation can displace or modify in its constitution. These replaceable rules govern the internal management of a company, matters that were previously dealt with under the model articles of association. Similar to the U.K.’s position, the Corporations Act vests the power to modify the constitution exclusively in the shareholders, and the shareholders cannot be deprived of this statutory right. 

Like their counterparts in the U.K., shareholders in Australia are entitled to initiate any change to the constitution. Shareholders can either give notice to the company of their intention to propose necessary resolutions at the company’s annual general meetings, or requisition an extraordinary general meeting at which such resolutions may be passed. Therefore, the Australian position vis-à-vis power allocation is substantially the same as that which obtains in the U.K. as it is also essentially shareholder-centric.

**Singapore**

Singapore’s regime differs from that in the U.K. and Australia. Prior to 2003, it was clear that Singapore’s Companies Act followed the English model very closely, with the internal regulation of the company generally left to the company’s constitution. A default constitution was prescribed in the Fourth Schedule (referred to as “Table A”) of the version of the Companies Act then in force. The allocation of power provision found in Table A mirrored the earlier English version. Although it was usual for registered articles to expressly exclude Table A, the power allocation provision is often

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44. Corporations Act, § 135(2).
45. Including matters such as the governance of meetings and the appointment, removal and resignation of directors. Section 141 of the Corporations Act sets out a table of all the replaceable rules. By s. 135(3), a contravention of a replaceable rule is not of itself a contravention of the Corporations Act. Instead these rules have the effect of a contract between the company, its directors and company secretary and its members (s. 140). See generally ROMAN TOMASIC, STEPHEN BOTTOMLEY & ROB MCQUEEN, CORPORATIONS LAW IN AUSTRALIA, Ch 9 (2nd ed. 2002).
46. Corporations Act, § 136(2).
47. Peters’ American Delicacy Company Ltd. V. Heath, 61 C.L.R. 457, 479 (1939).
48. Who held at least 5% of the votes or who number at least 100.
49. Corporations Act 2001, § 249N.
50. Id. at § 249F.
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reproduced verbatim.\textsuperscript{53} However, when Singapore undertook its first comprehensive review of its Companies Act in the early 2000s, it introduced a provision that resembles the statutory decision-making power allocation model adopted in U.S. state corporation law statutes. Section 157A of the Companies Act was introduced\textsuperscript{54} pursuant to a recommendation by the\textsuperscript{55} Company Legislation and Regulatory Framework Committee, which took inspiration from Section 198A of the Australian Corporations Act. The section provides:

The business of a company shall be managed by, or under the direction or supervision of, the directors. . . The directors may exercise all the powers of a company except any power that this Act or the constitution of the company requires the company to exercise in general meeting.

Subsidiary legislation then replaced Table A with a “Model Constitution,” which may be adopted in whole or in part.\textsuperscript{55} A new default power allocation article in the same terms as Section 157A is also found in Article 77 of the Model Constitution.

While Singapore’s statutory provision is modelled after the Australian version, a significant difference lies in the fact that Section 157A is not designated as a default rule. The Companies Act appears to prescribe a specific model for decision-making in companies. This suggests a regime that approximates the American statutory model of power allocation. However, the approximation is incomplete because the governance premise of the Companies Act remains shareholder-centric. The participative and interventionist rights accorded to the shareholders remain unchanged. The power to alter the constitution\textsuperscript{56} continues to be exclusively vested in the shareholders, as well as the right to propose and pass resolutions.\textsuperscript{57} Therefore, the question is whether, by the insertion of Section 157A, Parliament intended to provide for a mandatory statutory distribution of powers. In\textit{TYC Investment Pte Ltd v. Tay Yun Chwan Henry},\textsuperscript{58} Lee Kim Shin J.C. phrased the question thus:

[S]hould an express term in a company’s articles conferring management powers upon the shareholders be deemed invalid as a matter of law? Or does s. 157A establish a default rule which may be varied by the company’s articles?

In Lee J.C.’s view, Section 157A, notwithstanding its clear terms, did not introduce a statutory allocation of power. The provision was a default rule, which may be readily excluded or altered by the shareholders. Lee J.C. also opined that the fact that “the language of s. 157A is replicated in Art 73 of the Table A Articles suggests that a company may choose to depart from the

\textsuperscript{53} Id.
\textsuperscript{54} See Companies (Amendment) Act 2003 (Act 8 of 2003).
\textsuperscript{55} Companies Act Cap 50, § 37.
\textsuperscript{56} Id. at § 26.
\textsuperscript{57} Id. at §§ 180, 183.
\textsuperscript{58} [2014] 4 S.L.R. 1149 (H.C.)
statutorily prescribed division of powers.” 59 The issue of power allocation remained, therefore, a matter of contract. His Honour explained: 60

[A]s a matter of practicality and commercial reality, corporate structures are so varied that it would be impossible to prescribe a set form of corporate governance...[and] there may be good commercial justifications for certain management powers to be reserved to the members

While this is undoubtedly true, it should be noted that section 157A(2) already permits a company’s constitution to provide expressly for certain powers to be allotted to the general meeting. Indeed, this explicit legislative stipulation, read together with the use of the mandatory “shall,” suggests that reservation of a general supervisory power would be contrary to the intent of Section 157A. Two other factors lend support to this view. First, quite unlike Section 198A of the Australian Corporations Act, Section 157A is not specifically expressed as being “replaceable.” Second, Parliament did not simply alter the relevant article in Table A, opting instead to include the restatement as a provision in the Act itself. It may be that with these textual nuances, Parliament intended to underscore the mandatory nature of Section 157A’s division of powers. Nevertheless, this interpretation sits uncomfortably with the overall scheme of Singapore’s Companies Act, thus explaining Lee J.C.’s preferred view. It would seem that the precise purpose and effect of Section 157A remains unclear.

PART II: JUDICIAL DISSONANCE

From the preceding discussion, it is clear that, on the whole, the legislative regimes in the three jurisdictions recognize and give effect to shareholder primacy. Through a collection of rules and principles, shareholders are accorded general governance supremacy. 61 A number of consequences should logically follow from this premise. First, and most fundamentally, it should be permissible for a company’s constitution to confer general management powers on the shareholders. Second, it should remain permissible for shareholders to pass advisory resolutions, even with respect to matters falling within the purview of the board. And third, should the board be incapacitated for whatever reason, the powers to act should vest in the general meeting. Judicial treatment of these matters are considered in the ensuing paragraphs.

59. Id. ¶ 87.
60. Id.
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Power of Shareholders to Give Binding Directions to Directors

A governance regime that vests in the shareholder the exclusive power to decide on power allocation must accommodate an allocation that confers instruction rights on the shareholders, even as management powers are vested in the board. However, there appears to be some judicial reluctance to accord to the shareholders the full complement of their theoretical control rights. The doctrine of division of powers developed because the board of directors and the general meeting are treated as separate organs of the company, each with respective spheres of power, the boundaries of which are defined by the company’s constitution. Hence, should the constitution provide that managerial powers are to be vested in the board of directors, then the board “and they alone can exercise these powers.” Nevertheless, this view of the distribution of powers between the organs of a company is consistent with the proposition that power allocation remained a matter for the incorporators, and subsequently, the shareholders, to decide with the inclusion of an appropriate provision in the constitution. The doctrine should not therefore preclude, as a matter of law, the reservation of full management powers in the shareholders. Under the contractual model, the shareholders’ ability to give binding directions to the board to act in a management matter must depend on a proper construction of the relevant power allocation provision in the company’s constitution. This basic proposition was, however, deviated from in the U.K.. As we saw above, the English Companies Act does not dictate how power ought to be allocated. Instead, the default power allocation provision historically vested general management power in the board of directors, but reserves to the general meeting a power to intervene through a shareholder resolution. While there does not appear to have been any judicial pronouncement on the current model, decisions on the earlier version demonstrated a willingness to read down the power of the shareholders to intervene in management matters by ordinary resolution. In the earlier version, the grant of management powers to


63. An ordinary resolution sufficed in the earlier iterations of the default provision. This was changed to a special resolution in the 1985 Act.

64. Companies (Model Articles) Regulations 2008/3229, article 4.


66. Although it would appear, as was pointed out by both Goldberg, supra n.65, and Sullivan, id., that, besides Scott v. Scott [1943] 1 All E.R. 582, none of the other cases were either decided on an interpretation of Article 80 or could be explained on other grounds.
the board was made “subject . . . to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting.” 67 The obvious meaning of these qualifying words is to vest in the shareholders the overriding power to intervene in management matters. And yet, this straightforward proposition was impugned when a number of influential commentators 68 interpreted the case law 69 as laying down a “strict theory of a division of powers” 70 which curtailed the power of the general meeting to intervene in matters of management. 71 The source of this may be traced to the decision of the English Court of Appeal in Shaw & Sons (Salford) Ltd. v. Shaw, 72 where the Court of Appeal declined to permit the general meeting to direct the discontinuance of legal proceedings. Greer L.J. famously stated, “the only way in which the general body of shareholders can control the exercise of powers vested by the articles in the directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose actions they disapprove.” 73 His Lordship opined that “the law on this subject is . . . accurately stated in Buckley on Companies as the effect of the decisions there mentioned.” 74 The relevant passage in Buckley on the Companies Acts had stated as follows: 75

67. See Companies Act 1948 (U.K.), Table A, art. 80 which provided as follows:

The business of the company shall be managed by the directors, who may pay all expenses incurred in promoting and registering the company, and may exercise all such powers of the company as are not, by the Companies Acts 1948 to 1980 or by these regulations, required to be exercised by the company in general meeting, subject, nevertheless, to any of these regulations, to the provisions of the Act and to such regulations, being not inconsistent with the aforesaid regulations or provisions, as may be prescribed by the company in general meeting; but no regulation made by the company in general meeting shall invalidate any prior act of the directors which would have been valid if that regulation had not been made.

An identical version was found in the earlier 1929 Act.


70. See G.D. Goldberg, supra. at 177, citing The Principles of Modern Company Law 127 (2nd ed. 1957).

71. This position was described as “remarkable” in Paul L. Davies, Gower and Davies’ Principles of Modern Company Law 302 (7th ed. 2003).


73. Id. at 134.

74. This was a reference to H.B. Buckley et al., The Law and Practice Under the Companies Acts Containing the Statutes and the Rules, Orders and Forms to Regulate Proceedings (11th ed. 1930).

75. See counsel’s argument at [1935] 2 K.B. 113, 121.
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prescribed by the company in general meeting’, these words do not enable the shareholders, by resolution passed at a general meeting without altering the articles, to give directions to the directors as to how the company’s affairs are to be managed, nor to overrule any decision come to by the directors in the conduct of its business, even as regards matters not expressly delegated to the directors by the articles.76

It appeared that the learned authors of the eleventh edition77 had considered this to be the effect of the decision of the House of Lords in Quin & Axtens Ltd. v. Salmon.78 There, Lord Loreburn had, in obiter dicta, stated that he would require “a great deal of argument” to accept that “the word ‘regulations’ in this article79 does not mean that same thing as articles.”80 This reading of Quin & Axtens was also accepted by Slesser L.J.81 However, as a number of commentators82 have already pointed out, a context-sensitive reading of Quin & Axtens does not support any reading down of the shareholders’ general power of intervention. On the facts of the case, in addition to a general article conferring management powers on the board “subject to such regulations (being not inconsistent with the provisions of the articles) as may be prescribed by the company in general meeting,” there was a specific article requiring the consent of both the company’s managing directors before certain premises could be acquired or leased. The general meeting passed, by a simple majority, resolutions to acquire and let premises, to which one of the managing directors objected. Lord Loreburn himself considered that the “regulations or resolutions which have been passed are of themselves inconsistent with the provisions of these articles” and the company could not therefore act on them. The ratio decidendi of the decision, therefore, is that, on a proper construction of the company’s articles, the specific decision to acquire premises had been exclusively vested in the board of directors. Accordingly, with respect to this

76. Buckley, supra note 73 at 723.
77. One of the authors was Lord Wrenbury’s younger son, D.B. Buckley J.
79. Which, in providing that the business of the company was to be managed by the directors, who might exercise all the powers of the company ‘subject to such regulations (being not inconsistent with the provisions of the articles) as may be prescribed by the company in general meeting’, was in pari materia with the article under consideration in Quin & Axtens.
80. [1909] A.C. 442, 444. Lord Clauson (sitting as a judge in Chancery Division) expressed “greatest difficulty in seeing how any resolution of the company in general meeting, controlling the directors in the management of the business, can possibly be justified under the terms of this article”. See also Scott v. Scott [1943] 1 All E.R. 582, 585. Even if one reads “such regulations . . . as may be prescribed by the company in general meeting” to refer to ordinary resolutions, his Lordship thought that any such resolution would be ineffective as it would necessarily be ‘inconsistent with the aforesaid regulations.” Id. at 585. This reading of the article effectively divests the italicized words completely of any significance. See Credit Development v IMO [1993] 2 S.L.R. 370 (H.C.).
decision, the general meeting could not intervene short of amending the relevant article.

The Singapore High Court took a somewhat more robust position vis-à-vis the interpretation of a similar provision. In *Credit Development Pte Ltd v. IMO Pte Ltd*, the High Court of Singapore was confronted with the task of interpreting an article that was substantially identical to the then extant version in the Fourth Schedule to the Companies Act (otherwise known as “Table A”). That article provided that the board of directors shall exercise all management powers of the company, “subject nevertheless to the provisions of the statutes, these articles and to such regulations, being not inconsistent with the said provisions and articles, as may be prescribed by the company in general meeting.”

This article mirrors the older English version. Lim Teong Qwee JC meticulously reviewed relevant case law from both England and Australia, and concluded that the qualifying words mean:

... that although the directors are to manage the company’s business and may exercise all the company’s powers yet the company in general meeting may at any time prescribe regulations which the directors must comply with... The regulations which may be prescribed by the company in general meeting are not to be inconsistent with “the said provisions and articles”... “Articles” in the expression “said provisions and articles” refers to all the articles other than the first part of article 88(1). The first part of this article is qualified by the second part and must be read together.

In other words, under the terms of this article, the general meeting may instruct the directors on any matter that relates to the management of the business of the company provided there is no other article that requires that specific matter to be dealt with by the directors. In that case, the matter falls within the exclusive purview of the board.

Against the legislative backdrop provided by the respective companies legislation in both the U.K. and Singapore, Lim JC’s interpretation must be correct. The default positions in both the U.K. and Singapore were changed subsequently. In the U.K., the default provisions were altered to make it clear that the general meeting could give directions to the board, provided that these directions were given using special resolutions. Beyond the requirement of a

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84. Except that the word “regulations” have been replaced with the word “articles.”
88. Article 70 in the Table A prescribed by the Companies Act 1985 (U.K.) provided for general management powers to be exercised by the board but explicitly recognized the power of the general meeting to, by special resolution, curtail the board’s powers.
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special resolution, the power of the general meeting to intervene in management matters appears to be unqualified. While this amendment would appear to solve the interpretative difficulties associated with the predecessor article, the current position may be less clear. As pointed out above, the Model Articles provide explicitly for the “reserve power” of the shareholders to “direct the directors to take, or refrain from taking, specified action” by special resolution. Classifying this power of the general meeting as a “reserve” power suggests that the shareholders in general meeting may exercise the power only when the board is itself unable or unwilling to act. Unlike the previous position, therefore, under this new provision, shareholders may not have the general ability to give directions or instructions to the board.

Power of Shareholders to Pass Advisory Resolutions

Consistent with the idea of shareholder primacy, all three jurisdictions legislatively provide for shareholders to initiate meetings and bring resolutions to a vote. The English Companies Act 200689 provides that the directors must convene a general meeting upon the requisition of shareholders who control at least five percent of the paid-up capital carrying voting rights.90 The request must state the general nature of the business to be dealt with at the meeting,91 and may include the text of a resolution intended to be moved at the meeting. Whether the resolution does eventually get passed at the meeting is a separate matter. However, any resolution proposed must qualify as a resolution that may “properly be moved” by the shareholders.92 An exclusionary definition of resolutions that may “properly be moved” is provided in the Act. A resolution that is “ineffective,” if passed, is not a resolution that “may properly be moved” by the members of the company.93 Resolutions that are defamatory, frivolous, or vexatious are also not resolutions that “may properly be moved.” An ineffective resolution is a resolution that is contrary to any law, or more relevant for our purposes, one that is inconsistent with the company’s constitution. The latter exclusion is a clear reference to the constitutional allocation of decision-making powers between the general meeting and the board of directors.

There are similar provisions in Australia’s Corporations Act and in Singapore’s Companies Act permitting shareholders to initiate actions. These statutes generally empower shareholders to put resolutions they propose before a general meeting in a number of ways. Shareholders may: (1) requisition the

89. Id. at c. 46.
91. Id. at § 303(4).
92. See id. at §§ 292(2); 303(5); 338(2)
93. Companies Act 2006, §§ 292(2); 303(5); 338(2)
board to call a general meeting; (2) convene a meeting themselves;\(^94\) or (3) give notice to the company of resolutions which they propose to move at a general meeting. Typically, the exercise of such powers is subject to certain minimum threshold, often procedural,\(^95\) requirements. The Corporations Act 2001, for example, empowers shareholders with at least five percent of the votes that may be cast at the general meeting to either requisition the directors to call and arrange to hold a general meeting,\(^96\) or to call, and arrange to hold, a general meeting themselves.\(^97\) Shareholders “with at least 5% of the votes that may be cast on the resolution; or at least 100 members who are entitled to vote at a general meeting”\(^98\) are also entitled to give notice to the company of their intention to move proposed resolutions at a general meeting.\(^99\) Shareholders in Singapore are also accorded similar rights. The Companies Act \emph{obliges} the directors of a company, \emph{notwithstanding anything in its constitution}, to immediately convene a general meeting of the company, as long as the requisitionists comprise not less than 10% of the total number of paid-up shares.\(^100\) Additionally, two or more members holding not less than 10% of the total number of issued shares of the company may call a meeting of the company.\(^101\) Shareholders may also propose resolutions by requesting that the directors circulate notice of the same with the notice calling an Annual General Meeting.\(^102\)

Notwithstanding the generally permissive nature of these provisions, the courts tend to require adherence to the division of powers doctrine established in \textit{John Shaw \\& Sons (Salford) Ltd. v. Shaw}\(^{103}\) and limit the kind of resolutions that shareholders may propose. This is especially well-demonstrated in cases that involve shareholders seeking to circulate resolutions. As Lim Teong Qwee J.C. noted in \textit{Credit Development Pte. Ltd. v. IMO Pte. Ltd.}:\(^{104}\)

\begin{quote}
If the object of the meeting is to... pass a resolution which is \textit{ultra vires} the meeting, then the directors ought not to be required to convene the meeting. If such a meeting is in fact held and a resolution is passed, the directors are not bound to comply with it. The resolution is void and of no effect. There is nothing in the Act
\end{quote}

\begin{footnotes}
94. Corporations Act 2001, § 249D.
95. Such as a minimum shareholding requirement. Additionally, the Corporations Act 2001, § 249O(5)(a) provides that the company is not required to circulate proposed resolutions that are “more than 1,000 words long or defamatory.”
96. Corporations Act 2001, § 249D.
97. Corporations Act 2001, § 249F.
98. These requirements may be altered in respect of certain companies by prescribed regulations. Corporations Act 2001, § 249N.
100. Companies Act Cap. 50, § 176(1).
101. Companies Act Cap. 50, § 177(1).
102. Companies Act Cap. 50, § 183.
\end{footnotes}
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to suggest that the directors must act on a requisition for a meeting having as an
object that which is not within the powers of the meeting. I think the directors are
well entitled on receipt of such a requisition to decline to call a meeting.

Thus, unless the particular constitution of the company provided
otherwise,\(^{105}\) proposed resolutions which concern the exercise of management
powers that have been exclusively vested in the board, fall outside of the
purview of the general meeting, and are not resolutions that may be effectively
be passed by the shareholders in general meeting. To permit thus would be to
condone the general meeting’s usurping of the board’s powers.\(^ {106}\) It followed
from this that the directors of the company would be entitled to disregard a
members’ requisition if the proposed resolutions set out therein were of that
nature. Thus, in Queensland Press Ltd. v. Academy Investments No. 3 Pty.
Ltd.,\(^ {107}\) the court considered a members’ requisition for a general meeting to be
invalid as its object was to secure shareholder approval for a disposal of the
company’s asset, a matter that, under the company’s constitution, expressly fell
solely within the authority of the directors to determine.

This, thus far, is not particularly controversial, as these decisions may be
justified on the basis of a due construction of the company’s constitution.
However, a recent decision of the Full Federal Court of Australia appears to
have gone further in curtailing the powers of the general meeting. In
Australasian Centre for Corporate Responsibility v. Commonwealth Bank of
Australia,\(^ {108}\) shareholders were denied the power to pass purely advisory
resolutions concerning the management of the company. Advisory, or
sometimes called “non-binding,” resolutions are shareholder resolutions that do
not compel the board to act in any particular way. Instead, such resolutions
serve to convey the shareholders’ collective opinion or views on certain
matters. Such resolutions, although of no legal effect, are nevertheless very
influential given that board members, as a general proposition, tend not to act
contrary to the wishes of a large portion of shareholders. In the present case, the
shareholder concerned was a “not-for-profit association whose mission was to
promote informed shareholder engagement and advocacy for more just and
sustainable corporate activity.”\(^ {109}\) In an attempt to influence the environmental
reporting policy of the respondent bank, it gave notice to the bank that it
proposed to move one of three alternative resolutions at the upcoming annual
general meeting. The first was framed as an expression of opinion that it would be “in the best interests of the company” that the directors provide, together

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105. This should be subject to the earlier discussion.
with the annual directors’ report to the shareholders, a report outlining the quantum of greenhouse gas emissions financed by the bank, the risks posed by associated environmental issues to the bank, and the strategies adopted by bank to mitigate these risks. The second proposed resolution was couched as an expression of “concern” at the absence of such a report in the annual directors’ report. The third proposed resolution, in contrast, took the form of an affirmative special resolution to amend the bank’s constitution so as to include a requirement that the directors include in their annual report the amount of greenhouse gas emissions that the bank was responsible for financing. As the notice was given to the bank in due time, the bank would have been obliged to notify its members of the proposed resolutions. The bank, however, declined to include the first two proposed resolutions on the ground that they were “matters within the purview of the Board and management of the Bank.” The bank’s constitution vested responsibility for the management of the bank on the board on the terms of the replaceable rule in Section 198A of the Corporations Act. The third proposed resolution, on the other hand, was included in the notice, which was accompanied by a statement from the board that it did not consider the resolution to be in the best interests of the company and recommended that the members vote against it.

The applicant sought declarations, inter alia, that all three proposed resolutions were resolutions that could validly have been moved at an annual general meeting of the bank. Further, the applicant declared that the board had acted outside of its powers in “publicly offering an opinion with respect to the third proposed resolution.” Citing the New York Court of Appeals decision in *Auer v. Dressel*, the applicant contended that shareholders were vested with the power to pass such advisory resolutions, unless that power was expressly taken from them, which was not the case here. The primary judge rejected the application and held that unless the proposed resolutions were referable to a power vested in the shareholder in general meeting, and not to the power of management vested exclusively in the bank’s board of directors, the board was not required to put those resolutions to the annual general meeting. The Full Court affirmed her Honour’s decision, stating the following “fundamental proposition”:

110. Corporations Act 2001, § 249O,
111. [2016] FCAFC 80, ¶ 5.
112. Id. ¶ 66.
117. Id. ¶ 37.
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[S]hareholders in general meeting have no authority to speak or act on behalf of the company except to the extent and in the manner authorized by the company’s constitution or any relevant statute, and to an extent and in a manner consistent with the constitution or statute.

The Full Court found that such interests as shareholders may have, in the management of a company, provided no justification for the existence of any power to express corporate views or opinions, nor was there any constitutional or statutory basis upon which to premise such a power. The Full Court stated that “the shareholders in general meeting did not have a role to play in the exercise of powers vested exclusively in the board by passing a resolution which would express an opinion on the exercise of those powers.”

The directors of the company were therefore entitled to decline to include the proposed resolutions in the notice for the company’s Annual General Meeting. In reaching its conclusion that the general meeting had no power at all to pass advisory resolutions, the Full Court relied on authorities which, in its view, suggest that the general meeting could not, as a general proposition, pass “ineffective” resolutions. The Full Court cited the English Court of Appeal decision in *Isle of Wight Railway Company v. Tahourdin* as “[tending] against the existence of a ‘power’ vested in shareholders in general meeting to pass an ineffective resolution.”

Specifically, the court referred to the following statement of Fry L.J. in *Isle of Wight*:

> If the object of a requisition to call a meeting were such, *that in no manner and by no machinery could it be legally carried into effect*, the directors would be justified in refusing to act upon it. But if the object . . . be such that by any form of resolution or by any machinery sanctioned by the Act, it can be carried into effect, then it is the bounden duty of the directors to call the meeting.

In the Full Court’s view, Fry L.J. was “drawing a distinction between effective and ineffective resolutions, rather than between resolutions that did or did not seek to usurp the powers of the directors.” On this basis then, since the resolutions proposed by the applicant were, on its own case, not binding and without legal effect, the general meeting was without power to pass those resolutions, which therefore need not be circulated.

Fry L.J.’s statements have to be read in context. The case concerned a requisition to convene a general meeting for the purposes of appointing a committee to which it was intended that certain powers be delegated. The directors sent out a notice calling a general meeting but declined to include therein all the proposals of the requisition on the ground that those which were

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118. *Id.* ¶ 60.
119. 25 Ch. D. 320 (1883).
120. [2016] FCAFC 80, ¶ 27.
121. 25 Ch. D. 320, 334 (1883).
122. [2016] FCAFC 80, ¶ 33.
excluded could not “legally be submitted to an extraordinary meeting of shareholders.” The requisitionists treated the directors as having failed to convene the meeting, and proceeded themselves to convene a meeting for all the purposes expressed in the original requisition. The directors applied to restrain the requisitionists from holding the meeting. The English Court of Appeal held that there was no ground for granting the injunction. Cotton L.J. noted:

It is a very strong thing indeed to prevent shareholders from holding a meeting of the company, when such a meeting is the only way in which they can interfere, if the majority of them think that the course taken by the directors, in a matter which is intra vires of the directors, is not the benefit of the company.

There is no doubting, therefore, that the decision of Isle of Wight Railway Company stands as authority for the “supreme” position of the shareholders and their concomitant right to hold a general meeting than for any curtailment of the same. In the contemporaneous decision of the English Court of Appeal in Harben v. Phillips, Cotton L.J. had explicitly recognized that “the wish of a corporation” may be “effectually be expressed by any meeting of the shareholders duly called for such purpose” even if that wish is, per se, ineffective. Technically, advisory resolutions are generally accepted as ineffective, but in the sense that the directors are not bound to act on the advice or opinion. As Samuels J.A. observed in Winthrop Investments Ltd. v. Winns Ltd. “shareholders’ advice . . . do not involve the exercise of power. . . [t]hey are not acts in the law, and could have no effect.” It should follow then that the general meeting’s expressions of opinion or advice by way of resolutions should not be seen as contradicting the principle expressed by Greer L.J. in John Shaw & Sons, as the general meeting cannot, by such resolutions, “usurp” the board’s powers. Against the prevailing view of shareholder primacy and in the context of case itself, it seems more likely that Fry L.J. was concerned with proposed positive resolutions intended to effectuate some illegal or unlawful object. This was certainly the sense in which Fry L.J.’s statement was applied in a number of the cases that were cited by the Full Court in support of its interpretation of the same.

For instance, in the Full Court decision of Windsor v. National Mutual Life Association of Australasia Limited, the object of the requisition in question

124. 25 Ch. D. 320, 322 (1883).
125. Id. at 329.
126. see Foss v. Harbottle, 2 Hare 461, 493 (1843).
127. 23 Ch. D. 14 (1883).
128. Id. ¶ 39.
129. [1975] 2 N.S.W.L.R. 666.
130. Id. at 683-684.
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was to pass a resolution to convert the status of the company from one limited both by shares and by guarantee to a company limited by guarantee only. This, however, could not be lawfully done under the relevant legislation (i.e. the Companies (Vic.) Code). The requisition was therefore held to be “wholly ineffective.”133 Similarly, in Turner v. Berner,134 the resolution proposed by the shareholders and which the directors declined to include in the notice convening the requisitioned extraordinary general meeting was a declaration that the defendant director had “committed breaches of the provisions. . . of the Companies Act”135 which imposed criminal sanctions. The court held that, while the company could, by its appropriate organ, decide to commence proceedings against the director for a breach of his duties, it possessed no right to make a determination that the director was guilty of the breach. This was a matter for the court. Accordingly, the proposed resolution had been justifiably excluded from the notice.136 It is worth noting that one of the other proposed resolutions, which had not been excluded and in respect of which the court made no comment, was in fact a resolution that declared that the shareholders had “no confidence” in the beleaguered director as managing director of the company. In contrast, Young J. in Stanham v. The National Trust of Australia (New South Wales)137 declined to permit a motion of no confidence against the council of the National Trust (effectively its board of directors) to be included for consideration before an extraordinary general meeting of the National Trust on the ground that this was not a motion that could be validly passed at the meeting.138 Superficially, it would seem that Stanham supported the Full Court’s position. It is however important to point out that the National Trust was a body corporate established under the National Trust of Australia (New South Wales) Act 1960, and a creature that was rather different from companies. Under that Act, almost half of the statutorily required number of council members were statutory appointments or persons nominated by various Government or independent bodies and the powers of the council are statutorily vested on it. Membership of the Trust was ultimately subject to the “by-laws,” which under the Act, were to be made by the council itself, and subject to ultimate parliamentary approval.139 It is therefore clear that membership of the Trust is quite unlike membership of a company. In the circumstances, the relevance and utility of the decision in Stanham to the question of the powers of the general meeting of a company is doubtful at best.

136. Supra n. 132, at 72.
137. 15 A.C.L.R. 87 (1989).
138. Id. at 92.
139. See National Trust of Australia (New South Wales) Act 1960, § 16.
The Full Court also referred to Jordan C.J.’s dissenting judgment in *Clifton v. Mount Morgan Ltd.*, a decision of the New South Wales Court of Appeal, and opined that *Clifton* stood for “the fundamental proposition that the shareholders in general meeting have no authority to speak or act on behalf of the company except to the extent and in the manner authorized by the company’s constitution or any relevant statute.” With respect, the actual holding in *Clifton* provides little support for this general proposition. The case concerned competing claims to board seats by the plaintiffs and defendants, the latter were retiring directors who were seeking re-election. There was a dispute as to whether certain votes, which had been cast by proxy, were valid as this affected the outcome of the matter. The lower court concluded in favor of the plaintiffs and granted injunctions to restrain the defendants from excluding the plaintiffs from acting as directors and to restrain the defendants from acting as directors. The court however refused the defendants’ application for the court to order a general meeting, although Roper J. explicitly recognized that the company could, of its own accord, hold a meeting “to test the feeling of the meeting on the question of whether the plaintiffs [were] acceptable to the company as directors.” On appeal, the appellate court, by a majority, reversed the lower court’s conclusion as to the outcome of the election and discharged the injunctions. In the circumstances, it was unnecessary to consider whether a general meeting ought to be held. This notwithstanding, the majority judges expressed the view that, if they had concluded otherwise, they would have been inclined to allow the shareholders the opportunity to express their wishes. Thus, far from providing the support for the proposition contended for, the majority judgment would stand clearly for the contrary view.

Indeed, it is important to contextualize Jordan C.J.’s expressed opinion. The question his Honour considered was whether the court ought to direct the holding of a general meeting to ascertain by ordinary resolution whether the shareholders approved of the plaintiffs as directors. Under the company’s constitution, directors could be removed only by special resolution. It bears reiterating that his Honour had concluded that the plaintiff directors had been properly appointed. It followed then that they should not be prevented from acting as directors by those who are opposed to them simply by means of a mere expression of opinion procured by ordinary resolution. Indeed, as Jordan C.J. categorically noted, such “an expression of opinion. . . would be irrelevant to anything which this Court has to determine.” It was in this connection that

140. 40 S.R. (N.S.W.) 31 (1940).
141. *Id.* at 37.
142. *Id.*
143. 40 S.R. (N.S.W.) 31, 56, 62 (1940).
144. 40 S.R. (N.S.W.) 31, 51(1940).
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his Honour considered that Cotton L.J.’s observation in *Harben v. Phillips*,145 alluded to above, “opposed both to principle and to authority [as it] confuses the corporation with the persons who are its members...[I]t should be neither followed nor applied.”146 With respect, Jordan C.J. appeared to arrive at this conclusion on the basis that Cotton L.J. had accorded the general meeting’s non-binding resolution substantial significance, much more, than Cotton L.J. himself intended.

*Harben* also involved disputed board seats. The question before the English Court of Appeal was whether the court ought to compel, by injunction, the company and the other members of the board to allow the plaintiffs to act as directors. At a general meeting requisitioned by the defendant directors, a strong majority of the general meeting, albeit falling short of the special majority required for the removal of directors, expressed the view that they were not in favour of the plaintiffs acting as directors. The court declined to grant the injunction. It is important to note, however, that the court did not come to its decision solely on the basis of that expression of adverse opinion, which Cotton L.J. had clearly accepted was ineffectual to remove them as directors. Instead, it was on account of the “accidental”147 nature of the plaintiffs’ appointment that the court felt unable to intervene, as to do so would mean “compelling the company to put the management of its affairs into the hands of the plaintiffs.”148 The factual matrices in the two cases were thus quite different – while the plaintiff directors in *Clifton* had been properly appointed in Jordan C.J.’s view, there was significant doubts in *Harben* as to the propriety of the plaintiffs’ appointments. Under the circumstances, it was not appropriate for the court in *Harben* to order the injunction.

The applicant had also argued that the general meeting had the power to consider and pass the proposed advisory resolutions because the shareholders “had a legitimate interest in their subject matter.”149 The Full Court considered that argument “misunderstands the nature of the company as an entity distinct from its shareholders and directors.”150 The court stated:151

An act of the company (of which a resolution of its members is an example) must necessarily be an act which the company has the capacity or power to undertake. The legitimate interests of the various shareholders in the management of the company are distinct interests which cannot be aggregated to provide a justification for a resolution of the shareholders in general meeting, because the powers and

145. 23 Ch. D. 14 (1883).
146. 40 S.R. (N.S.W.) 31, 49 (1940).
147. 23 Ch. D. 14, 40 (1883).
148. *Id*.
149. [2016] FCAFC 80, ¶ 41.
150. *Id*., ¶ 42.
151. *Id*.
capacities of the company arise from its constitution and statute and not from the legitimate interests of its shareholders.

The case generated a significant amount of interest in Australia, as it had implications for shareholder rights and hence the scope for shareholder activism. Indeed, in affirming that “the powers and capacities of the company arise from its constitution and statute,” the Full Court had confirmed that, as a matter of law, there has been no retreat from the traditional precept of shareholder primacy. The Full Court had recognized that the impugned resolutions did not require the board of the bank to exercise its management powers in any particular manner. Accordingly, the general meeting’s passing of the resolutions would not have involved any infraction of the constitutional allocation of powers. In the circumstances, to deny the general meeting the power to pass such non-binding resolutions signals a failure to accord sufficient significance to the legislatively conferred status of the general meeting of shareholders. Recall that the board of directors had included in the notice a statement of its view that the resolution to alter the company’s constitution was not in the company’s best interests and recommended that the shareholders vote against the same. It is of interest to note that the Full Court accepted that the board’s expression of its opinion was permissible, notwithstanding that it was in respect of a matter that clearly fell within the purview of the general meeting.

The decision of the Full Court of the Federal Court of Australia demonstrates a judicial reluctance to recognise the full extent of the shareholders’ participatory rights, when doing so is perceived as intruding into management matters.

**Reserve Powers of Shareholders**

Where the constitution confides management powers exclusively on the board, are the shareholders necessarily stripped of all ability to take on management decisions? The Singapore Court of Appeal stated the issue in the following manner:

But what if it turns out for some reason that the board is unable or unwilling to act? In such circumstances, should it be implied into the company’s constitution that the management power is then reserved to the other organ, the shareholders in general meeting? Or is it the case that only the board may manage the company such that where the board does not function, the remedy, if there be one, is confined to reconstituting the board or commencing proceedings to compel the board to act?

The latter alternative, which effectively denies shareholders all intervention rights, is inconsistent with the contractual model. Thus, while it is accepted

152. [2016] FCAFC 80, ¶ 69.
Power Allocation and the Role of Shareholders

Shareholders are bound by the power allocation found in the constitution unless this allocation is properly altered, the courts have generally recognized the existence of residual or reserve powers in the shareholders when the board is dysfunctional. The often-cited authority for this is the decision of the English High Court in Barron v. Potter, where Warrington J. observed:

If directors having certain powers are unable or unwilling to exercise them – are in fact a non-existent body for the purpose – there must be some power in the company to do itself that which under other circumstances would be otherwise done.

However, the precise scope of such reserve powers is not clear. Barron v. Potter concerned a board comprising two directors who were not on speaking terms with each other. Under the circumstances, the court held that the general meeting had the power to appoint additional directors. Given that the power to appoint directors is, in any case, normally vested in the general meeting, the case does not support the conclusion that the general meeting has the power itself to make those decisions which, by the articles, are exclusively for the board to make. Nevertheless, subsequent English cases have affirmed the existence of reserved powers. In Alexander Ward & Co. Ltd. v. Samyang Navigation Co. Ltd, the subject company had the usual provision in its articles conferring managerial powers on the board. There were, however, no directors at the relevant time. The House of Lords nevertheless held that the company had the power to commence legal proceedings. Lord Hailsham said:

In my opinion at the relevant time, the company was fully competent . . . to raise proceedings in the . . . courts. The company could have done so either by appointing directors, or . . . by authorising proceedings in general meeting which, in the absence of an effective board, has a residual authority to use the company’s powers.

To Lord Hailsham, the shareholders’ reserve powers are not necessarily constrained. However, this view is not universally accepted, as the courts in Australia and Singapore have exhibited a clear preference for circumscribing the general meeting’s reserve power to assume the management mantle.

In the New South Wales decision of Massey v. Wales, Hodgson J.A. observed as follows:

Where the articles contain an express power to appoint additional directors . . . it does not seem . . . reasonable to regard a deadlock . . . as giving rise to any general power of management, when the deadlock can be resolved by the general meeting exercising its power to appoint additional directors. It may be that, even if the articles do not provide for the appointment by general meeting of additional directors, the power which the general meeting has to remove directors and replace them with other directors would

154. [1914] 1 Ch. 895, 903.
155. Id. at 678
156. 57 N.S.W.L.R. 718 (2003).
itself be sufficient to prevent the implication of any general reserve powers in the general meeting to undertake management decisions.\textsuperscript{157}

The company had three approximately equal shareholders, two of whom sat on the board of directors. The directors, however, had fallen out with each other, and the board was unable to act. One of the directors, together with the remaining shareholder, instructed a firm of solicitors to commence proceedings in the name of the company against the other director. These proceedings were subsequently dismissed as incompetent. A general meeting of the company then passed a resolution purporting to ratify the appointment of the firm as solicitors to the proceedings. The New South Wales Court of Appeal held that the purported ratification by the shareholders was invalid as it was beyond the power of shareholders. Hodgson J.A. explained his rationale:\textsuperscript{158}

\begin{quote}
It is of significance that management of the company should be by a body of persons who each have a fiduciary duty to act in the interests of the company as a whole, rather than a body where the majority is free to favour its own interests over those of the minority. The general meeting does have power to approve transactions undertaken by directors which might otherwise be a breach of fiduciary duty; but this requires that there be full disclosure by the board to the general meeting, and it is also subject to the requirement that there not be “fraud on the minority” or oppression. Despite this power in the general meeting, it is reasonable to see the entrusting of management to a body of persons subject to fiduciary duties to act in the interests of the company, as a whole, as giving greater protection to minority shareholders than they would have if the general meeting could simply make majority decisions on management matters.
\end{quote}

The Singapore Court of Appeal also adopted a restrictive approach to shareholders’ reserve powers, as demonstrated by its recent decision \textit{Chan Siew Lee v. TYC Investment Pte. Ltd.}\textsuperscript{159} A private company, TYC, was essentially controlled by HT and JC, who were husband and wife. Each of HT and JC held almost half of the issued shares and were the only directors on the board. Their marriage broke up and as a result, they entered into a number of agreements to resolve some issues between them, including the management of the company. Crucially for the present proceedings, they agreed on a voucher system for payments out of the company’s bank accounts. Accordingly, neither director could issue a check on the company’s bank accounts unless the other director had signed a voucher approving of the payment. This particular provision was included in the agreements to prevent either party from making payments in their personal interest out of the company’s assets. Unfortunately, it also meant that either could stymie legitimate payments that the company had to make. This happened when JC refused to approve certain payments that HT wanted to make. The board was therefore deadlocked. HT then called an extraordinary

\begin{flushright}
\textsuperscript{157} \textit{Id.} at 730. \\
\textsuperscript{158} \textit{Id.} \\
\textsuperscript{159} [2015] 5 S.L.R. 409.
\end{flushright}
Power Allocation and the Role of Shareholders

general meeting where he and his son (who held 5% of the voting power) commanded a 51% majority. They passed resolutions to authorize HT to unilaterally sign the chec

ks necessary to make those payments. The general meeting also resolved to appoint lawyers to commence litigation against JC for breach of directors’ duties. At issue was whether the resolutions had been validly passed by the general meeting even as the constitution vested management powers on its board of directors, and not its shareholders. It was accepted that the power to authorize payment of obligations owed by the company would, as a general principle, fall within the ambit of management powers.160

The Court of Appeal agreed with the High Court that the existence of any reserve power of the general meeting to make management decisions, and its scope, depended on whether the existence of such power could be implied into the statutory contract. The basis on which such implication might be made was “necessity.”161 There would simply be no need to invoke any reserve power if a functional board existed. Hence, the “predicate” of necessity would generally be the existence of a deadlock within the board. However, even where there was a deadlock, there would still be no need to imply reserve powers if that deadlock “could be broken by the appointment of additional directors and/or the removal of existing directors in a general meeting.”162 On the facts of the present case, there was undoubtedly a deadlock on the board in respect of payment matters given the breakdown in the relationship between HT and JC. This deadlock could not be broken by the majority shareholders by the simple expedient of changing the composition of the board because the company’s constitution provided that any appointment of new directors required the approval of both HT and JC. The preconditions for the implication of shareholder reserve powers were therefore amply met. The only question that remained was that of scope – what exactly did these implied reserve powers enable the shareholders to do? Diametrically opposing conclusions were reached by the High Court and by the Court of Appeal. The High Court held that while the implied reserve powers enabled the shareholders to appoint solicitors to commence legal proceedings against JC for breach of directors’ duties, there was nevertheless no implied power to authorize HT to unilaterally make payment on the company’s behalf.164 The Court of Appeal, on the other hand, concluded that the shareholders did have the reserve power to authorize

160. This was explicitly accepted by the High Court in TYC Investment Pte. Ltd. v. Tay Yun Chwan Henry [2014] 4 S.L.R. 1149, ¶ 85, and, while no overtly stated, it was necessarily the premise upon which the Court of Appeal discussed the issue of division of powers. Id. ¶ 35.
161. Id. ¶ 48.
162. Id. ¶ 49.
payment of the company’s obligations, but not to appoint solicitors in respect of the alleged breach of duty.

While the Court of Appeal accepted that the need for implied reserve powers rested upon the “underlying principle... that a company should not needlessly be hamstrung by a deadlock on the board but should be allowed to get on with managing its affairs provided there is a functioning majority of shareholders”, it was nevertheless a “general rule” that any reserve power must be limited so as to ensure that “the power reserved to the general meeting is not to do whatever the board may do and hence, in effect, to step into the shoes of the board.” Accordingly, the court imposed two further restrictive requirements before the shareholders may be permitted to exercise a reserve power. First, the exercise of the power must relate to the performance of a bona fide obligation owed by the company to a third party. Second, there must not be any suggestion that it would not be in the company’s best interest to honor those obligations. The court held that as these requirements were satisfied on the facts of the present case, the shareholders’ reserve power included the power to authorize those payments. In connection with the power to bring proceedings against JC, however, the court held that such a power did not fall within the shareholders’ reserve powers. In the court’s view, allegations of breach of directors’ duties were better pursued by the shareholders via the statutory derivation action under section 216A of the Companies Act. Accordingly, it was unnecessary to imply the existence of such a reserve power in the shareholders.

The Court of Appeal stated its rationale for adhering strictly to the power allocation provided in the company’s constitution thus:

The division of power between the board of directors and the shareholders in a general meeting is a matter of contract. In general, the court will lean towards preserving this division, not least because it has no power to alter the company’s memorandum or articles; but also because there is no reasonable basis for thinking that management responsibilities should also be allocated to the shareholders, where there is a general provision that they are allocated to the directors.

However, a counter argument can also be advanced. If, as the court accepts, the allocation of power is a matter of contract, and, under the statutory scheme of the Companies Act, it is the shareholders who determine the “terms” of this “contract,” it should follow that the board’s management powers derive ultimately from the shareholders. Shareholder primacy, which underpins the

165. [2015] 5 S.L.R. 409, ¶ 44.
166. Id. ¶ 45.
167. Id.
168. Id.
169. Id. ¶ 83.
170. Id. ¶ 36.
Power Allocation and the Role of Shareholders

statutory contract contained in the company’s constitution, thus provides the framework, or context, within which its terms are construed. Accordingly, if
the scope of the reserve powers of the shareholders is informed by this premise,
there seems little justification to overly constrain these powers beyond a
requirement that they are exercisable only when the board is unable or
unwilling to act.

PART III: THE ROLE OF SHAREHOLDERS

The apparent reluctance of the courts to give full effect to shareholder
supremacy in connection with management matters suggests that there may
well be concerns over according shareholders intervention rights in
management matters. These concerns are not without ground. As the Singapore
Court of Appeal pointed out in Chan Siew Lee v. TYC Investment Pte. Ltd.,
while directors are constrained to act in accordance with their fiduciary duties,
the shareholders are not. Accordingly:

[i]n the preference for vesting management power in the board of directors alone is
thus grounded in the fact that the risk of managerial abuses is best curbed by
allocating the responsibility to manage the company to the directors, who in turn are
constrained by the fiduciary duties they owe to the company.172

It should be noted that the imposition of duties on directors is borne out of
an awareness of the “agency problem”173 that arises because of the separation
of the function of decision-making (the purview of the board) from the risk of
investment loss (which is borne by the shareholders). Accordingly, where there
is a breach of directors’ duties, the company’s power to forgive or ratify that
breach is generally174 vested in the shareholders collectively. This is the
common law position,175 and remains substantially the position in Singapore.176
In the U.K., the statute provides that the ratification of any breach of duty
“must be made by resolution of the members of the company.”177 In Australia,
this position is also true, except with respect to any breach of the statutory

172.  Id. ¶ 36.
173.  See generally REINER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A
    COMPARATIVE AND FUNCTIONAL APPROACH, ch 2 (2d ed. 2009).
174.  This is subject to the rules on minority oppression.
175.  See North-West Transportation Co. Ltd. v. Beatty 12 App. Cas. 589, 593 (1887); Regal
    also in Australia, Furs Ltd v. Tomkies 54 C.L.R. 583, 592 (1936).
    however, some uncertainty as to whether shareholder ratification can ever be effective with respect to
    breaches of statutory duties. The High Court of Australia courts has held that shareholders cannot
    release directors from the statutory duties imposed on directors by statute; See Angas Law Services Pty.

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duties contained in Pt. 2D.1 of the Corporations Act of 2001. It seems reasonably clear that the company’s power to forgive errant directors is vested in the shareholders collectively. This is simply because shareholders benefit from the due enforcement of these duties more directly than any other constituent body. In the circumstances, it is somewhat incongruent to deprive the shareholders of the right of intervention on the basis that, unlike directors, they are not subject to duties.

Despite this, the courts have expressed their concern. Perhaps the solution lies in the approach taken in New Zealand’s Companies Act of 1993. At first glance, New Zealand’s approach to power allocation is not that different from the approaches in the jurisdictions considered here. Although the Act provides an allocation of power which confers on the board of directors “an original statutory jurisdiction to manage,” this statutory allocation was conceptualized as “presumptive only,” and may be excluded by the company’s constitution. Even where there is no such exclusion, it appears that the shareholders are statutorily conferred with the right, “notwithstanding anything in [the] Act or the constitution of the company,” to pass a resolution relating to the management of a company. The Act expressly provides that such shareholder resolutions are not binding on the board unless the constitution otherwise provides. As the power to alter the constitution lies exclusively with the shareholders, New Zealand also embraces shareholder primacy and does so overtly. What is interesting is that the Act confronts the concern raised by the Singapore Court of Appeal and deals explicitly with it. Section 126(2) of the Act provides:

If the constitution of a company confers a power on shareholders which would otherwise fall to be exercised by the board, any shareholder who exercises that power or who takes part in deciding whether to exercise that power is deemed, in relation to the exercise of the power or any consideration concerning its exercise, to be a director for the purposes of sections 131 to 138.

178. See Angas Law Services Pty Ltd (in liq) v Carabelas 215 A.L.R. 110 (2005); Forge v ASIC 213 A.L.R. 574 (2004). It may be that this is also the position in Singapore vis-à-vis the duties imposed under section 157 of the Companies Act, but courts have not weighed in on the issue.
182. Companies Act 1993 (NZ), § 109(2).
184. Companies Act 1993 (NZ), § 32.
185. PETER WATTS, DIRECTORS’ POWERS AND DUTIES 27 (2009).
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Imposing obligations on shareholders who take on the management of the company will, however, do little to allay the concerns of those who view shareholders as ill-suited for decision-making at all. As a generalisation, it may be said that shareholders tend not be to a homogeneous group. As Professor Bainbridge noted, “[s]hareholders have widely divergent interests and distinctly different access to information.”\(^{187}\)

According to critics of shareholder primacy, the presence of these afflictions justifies a system of centralized decision-making, with the board of directors elected as the central decision-maker. Nevertheless, these views are usually confined to the large listed company as proponents of such board-centric decision-making regimes recognise that shareholders in closely-held companies are less likely to suffer from the sort of collective action problems that affect their brethren in large dispersed corporations. Indeed, the issue of power allocation within a company is a question that cannot be considered without reference to the type of company concerned and its paradigm structural makeup. Unlike the U.S., where the general incorporation acts are designed to deal with large public companies,\(^{188}\) the Companies Acts of Australia, Singapore and the U.K. are intended to provide a basic scheme that applies not only to, at one end of the spectrum, the small private company, but also, at the other end, the large commercial enterprise with a widely dispersed public membership. Conferring management powers on the board of a publicly held company would not only be theoretically justifiable, but certainly also practically necessary, as its shareholders are many and dispersed, with little if any interest in the running of the company beyond its profitability. In a closely held company, on the other hand, there is likely little or no difference between ownership and control, and the shareholders will tend to expect the ability to control management decisions. Ultimately, perhaps there is a need to distinguish between private and public companies. While one form of allocation of powers may be suited to one, it is not necessarily suited to the other. For closely held companies, a default rule will probably work better, and a less restricted view of residual powers would be more appropriate.

**PART IV: CONCLUSION**

The judicial decisions considered in this paper disclose an apparent reluctance to recognize the full extent of shareholders’ intervention rights. It may well be that this illustrates the difficulty of defining an appropriate role for shareholders generally. Indeed, while there are discernible corporate

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governance benefits to providing shareholders with stronger participatory and control rights, there are also convincing arguments against doing so. In particular, there is the risk that permitting shareholder activism will result in unnecessary disruption to the running of businesses generally. It is, however, not the purpose of this paper to advocate the supremacy of any particular system or regime over another. Its objective is much more modest: to highlight the dissonance between judicial attitudes towards the shareholder franchise and the underlying legislative terrain. Companies are not homogeneous, and a governance system that works for the large listed company may not be appropriate for the small closely held company. A single-dimensional judicial approach towards the role and powers of shareholders is likely to risk a disjunction between the letter of the law, and the reality on the ground. It is suggested that clarification is in order, and judicial sensitivity to the contours and characteristics of the particular corporate entity in which the issue of power allocation arises will go towards this ultimate goal.
Dual-Class Shares in Singapore – Where Ideology Meets Pragmatism

Pey-Woan Lee*

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PART I: INTRODUCTION

Dual class share (“DCS”) structures are a type of governance structure that deviates from the standard one share, one vote (“OSOV”) structure. They occur when a company issues two classes of shares with the same economic entitlements but different voting rights, thus creating a wedge between voting and cash flow rights. Because a DCS structure could vest control in the hands of a minority, it is often thought to be inherently unfair and objectionable. That notwithstanding, DCS structures have long been a familiar feature of American and European markets. In Asia, however, the idea is still relatively novel as concentrated shareholdings are more commonly achieved through pyramid structures and cross holdings.

In Singapore, the principle of proportionality—that voting power should correlate to economic interest—has for the most part of its young history been an entrenched feature of the nation’s regulatory framework. Companies with DCS structures are not therefore permitted to list on the Singapore Exchange. But that is set to change as the Singapore Exchange has recently confirmed its decision to introduce a new framework for DCS listings.1 Unsurprisingly, this

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development has sparked controversy. Detractors have criticized it as a lamentable step that will trigger “a race to the bottom”.\(^2\) Supporters, on the other hand, see it as a “progressive step forward to keep pace with global markets”,\(^3\) justified or even necessitated by the need to enhance Singapore’s attractiveness as a listing venue for promising start-ups.

This article seeks to understand the rationale for and potential implications of this development. It does so by first considering the theoretical as well as evidential arguments for and against the use of DCS, followed by a survey on the reception (or otherwise) of such structures in four common law jurisdictions with vibrant capital markets, viz., Canada, the United States, United Kingdom and Hong Kong. It observes that the chief argument cited by business founders to justify the use of DCS structures is the desire to enhance a firm’s long-term profitability by shielding the (talented) founder from short-term market pressures. Though the use of DCS structures remains controversial, the phenomenal success of technology unicorns such as Alphabet Inc. and Alibaba appears (for now) to have sealed the place of DCS in the American securities markets. This exerts considerable pressure on competing markets to follow suit. Singapore’s response to this aggressive competition is pragmatic but measured. The indications so far are that the regulators would chart a middle path between the conflicting goals of incentivizing entrepreneurial fundraising and investor protection by permitting DCS structures in exceptional cases circumscribed by stringent safeguards. This, it is submitted, is an appropriate response given the theoretical and evidential underpinnings of DCS structures as well as economic and regulatory conditions peculiar to Singapore. Should it succeed, this development would serve as an interesting and notable example of a regulatory innovation that avoids the proverbial race to the bottom in the face of intense competition.

PART II: THE CONTROVERSY

A. The Theoretical Debate

In modern economies, the OSOV principle is widely regarded as the bedrock of sound corporate governance. Leading markets such as those of London\(^4\) and Hong Kong\(^5\) explicitly endorse the principle in their regulatory

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Jie, Timothy Tan Ziming and Thia Zhang Jie for their research assistance. All errors remain my sole responsibility.

5. Hong Kong Exchanges and Clearing Limited, Main Board Listing Rule 8.11. But this is also set to change, see discussion in text accompanying infra, notes 105 – 117.
regime to underscore the importance of fair and equal treatment of shareholders. At the theoretical level, Easterbrook and Fischel present the classic justification of the principle,\(^6\) arguing that shareholders, as residual claimants, have the strongest incentives to maximize firm value. The OSOV rule is a logical consequence of that function because shareholders are most likely to make optimal decisions when their gains (or losses) are proportionate to their investments in the company. Disproportionate voting, on the other hand, leads to increased agency costs as it distorts the incentives for decision-making. A super-voting minority may take more risks than are optimal because it has (proportionately) less to lose if the risk materializes. For modern corporations typified by the separation of ownership and control, the OSOV principle is all the more imperative because it enhances voting as a monitoring mechanism.\(^7\) Where the managers underperform, shareholders may vote to remove them.\(^8\) By vesting the right to transfer control on majority equity owners, the OSOV rule ensures the decision is made by those most likely to act optimally. By contrast, dual class share structures may impede optimal transfers by allowing an insider-minority to entrench themselves, particularly by blocking value-enhancing takeover bids. On this view, the OSOV rule is crucial to good corporate governance as it facilitates optimal decisions and promotes managerial accountability. Deviations from the rule weaken the governance framework by heightening the risks of expropriation and entrenchment.

Although shareholder vote is an important means of containing agency costs, its effectiveness is limited by problems of collective action.\(^9\) This occurs when a corporation has diffused shareholding such that the holding of each shareholder is too small to justify the high cost of monitoring activities. The result is shareholder apathy and passivity, with decision-making left in the hands of either a small controlling minority or management. In their thesis, Easterbrook and Fischel recognize that problems of collective action undermine shareholder primacy, but they also observe that such problems may be overcome by the aggregation of shares, for those holding a sizeable block of shares (such as institutional investors) would, by reason of their economic exposure, have sufficient incentive to monitor management performance.\(^10\) To that end, proponents of OSOV argue that the principle remains significant as it

\(^8\) The right to remove and elect board members is arguably the most fundamental of shareholder rights: see Julian Valesco, *The Fundamental Rights of the Shareholder*, 40 U.C. Davis L. Rev. 407, 416–417 (2006).
\(^10\) Easterbrook & Fischel, *supra* note 6, 402 and 406.
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optimizes shareholders’ capacity to amass control. Unequal voting structures, on the other hand, are likely to exacerbate collective action problems since the more the votes vested in (minority) insiders, the more the votes needed to defeat their proposals.\(^\text{11}\) The increased costs of organizing and coordinating collective action of a large(r) group of dispersed shareholders also renders shareholder opposition more arduous, further deterring shareholder activism and aggravating apathy.\(^\text{12}\) However, the cogency of these arguments is limited to the context of “horizontal conflicts”—typically cases of minority oppression where different groups of shareholders are battling each other.\(^\text{13}\) In the distinct context of takeover offers, where shareholders are required to collectively confront an outside party (the acquiror), a dual class structure may be optimal because it creates a controlling group that could overcome the problems of collective action to extract higher takeover premia from the acquiror.\(^\text{14}\) Context is therefore important when evaluating the merits of DCS structures.

Another limitation of Easterbrook and Fischel’s thesis concerns its assumption of shareholder homogeneity—that shareholders are best placed to maximize firm value because they are “a reasonably homogeneous group with respect to their desires for the firm” whose preferences can be aggregated to “form a consistent system of choices”.\(^\text{15}\) Grant Hayden and Matthew Bodie have persuasively demonstrated that this assumption is flawed.\(^\text{16}\) In their view, shareholders are not the homogenous share-value maximizers that the “one share, one vote” theory envisions. Instead, shareholders are likely to have a variety of interests that can potentially compete with their interests as shareholders.

Thus, majority shareholders may differ from the minority in preferring decisions that advance their own interests at the expense of the minority; shareholders who have effectively hedged against downside risks may be indifferent to or even support a fall in stock price; employee-shareholders may be more concerned with protecting their employment than maximizing firm value; and institutional shareholders such as sovereign wealth and pension funds may invest with a view to advancing specific national or institutional agenda. Moreover, the term “wealth maximization” is inherently vague since

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\(^\text{12}\) Gordon, supra note 11, 46.

\(^\text{13}\) Indeed, it has been observed that the notion of shareholder primacy and the related notion of “one share, one vote” were generated primarily to resolve such horizontal conflicts: see Grant M. Hayden & Matthew T. Bodie, “One Share, One Vote and the False Promise of Shareholder Homogeneity” (2008) 30 Cardozo L. Rev. 445, 480.

\(^\text{14}\) Mike Burkart and Samuel Lee, One Share – One Vote: The Theory, 12 Rev. Fin. 1, 3 and 29 (2008).

\(^\text{15}\) Easterbrook & Fischel, supra note 6, 405.

\(^\text{16}\) Hayden & Bodie, supra note 13.

\(^\text{17}\) Id. 449.
shareholders with divergent time horizons are likely to conceive of firm value differently. While a short-term investor would vote to maximize short-term gains, the long-term investor may prefer to hold out for long-term appreciation. The narrow focus on maximizing financial wealth also fails to recognize that some shareholders may prize other values over financial gain. The rise in sustainable investment, for instance, suggests that a sizeable proportion of investors are committed to maximizing profits within the strictures of desired environmental, social, and governance goals. Therefore, far from being homogenous, shareholders are a heterogeneous group that seek to optimize a variety of interests beyond their residual interests in the firm. Consequently, shareholders do not invariably have the strongest incentive to maximize firm value and hence the case for maintaining the OSOV principle is correspondingly weakened.

The fact that the OSOV principle may not appear as sacrosanct as it is commonly assumed is not, of course, a sufficient reason for permitting disproportionate share structures. Supporters of DCS typically point, instead, to various benefits as justifications for such structures. First, it is said that unequal voting structures may be efficient if insiders value control more than outside shareholders. Allowing differentiated voting structures may therefore optimize social value as more votes may be granted to those who value them more. Second, consolidated voting control may increase a firm’s value by inducing its managers to invest in firm-specific human capital. This refers to skills and knowledge that are of value only for a particular firm, which managers would not be incentivized to acquire unless they are assured of continued employment by the company. Enabling insiders to hold superior-voting shares is one means of encouraging such firm-specific investment. Third, DCS structures allow controlling shareholders and management to focus on the firm’s long-term profitability and success by shielding them from short-term market pressures. This, as we shall see below, is now the dominant justification for the adoption of dual class structures by technology

20. Indeed, Hayden and Bodie cite dual class shares as a settled instance of how the law has accommodated shareholders’ diverse interests: id. 481 – 482.
21. Fischel, supra note 7, 136 – 137; Ashton, supra note 11, 872 and 928.
22. Id. 137 – 138; Ashton, supra note 11, 929; Harry DeAngelo & Linda DeAngelo, Managerial Ownership of Voting Rights – A Study of Public Corporations with Dual Class Stock, 14 J. F. Econ. 33, 35 (1985); Burkart & Lee, supra note 14, 27.
23. Ashton, supra note 11, 925.
24. Id. 929; Thomas J. Chemmanur & Yawen Jiao, Dual Class IPOs: A Theoretical Analysis, 36 J. Banking & Fin. 305 (2012).
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companies. Fourth, dual class voting promotes entrepreneurial activities as it lowers the cost of acquiring control and facilitates risk-diversification. Entrepreneurs who wish to access the capital markets without relinquishing control (and who may not otherwise have the means to acquire a controlling equity stake) may achieve that by acquiring a minority stake with super-voting rights. At the same time, the lower cost of investment allows controllers to diversify their firm-specific investment by sharing some of the firm-specific risks with outside investors. Such diversification is ultimately beneficial not only to the insiders but also to society as a whole because diversified controllers are likely to pursue riskier investments that will increase the production of goods and services. Finally, it is well established that dual class structures are an effective anti-takeover mechanism. We have seen that this is a drawback of dual class structures insofar as it enables insiders to shield themselves from the discipline of the market and retain control, but it can also benefit shareholders when it is used primarily to fend off detrimental hostile bids.

In recent years, the popularity of DCS structures among high-growth technology companies has been justified chiefly on the need to maintain the long-term vision and control of the founders. For these companies, such control is seen as necessary to protect innovation and risk-taking from short-term market forces and risk-averse shareholders. For example, in defending Google’s DCS structure, Larry Page and Sergey Brin observed that “outside pressures too often tempt companies to sacrifice long-term opportunities to meet quarterly market expectations.” Likewise, Joe Tsai of Alibaba wrote in a blog post that the company’s disproportional voting structure was designed to

25. See text accompany infra, notes 29–33.
26. Fischel, supra note 7, 139.
27. Id; Ashton, supra note 11, 927 – 928. It has also been argued that restricting all firms to a OSOV structure may have “a distortionary effect on firms’ financing and investment decisions, or induces firms to resort to other means of separating ownership and control”: see Burkart & Lee, supra note 14, 30.
28. Kishore EeChambadi, The Dual Class Voting Structure, Associated Agency Issue, and a Path Forward, 13 N.Y.U.J.L. & Bus. 503, 517 (2017); Burkart & Lee, supra note 14, 26. Fischel explains this benefit in another way, by understanding insider control as a “signalling device” to communicate private information (as regards the firm’s value) to outsiders, thus decreasing the need for expending resources to convince potential bidders that the firm’s current use of assets is optimal: see Fischel, supra note 7, 138.
31. Alibaba did not adopt a typical dual class structure that comprises two or more classes of shares with different voting rights. Instead, it instituted a “partnership” comprising the company’s leading executives to appoint a majority of the company’s directors. In addition, the company also adopted a series of anti-takeover provisions in its Articles of Association that make it practically impossible for public shareholders to alter the nomination rights of the founders. Commentators have
ensure that management could “set the company’s strategic course without being influenced by the fluctuating attitudes of the capital markets so as to protect the long-term interests of our customers, company and all shareholders.”

Outside the context of technology companies, this “preservation of founder ethos and values” rationale has also been invoked to rationalize the use of DCS in media (to maintain editorial integrity), fashion (to build brand equity closely associated with a founder) as well as employee-owned companies (to build high employee morale and increase productivity).

For advocates of DCS structures, the unparalleled success of companies such as Google, Facebook, and Alibaba stands as irrefutable evidence that disproportional voting structures can and do—when coupled with visionary leadership—enhance rather than destroy share value. Critics, however, argue that the “visionary founder” justification is no more than “a quixotic notion fed to public investors that allows an escape from shareholder accountability.” After all, examples of outstanding single-class stock companies abound—Microsoft, Amazon, Twitter and Netflix are some that come to mind—and these have not needed heightened founder control to prosper. Even if a founder were particularly talented and committed such that her entrenchment at the time of IPO seemed right, there is no guarantee that that will always be the case. Her priorities may change, or she may depart or decease. If, as is often the case, her successor is less capable, a DCS structure will more likely be used as a shield against market discipline than to protect the company’s long-term interests.

Viewed in that light, the DCS structure is, ironically, no less a form labelled this as a form of “extreme corporate governance” that creates an even larger discrepancy between cash-flow rights and control rights than the typical dual-class structure: see Yu-Hsin Lin and Thomas Mehaffy, Open Sesame: The Myth of Alibaba’s Extreme Corporate Governance and Control, 10 Brook. J. Corp. Fin. & Com. Law 437, 456 (2016).


35. As Sorkin (id.) wrote, “Just think about other once highflying technology companies that turned sour. Yahoo. Or Research in Motion. Its founders were once lionized as visionaries — until they weren’t. The problem is that Google will succeed until it doesn’t. And when it falters, it won’t have the kick in the pants that the prospect of pressure from shareholders can provide.”

36. Chemmanur & Jiao, supra note 24, 306 (postulating that “while talented managers may create considerable shareholder value by focusing on value maximization, the average CEO may not be able to do so, but would instead use this insulation from the disciplining effect of the takeover market to slack off and enjoy the perquisites of control.”) Wen cites the example of Rupert and James Murdoch, who were able to retain their positions as heads of News Corp despite having been implicated in criminal investigations for phone hacking; see Tien Wen, You Can’t Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchange, 162 U. Pa. L. Rev. 1495, 1502 (2014). See also Lin & Mehaffy, supra note 31, 469 – 470.
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of short-termism. At the very least, concerns over succession would suggest that even if DCS structures were to be permitted, the case for their perpetual continuation is tenuous.

More fundamentally, these objections are concerned with the risk of expropriation by the controlling minority to the detriment of other shareholders. The argument, as explained, is that DCS structures undermine the function of shareholders as a monitoring mechanism, leading to increased extraction of private benefits. To this, the standard rejoinder of DCS advocates is that the market (being efficient) would itself be able to regulate such risks as investors would be able to anticipate the extent of private benefit extraction and discount the stock price accordingly. There is, in other words, a “price at which prospective investors are willing to accept any negative firm characteristics, including agency costs, bad corporate governance and so forth”. That being the case, private ordering (which is the general preference of corporate law) should prevail so companies can be free to select the capital structure that best suits their needs, and investors can choose between shares with different control rights. The problem with this reasoning, however, is that it assumes that investors are able to accurately price the inferior-voting shares at the time of purchase (usually upon IPO). In reality, investors’ judgment may be impeded by information asymmetry (both at the point of IPO and subsequently), and the assessment of underwriters may not be reliable as they are susceptible to being “captive” of issuers. The risk of unfair expropriation by the controlling minority therefore remains.

The theoretical arguments examined in this section suggest that the arguments for and against DCS structures are finely balanced. Among the reasons commonly cited to justify the structure, the most significant is that it promotes innovation and entrepreneurial risk-taking, which is beneficial to both

37. James Kristie, Dual-Class Stock: Governance at the Edge, Directors and Boards, Third Quarter 2012 at 38.
40. See text accompanying supra, notes 6 – 7.
41. Fischel, supra note 7, 147; Burkart & Lee, supra note 14, 34 – 35; and EeChambadi, supra note 28, 517.
43. Hayden & Bodie, supra note 13, 482.
44. Wen, supra note 36, 1505. Wen cites as example Facebook’s botched IPO, where underwriters were informed just 11 days before the launch of the IPO that Facebook was slashing its revenue estimates. While the news reached the banks in time to allow them to either make a profit (by shorting the stock) or avoid substantial losses, many retail investors were left out in the cold when the stock price plummeted subsequent to the IPO. See also Khadeeja Safdar, Facebook, One Year Later: What Really Happened in the Biggest IPO Flop Ever, ATLANTIC (May 20, 2013), https://www.theatlantic.com/business/archive/2013/05/facebook-one-year-later-what-really-happened-in-the-biggest-ipo-flop-ever/275987/.
shareholders and the economy as a whole. Conventional understanding of market behavior tells us, however, that DCS structures are likely to aggravate agency problems by concentrating control in owner-managers whilst further disenfranchising outside shareholders. Given these concerns, DCS structures are only justified if their positive effects are substantial and exceed the costs thereof. The discussion below will briefly consider whether and to what extent empirical evidence gathered from jurisdictions that permit DCS structures elucidate that analysis.

B. The Empirical Evidence

Many empirical studies have been undertaken to understand the rationale and effects of DCS structures, but the evidence that has emerged is often inconclusive. This is, in part, due to the partisan nature of the debate (lobbyists on each side commission and cite studies that vindicate their cause\textsuperscript{45}), and, in part, to the analytical difficulties in establishing the impact of DCS structures on firm value and profitability.

Because a company’s performance and returns on equity are dynamic and contingent upon a wide range of factors, it is often difficult to identify the true drivers that account for differences in firm performance: either between different firms at the same time or at different times for the same firm.\textsuperscript{46} One company may perform better than another because of its superior product, better leadership, or more efficient operational processes, and hence no two companies are so similar or alike as to be truly comparable. To some extent, this difficulty may be tempered by looking at large sample sizes but that is often not possible given that DCS structures remain a relatively rare phenomenon in most jurisdictions.

Further, some studies—particularly those involving recapitalization—are affected by the problem of endogeneity. For example, it is often unclear whether a firm’s (better or worse) performance was the reason for recapitalizing as DCS in the first place, or whether that performance is a consequence of the new capital structure. The discussion below should, therefore, be understood with these difficulties in mind.

For policy makers facing the decision of whether to permit or prohibit DCS structures for public companies, the key question is whether such structures destroy firm value. As mentioned above, value destruction may come about mainly via the extraction of private benefits by minority controllers.

\textsuperscript{45}. EeChambadi, \textit{supra} note 28, 526 – 527.

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In a thorough review of the relevant empirical research, Adams and Ferreira conclude that the empirical evidence strongly supports the hypothesis that controlling shareholders of DCS companies are able to extract sizeable private benefits at the expense of non-controlling shareholders. The authors derive this conclusion principally from studies that measure the value of control to controlling shareholders. For this purpose, the primary hypothesis is that control has value because it allows those in control to extract private benefits from the firm. One method of computing this value is to compare the market prices of different classes of shares. The premium at which superior-voting shares trade over inferior-voting shares is indicative of the value of control.

Adopting this approach, Nenova established that quite a few countries exhibited high block control value, ranging from 48% in South Korea to 2.28% in Hong Kong. Importantly, her results also demonstrate that legal environments characterized by effective law enforcement, good investor protection, and pro-investor takeover rules have the effect of lowering the voting control premia. In addition, her analysis suggested that a legal environment characterized by strong corporate governance rules is effective in mitigating the risks of controller expropriation.

Dyck and Zingales arrived at similar conclusions using a different methodology—by drawing inferences from the acquisition prices of controlling blocks in publicly traded companies. Their results show that, on average, control value is worth about 14% of the equity value of the firm. They also found that the control premium is higher in countries where the investor is less protected, demonstrating once again that the legal environment has direct impact on the extent to which controllers extract private benefits from DCS companies. Thus, these studies suggest that DCS structures impose costs on non-controlling shareholders, but such costs can be mitigated by appropriate legal rules and effective enforcement.

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48. As Zingales explained, “If there were no private benefits, there would be no reasons to hold large blocks of share in any one company.” Luigi Zingales, The Value of the Voting Right: A Study of the Milan Stock Exchange Experience, 7 Rev. Fin. Stud. 125, 126 (1994). But see Valentin Dimitrov & Prem C. Jain, Recapitalization of One Class of Common Stocks into Dual-class: Growth and Long-run Returns, 12 J. Corp. Fin. 243, 344 (2006), who argue that the presence of a voting premium does not always imply that the controllers are benefiting at the expense of the holders of inferior vote shares. This is because: “[t]he shareholders of the inferior voting class would also benefit if the dual-class structure induces the controlling managers to take profitable projects that they would otherwise not take. The premium may simply be thought of as an optimal compensation mechanism to the controlling managers that is in the best interests of all shareholders.”
While the studies on control value provide an indirect means of estimating controllers’ private benefits, another group of studies sought to adduce evidence of the direct impact of DCS ownership structures on firm performance. For example, Gompers, Ishii, and Metrick compared DCS companies with single class share companies and found that a higher proportion of insider-voting rights will likely lead to lower firm valuation.\textsuperscript{51} More specifically, Masulis, Wang, and Xie found that increased divergence between insider control and cash-flow rights would likely lead to lower shareholder value through greater misuse of corporate cash, excessive compensation, value-destroying acquisitions and poor capital expenditure.\textsuperscript{52}

In contrast to the above findings, other studies have found that DCS companies enhance shareholder value notwithstanding the risks of expropriation and entrenchment. In a study of dual-class IPOs, Böhmer, Sanger, and Vashney found that companies listed with DCS structures outperform their single class counterparts in terms of stock returns and operational performance, thus suggesting that the benefits of adopting DCS structures outweigh the costs for some firms.\textsuperscript{53} In another study focused on recapitalizations of single class shares into dual class shares, Dimitrov and Jain found that recapitalizations are not undertaken to entrench managers but to finance growth without losing control.\textsuperscript{54} Consequently, they observed that such companies experienced higher growth rates in sales, assets, and operating income than their single class competitors, and also enjoy significant long-run abnormal returns.

Overall, the empirical evidence is inconclusive as the studies suggest that DCS structures could enhance shareholder value in one context but destroy it in another.\textsuperscript{55} For policy makers, this ambiguity leaves room for development in either direction. What is ultimately required is a judgment call on the possible impact of greater flexibility in divergence between ownership and control. That judgment would relate not only to the effects of such structures on shareholders (and other stakeholders) of the firm, but (perhaps more pertinently) on the wider economy. In particular, given that robust investor protection is linked to strong financial markets (and ultimately, economic growth),\textsuperscript{56} and that DCS structures may erode investor protection by generating private benefits, it


\textsuperscript{52} Ronald Masulis, Cong Wang & Fei Xie, \textit{Agency Problems at Dual Class Companies}, 64 J. Fin. 1697 (2009).


\textsuperscript{54} See supra note 48, 346 – 347.

\textsuperscript{55} Adams & Ferreira, supra note 47, 84.

\textsuperscript{56} Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, & Robert Vishny, \textit{Investor Protection and Corporate Governance}, 58 J. Fin. Econ. 3 (2000).
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would be relevant to ask if the introduction of such structures would eventually lead to higher costs of capital that would in turn hamper financial development. On the other hand, the absolute prohibition of such structures may also have cost implications: entrepreneurs may refrain from seeking outside capital or choose other forms of control enhancing mechanisms. Balancing such costs is, once again, critical but it can only be broadly appraised until more definitive evidence is available.

In the absence of overwhelming evidence that DCS structures are always harmful, it may be contended that there is no a priori reason why an absolute prohibition of such structures should be maintained. Indeed, if the evidence suggests that DCS structures enhance firm value in some contexts, and that the costs of such structures can be mitigated by robust investor protection rules, it would be rational to attempt to circumscribe their availability in conditions that are likely to optimize share value. This, as we shall see, is largely the approach that is adopted in those markets that have accepted DCS structures as a permissible form of governance.

PART II: A COMPARATIVE SURVEY

This section surveys the different approaches that are currently adopted in Canada, the United States, United Kingdom, and Hong Kong. These jurisdictions provide a useful point of reference for Singapore as their stock exchanges are among the world’s largest and their legal systems are founded on the common law tradition.

A. Canada

Canada offers an interesting context for study and comparison as its approach to DCS structures is largely based on market discipline. Consequently, the regulatory regime is relatively liberal with generally no legal prohibitions against DCS structures. Under Canadian corporate law, the OSOV principle is the default principle but companies are free to provide for multiple vote shares in their constitution. The listing and public trading of multi-vote shares on Canadian stock exchanges is also a common

57. Adams & Ferreira recognised this possibility but were of the view that the evidence as to effects of DCS structures on the financial markets and the wider economy are not as yet clear: see supra note 47, 81.
59. s 24(3) of the Canadian Business Corporations Act (hereafter “CBCA”).
60. s 24(4) CBCA.
phenomenon. The Toronto Stock Exchange (“TSX”), for instance, permits the listing of shares with multiple or restricted votes. Moreover, listed companies may reorganize or reclassify its share capital so as to convert common shares into multiple or restricted vote shares provided that such changes are approved by a majority of the minority shareholders. The TSX does, however, impose certain minimal safeguards against risks of abuse and exploitation by the controlling minority. These include the requirement for “coat-tail” provisions for all newly listed dual class share issuers and various disclosure requirements to “alert investors of the fact that there are differences in the voting powers attached to the different securities of an issuer”.

Notwithstanding a number of high profile scandals involving DCS firms, the consensus in Canada appears to be that DCS structure should be permitted as it can be an optimal means of financing entrepreneurial activities. Disallowing this form of financing would cause entrepreneurs to “shun the stock market, curtail growth of their companies or find sub-optimal means of financing” with the result that “[a]ll would suffer: innovation, investors, economic growth and employment.” Whilst the risks of exploitation and entrenchment persist, such risks appear to be reasonably well contained by adequate minority protection rules (the most significant of which is the mandatory coat-tail provision) fomented, in part, by activist institutional
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investors opposed to DCS structures. Consequently, calls for reform in Canada appear largely focused on suggestions to improve the governance of DCS structures rather than their complete abolition. The measures advocated include (inter alia) further tightening of the coattail requirement, limiting the voting ratio of different classes of shares or of the total number of votes controlled by the insiders or founders, abolishing non-voting shares, and mandating sunset clauses.

B. United States

Compared to Canada, the regulatory regime in the US is more restrictive. The major markets (viz., NYSE and NASDAQ) permit the listing of DCS only by way of IPOs but not post-listing recapitalization. An issuer listed with a single class of shares is not thereby permitted to convert existing shares into multiple-vote shares or issue new classes of shares with different voting rights. That said, the US regime is also liberal in that it imposes few bespoke rules to safeguard minority interests in DCS companies. One exception is the specific prescription that non-voting shares must be accorded substantially similar rights (except for voting) to those of common shares. Beyond that, minority shareholders of DCS companies can only look to standard safeguards such as prohibitions against conflicts of interests and misappropriation of corporate opportunities for protection against expropriation. Curiously, NYSE listing rules also exempt “controlled companies” (companies with block-holders controlling 50% or more of voting rights) from the requirements of majority board independence. This has, unsurprisingly, been accused of engendering “a rubberstamp board that is beholden to the chief executive”.

DCS structures have long been a divisive topic in the US. In particular, the use of such structures has been criticized by institutional investors and their representatives, who argue that such structures effectively create “the equivalent of a corporate safe room by making it nearly impossible for the rights of minority shareholders, have removed most, if not all, of the drivers of price premium and private benefits for Canadian dual-class-share structures.” This would, in Allaire’s view, explain why the control premium of Canadian dual class shares are among the lowest in the world: id. 11.

70. Ben-Ishai & Puri, supra note 66, 154 – 156.
72. NEW YORK STOCK EXCHANGE, NYSE LISTED COMPANY MANUAL §313(A) (2013).
74. NYSE LISTED COMPANY MANUAL §313(B) (2013).
76. NYSE LISTED COMPANY MANUAL §303A.00 (2013). See also NASDAQ Stock Market Rules §5615(c)(2) (2009).
77. EeChambadi, supra note 28, 518.
shareholders to replace directors, challenge management, or force change in control transactions.”

Thus, the Council of Institutional Investors has urged both the NYSE and NASDAQ to ban DCS structures, citing empirical studies that establish that dual class companies underperform those with single-class share structures, and have more weaknesses in internal controls and related party transactions.

Likewise, CalPERS, the largest public pension fund in the US, has indicated that it would boycott companies with DCS structures and has instituted legal actions to stop companies from issuing more weighted vote shares to further entrench the controllers. Such persistent opposition of institutional investors has yielded palpable results. A striking example is the S&P 500’s recent decision (following an uproar over Snap Inc.’s controversial issue of non-voting shares) to exclude companies with multiple voting share structures. MSCI, another major index provider, had temporarily blocked new companies with unequal voting structures from two of its indexes pending a consultation on the merits of a permanent exclusion.

Strong criticisms notwithstanding, DCS structures will likely continue to feature in US markets. Its popularity amongst exceptionally successful technology companies, the perception that existing legal infrastructure adequately constrains abuses, faith in visionary founders, as well as intense regulatory competition both at home and abroad—all coalesce into the belief that such unique governance structures are not only defensible but necessary.

C. United Kingdom

Listing on the London Stock Exchange (“LSE”) is organized under the Premium/Standard listing regime. The main difference between the two categories is that Standard Listing only requires compliance with minimum governance standards stipulated by the European Union, whilst the Premium Listing requires compliance with enhanced listing requirements laid down by

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78. Glover & Thamodaran, supra note 33, 10.
82. Trevor Hunnicutt, S&P 500 to Exclude Snap after Voting Rights Debate, Reuters, Aug. 1, 2017, https://www.reuters.com/article/us-snap-a-psp-500-to-exclude-snap-after-voting-rights-debate-idUSKBN1AH2R2V. Existing components of the S&P index with dual or multiple vote share classes (e.g. Alphabet Inc. and Berkshire Hathaway Inc.) will be “grandfathered”.
83. EeChambadi, supra note 28, 529.
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the Financial Conduct Authority ("FCA"). DCS structures are permitted under Standard but not Premium listing. Hence, DCS structures are not absolutely prohibited in the UK. Nevertheless, the general observation is that it is rare for public companies to list with dual or multiple vote structures. Commentators attribute this relative low occurrence to the strong presence of activist institutional shareholders in the UK. Institutional investors who believe DCS structures to be harmful by reason of their disenfranchising effects on outside shareholders routinely opposed such structures. Over time, this sustained opposition has influenced policy makers such that the UK government is said to have "systematically discouraged" the IPO of new companies with DCS structures. Indeed, the FCA’s steadfast adherence to the default OSOV rule is evidenced by both its rejection of Manchester United’s bid to list on the LSE with a DCS structure and its very public support of Hong Kong’s refusal to accede to Alibaba’s proposed dual class listing.

A further development that may be seen as signalling the FCA’s resolve to strengthen minority shareholder rights—and thereby distance itself from unequal voting structures—is the introduction of an enhanced listing regime for block-controlled premium-listed companies. The enhancements seek, firstly,

85. See supra, note 4.
86. In a study conducted by Shearman and Sterling LLP in 2007, it was found that only 5% of the UK companies analyzed had multiple voting structures: see SHEARMAN & STERLING LLP, PROPORTIONALITY BETWEEN OWNERSHIP AND CONTROL IN EU LISTED COMPANIES: COMPARATIVE LEGAL STUDY (2007) at 12. http://www.ecgi.org/osov/documents/study_report_en.pdf. In total, 40 UK listed companies were analyzed in this study, comprising a mix of top 20 market-capital companies and small and recently listed companies.
87. See Amy Chen, Spending Less Time with the Family: Are Dual-Class Shares A Necessary Evil?, 7 Queen Mary L. J. 72, 87 (2016); Wolf-Georg Ringe, Deviations from Ownership-Control Proportionality – Economic Protectionism Revisited in COMPANY LAW AND ECONOMIC PROTECTION, 228 (Ulf Bernitz & Wolf-Georg Ringe eds., 2010).
88. Flora Huang, Dual Class Shares around the Top Global Financial Centres, J. Bus. L. 137, 145 – 146 (2017). Huang further argued that a further reason for DCS’s lack of popularity is the break through rule that is present in the Article 11 of the UK Takeover Bids Directive. Essentially, this rule allows a shareholder who owns 75% of total equity to break through the company’s voting structure and exercise control according to the one share one-vote principle. Further, the investor will have complete control of the firm and can appoint/remove board members. Thus, should an outside investor succeed in acquiring 75% of the ordinary shares, it will essentially be able to break the control of the founders despite them holding shares with more voting rights.
89. Id. 87.
90. Commenting on the Hong Kong regulator’s decision, Martin Wheatley (then chief executive of the FCA) said that “no matter how difficult it would be to lose a very high-profile company to list, it is important to keep the principle to protect shareholders’ interests”: see Enoch Yiu, British Regulator Backs Hong Kong Stance on Alibaba IPO, South China Morning Post, Mar. 20, 2014, http://www.scmp.com/business/money/markets-investing/article/1452681/british-regulator-backs-hong-kong-stance-alibaba.
91. FINANCIAL CONDUCT AUTHORITY, RESPONSE TO CP13/15—ENHANCING THE EFFECTIVENESS OF THE LISTING REGIME (May, 2014), https://www.fca.org.uk/publications/policy-statements/ps14-8-
to limit the influence of the controlling shareholder by requiring it to enter into a mandatory agreement undertaking to transact with the company at arm’s length and not to take any action to impede or circumvent proper compliance with the listing rules;93 and secondly, to give more control to minority shareholders by subjecting the election of independent directors of the company to independent shareholder approval.95 Underpinned, as it were, by the “fundamental concept” that shareholders are entitled to participate directly in the governance of the companies they own,96 these changes suggest that the UK regulators are likely to continue to view with disfavor disproportional voting structures that effectively disenfranchise minority shareholders. That said, one cannot completely rule out the possibility that the UK regulators may review and soften their stance on this issue as competitive pressures mount against the backdrop of Brexit and growing acceptance of DCS structures elsewhere (such as Hong Kong and Singapore).97

D. Hong Kong

Hong Kong does not currently countenance the public listing of companies with DCS structures,98 but this state of affairs will soon be consigned to history as the Hong Kong Exchange (“HKEx”) has—in a move to defend Hong Kong’s pre-eminence as the leading global IPO destination—announced its decision to push ahead with DCS listings. This outcome was not, of course, achieved without a protracted and stormy campaign sparked by the painful loss of Alibaba’s potential listing on the Stock Exchange of Hong Kong (“SEHK”) in 2014. The heated debate that ensued prompted the HKEx (parent company of SEHK) to embark on an extensive review of DCS structures and sought market feedback through the issue of a Concept Paper.99 But while there was sufficient support to proceed to a second stage of consultation,100 this first attempt at


93. FCA Handbook, L.R. 6.5.4 and L.R. 9.2.2AD.

94. Id. LR 9.2.2E and L.R. 9.2.2F.

95. Id. LR 5.2.5(2).


98. See HKEx Main Board Listing Rule 8.11; Growth Enterprise Market Listing Rule 11.25. Although the HKEx is empowered “in exceptional circumstances” to approve listings of DCS companies on a case-by-case basis, no DCS company has to date been admitted by the HKEx under this exception: HKEx Concept Paper, supra note 46.

99. HKEx Concept Paper, supra note 46.

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reform came to an abrupt halt when the Securities and Futures Commission (“SFC”) publicly rejected the HKEX’s proposals. At that time, the SFC was concerned, inter alia, that the eligibility criteria identified by the proposals were inherently uncertain, and that the suggested safeguards would not be sufficient to protect minority shareholders against the risk of abuse by controlling shareholders.

For a while, the SFC’s objections forged an uneasy truce. However, the pressure for Hong Kong to keep pace with the more liberal regimes of other leading financial markets mounted as Chinese information technology firms increasingly prefer to list in the US with weighted-voting structures. In the face of such aggressive and relentless competition, the Hong Kong regulators had to respond with concrete measures to protect the market. In June 2017, the HKEx issued another Concept Paper to seek public feedback on a proposed third board to facilitate fund-raising by mega-technology firms with DCS structures and smaller start-ups. However, this proposal was soon aborted.

In place of a third board, the HKEx concluded that the better way forward was to amend the listing rules to accommodate the listing of “New Economy” companies with weighted voting rights (“WVR”) structures as well as pre-

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101. SECURITIES AND FUTURES COMMISSION, SFC STATEMENT ON THE SEHK’S DRAFT PROPOSAL ON WEIGHTED VOTING RIGHTS (25 June 2015), http://edistributionweb.sfc.hk/t/ViewEmail/j/C5CD004D12EE9F25/. F672ACD8BF32846942A2DF0F503B7C. This dramatic turn of events spawned, in a short time, a proliferation of academic commentary. On the one hand, there are those who argue that some relaxation of the current strict policy is defensible since it is beneficial to have greater flexibility in ownership structures and that the drawbacks of such structures can (mostly) be managed by prescribing appropriate legal rules: see eg, Junzheng Shen, The Anatomy of Dual Class Shares: A Comparative Perspective, 46 H.K.L.J. 477 (2016). Opponents, on the other hand, have argued that Hong Kong’s market structure, which is dominated by concentrated ownership, has (rightly) caused regulators to favor the extant approach that emphasizes ex ante prevention of abuses over ex post enforcement: Raymond Chan & John Ho, Should Listed Companies be Allowed to Adopt Dual-Class Share Structure in Hong Kong? 43 Common L. World Rev. 155, 175 (2014). Yet another view is that the unique social and political context of Hong Kong renders perceptions of fairness and equity particularly critical in its formulation of economic policies, and it is in maintaining a high quality legal infrastructure (more so than the acceptance of DCS structures) that would help Hong Kong to preserve its competitive edge in attracting foreign as well as Chinese listing applications: see Shen and Young, Dual Share Plan in Context: Making Sense of Hong Kong’s Decision Not to Embrace Alibaba’s Listing, 26 Int’l Co. Com. L. Rev. 4 (2015).

102. As of 13 June 2017, “33 out of 116 (28%) Mainland companies with primary listings in the US have [weighted voting rights] structures 25, their combined market capitalisation of US$561 billion represents 84% of the market value of all US-listed Mainland companies. Their market capitalisation is equivalent to 15% of the entire market capitalisation of the Hong Kong market”: see HONG KONG EXCHANGES AND CLEARING LIMITED, CONCEPT PAPER: NEW BOARD at para. 40 (June 2017), https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/Concept-Paper-on-New-Board/cp2017061.pdf.

103. Id. See also Enoch Yiu, Hong Kong Moves Closer to Dual-share Listings as SFC Backs Consultation on Third Board, South China Morning Post (Apr. 28, 2017).

104. Laura He & Enoch Yiu, Hong Kong Stock Exchange Backs Down on Demand for Third Board to Let Start-ups Raise Funds, South China Morning Post (Oct. 23, 2017).
As it stands, the WVR framework outlined by the HKEx is tightly circumscribed (at least initially) to admit only companies with demonstrated potential for extraordinarily high growth. Hence, a WVR structure would ordinarily only qualify for listing if it were an “innovative company”\textsuperscript{107} with a track record of and potential for high business growth;\textsuperscript{108} has received meaningful funding from sophisticated investors\textsuperscript{109} and an expected market capitalization of at least HK$10 billion and total revenue of at least HK$1 billion in the last financial year.\textsuperscript{110} In addition, WVR holders must be persons who have materially contributed to the company’s growth and who are or will be directors of the company with executive functions post-IPO.\textsuperscript{111} To attenuate the heightened risks posed by WVR structures, the HKEx also included in its proposal a slew of investor-protection measures, of which the more salient ones are:

(a) The use of WVR structures will be restricted to new listing applicants and the proportion of WVR may not be increased post-IPO except in very limited circumstances.\textsuperscript{112}

(b) Only directors of the company are eligible to hold shares with WVR. The WVR will lapse upon the director’s death, cessation as director, or transfer to a non-director. Such directors will also be required to meet minimum equity threshold at the time of IPO.\textsuperscript{113}

(c) Voting differential between the superior and ordinary shares are capped at the ratio of 10:1. Other than voting rights, the rights attached to both classes of shares must be equal in all aspects. Selected key decisions such as material changes to constitutional documents, variation of class rights, appointment and removal of
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independent directors and winding up of the company will be voted on an OSOV basis. 114

(d) Companies listed with WVR structures will be required to constitute a corporate governance committee comprised of independent non-executive directors to ensure compliance with governance rules. 115

(e) Companies with WVR structures must further enshrine the prescribed safeguards in their constitutions so as to afford shareholders private redress in the event of breach. 116

The intention of this proposed framework is unambiguous: it is to single out the “truly big boys” that have the (actual and potential) scale of success that justifies limited incursion in investor protection. The proposal is also innovative and coherent as it seeks to adhere closely to the visionary-founder rationale by restricting WVR to founder-directors (and by this means ensure that the controlling minority is constrained by the fiduciary obligations that they owe as directors to the company). Further, the exceptionally broad range of suggested safeguards evidence an earnest attempt at seeking optimal ways to preserve investor rights. In practice, however, their efficacy may still be limited by an enforcement regime that is characterised by relatively restrictive access to minority actions and general shareholder inertia (due, perhaps, to the absence of a litigious culture fuelled by contingency fee-based class actions), with the result that the extraction of private benefits by controlling shareholders will continue to be difficult to detect and remedy. 117 This, as we shall see, is also a regulatory constraint that Singapore has to contend with.

PART III: EVOLUTION OF DCS IN SINGAPORE

Historically, the principle of OSOV was firmly entrenched in Singapore. Section 64 of the Companies Act 118 (hereinafter referred to as “the Act” or “CA”) made clear that a public company and its subsidiaries (other than a newspaper company 119) may only issue equity shares that confer upon its holder one vote per share. 120 In 2003, this rule was relaxed to allow private companies that are subsidiaries of public companies to issue shares with

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114. Id. at para. 266.
115. Id. at para. 268.
116. Id. at para. 269.
117. See Chan & Ho, supra note 101, 175 – 179.
118. Cap. 50, 2006 Rev. Ed., §64(1) read with §64(5).
119. Newspaper companies are expressly permitted to issue management shares that carry more votes than ordinary shares. For example, Singapore Press Holdings Limited has both ordinary and management shares which carry respective 1 and 200 votes per share: see SINGAPORE PRESS HOLDINGS ANNUAL REPORT 2017 at 127, http://sph.listedcompany.com/misc/annualreport/2017/SPH%20AR2017.pdf.
120. Although this did not prohibit public companies from issuing preference shares with different voting rights (see CA § 75). Preference shares are a separate class of shares with distinct economic risks and benefits from those of ordinary shares. In contrast, dual class shares typically comprise classes of shares with similar economic benefits and risks but different voting rights.
multiple, limited, or no voting rights. This was thought to be desirable as it would afford such companies greater flexibility in structuring joint ventures and strategic alliances. However, the same extension was deemed inappropriate for public companies. Allowing a public company to issue shares with multiple or no voting rights would result in the concentration of control in the hands of a few without commensurate economic investments. Such an outcome would run counter to the fundamental precept of shareholder democracy, the cornerstone of good governance.

By 2011, however, regulatory attitude had shifted owing to concerns that insistence on the one share per vote principle might render Singapore uncompetitive as a destination for IPOs. The trigger for this turnaround is often traced to Manchester United’s aborted plans to list on the Singapore Exchange (“SGX”) on account of the latter’s ban of dual class share structures. In a report issued by the Steering Committee for the Review of the Companies Act, the committee recommended abolishing the one-share-one-vote structure to allow public companies greater flexibility in capital management. Acting on this recommendation, the Singapore Parliament amended §64 of the Act in 2014 to clarify that the one-share-one-vote principle is only a default rule which may be displaced by contrary provisions in the company’s constitution. Following this amendment, public companies became free to adopt dual class share structures.

Although the change in general corporate law did not apply to listed companies, it was widely seen to herald a similar development in securities regulation. In early 2017, the Listings Advisory Committee (“LAC”), a committee comprising independent and experienced market professionals set up to advise the SGX on listing policies, endorsed the listing of DCS structures.

Under the amended rules, the issue of shares with no or different voting rights is subject to the following safeguards:

(1) A public company may only issue different classes of shares if (a) its constitution provides for the issue of different classes of shares, (b) the rights attached to each class of shares are set out therein, and (c) the issue is approved by special resolution: see CA §64A(1) & (3); and

(2) The holder of a non-voting share will still have one vote in a general meeting to vote on any resolution that seeks to wind up the company voluntarily or vary the rights attached to that share: see CA §64(4).

122. REPORT OF THE COMPANY LEGISLATION AND REGULATORY FRAMEWORK COMMITTEE, at para. 3.6.4, 2002 (hereinafter referred to as the “CLRFC Report”).
123. CLRFC Report, at paras. 3.6.2 – 3.6.3.
124. See Singapore to Allow Dual-class Shares to Attract Listings, Reuters (Oct. 3, 2012); and Lance Lim, Recent Amendments to the Companies Act: Rethinking Dual-class Shares in Singapore – Caveat Emptor?, Sing. Law. Gaz., 30 (Jan. 2015).
125. MINISTRY OF FINANCE, REPORT OF THE STEERING COMMITTEE FOR REVIEW OF COMPANIES ACT, at 3-14 (June 2011).
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in the belief that it could help “SGX’s capital market . . . become more attractive for businesses run by entrepreneurs to list, thereby providing investors access to a wider range of companies and sectors.”128 However, LAC’s support was predicated upon the institution of various safeguards against risks to investors.

Since then, the SGX has publicly consulted129 on the LAC’s recommendations and confirmed its decision to allow dual class share structures.130 More recently, it has issued a further consultation paper131 (“SGX Consultation Paper II”) to solicit public feedback on a proposed listing framework for DCS structures. This proposal restricts DCS to new listings and to occasions where an issuer demonstrates it is “suitable” for adopting such a structure.133 The factors relevant for determining an issuer’s suitability for listing with a DCS structure include the company’s business model, its operating track record, the role and contribution of the holders of multiple-vote shares, and participation by sophisticated investors.134

Similar to the framework proposed for Hong Kong, the SGX proposal comprises substantial safeguards against the risks of entrenchment and expropriation. These measures include: imposing a maximum voting differential (between multiple and one-vote shares) of 10:1;135 enhancing the rights of one-vote shareholders to convene general meetings;136 prohibiting post-IPO issue of multiple-vote shares;137 restricting the issue of multiple-vote shares to directors;138 requiring the automatic conversion of multiple-vote shares to single-vote shares once the director disposes of his shares or when he

128. LISTINGS ADVISORY COMMITTEE: FY 2016 ANNUAL REPORT at 13.
129. SGX CONSULTATION PAPER, POSSIBLE LISTING FRAMEWORK FOR DUAL CLASS SHARE STRUCTURES (Feb. 16, 2017), http://www.sgx.com/wps/wcm/connect/1f41364-8584-4da0-b8a5-7891dd16e52e/DCS+Consultation+Paper+%28SGX+20170216%29%2Ffinal%29.pdf?MOD=AJPERES
132. Id. at Part II, para. 2.1. Existing companies with a OSOV structure would not be permitted to convert to a DCS structure post-listing.
133. Id. at Part II, para. 2.2.
134. Id. Such applications would also be referred to the LAC for review and advice, at least during the initial phase of the implementation of the new regime (see Id. at Part II, para. 2.3). Previously, the SGX had contemplated imposing two additional listing criteria: (1) a minimum market capitalization of S$500 million and (2) sophisticated investors must have subscribed for at least 90% of the public float (see SGX Consultation Paper I, supra note 129, at Part II, paras 4.7 and 4.9) but this suggestion has been abandoned as it did not have the support of consultees.
136. Id. at Part III, para. 2.1.
137. Id. at Part III, para. 3.1, except in the event of rights issues.
138. Id. at Part III, para. 4.1.
ceases to hold executive office in the company;\textsuperscript{139} requiring enhanced independent elements on board committees;\textsuperscript{140} and mandating an enhanced voting process (which accords only one vote to each multiple-vote share) to certain reserved matters including changes to the issuer’s constitution, variation of share rights and the appointment and removal of independent directors.\textsuperscript{141}

Singapore’s proposal to introduce DCS has stirred both excitement and controversy. Supporters see this potential development as “a progressive step forward to keep pace with global markets”\textsuperscript{142} and as a move that could help to establish Singapore as a “leading technology listing market” that attracts high profile IPOs.\textsuperscript{143} Supporters also argue that if Singapore does not woo start-ups by accepting DCS, it may “be squeezing out huge chunks of growth”.\textsuperscript{144} On the other hand, detractors, are pessimistic about the consequences of allowing DCS. Mak Yuen Teen, a vocal critic, castigates the introduction of DCS as a retrograde step—its effect is to “[export] the monitoring function to third parties[—]to the government, the courts, the regulators . . . because dual class shares will severely inhibit the role of directors, shareholders and markets in corporate governance.”\textsuperscript{145} Mak further points out that Singapore lacks the legal infrastructure needed to protect investors against the heightened risks of abuses inherent in unequal voting structures. In the US, where a disclosure-based caveat emptor approach predominates, shareholder rights are “backed by strong regulatory enforcement, a very developed commercial court system and the availability of contingency-fee class actions.”\textsuperscript{146} In contrast, there is a general lack of shareholder activism in Singapore,\textsuperscript{147} as investors rely primarily on public enforcement to guard against the excessive exploits of controllers.\textsuperscript{148}

\textsuperscript{139} Id. at Part III, para. 4.3, although shareholders may approve of any deviation from this requirement through an enhanced voting process.

\textsuperscript{140} Id. at Part IV, para 1.1. This means that the majority of the Nominating Committee, Remuneration Committee and Audit Committee, including the Chairman, must be independent.

\textsuperscript{141} Id. at Part IV, para. 2.2.

\textsuperscript{142} Lim, supra note 3.

\textsuperscript{143} Oliver Ward, The SGX Grows Stronger from its Challenges and is on the Cusp of a Turnaround, ASEAN TODAY, Sep. 29, 2017.


\textsuperscript{145} Mak Yuen Teen, Say No to Dual Class Shares, Business Times, Nov. 27, 2015.

\textsuperscript{146} Mak Yuen Teen, The Risks of Having Minority Controlling Shareholders in Firms, Business Times, Dec. 28, 2017.

\textsuperscript{147} Although there are signs that shareholder activism is increasing: see infra note 166168.

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PART IV: CHARTING THE MIDDLE PATH

In deciding whether to lift the ban on DCS in Singapore, the SGX has had to squarely confront the conflict between its rational pursuit of profits as a for-profit demutualized exchange, and its regulatory function in ensuring high standards of investor protection. A vigorous investor protection regime is crucial for maintaining a strong and vibrant securities market, but DCS structures threaten to undermine that by subverting outsider monitoring and augmenting the risks of private benefit extraction. At the same time, however, the uptrend in DCS listings among technology companies is a reality that cannot be ignored. Attracting high-growth companies to Singapore is important for optimizing SGX’s revenue and market capitalization, defending the country’s position as a leading financial market in the region, and generating “positive externalities” of growth and employment in the wider economy.

Seen in that light, the decision over DCS listings primarily requires a balancing of divergent public (viz., investor protection and wider economic) interests. The safeguards outlined in the SGX Consultation Paper II suggest that Singapore, like Hong Kong, is charting a pragmatic yet cautious path forward. DCS structures will be permitted but only on an exceptional basis on proof of “suitability”. Investor protection will still be paramount, but such protection will reside in a series of safeguards rather than in rigid adherence to the OSOV principle. The result is a unique regime that has more safeguards, and is therefore stricter, than those found in other jurisdictions.

As a matter of theory and evidence, this balance between minority protection and promoting entrepreneurial financing is defensible since there is some consensus that DCS issued with adequate investor protection enhances share value.

Although it is not possible at this early stage of its development, to comment on the efficacy of the proposed new regime, several observations may nevertheless be made of its implications.

First, the developments in Singapore and Hong Kong are significant because they entail regulatory innovation. In both jurisdictions, an optimal compromise is thought to be found in combining weighted voting arrangements with stringent listing criteria and extensive safeguards. This combination deviates from the market-based approach in the US and Canada, where DCS structures are only lightly-regulated so that market discipline remains a


150. SINGAPORE PARLIAMENTARY DEBATES, OFFICIAL REPORT, vol. 92 (Oct. 8, 2014).


152. Dy, supra note 144, 7.

153. As discussed in supra Section 1.
significant restraint of abuse. This deviation reflects the appreciation that a
light-touch approach works only in contexts where the corporate governance
system is not founded on only formal rules but also “a wide array of
complementary institutions, constraints, and practices that work together to
create a whole that is greater than the sum of its parts.” These would include
factors such as diffused share ownership, an active market for control, an
experienced and sophisticated judiciary that regularly articulates standards of
best practices (e.g., Delaware’s Court of Chancery), and other “second-order”
institutions (such as investment bankers, securities analysts, accounting firms,
lawyers, rating agencies and the financial media) that help to monitor
compliance with corporate governance rules. In contrast, the market in
Singapore is largely characterised by concentrated ownership held by the
State: the market for control is practically non-existent and shareholder
activism as well as enforcement are relatively subdued. This divergence in the
overall “institutional mix” of different jurisdictions thus renders the
wholesale importation of the US regime inappropriate. Instead, a modified
scheme with extensive safeguards is necessary to make up for the lack of
complementary institutions in Singapore.

One may, of course, doubt the efficacy of this proposal: to the extent that
the safeguards prescribed by Singapore or Hong Kong are more restrictive than
those found in other jurisdictions, why would issuers choose to list there? There
is force in such scepticism. To the extent that DCS structures are desired
for their ability to enlarge and entrench board control, their appeal would likely
diminish as the austerity of safeguards increases. That said, there is no reason
to assume that issuers are always motivated by the desire to exploit. A
rational issuer generally seeks to list on an exchange with a strong investor
protection regime in order to minimise its cost of capital. In the context of DCS
listings, an issuer who is willing to subscribe to the additional prescribed
safeguards would be perceived as authenticating its commitment to high
standards of corporate governance. When that occurs, the safeguards would
serve as a badge of quality rather than as a form of deterrence. It remains to be
seen whether such an approach would succeed in identifying the true winners

155. Id. 1094 – 1095.
157. Paredes, supra note 154, 1060.
158. ACGA Submission on SGX Consultation: Possible Listing Framework for Dual-Class Share Structures, Apr. 11, 2017, https://www.acga-asia.org/upload/files/20170411_ACGA_Submission_SGX_DCS_Consultation_Final.pdf. See also Goh Eng Yeow, Protecting Investors in Dual-class Listings, Business Times, Dec. 5, 2016 (arguing that DCS should be disciplined by market forces as “the best safeguard is to have no safeguard.”)
159. Fischel, supra note 7, 128 – 129.
that preserve founder autonomy without eroding responsible governance. But to the extent that it is successful, this novel approach would serve as a striking example of how regulatory competition could excite a race to the top rather than the bottom.

A second observation concerns the regulatory philosophy underlying the proposed listing framework. Under the proposed regime, SGX is ultimately responsible for deciding whether a company is “suitable” for adopting DCS structures. To the extent that this involves an assessment of the merits of a listing application, it seems redolent of the outmoded merit-based approach and hence a departure from the market-driven, disclosure-based approach that has shaped securities regulation in Singapore over the last two decades. Although such deviation may be seen as an isolated measure to mitigate the heightened risks of DCS structures, it is also illustrative of the adaptations that are necessary when applying the market-based model of corporate governance to less sophisticated and developed markets. In such markets, a measure of paternalism remains important to make up for inadequate market mechanisms. However, the obvious drawback of a more regulated regime is the risk of moral hazard—investors may discount the risks of acquiring inferior-voting shares if they perceive SGX’s approval of a particular DCS listing as an assurance against the downside risks of their investment. The result is that, rather than sensitizing investors to the higher risks of DCS structures, the “suitability” criterion may have the opposite effect of inducing complacency. Given this concern, it may be that such a discretionary criterion is only appropriate at the germinal stage of the new framework and ought eventually be replaced by a more objective measure of eligibility.

Finally, there may be merits in the criticism that the proposed framework does not sufficiently address the risks of ineffective enforcement. In the first round of consultation, SGX acknowledged the importance of enforcement as a means of controlling managerial opportunism but took the view that the existing enforcement regime is sufficiently robust since both private and public enforcement options have increased in recent years. It cites, as examples, the extension of statutory derivative actions to listed companies—and institutional investors can fund such actions—and the set-up of an independent enforcement regime.

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160. Where the regulator, rather than the market, judges the suitability of securities being offered to the public company.
161. A disclosure-based regime is a key tenet of financial regulation in Singapore: see MONETARY AUTHORITY OF SINGAPORE, OBJECTIVES AND PRINCIPLES OF FINANCIAL OVERSIGHT IN SINGAPORE, April 2004 (Sep. 2015) at para. 15.
163. SGX CONSULTATION PAPER I, supra note 129 at Part III, para. 2.5.
164. CA § 216A, as amended by Companies (Amendment) Act 2014, § 146.
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Listings Disciplinary Committee. However, while there are signs of increased activism, institutional investors in Singapore have traditionally preferred to influence management decisions through media campaigns rather than seek recompense through enforcement of legal rights. In the near to medium term, therefore, some measure of enforcement deficit is likely to persist. So even if the holders of multiple-vote shares, being directors, are obliged to act in the company’s interests, the enforcement of such duty would still be weak given the public shareholders’ lack of financial and informational resources. To bridge that gap, further regulatory reform may be needed to equip shareholders of DCS companies with more means to call controller-insiders to account. Possible measures include further reducing the shareholding threshold for convening general meetings and strengthening statutory remedies for shareholders who have incurred losses as a result of material non-disclosure by the company or trading misconduct by insiders. A more radical step would be to vest in the Monetary Authority of Singapore, as a public enforcement agency with the power to pursue civil actions when this is in the interests of the public. This could serve as a deterrent as well as redress for small minority shareholders without the wherewithal to mount legal suits.


166. There is, for example, increased activist-investor interests in Singapore stocks: see Klaus Wille & Jonathan Burgos, Activist Investors Take Aim at Singapore’s ‘Buy, Pray and Hope’ Model, Bloomberg, Nov 4, 2016. A recent study also suggests that there is a clear trend of increase in shareholder-initiated general meetings: see MAK YUEN TEEN & CHEW YI HONG, THE SINGAPORE REPORT ON SHAREHOLDER ACTIVISM: THE DAWN OF SHAREHOLDER ACTIVISM at 24 (Mar. 2017), http://governanceforstakeholders.com/wp-content/uploads/2013/07/Shareholder-Meetings-Volume-3-.pdf.


168. In the context of disclosure obligations, such deficit is said to reflect the legislative emphasis on corporate governance over investor protection; see Tjio, supra note 162.

169. CA § 176 currently provides that holders of at least 10% of a company’s total voting rights may requisition for a general meeting to be held. In the SGX Consultation Paper II, SGX contemplates modifying this threshold such that the requisite 10% is determined on a one-share-one-vote basis: see supra note 131, at Part III, para. 2.1. But it is arguable this threshold could be further lowered to 5% given the increased risks of expropriation in DCS companies.


171. A similar suggestion (modelled after s 50 of the Australian Securities and Investments Commission Act 2001 (Cth)) had previously been made in the reform of Singapore’s insider trading laws (see CORPORATE FINANCE COMMITTEE, THE SECURITIES MARKET: FINAL RECOMMENDATIONS 29, Oct. 21, 1998) but was not adopted by the Government.
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In all, the DCS listing regime proposed by SGX may be seen as a measured attempt at mediating the opposing demands of intense competition and legitimate governance concerns. In a sense, it is “inevitable” that Singapore would have to open its doors to DCS structures to be competitive, but an accompanying suite of exacting criteria and safeguards is put in place to avoid racing to the bottom. Excessive prudence may blunt the effectiveness of the new device, but a calibrated approach that can be fine-tuned over time makes sense when one is sailing in a sea of uncertainty and volatility.

PART V: CONCLUSION

At a basic level, the debate on DCS structures may be pitched as a contest between the interests of investors and the profitability of demutualized stock exchanges. Historically, however, DCS structures have often been invoked to advance wider public or national policies. Thus, while the ideology of shareholder parity remains significant, it has not been and is not the sole determinant of regulatory policies. Rather, it is an important factor to be weighed against economic and social policies. In Singapore, the use of DCS structures has been advanced as one of multiple strategies for economic growth, and this serves as a heavy counterweight against shareholder governance concerns. Whether this strategy will turn out to be the winning bet remains to be seen, but, for now it would seem that the assumption of that risk is unavoidable.

POSTSCRIPT:

Since the submission of this Article, the SGX has confirmed the listing framework for DCS structures, the rules of of which reflect the proposals set out in SGX Consultation Paper II.

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174. It has been observed, for example, that nationalist concerns of foreign ownership and domination of Canadian companies best explain the proliferation of DCS structures in Canada in the 1970s and their persistence to the present: see Ben-Ishai & Puri, supra note 66, 132 – 142. Ringe likewise argues that post-2008 financial crisis, the use of multi-vote structures was expected to rise in Europe as a form of economic protectionism against the infiltration of Sovereign Wealth Funds from the middle east and far east: see supra note 87.
