Corporate Governance in Emerging Markets

Enforcement of Corporate Governance in Asia

THE UNFINISHED AGENDA

Over the past few years, most Asian jurisdictions have substantially revamped their laws, regulations and other corporate governance norms. In many cases, Asian rules now reflect the most developed thinking on established corporate governance systems. However, enforcement remains a significant challenge and “an unfinished agenda”.

This publication offers a unique snapshot of how corporate governance is being enforced in Asia. It provides policymakers, judges, investors, board members and stakeholders with case studies and analyses that illustrate how regulators deal with enforcement in practice.

The six articles compiled in this publication cover a number of important sub-themes. Liu describes civil enforcement in Chinese Taipei, illustrated by a case study of a well-known corporate governance scandal. Kroene looks at the pros and cons of setting up specialised business courts to deal with governance issues within Asia. Jung discusses co-operation between regulators and public prosecutors in Korea, and Hwang reviews the growing interest in Singapore for enlarging the role of arbitration in corporate law disputes. Finally, Mak, Lan and Buang present an enforcement case study that highlights director negligence. All papers were presented and discussed at the Asian Corporate Governance Roundtable, a high-level policy forum that comprises Asian policy makers, regulators, stock exchanges, academics and private sector leaders, as well as international experts.
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THE UNFINISHED AGENDA
ORGANISATION FOR ECONOMIC CO-OPERATION
AND DEVELOPMENT

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Foreword

Over the past several years, most Asian jurisdictions have substantially revamped their laws, regulations and other corporate governance norms. In many cases, Asian rules now reflect the most developed thinking in corporate governance. But the credibility – and utility – of corporate governance rules and regulations ultimately rest on the ability to enforce them. It is therefore essential to ensure that recent improvements in the regulatory frameworks are matched by effective enforcement.

Against this background, participants to the Asian Roundtable on Corporate Governance decided to look deeper into the challenges to effective enforcement. This publication collects some of the papers that have been discussed in recent Roundtable meetings, including the meeting in Bangkok, Thailand in 2006. It provides policy makers, judges, investors, board members and stakeholders with case studies and papers that illustrate real problems and specific examples of how regulators deal with enforcement in practice. The papers are preceded by an executive summary that draws out key lessons learned in the “unfinished enforcement agenda” in Asia.

Established in 1999, the Asian Roundtable on Corporate Governance serves as a high-level regional hub for policy dialogue on corporate governance. Its goal is to assist decision-makers in their efforts to improve corporate governance in the region. It gathers the most prominent, active and influential policy makers, practitioners and experts on corporate governance in the region, from OECD countries and relevant international institutions.

Special thanks go to the participants in the Asian Roundtable on Corporate Governance and in particular the authors of the case studies and papers presented. The OECD is grateful to the Japanese government and the Global Corporate Governance Forum for supporting this work. This publication was prepared by Fianna Jesover, Corporate Affairs Division, OECD in cooperation with Richard Frederick, Governance Consultant.

1 The participating Asian economies include: Bangladesh, China, Hong Kong China, India, Indonesia, Korea, Malaysia, Pakistan, the Philippines, Singapore, Chinese Taipei, Thailand and Vietnam.
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Executive Summary

1. Introduction

This publication collects some of the papers that have been discussed in recent meetings of the Asian Roundtable on Corporate Governance, including the meeting in Bangkok, Thailand in 2006. The principal purpose of these meetings was to explore how corporate governance was being enforced in the Asia region.

The Asian Roundtable on Corporate Governance was established in 1999 and serves as a high-level regional forum for a structured policy dialogue on corporate governance. It also provides participants with direct access to the work of the OECD and to developments in other parts of the world. To support both private and public sector efforts, the Asian Roundtable participants carried out a detailed inventory of corporate governance weaknesses, challenges and solutions. The result of this significant undertaking was presented in the White Paper on Corporate Governance in Asia (2003). The White Paper contains a set of common policy objectives and a number of concrete recommendations on how to improve corporate governance in Asia. The White Paper recognises that the more detailed implementation of various recommendations may vary between economies, since Asia is a diverse region in terms of legal traditions, regulatory infrastructure, and economic development. However, it also drives home the essential point that specific national characteristics do not excuse any jurisdiction, which wants a strong private sector, from improving corporate governance.

The White Paper has provided Asian economies with a roadmap for developing policy and a reference point against which to measure their own progress. While much has been achieved since its publication in 2003, questions remain with respect to how policy recommendations translate into law and regulation, and filter down to the companies who must ultimately put good governance into practice.
As a consequence, enforcement was chosen as the theme of the 2006 meeting. Enforcement is often a weak spot in many countries. It is no surprise that it is also a challenge in emerging economies. The enforcement of good governance relies on a large number of factors, one of which is a strong judicial infrastructure. The reality in Asia is that the legal environment in some countries is determined by a judiciary that is often under-funded, requires additional commercial experience, and is vulnerable to influence by powerful interests. Research indicates judicial systems in a number of Asian countries require further strengthening in order to better protect shareholder and creditor rights.\textsuperscript{1}

Six papers are compiled in this publication, which cover a number of important sub-themes. Liu describes civil enforcement in Chinese Taipei, as the legal system adapts to scandals and new economic challenges. He also presents a case study on the equivalent of Chinese Taipei’s Enron. Kroeze looks at the pros and cons of setting up specialised business courts to deal with governance issues, and considers their utility in Asia. Jung discusses co-operation between regulators and public prosecutors in Korea, and Hwang discusses the growing interest in enlarging the scope of arbitration in company law disputes in Singapore. Finally, Mak, Lan and Buang present a case study to illustrate enforcement issues, and highlight the matter of negligent directors in Singapore.

The 2006 Asian Roundtable meeting devoted particular attention to practical realities. Case studies were used to illustrate real problems and provide to-the-point examples of how regulators deal with enforcement in practice. Case studies of China Aviation Oil in Singapore, an anonymous company group in Thailand, and Procomp in Chinese Taipei were presented and discussed. The remainder of this summary synthesises the key messages on enforcement of corporate governance rules from the papers and case studies presented at recent Roundtable meetings.

2. Synthesis of proceedings

\textit{Asian countries improved their corporate governance regimes significantly after the 1997 crisis.} Awareness of the importance of good governance practices is now widespread, as most of the countries in the region continue to work on improving their corporate governance frameworks. The initial reason for corporate governance reform in Asia may have been the 1997 crisis, however, the continuing impetus for improved governance has been economic growth, the desire of countries to remain competitive, continued globalisation, international capital flows, and the growth of global financial markets.
a. The institutional framework

Many countries that had considered framework issues resolved are now finding that further work on legislation is required. The reason is that the process of implementation and enforcement has revealed where the legislative framework could and should be strengthened. Some areas where countries have found that their law requires further attention are in sanctions for breach of fiduciary duties, administrative sanctions on management of listed firms, civil penalties, better disclosure, and derivative and class actions. Indeed, company legislation in a number of Asian countries continues to be reviewed and renewed. Future reforms will likely aim at a greater reliance on civil and administrative enforcement options and reduced dependence on public enforcement by strengthening the legal foundations for private enforcement. Work on the legal framework, thus, remains topical.

As in other parts of the world, scandal has heightened awareness of governance issues, and public outcry has forced governments to protect the public interest and restore confidence in the financial markets. The Procomp case in Chinese Taipei illustrates how one government chose to respond. On the institutional level, the Procomp scandal greatly enhanced the standing of the Financial Supervisory Commission (FSC), which had new enforcement powers bestowed upon it by the Ministry of Finance. The FSC, in turn, mobilised the Securities and Futures Investors Protection Centre, a pseudo public institution, to protect investor interests and help achieve recourse through civil litigation. The institute effectively subsidises the cost of civil enforcement. In most countries existing and emerging institutions are being strengthened and have become considerably more effective.

Laws were amended in response to scandals and to prevent further corporate misdeeds. In Chinese Taipei, for example, the most important legal change was the modification of the Company Law to create the basis for establishing and mandating independent directors and audit committees. Changes also prohibited the same persons from being elected through their representatives as both a manager and a board member of a company. Amendments to the Securities and Exchange Law also strengthened the integrity and honesty requirements for company officers and representatives. Managers of issuers must now certify financial statements and are liable for material misstatements in reports and filings. Employees and auditors are also subject to liability for misstatements. Finally, criminal and administrative penalties were strengthened. Responses vary from country to country, however, the general tenor of government actions in Asia has been to strengthen and deepen law and regulation in response to scandals.
Co-operation between various regulatory institutions is important for achieving maximum regulatory efficiency since responsibility for corporate governance enforcement is often shared by several agencies. Co-operation may, nevertheless, be difficult to achieve even with the best of intentions. Some techniques which countries have used to enhance co-operation are: internal working committees and dialogues; regular inter-agency meetings between government agencies to discuss operational issues and sharing of information; formal agreements such as memorandums of understanding between regulatory bodies, and; personnel exchanges, such as joint training and educational efforts. Finally, overarching national-level committees, such as the High-Level Enforcement Committee in Malaysia, which includes the Securities Commission, the police, and the Companies Commission and reports to the Prime Minister, can help create bridges between regulatory organisations.

Asian countries have made liberal use of legislation and practices from other countries as a source of inspiration when strengthening their own systems. For example, the Companies Act in Singapore is generally based on principles of UK company law. Singapore has also drawn on other countries’ legislative frameworks such as that of Australia, (statutory statement of the duties of a director), Canada (statutory derivative actions) and New Zealand (share buybacks and abolishing of par value). Hong Kong China has been strongly influenced by the UK Combined Code. Finally, international principles such as the OECD Principles of Corporate Governance and IOSCO’s Objectives and Principles of Securities Regulation have served as important internationally agreed reference points.

International practices provide valuable models, but making them work in Asia, outside of their natural context, is often difficult. One reason is that Asia is a diverse region with both civil and common law traditions. Transplanting and implementing mismatched laws and enforcement techniques can thus reduce their effectiveness. In particular, codes of procedure in civil law jurisdictions can make it difficult to conduct group, collective, or representative litigation, which are more widespread in common law traditions. Other requirements of good corporate governance, such as the director’s duty of loyalty and care, may not translate effortlessly into the local legal culture even if somewhat similar concepts may exist. The experiences related during the meeting clearly show that Asian countries are finding their own path to legislative reform and enforcement, while making the best possible use of international practices where feasible.
b. Private and public enforcement

*There are different public and private enforcement options, each of which has relative merits.* Criminal sanctions provide strong deterrent value, but are subject to procedural delays of the court system because of the high burden of proof that is demanded. Civil sanctions have less deterrent value than criminal sanctions and, while still subject to procedural delays, have a burden of proof that is lower than criminal proceedings. Administrative sanctions have less deterrent value than either criminal or civil sanctions; on the other hand, they allow for speedy action. With administrative sanctions, regulatory agencies determine the standard of proof. Private rights of action allow for a market-based enforcement response; they are less subject to procedural delays of the court system and have a lower burden of proof. In most developing markets, public enforcement holds a more prominent position than private enforcement. An array of different sanctioning options is crucial for effective enforcement.

Key prerequisites for both public and private enforcement are: a certain level of market maturity and sophistication; the awareness of managers and directors of their duties, and shareholders of their rights; transparency and disclosure (since market discipline is premised on the reliability of information); the presence of enforcing institutions; the integrity and efficacy of regulatory agencies and the court system; a supportive legal framework, and; a complete set of corporate and financial laws.

*As in most emerging economies, private monitoring and enforcement are at a relatively nascent stage of development.* Regulatory agencies, on the other hand, are typically endowed with strong investigative powers and a wide range of sanctioning options, though criminal sanctions are increasingly being complemented by civil and administrative sanctions.

i. Private sector enforcement

*There are numerous and significant impediments to class actions in Asia.* In Chinese Taipei, for example, one impediment is that the political culture has traditionally suppressed collective actions. Furthermore, court procedures require investors to organise themselves as a class of plaintiffs, which requires co-ordination and other up-front costs. Out-of-pocket court fees of up to 3.5% of a claim may be required to launch an action. In addition, there is no civil discovery. Finally, judges lack expertise and find it difficult to examine the legal and factual issues of cases. In short, small investors lack the power to assert their rights.
Asia also has a growing interest in enlarging the scope of arbitration in company law disputes. There are many good reasons for considering arbitration. It is cost effective and timely compared to litigation. Arbitration offers: greater neutrality compared to litigation; the ability of parties to choose the governing law of the dispute; the potential for specialist arbitrators with experience in, for example, accounting, and; greater flexibility compared to national courts. Arbitration is thus well suited for use in disputes which require creative remedies.18

There are also important drawbacks associated with arbitration. The problem with arbitration in company law disputes is that arbitration is contractual in nature. Arbitration in company law disputes requires parties to the arbitration to have signed up for arbitration in advance.19 In addition, courts may allow exceptions provided for under the New York Convention on the recognition and enforcement of foreign arbitral awards. Expansive interpretations of what constitutes a legitimate exception can result in the setting aside of arbitral awards and the effective gutting of shareholder rights. In general, actions which involve financial relief are more suitable for arbitration than actions which involve requests for injunctive relief or declarations of status. Other kinds of company law disputes which are suitable for arbitration include shareholder disputes in privately held companies and breaches of joint venture agreements—particularly foreign joint ventures.20

Gatekeepers (anyone who monitors or oversees the actions of others), play an important role in corporate governance and are increasingly being held accountable for their actions as corporate advisors. Gatekeepers include auditors, accountants, legal and financial advisors, and underwriters among others. Past scandals have consistently raised questions regarding the extent to which gatekeepers are fulfilling their promised functions. Too often they have been seen as negligent and even complicitous in corporate misdeeds. For example, in the Energo Berhad case in Malaysia, both the promoter and the accountant were prosecuted. In the case of Kiara Emas Asia Industries, both the internal accountant and the external auditor were charged for their role in submitting false information to the Malaysian Securities Commission.21 Gatekeepers throughout Asia now face the prospect of increased damages for negligent sponsorship or negligent certification of financial statements.

Against this backdrop, there have been positive efforts to enhance the role of the accounting and audit profession by improving regulation. In Hong Kong, the Independent Investigation Board was established to consider complaints of accounting, auditing and ethics irregularities committed by professional accountants involving listed entities. In addition, the Financial Reporting Review Panel was established to inquire into
departures from the law and accounting standards in the annual accounts of companies and to seek remedial action.\textsuperscript{22}

There have also been efforts to encourage greater professionalism among financial advisors. In Hong Kong, for example, the stock exchange is strengthening the regulation of sponsors and financial advisers, and is clarifying its expectations of them (e.g. definitions of independence and expectations of due diligence). Listing rule amendments address, among other things: when an issuer must appoint a sponsor or post-listing adviser; the role and responsibilities of issuers in assisting sponsors and compliance advisers; undertakings and declarations required to be given to securities regulators, and; independence requirements for sponsors, compliance advisers and financial advisors, including the due diligence they should typically perform.\textsuperscript{23}

Another critical issue is what actions should be taken against board members who are negligent or incompetent, but whose actions fall short of serious crime. In most cases directors are only punished for the most egregious crimes, usually involving dishonesty or fraud. Gross negligence though, is generally not punished by the authorities or through civil action, even though it constitutes a breach of the director’s duty to act with reasonable diligence. Firm action against directors may therefore be necessary to send a clear signal on directors’ duties and their role in corporate governance. While there is legitimate concern that tougher actions against negligent directors may deter qualified people from becoming directors, it can also be argued that allowing directors to retain their positions after presiding over problems violates the spirit of good corporate governance and sends negative signals to the markets.\textsuperscript{24} Concerning self-discipline by the private sector, it was stressed that there is still a need for companies to realise for themselves the benefits of better corporate governance practices, particularly with respect to the effectiveness of boards that are dominated by controlling shareholders.

\textit{ii. Public sector enforcement}

Securities law enforcement in Asia relies largely on the public sector (regulators and prosecutors) despite the emergence of private remedies. Furthermore, there is significant reliance on criminal penalties, even if criminal sanctions are increasingly being complemented by civil and administrative sanctions.\textsuperscript{25} Civil sanctions are comparatively infrequent. This can be attributed to various factors such as its cost, the difficulty in proving a breach of duty and the uncertainty regarding the eventual recovery of damages. It is also attributable to a lack of a tradition of civil action. When they do occur, however, civil actions do appear to work in Asia. In
Singapore, for example, the introduction of civil penalties was useful in achieving legal redress without having to go through litigation. The lower burden of proof is likely a key reason why regulators have increasingly turned to the use of civil penalties. Addressing the relative absence of civil action is of great interest in Asia since it is one additional mechanism to deter breaches of good governance.

Specialised business courts are in some cases improving the enforcement of corporate governance rules. Kroeze cites examples of specialised courts in Asia including that of the Thai Central Intellectual Property and International Trade Court where better enforcement through specialised courts has helped attract investment and contribute to economic growth. The establishment of this court addressed structural problems of inefficiency, security breaches, inter-agency rivalry and the lack of coordination that had hampered Thai enforcement efforts in the past. Specialised courts can be seen as an important factor in creating a legal environment friendly to international trade and investment.

Specialised business courts can only be successful if certain preconditions are satisfied. These conditions vary from well-trained judges and well-balanced procedures that guarantee impartial adjudication, to a working system of notifying parties of court dates and a transport infrastructure to get parties to courtrooms. These conditions exist in some Asian countries and are expected to exist in more countries in the region in the future.

c. Capacity building

In Asia, as is the case elsewhere, regulators are confronted with considerable organisational and operational challenges in fulfilling their duties. The challenges include the volume and complexity of laws and regulation, and inefficiencies within regulatory structures. There is a good understanding of these problems and how to go about solving them.

Achieving effective regulation is contingent upon the capacity, integrity and accountability of regulators. Capacity building for public enforcement agencies means first and foremost that they have sufficient resources. Human resources are, arguably, most important to the success of a regulatory agency. Good human resource management covers aspects of recruiting (civil service examinations, standards, and recruiting requirements); job development (external training programmes, international meetings, and in-house training programmes), and; incentives (non-monetary recognition, pension plans, growth potential, achievement recognition, and job security). Regulatory agencies must have properly motivated staff with appropriate investigative and prosecutorial skills.
Regulatory staff needs to know the law, have the resources to enforce it and be able to take punitive action based on sound reasoning.29

At the same time, the staff of the regulator needs to observe the highest professional standards. Professional standards should cover the avoidance of conflicts of interest, appropriate use of information obtained during the course of duty, observance of procedural fairness, and the observance of confidentiality and secrecy requirements. Achieving higher regulatory capacity may imply a trade off with integrity and accountability (a classic quantity versus quality trade-off). Given the importance of the perception of integrity and incorruptibility for the public sector, this argues for erring on the side of integrity.30

The legal framework must be supportive, and regulators must have the powers necessary to fulfil their tasks. Legislation should protect regulators in the discharge of their regulatory duties and clearly define their responsibilities. The law should also convey the needed powers to investigate matters pertaining to cases; provide the ability to take action to ensure compliance with regulations; provide the power to initiate or refer cases for prosecution, and; give the power to impose sanctions and seek orders from courts or tribunals.31 Laws should be consistent and avoid duplication and complexity. If these conditions are not fulfilled the ability of the regulator to achieve his goals may be limited.

Finally, the scarcity of resources means that regulators must develop enforcement strategies that increase the likelihood of achieving their policy goals with the means at hand. An enforcement strategy needs to consider when to use criminal or civil powers or take administrative actions, and needs to taken into account the costs and benefits of each. It should also consider how to deal with serious offences compared to technical breaches, the balance between the quantity and quality of enforcement actions, and when to take action on behalf of investors.32 An enforcement strategy should not only address how to handle the case load, but how to apply limited resources to best effect.

d. Public sector accountability

Public sector and private sector accountability go hand in hand; it is difficult to achieve one without the other. Many Asian countries still suffer from influence over regulators and arbitrary regulatory actions. It is therefore important to demand greater accountability when empowering regulators with administrative enforcement options, since enforcement is taken outside of the regular court system. In Malaysia, for example, as in
other common law countries, the challenge is typically provided for under the administrative law framework.33

Greater accountability can be achieved in a number of ways including the greater transparency of administrative functions. Transparency is one of the principal methods to ensure accountability. In many cases transparency is lacking, and it may be difficult for investors and other stakeholders to judge whether enforcement actions have been pursued properly and applied fairly.34 Key disclosures should include: policies; procedures and decisions; investigations; criminal prosecutions, and; civil and administrative actions taken.35

e. Jurisdictional issues

The internationalisation of financial markets also raises important jurisdictional issues. Today’s reality is that companies have their home offices in one place, operate in another place and list in yet another. Foreign-based companies make it difficult to pursue misdemeanours, conduct investigations or extradite offenders.36 Complex organisations cause difficulties for regulators, especially in countries with a large number of foreign listings such as Hong Kong and Singapore. In Hong Kong, for example, there are over 280 mainland Chinese enterprises, and over 80% of listed issuers are incorporated abroad.37 In Singapore, one in every three listings was a foreign company in 2006, with about 100 listed Chinese companies. In most of these companies, the management, operations and directors are predominantly based overseas.38 Resolving jurisdictional issues will be an area requiring further attention.
Notes

1. Kroeze, Maarten, professor of company law at Erasmus University Rotterdam, the Netherlands (See paper in this publication).


7. Liu, Lawrence S., Executive Vice President and Chief Strategies Officer, China Development Financial Holding Corporation, and Professor, Soochow University Law School and National Taiwan University Business School, Chinese Taipei (See case study and paper in this publication).

8. Liu, Lawrence S.

9. Jung, Yong-Jin, Seoul Northern District Prosecutor’s Office, Korea, Netherlands (See paper in this publication).


12. Liu, Lawrence S.
13. Ibid.
14. Ibid.
18. Hwang, Michael, Senior Counsel and Arbitrator, Singapore (See paper in this publication).
19. Ibid.
20. Ibid.
23. Ibid.
24. Mak, Yuen Teen; Lan, Luh Luh, and; Buang, Azrudi Bin, National University of Singapore, (See paper in this publication).
26. Mak, Yuen Teen; Lan, Luh Luh, and; Buang, Azrudi Bin.
28. Ibid.
33. Ibid.
34. Mak, Yuen Teen; Lan, Luh Luh, and; Buang, Azrudi Bin.
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38. Mak, Yuen Teen; Lan, Luh Luh, and; Buang, Azrudi Bin.
Chapter 1.

The Merits of Shareholder Collective Actions
(Class Action Suits) in Chinese Taipei

by

Lawrence S. Liu*

1. Securities class actions in Chinese Taipei

In the wake of the Asian financial crisis, there has been much discussion of improving corporate governance in Asia, including the enhancement of mechanisms for securities class actions. This paper examines how Chinese Taipei tries to simulate the securities class actions prevalent elsewhere as in, for example, the United States. Even though efforts to emulate international practices have met many challenges, there have been some preliminary successes, including innovative ways to engineer partial reform.

Chinese Taipei is a civil law jurisdiction with a strong economy and a robust capital market that was not overly affected by the Asian financial crisis. These features make Chinese Taipei an interesting case study because, like Japan and Korea, Chinese Taipei has not traditionally been strong on corporate laws. Unlike the distressed Asian economies, it is not susceptible to as much external pressure to enhance shareholder protections.

Chinese Taipei’s case is also interesting and relevant to China, which shares the same cultural affinities, and shows a strong though quiet interest in Chinese Taipei as a benchmark for its efforts to strengthen its own

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economic and legal infrastructure, including its corporate laws. For example, Anthony Neoh, an advisor to the China Securities Regulatory Commission and former chairman of the Hong Kong Securities and Futures Commission, has indicated that Chinese Taipei’s securities law enforcement mechanism is worthy of close study by China.

As this paper will show, despite the emergence of a civil society in Chinese Taipei and the transplant of many substantive corporate and securities law rules from abroad, securities law enforcement relies largely on the public sector, that is, regulators and prosecutors. Public agency enforcement thus far has subsidised the private enforcement of corporate and securities laws because of inadequate procedural laws that create high information and co-ordination costs, and significant court costs for private enforcement. To reduce these costs, claimants in Chinese Taipei and government-supported organisations have recently adopted a new form of resolution: simulating US-style securities class actions. However, such a functional approach is still inefficient. Nonetheless, since an investor protection law went into force in 2003, there has been better enforcement and more aggressive plaintiff mobilisation.

2. Rigid civil law approaches weaken corporate and securities laws

As shown by some recent studies, sources of corporate and securities laws are relevant and arguably important to the strength of corporate governance systems. Chinese Taipei’s Company Law was enacted by the Nationalist government in Mainland China in 1928 and has largely followed the German and Japanese models. Despite some initial influence on Chinese Taipei’s Securities and Exchange Law (SEL) of 1968, the enforcement of the SEL is closer to the Japanese than the US model. Transplanting Chinese Taipei’s corporate and securities laws from civil law countries without a strong history of capital markets has affected their effectiveness.

One important feature of the civil law approach is that there is more emphasis on form than substance. This is a by-product of the codification culture. One classic example of placing form over substance is the rigid way in which codified rules are written, which makes adaptation to new market conditions or new behavioural patterns difficult. Examples of the emphasis of form over substance include the definition of control, and tracing beneficiary ownership in the context of the opaque labyrinth of family holdings and cross ownership prevalent in Asia and Chinese Taipei.

The rigidity of this approach is even stronger in procedural laws. Ultimately, it can be argued that codes of procedure in civil law jurisdictions were not set up for group, collective, or representative litigation. They are
better suited for one-on-one dispute resolution. For civil claimants to assert collective pressure, some substitutes have to be found.

3. Regulatory competition fragments corporate law enforcement

There is some regulatory competition in enforcing corporate law rules in Chinese Taipei. While the Ministry of Economic Affairs (MOEA) enforces the Company Law, the Securities and Futures Bureau (SFB) of the Financial Supervisory Commission (FSC) enforces the SEL. The Company Law is generally believed to be out of date. It fails to provide either adequate flexibility to deal with the rapidly changing global economy or the necessary level of shareholder protection. The MOEA’s overhaul of the Company Law in recent years has moved slowly, and the SFB has sometimes lost patience. It has sponsored, for example, amendments to the SEL embodying basic corporate law rules, thereby pre-empting the Company Law. Even though this approach solves short-term problems, over the long term it splinters corporate law enforcement.

4. Insufficient supervision of directors by supervisors

Under Chinese Taipei’s Company Law there is a concept of the directors’ duty of due care under the civil law principle of the contract of mandate. But, until the 2001 amendment, the Company Law contained no explicit provision on directors’ fiduciary duty. The 2001 amendment followed similar amendments earlier in Japan and Korea to transplant a concept that grew largely out of common law jurisdictions. It should, nevertheless, be noted that there is a criminal offence of breach of trust, which may arise from both a violation of the duty of due care and the duty of loyalty.

The Company Law also provides for indirect supervision by statutory auditors (more commonly known as supervisors) much like the kansaiyaku under the Japanese Commercial Code. Unlike a two-tier board structure, supervisors in Chinese Taipei can wield significant oversight power and are potentially powerful. They could, for example, bring suit against directors. In practice, however, they seldom do so. Often affiliated with major shareholders or founders, they are actually figureheads.

The Company Law in Chinese Taipei allows corporate or government shareholders to appoint their representatives as directors and supervisors. This inherent conflict of interests essentially nullifies supervision by supervisors. This is because the same large corporate or government
shareholder may elect a slate of directors and another slate of supervisors. The right hand thus finds it difficult to meaningfully supervise the left hand.

Directors are nevertheless viewed, pursuant to civil law concepts, as entrusted by the company to conduct its affairs under a contract of mandate. As mentioned above, they could be sued criminally for breach of trust for every act or omission. This is an important feature of corporate law enforcement in Chinese Taipei and reminds one of the era of draconian criminal law in imperial China. However, as will be shown below, this situation exists because private enforcement of corporate and securities law in Chinese Taipei has been difficult.

5. Institutional barriers to class actions in Chinese Taipei

The Company Law allows derivative actions by shareholders owning 3% of a company continuously for a year (reduced from 5% in the 2001 amendment), who may petition supervisors to sue directors and bring suits directly if supervisors fail to do so. Even so, group litigation in Chinese Taipei is still difficult and unusual. There are several reasons. First, before the Martial Law decree was lifted in 1987, authoritarianism did not lend itself to rights consciousness. It was not until the early 1990s that ingredients for a civil society began to emerge in Chinese Taipei. In sum, the political culture suppressed collective actions including group litigation.

Second, Chinese Taipei’s court procedures are not conducive to class actions. Its Code of Civil Procedure is heavily influenced by German and Japanese legislation, which does not offer effective measures to facilitate group litigation arising from mass torts. For example, in order for several plaintiffs to bring joint actions, they have to opt into a collective action plan. In other words, they have to be specific, known parties acting under rigid joint rules. Even though a modest amendment to improve this kind of opt in group litigation was enacted in 2001, it has not led to any meaningful class action cases under the Code of Civil Procedure.

For the same reasons, the shareholder derivative suit mechanism authorised under the Company Law does not work well. To the author’s knowledge, it has not been invoked when minority ownership is diverse, as in the case of public companies. Furthermore, this mechanism is not necessary when minority shareholders still command substantial ownership, as in the case of a joint venture. In short, there is a very high co-ordination cost to organising a class of plaintiffs. As a result, virtually no mechanism similar to US class actions exists, whereby parties can be represented even without the knowledge of a law suit and where, once certified as a class, the plaintiffs become parties unless they choose to opt out.
Third, there is a serious out-of-pocket economic disincentive to plaintiffs. Plaintiffs have to advance a hefty court fee (which was a flat 1% of the claim before 2002, and remains about the same under a post-2002 fee schedule) at the district court and appellate court levels, and another significant fee (for 1.5% of the claim before the 2002 amendment) at the final court level. In Chinese Taipei, the losing party pays for the court fees and each party pays for his own attorney’s fees. As a result, even though attorney’s fees would be less than, say, in the United States, the requirement to advance exorbitant court fees (potentially a total of 3.5 percent of the claim before the 2002 amendment) makes it virtually impossible for small plaintiffs to assert large claims. In addition, until recently, there were no punitive damages that could otherwise offset such disincentives to sue. Even though some consumer protection, securities and antitrust statutes now provide for treble punitive damages, actual awards of such damages are rare.

Fourth, there is no civil discovery in Chinese Taipei. As a result, information costs to plaintiffs can be high. Plaintiffs often have to rely upon whatever evidence they can gather to conduct the proceedings. To be sure, under the system of trials in Chinese Taipei, judges can compel testimonies and production of evidence. However, judges’ case loads make it difficult for them to conduct thorough fact finding. Therefore, the high information cost to plaintiffs discourages class actions.

Fifth, securities class actions often require some expertise without which judges find it difficult to examine the legal and factual issues. One could also point to the low level of practitioners admitted to practice law as a reason. Corporate misbehaviour, unfair related party transactions, and insider or manipulative securities trading have been classic examples of difficult cases for Chinese Taipei judges. These judges are professionally trained, become judges usually early in life, and do not have much other business experience. With economic growth in recent years, Chinese Taipei’s judges have come to know more about business practices and even stock trading, even if it remains difficult for them to determine fair market value or the legality of some commercial practices. Nonetheless, as will be shown later, some young judges in the district courts are very inquisitive, and have begun to learn from case law, and law and economics principles elsewhere, like in the United States. One such example is the introduction of the “fraud on the market” theory in securities fraud cases in 2004 that first arose in the US case of Basic v. Levinson in 1988.

6. Reliance on criminal enforcement

If it is difficult to impose civil liabilities, what recourse is available to potential victims? There are two alternatives, both of which play a
prominent role in the Chinese Taipei way of simulating class actions. The first involves the prosecutors in a criminal proceeding. The second involves a public interest foundation charged to bring actions on its behalf or on behalf of other similarly situated victims.

If an act injures multiple victims, there is enough public interest to make it a crime. Some violations of the Company Law and the SEL in Chinese Taipei are criminally punishable. Indeed, as indicated above, under the Civil Code, directors have a contract of mandate with the company they serve. Failure to properly perform their duties may constitute a breach of trust under Chinese Taipei’s Criminal Code. Prosecutors may then proceed with criminal indictment and bring their formidable subpoena and other investigative powers to bear.

**Simulating class actions through piggyback civil actions**

Once a prosecutor has made an indictment, victims of the crime may bring a civil action in tandem with such a criminal prosecution. In other words, the victims may piggyback on the efforts of the prosecutor and reduce the information costs to them. Indeed, they may ride on the coattails of the *in terrorem* power of the prosecutors. In addition, the president of the district court in which the criminal tribunal is hearing the criminal case may rule that, because of the complexity of the piggyback civil action, it should be referred to the civil tribunal of the same court. If such a ruling is made, the hefty court fees that otherwise would have to be advanced by the plaintiff will be waived. Effectively, this ruling removes the economic disincentives to bringing a class action. However, there is one catch: the sitting judge(s) in the civil tribunal to which the case is referred typically wait(s) for the result of the criminal trial proceedings. There is usually a significant delay of a few years before such cases receive substantive hearings in the district court level.

Warts and all, this is the Chinese Taipei way of solving the civil enforcement problem: simulating class actions. The complexity requirement of this referral rule and criminal judges’ workload have increasingly lead to referrals of mass victim cases in recent years. In a securities case involving improper conduct of the issuer or insiders, the facts are invariably complicated and involve multiple investors. Criminal court judges would rather avoid the piggyback civil actions, which are more tedious than just convicting the culprits. In addition, the ruling to waive court fees seems natural: victims are often “mom and pop” investors. As such, the waiver is not only “politically correct”, it also alleviates whatever feelings of guilt that criminal court judges may have from not handling the civil cases themselves. Considering that this German inspired piggyback civil action
rule was not intended to accommodate public interest litigation, the result is remarkable. The chemistry among this historical accident, litigation economics and judicial behaviour has inadvertently created a unique Chinese Taipei style of public interest litigation.

**The role of the government-sponsored foundation as de facto plaintiff**

Even if it is possible to organise piggyback civil actions, multiple actions by diverse plaintiffs are still inefficient. A good Samaritan organiser is needed to reduce co-ordination costs. One alternative, therefore, is to create a foundation to enhance civil enforcement. Such a mechanism could solve or reduce the collective action problem in group litigation. Until 2003, this foundation was the Securities and Futures Market Development Institute (the Institute). The Institute was founded in the early 1980s with an endowment by the SFB (known at that time as the Securities and Futures Commission of the Ministry of Finance) and received SFC grants and directives to carry out financial market studies and personnel training. The Institute owns at least one trading unit in each company that is publicly listed in Chinese Taipei. By doing so, it ensures that it can assert claims against directors and management as a shareholder.

To this end, the Institute formally set up an investor service and protection centre in March 1998, which is functionally similar to a public interest law firm. It used public means of communications to entertain applications to register investor claims. These investors had to ask the Institute to be their agent in asserting claims following the opt in method mentioned above. Although this could be a time consuming and tedious process, the recent enforcement cases summarised below demonstrate that the Institute has done a good job of managing these mass litigation cases.

In May 1999, the Institute formalised its procedures governing the acceptance of engagements by investors for civil liabilities in securities cases after they were approved by the SFC. For egregious violations of the SEL and for cases for which there has been a public prosecution, the Institute would either exercise its own minority shareholder right pursuant to the Company Law or bring *de facto* class actions as agents for other claimants. In either case, it would budget for the payment of court and lawyers’ fees when necessary. In other words, the Institute (and its funding agency, the SFC) was willing to subsidise the cost for civil enforcement.
7. Enforcement against short-swing profit disgorgement

One of the easiest ways to assert SEL claims is to sue for the disgorgement of what is known as six-month, “short-swing trading profit” against insiders of a publicly listed company. As in the United States, where this rule originated, civil liabilities for such trading are not based upon fault, and are thus easier to establish. However, there is one major difference. In Chinese Taipei a publicly listed company is required under the SEL to seek disgorgement; there is no discretion for other alternatives like granting a waiver.

This mandatory claim requirement therefore allowed the Institute to step in when the issuer, being controlled by insiders, failed to bring a disgorgement action. The management simply has no discretion to decide not to make a claim once the Institute raises this issue; to procrastinate further would mean a breach of trust, and potentially a criminal affair.

The Institute has maintained an active enforcement programme in this area. Disgorgement cases nevertheless have their limitations. The company controlled by the insiders is made whole, but individual investors do not receive any compensation. Indeed, insiders may squander or expropriate recouped profits. In 2003, all securities claims and enforcement programmes at the Institute were transferred to a new foundation, discussed below.

8. Recent piggyback enforcement case studies

Around the late 1990s, close to forty listed companies in Chinese Taipei experienced management irregularities. Although Chinese Taipei was not as affected as other countries by the Asian financial crisis, these irregularities occurred around the same time, thereby creating a small domestic financial crisis. Most of these companies were family controlled and operated in the more traditional sectors of the economy like food, metal and steel, automobile distribution, construction and the like.

Often, the irregularities were similar: a few insiders used corporate funds funnelled through wholly owned subsidiaries of the issuer to speculate in company stock or real estate. By using captive subsidiaries to engage in de facto secret market buybacks, they also shored up the value of their personal holdings, if not cashing in at the same time. Some company insiders simply doctored financial accounts or embezzled corporate funds. Typically, the scandal led to public prosecution, thereby setting the stage for piggyback civil actions organised by the Institute. At the end of this paper,
an appendix shows a list of cases still pending. The more representative cases are summarised below.\(^20\)

An April 2000 research study by the Taiwan Stock Exchange of the companies that engaged in such irregular activities suggests that the board of directors was “captured”\(^21\) by the controlling family. The study found that, on average, family members and affiliates controlled about 28% of the voting rights of these companies. However, they averaged about 75% of the board representation. In addition, these companies tended to engage in irregular activities when the major shareholders and insiders pledged substantial blocks of their holdings. In other words, argues the study, this phenomenon shows a classic need for independent directors.\(^22\)

**Tong Lung Metal Industry**

The Fan brothers were the chairman and president of this metal company. As a result of a family feud, and in an effort to gain corporate control, they pledged company shares, held by the company’s wholly-owned investment holding subsidiaries, to secure funds with which they bought proxies. They also caused the company to issue checks to guarantee repayment to the lenders. When the market turned, they instructed employees to divert corporate funds to make ends meet. As a result, Tong Lung lost more than USD 70 million as of late 1998, and was put into corporate reorganisation. Trading of its shares has since been suspended.\(^23\)

This was one of the first of the so-called “land mine” cases in the late 1990s. The defendants were convicted within four months of their indictment, and sentenced to prison terms of three and eight years. Multiple counts were established, including violations of insider trading, market manipulation and securities fraud under the SEL, forgery and aggravated embezzlement under the Criminal Code, and violation of the Financial Accounting Law. The Institute then filed a piggyback civil action in April 1999 with the district court and began registering other complainants. After the defendants appealed their criminal convictions with the Taiwan High Court in November 1999, the Institute again filed a piggyback civil action with that court.

By late July 2000, the Institute had already registered to act as the agent of 4,371 investors in the piggyback civil actions. The main causes of action include civil liabilities arising from securities law violations, breach of the Company Law duties for insiders, and the general tort provision of the Civil Code.\(^24\) Based on the Institute’s assessment, 3,516 investors in the piggyback civil actions would qualify for total claims of more than USD 40 million based on improper financial disclosures. About 274 investors would
qualify for total claims of more than USD 7 million based on insider trading violations.

**Chinese Automobile**

One of the Chang brothers of the founding family involved in this case was adjudicated bankrupt. Before, however, he and others were convicted of securities fraud and violations of the Company Law and the Financial Accounting Law. Their company, one of the largest automobile distributors in Chinese Taipei, was put into corporate reorganisation. The Institute is acting for 37 persons in a piggyback civil action for about USD 6.6 million.

**Kuoyang Construction**

One of the most notorious takeover specialists, and rumoured speculator in securities and property markets, Mr. Ho and his associates were prosecuted for securities violations and sued by the Institute for securities and general tort liabilities. Kuoyang was suspended from trading. The Institute acted for more than 1,154 claimants for a total claim of more than USD 60 million against the defendants.

**Taiyu Products**

Mr. Tseng and his associates were rumoured to use their political connections to get commercial deals. He and about 35 associates were prosecuted on almost ten counts of securities and criminal law violations. In one of the two piggyback civil group-litigation cases, the Institute acted for 130 investors for a total claim of almost USD 2 million. In another related piggyback group litigation arising out of the same facts, the Institute acted for 591 investors seeking a total claim of almost USD 7 million.

**Ban Yu Paper**

One of the well established paper companies in Chinese Taipei, this company deteriorated in the increasingly competitive market environment. For criminal law violations and insider trading, the elderly founder/chairman and five associates were prosecuted, and the company has been in corporate reorganisation. The Institute acted for 400 investors in a piggyback group litigation for a total claim of almost USD 600,000.
Cheng-I Food

This case may be the first ever securities related group claim case in Chinese Taipei. A maker of salad oil and other products, Cheng-I Food was listed on Taiwan’s over-the-counter market (now known as the GreTai Securities Market) in 1995. However, it turned out that since October 1990, the company had had bad debts of over USD 7 million from a distributor default. The chairman suppressed this material adverse information, privately sold company inventory and engaged in fraudulent accounting practices for the five subsequent years.

In February 1997, trading of Cheng-I shares was suspended. Its de-listing occurred in October 1997, followed quickly by criminal investigations. As of July 2000, the Institute had registered 77 investor claimants arising from the initial public offering of Cheng-I, and an additional 312 trading investor claimants.

Master Home Furniture

The founder and chairman, Mr. Shieh, and other officers were prosecuted for criminal embezzlement. The company has been de-listed since May 2000. The Institute brought a piggyback action and solicited other claimants by public notice to join in this action.

Ta-Chung Steel

About ten insiders and officers were prosecuted for embezzlement and for Financial Accountancy Law, Company Law and securities law violations. The company has ceased trading. The Institute acted for 976 investors to seek a total claim of more than USD 6.6 million.

King-Wei Textile

This piggyback action arose from criminal prosecution of the principal, Mr. Cheng, for forged accounts, securities fraud, tort and Company Law violations. The Institute acted for 36 claimants for a total claim of slightly less than USD 2 million.


The high-profile mass securities claims arising from these cases called public attention to the inadequacy of the current civil justice system in Chinese Taipei for class actions and the lack of board accountability. In a
A series of meetings of the Ministry of Finance empanelled blue ribbon Financial Reform Task Force held in 1998-99, a decision was made to rectify these inadequacies. The Task Force members recommended that a class action mechanism be adopted, drawing insight from the group litigation provisions of the Consumer Protection Law (CPL) of 1994. Acting on this recommendation, in December 1999, the cabinet submitted a Securities and Futures Investors Protection Law (Protection Law) bill to the parliament. It was enacted in 2002 and became effective in 2003.

The Protection Law authorises the establishment of a foundation called the Securities and Futures Investors Protection Centre (the Centre), thereby formally recognising the important work of the Institute. Spun off from the Institute, and now operating independently, the Centre has set up an Investor Protection Fund, which is funded primarily by mandatory contributions from securities and futures firms, and self-regulatory organisations like the stock exchange, the futures exchange and other self-regulatory organisations. This war chest, now valued at over TWD 1 billion (or about USD 30 million), is used in part to defray mediation and litigation costs and reimburse investors for their losses arising from violations of the SEL and Futures Trading Law.

The Protection Law also authorises the Centre to conduct high-profile mediation of investor disputes; it has a controversial “cram down” power to force the preliminary decision of a majority of the mediation panel on a party unless that party formally signals a repudiation of this decision in time. Should a party refuse to accept this preliminary decision, the mediation panel may publicise its decision as appropriate. In other words, if a party (usually the defendant) does not co-operate, it may have to deal with substantial adverse publicity and risk ruining its reputation.

The Protection Law provides for further preferential treatment for investors and the Centre. For example, if a party is part of a group of similarly situated persons, it may opt out of a decision of the mediation panel without affecting the validity of this decision, unless a majority of such parties in the same group opts out as well. But, once parties agree to the mediation decision, it is as binding as a final, non-appealable judgment.

The most important provision of the Protection Law is perhaps the formal recognition of representative litigation and group arbitration. These proceedings may be brought by the Centre in its own name if they are on behalf of at least 20 or more investors arising from any single dispute in the securities and futures markets.
The centrepiece of the Protection Law, this representative action and representative arbitration rule, is intended to formalise and improve proceedings in the *de facto* class actions described above. One may not be surprised by the attempt to formalise group litigation. However, this rule offers group arbitration as an unusual mechanism for alternative dispute resolution.

The Centre may not charge investors any separate compensation. This suggests the public interest nature of this programme. However, it will receive some preferential treatment in group investor litigation. In acting on its motion for provisional relief on behalf of investors, such as a pre-judgment injunction or post-judgment demand for satisfaction, the courts shall waive the requirement of posting a bond as security. For assessing court fees, the amount of investor claims which serves as the basis of calculation will be deemed not to exceed TWD 100 million (about USD 3.3 million). This would substantially reduce the court fees that have to be advanced by the Centre as plaintiff. By the same token, if the Centre suffers an adverse final, non-appealable judgment, it only has to pay court fees up to this deemed amount.

The Protection Law is a very innovative piece of legislation. A government-sponsored centre funded through a legislatively authorised levy on the securities market brings public interest securities class actions in Chinese Taipei. It works like the Hong Kong Association of Minority Shareholders (HAMS) proposal, made by corporate governance activist David Webb, which was defeated in Hong Kong. As Chinese Taipei does not suffer from extreme industrial concentration like *chaebols* in Korea, it cannot find a truly publicly interested social movement like Korea’s People’s Solidarity for Participatory Democracy (PSPD). Therefore, even though the PSPD in Korea offers perhaps the only meaningful securities class action enforcement experience by any non-profit organisation in Asia, Chinese Taipei’s experience with the Institute and the Centre demonstrates another interesting path of semi-governmental enforcement of civil claims stemming from securities violations. Of course, it remains to be seen how successful and sustainable this model will be.

10. **New experience under the Investors Protection Law**

Since 2003, the Centre has strengthened its work. For example, when the Institute brought suits in the late 1990s, it relied on piggybacking civil claims on top of criminal prosecutions. The Centre has brought independent civil suits because of the more favourable provisions under the new legislation. Even though the courts are still congested, an independent suit does not incur the delays as in the case of the piggyback civil suit, which
require waiting for hearings until the criminal proceeding has produced a conviction.

There have already been successful preliminary judgments in the Taiyu and Ta Chung Steel cases, which were handed down in 2004. In the Taiyu case, the leader was held liable for a significant sum of damages (TWD 202 million, or about USD 6 million). A similar success was obtained in the King Yuan securities fraud case decided in 2004, even though it did not involve a class action. In these cases, the court did not find the external auditors liable because the applicable provisions in section 20 of the SEL focus on issuer liability. This result is essentially similar to the 1994 United States Supreme Court decision in the Central Bank case to not recognise “aider and abettor” liability. The FSC is frustrated with district court decisions absolving external auditors in these cases. Therefore, it has proposed to strengthen the SEL provisions governing disclosure liability and fraud in securities trading to broaden the class of actors who may be held liable.

Most interestingly, in some of these decisions, young judges have borrowed from foreign experience and case law. For example, under the traditional tort principle of requiring reliance and causation to prove fraud and injury, it has been notoriously difficult to establish liability when there was fraudulent misrepresentation or omission of material adverse disclosure. In some of these 2004 decisions, judges have reversed the burden of proof by following the efficient market hypothesis and the “fraud on the market” theory of liability that arose from the 1988 United States Supreme Court decision in Basic v. Levison.

The Centre is actively preparing suits against issuers, directors, officers and other gatekeepers in response to a new wave of securities fraud incidents in 2004 that implicated the senior management and the external auditors of Procomp, Summit Computer and Infodisc. Informal accounts indicate that more than four thousand claimants may be mobilised by the Centre to join in a class action.

11. Conclusions

Corporate governance matters in Asia. However, as shown by Chinese Taipei’s experience with securities class actions, procedural rules matter as much if not more than substantive rules. Another lesson of the Chinese Taipei story is that the state matters, too. Unlike US-style class actions, in Chinese Taipei group litigation is possible because of the government’s organising efforts and the coercive power of the criminal investigation.
system, which then provides the impetus for piggyback civil actions brought by the Institute and direct class actions brought by the Centre. Arguably, litigation (or threats thereof) by disgruntled investors and angry prosecutors is inferior to other means of improving corporate governance. But, it could very well remain an important building block of Asian corporate governance systems.

Notes

1. One important feature of Asian public corporations (with the exception of Japan) is that they are often family owned despite public listing. As a result, expropriation cost rather than agency cost is the more important issue for corporate governance in Asia.


3. China’s Company Law of 1994 is very similar to Chinese Taipei’s Company Law. Although China’s Securities Law of 1999 emulates US securities laws, it still shows remarkable similarity to Chinese Taipei’s Securities and Exchange Law in areas such as the definition of securities encompassed by the legislation.


6. The most recent example is the SEL amendment in mid-2000, which permits warrants, options and corporate buybacks, and strengthens the control of related party transactions.

7. To address this problem, the Company Law actually was amended in the 1970s to force a choice. That is, once a corporate or government shareholder appoints a representative as a director, it may not designate any representative as a supervisor. A year later, however, this provision was repealed under industry pressure.

8. Company Law, article 214.

9. Since 2004, Chinese Taipei has introduced the adversarial system and cross examinations in criminal cases.

10. Since World War II, this admission rate has averaged just slightly over 1% annually. It increased to about 5% in the last ten years. The bar admission rates in Japan and Korea are similarly low. As a result, many law graduates in Chinese Taipei virtually work as permanent associates with law firms. They avoid litigation so as not to be challenged in court.

11. The lack of a corporate bar poses similar problems. In addition, the late development of financial and property markets (including suppression of foreign investment, which otherwise would have introduced some necessary know-how), until recently also inhibited the development of valuation expertise.

12. Chinese Taipei’s Code of Criminal Procedure follows the German rule of allowing private prosecution by the victim of a crime. However, in such a case, the victim would not enjoy the investigative power of prosecutors.

13. Code of Criminal Procedure, article 487. Like the private prosecution rule mentioned above, this “piggyback rule” was inspired by comparable rules in Germany.

14. Latin for “in [order to] frighten”. In terrorem is a legal term used to describe a warning, usually given in hope of compelling someone to act without resorting to a lawsuit or criminal prosecution.

15. Code of Criminal Procedure, article 504(1). An en banc deliberation must precede this ruling to refer the civil action to the civil tribunal.

16. Id., article 504(2).


18. SEL, article 157. Insiders are 10% shareholders, directors, supervisors and managers.

19. For example, based on information provided by the MOF in a parliamentary hearing in mid-2000, in 1997 the Institute launched 420 disgorgement cases. In 1998, it launched 353, and in 1999 it launched 416 such cases. The same
hearing also showed that the SFC referred a total of 187 manipulation cases and 61 insider trading cases to the prosecutors for the period from 1994 to April 2000. See Chinese Taipei’s Legislative Yuan Gazette, vol. 89, no. 37, pp. 89-90, 2000.

20. Most of such information was gathered from news reports, court judgments and the Institute’s information statements as of 20 July 2000.

21. Capture (often “regulatory capture”) is a phenomenon whereby the oversight body (often a government regulatory agency) becomes dominated by the interests of the industry that it oversees.


23. Tong Lung has reduced its capital by more than USD 90 million so as to realise the losses and concurrently increased its capital by more than USD 40 million. The reason for doing a concurrent capital reduction and increase, which is common in Chinese Taipei, is because of the Company Law’s infatuation with par value; shares may not be issued below par value. Thus, for a loss making company this complicated recapitalisation procedure has to be followed.

24. SEL, articles 20 (securities fraud), 32 (false disclosures), 155 (market manipulation), 157-1 (insider trading); Company Law, article 23 (duties of directors and managers and officers); Civil Code, article 184 (general tort).

25. The author was a member of the task force and advocated this approach.

26. CPL, article 52 (deemed ceiling of TWD 600 000 for consumer group litigation, meaning the court fees will be capped at 1% thereof or TWD 6 000, which is about USD 20, for a group litigation of 20 or more claimants), article 53 (mandatory waiver of court fees for application for injunction by consumer protection ombudsmen) and article 54 (claimants need to opt in to become a group litigation plaintiff). These CPL provisions have become more important as a public interest litigation tool. For example, after a major industrial waste dumping incident in mid-2000 contaminated the water source in the metropolitan Kaohsiung area, Mayor Frank Hsieh threatened to seek redress under the representative litigation rules of the CPL for millions of residents. Also, with the help of the Taipei City Government, owners and residents of an improperly constructed apartment building in Taipei that tumbled in the September 21, 1999 earthquake recently reached a settlement with the construction companies after threatening similar group litigation under the CPL. As in the securities cases mentioned above, some form of government actions preceded or supplemented the group litigation claims.

27. Protection Law, article 5.

28. Id., article 18

29. Id., articles 20, 21.

30. Id., articles 22, 25.
31. *Id.*, article 25.
32. *Id.*, article 25. Despite the apparent equality of this provision in its treatment of the parties, only investors can enjoy this flexibility.
33. *Id.*, article 26.
34. *Id.*, article 28. However, the 20-claimant requirement applies only at the beginning of the litigation or arbitration. If some claimants withdraw later and the total number of plaintiffs is reduced below 20, the case may still proceed with respect to the remaining claimants. *Id.*, article 29.
35. *Id.*, article 33.
36. *Id.*, articles 34, 36.
37. *Id.*, article 25. This would essentially cap the court fees for, say, district court proceedings, to TWD 1 million (about USD 33,000), even for exponentially high claims.
Appendix

List of securities class action and criminal prosecution cases in Chinese Taipei

<table>
<thead>
<tr>
<th>No.</th>
<th>Company name</th>
<th>Date of activity in question</th>
<th>Type of activity</th>
<th>Defendants</th>
<th>Date on which the Centre filed civil suit</th>
<th>Compensations demanded (in TWD 1,000)</th>
<th>Defendants of criminal case</th>
<th>Status</th>
<th>Court</th>
<th>Status of criminal case</th>
<th>Status of civil case</th>
<th>Latest development of case</th>
<th>Civil case</th>
<th>Court date</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Cheng I Food Co. Ltd.</td>
<td>1995</td>
<td>1</td>
<td>1 1 1 1</td>
<td>1998.10</td>
<td>71 018</td>
<td>389</td>
<td>Guilty</td>
<td>Jan-98</td>
<td>Guilty</td>
<td>Civil case</td>
<td>December 2, 2003. High Court reversed district court ruling. Case appealed to Supreme Court.</td>
<td>Taipei District Court</td>
<td></td>
</tr>
<tr>
<td>No.</td>
<td>Company name</td>
<td>Date of activity in question</td>
<td>Type of activity</td>
<td>Defendants</td>
<td>Compensations demanded (in TWD 1 000)</td>
<td>Number of plaintiffs</td>
<td>Status of criminal case</td>
<td>Court date</td>
<td>Latest development of case</td>
<td>Status</td>
<td>Civil case</td>
<td></td>
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<tr>
<td>2</td>
<td>Chinese Automobile Co. Ltd.</td>
<td>1998</td>
<td>1</td>
<td>1</td>
<td>14 983</td>
<td>33</td>
<td>Guilty</td>
<td>Feb-02</td>
<td>Mar-00</td>
<td>Guilty</td>
<td>Taipei District Court</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Kao Yang Construction Co. Ltd.</td>
<td>1998</td>
<td>1</td>
<td>1</td>
<td>1 924 074</td>
<td>154</td>
<td>Guilty</td>
<td>Sep-00</td>
<td>Ruling by High Court. Case appealed to Supreme Court.</td>
<td>Not guilty</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Tong Lung Metal Industry Co. Ltd.</td>
<td>1997-1998</td>
<td>1</td>
<td>1</td>
<td>369 630</td>
<td>827</td>
<td>Guilty</td>
<td>Jul-03</td>
<td>Jul-03</td>
<td>Guilty</td>
<td>Taipei District Court</td>
<td></td>
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</tr>
<tr>
<td>No.</td>
<td>Company name</td>
<td>Date of activity in question</td>
<td>Type of activity</td>
<td>Defendants</td>
<td>Compensations demanded (in TWD 1 000)</td>
<td>Status of criminal case</td>
<td>Status of civil case</td>
<td>Court</td>
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<td>Type of suit</td>
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<td>Aug-01</td>
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<td></td>
<td></td>
<td></td>
<td>Insider trading</td>
<td>Directors / supervisors</td>
<td>9</td>
<td>9</td>
<td>Reverse</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

*Chart arranged by the date on which the Centre filed the civil suit.

*A mark under “status of criminal case” indicates the company has received a ruling.

*The said company is “guilty” if the main defendant receives a “guilty” verdict, regardless whether the act for which the defendant is convicted involves the violation of the Securities Transaction Law (he might be convicted only for breach of contract or illegal proprietorship of property) or whether other defendants are convicted.

*For the latest developments in civil case, the number in parenthesis after the court date indicates the number of court hearings.

Source: Securities and Futures Investors Protection Centre, Chinese Taipei (October 2004)
Chapter 2.

Procomp: A Case in Chinese Taipei

by

Lawrence S. Liu*

1. Background

The Procomp case in Chinese Taipei is like the Enron case in the United States around 2001-2002: a new scam in a new economy. This scandal broke in 2004, but one is reminded of the wave of securities fraud cases known as the “land mine” companies cases in the late 1990s that involved the traditional sector in Chinese Taipei. Chinese Taipei had just experienced an indigenous financial crisis after having a hi-tech boom in much of the 1990s when electronics shares reigned. At the time of the land mine companies incidents, regulations were inadequate and disclosures were limited.

Procomp became a scandal in June 2004, when it defaulted on TWD\(^3\) 3 billion (USD\(^2\) 96 million) of domestic convertible bonds. Just prior to its default, in December 2003, Procomp had made a material downward adjustment of its financial forecast. In retrospect, the year 2004 seemed like the year of fraud. In addition to the Procomp scandal, two other scandals involving Infodisc and Summit were uncovered in September of that year.

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Table 1: Largest corporate scandals in 2004

<table>
<thead>
<tr>
<th>Company name</th>
<th>Date</th>
<th>Wrongful activity</th>
<th>Date on which SFIPC filed civil suit</th>
<th>No. of plaintiffs</th>
<th>Claims (TWD/USD in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procomp</td>
<td>06/2004</td>
<td>Misrepresentations in financial statements</td>
<td>11/2004</td>
<td>10 056</td>
<td>5 825/182</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Misrepresentations in prospectus</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Infodisc Tech</td>
<td>09/2004</td>
<td>Misrepresentations in financial statements</td>
<td>09/2005</td>
<td>10 498</td>
<td>3 050/95</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Insider trading</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Summit Computer Tech</td>
<td>09/2004</td>
<td>Misrepresentations in financial statements</td>
<td>02/2006</td>
<td>1 590</td>
<td>364/11</td>
</tr>
</tbody>
</table>

Note: SFIPC=Securities and Futures Investors Protection Centre

2. Facts in the Procomp case

Procomp’s main products were motherboards, IA products, and semiconductors such as GaAs EPI-wafers. A darling of the securities market in Chinese Taipei, its initial public offering price in December 1999 was at TWD 85.5 (USD 2.7) per share, and represented a price earnings ratio of 28. During its heyday, the stock traded at TWD 368 (USD 11.5 per share), representing a P/E ratio of 82, almost three times its initial P/E ratio.

In 2000 and 2001, TWD 5.9 billion (USD 188 million) of additional equity funds were provided by investors to Procomp. In 2001, Procomp issued TWD 3.5 billion (USD 109 million) of domestic convertible bonds, followed by another tranche of TWD 1.7 billion worth (USD 50 million) of offshore convertible bonds issued in 2003. In total, Procomp raised TWD 11 billion (USD 347 million) from the capital market.

The orchestrator of the Procomp scandal was its chairman, Sophie Yeh, who claimed a master’s degree from Louvain University in Belgium. A demure, quiet-looking woman, she gained notoriety after Procomp became a hot stock. Her husband is Dr. Walter Lin, a well known academic
economist in Chinese Taipei, who joined the financial community in the 1980s when a government linked bills finance company suffered a major loss because of employee fraud and embezzlement. He was asked by the Ministry of Finance to step in for the rescue, which he executed admirably. This successful turnaround earned him the nickname “the Lee Iacocca of Chinese Taipei’s financial industry”, an accolade drawn from the turnaround of Chrysler Motors in the United States by Mr. Lee Iacocca around the same time. This bills finance company was later converted into a financial holding company named “Waterland” (in English), which was presumably a word play in honour of Dr. “Walter Lin”, its chairman.

As with any other scam, the Procomp case involved a number of tricks, the first one being repeated fabricated sales. Specifically, Procomp insiders were believed to have set up a number of dummy companies in Hong Kong with Procomp employees as their representatives.

**Illustration 1: Falsification of Procomp sales**

![Diagram of Procomp sales falsification]

<table>
<thead>
<tr>
<th>Domestic Co-conspirators/Suppliers</th>
<th>Buyers</th>
</tr>
</thead>
<tbody>
<tr>
<td>A E</td>
<td>Marksman</td>
</tr>
<tr>
<td>B F</td>
<td>Emperor</td>
</tr>
<tr>
<td>C G</td>
<td></td>
</tr>
</tbody>
</table>

Sold back to Procomp

False sales

Repacked and exported commodities

(Dummy companies in HK run by Procomp Employees)
These dummy companies included: Marksman, Emperor, Farstream, Kingdom and Fasson. In addition, a number of Procomp’s suppliers in Chinese Taipei conspired in falsifying sales. These are shown as companies A through G in the illustration above.

Procomp essentially made false sales by exporting goods to these Hong Kong dummy companies which turned around and repacked these goods for export to Companies A through G and then resold to Procomp. Funds as payment would follow.

**Illustration 2: Payment flows in the Procomp case**

But, the key fact is that part of the funds at the Hong Kong dummy companies were believed to have been diverted by Sophie Yeh, and disappeared without a trace. Part of the funds were also used to pay off Companies A through G. With these repeated fabricated sales, Procomp accumulated TWD 16 billion (USD 504 million) of accounts receivable, and TWD 5.6 billion (USD 175 million) in accounts payable. If the accounts receivable and accounts payable were real, Procomp had a net accounts receivable position of TWD 10.4 billion.

A company with such an inordinate amount of accounts receivable and accounts payable and this kind of sales/purchases concentration would, of course, cause suspicion. As a result, Procomp resorted to another trick to window dress its financial statements. It converted the accounts receivable into deposits with financial institutions. The Hong Kong dummy companies deposited USD 85 million in Procomp’s account at Metropolitan Bank and Trust Company as partial payment for goods they had purportedly bought from Procomp. Procomp concurrently authorised Metropolitan Bank to buy
a credit linked note (CLN) issued by the Hong Kong branch of Société Générale (SGA) for the same amount. The CLN was linked to North Asia Financial Company, which was another dummy company with a Procomp employee as its representative. North Asia borrowed the same USD 85 million from SGA.

Illustration 3: USD 85 million fabricated deposit with Metropolitan Bank & Trust Company

Fabricated sales used to transfer funds to dummy companies in HK
Dummy companies in HK deposit USD 85 million in Procomp’s account at Metropolitan Bank & Trust Company as partial payments for goods

Procomp was able to show this deposit (which had restrictions that were not disclosed) on its balance sheet. When Procomp announced its application to seek corporate reorganisation, Metropolitan Bank transferred the CLN to Procomp and terminated its deposit agreement with Procomp. So, this USD 85 million simply “evaporated” upon the bankruptcy filing.
Illustration 4: Fabricated deposit with Metropolitan Bank & Trust Company (continued)

Authorised Metropolitan Bank & Trust Company to buy USD 85 million CLN with credit link to North Asia Financial Company issued by SGA. The CLN was put under Metropolitan Bank & Trust Company’s custody.

The North Asia Financial Company borrowed USD 85 million from SGA

Procomp announced reorganisation proposal. Metropolitan Bank & Trust Company transferred CLN to Procomp and terminated the deposit contract with Procomp

The same deception was used to fabricate a USD 45 million deposit with Austrian Commonwealth Bank which bought some accounts receivable from Procomp through CTB, a subsidiary. CTB, in turn, sold the accounts receivable to AIM Global Finance Ltd., another dummy company chartered in the British Virgin Islands, which was believed to be controlled by Sophie Yeh.
The payment for the accounts receivable by CTB was remitted to Procomp’s account with Australian Commonwealth Bank and was placed as a deposit. It was used to buy a zero-coupon bond issued by AIM based on the accounts receivable. Again, with the bankruptcy filing by Procomp, Australian Commonwealth Bank exercised an offset against the USD 45 million deposit that was used to buy the zero-coupon bond.

There was another fabricated deposit of USD 50 million with Rabobank and Metropolitan Bank, using Best Focus Assets Ltd. and Fernvale Assets Ltd, two British Virgin Islands dummy companies controlled by Sophie Yeh’s friends. These dummy companies borrowed USD 50 million from the two banks to subscribe to an offshore convertible bond (OCB) issued by Procomp, which was underwritten by the Hong Kong subsidiary of Hua Nan Securities, a subsidiary of Hua Nan Financial Holding, a financial holding company in Chinese Taipei. Procomp placed the OCB proceeds as a deposit with the banks. Meanwhile, it executed a share buyback plan which caused the shares to rally, whereupon the dummy companies converted all the OCBs into shares and sold them to make capital gains on the side. Again,
when Procomp filed for corporate reorganisation, the banks made an offset against the deposit.

A final ploy that came to light involved Addie, yet another British Virgin Islands dummy company with a Procomp employee as its representative. A USD 10 million deposit was placed with Bank SinoPac which is a subsidiary of SinoPac, a financial holding company in Chinese Taipei. Grand Capital, an offshore second-tier subsidiary of that bank, then made a loan for the same amount to Addie with Procomp guaranteeing the loan repayment obligations using the deposit. When Procomp sought corporate reorganisation, the USD 10 million again disappeared because the bank made an offset through the loan against it.

Illustration 6: Guaranteed dummy companies to transfer cash USD 10 million

1. Deposited USD 10 million

   **Procomp**

2. Lent to Addie USD 10 million

   **Addie**
   (Dummy company in BVI. Representative was Procomp’s employee)

3. Deposits as guarantee for Addie’s borrowing

   **Bank under a financial holding corp.**

   **Grand Capital**
   (Overseas subsidiary of the same financial holding corp.)

To tally up, through these tricks, about TWD 6 billion (USD 190 million) of deposits disappeared after Procomp filed for its corporate reorganisation. The existence of these funds was questionable in the first place because they may have been camouflage for the inflated accounts receivable that Procomp generated. Furthermore, these deposits carried restrictions and underlying obligations that were never disclosed.
3. Liabilities

The directors (supervisors under Chinese Taipei’s binary board system), senior management and employees at Procomp were liable for wrongful conduct. The primary wrongful conduct involved misrepresentations in the financial statements, misappropriation of company assets, and making false statements in connection with applications and filings made with government agencies.

In addition, other third parties were liable. The external auditing firms (in this case KPMG and Deloitte Touche Tohmatsu), and the audit accountants apparently failed in their audit, and did not follow generally accepted auditing standards. They were liable for errors and omissions in the certification of Procomp’s financial statements.

Yet another group of third parties were potentially liable: underwriters in Chinese Taipei that worked on the offshore financial transactions like Yuanta, Fubon, Hua Nan (which is a government-linked bank), and Taiwan International Securities (which is now more than 40% owned, though not controlled, by China Development Financial Holding (CDFH)). In Chinese Taipei, underwriters have to file reports in connection with the financial transactions they sponsor. There were misrepresentations in the reports written in connection with the Procomp transactions.

In the public’s view, certain foreign banks also played a dubious role. But authorities in Chinese Taipei did not have the power to launch investigations abroad to prove this theory. Some of these foreign banks only had a representative office in Chinese Taipei. In the end, no sanctions against these foreign banks were made or came to be known to the public, perhaps because of enforcement difficulties. However, it is fair to say that they would not be in good standing in the eyes of Chinese Taipei regulators.

4. Investigations and enforcement

The Procomp case fell in the lap of the Financial Supervisory Commission (FSC) immediately upon its creation in July 2004. The FSC was reconstituted as a commission by transferring the enforcement power of the Ministry of Finance to it. Only some of the commissioners had been recruited at the time when Procomp filed for reorganisation.

Nevertheless, the FSC immediately began investigations amidst the public outcry. In October 2004, prosecutors brought criminal charges against 31 individuals related to Procomp. In December 2005, Sophie Yeh was sentenced to a 14-year prison term and was also assessed a
TWD 180 million (USD 5.6 million) criminal fine. In May 2006, prosecutors in Chinese Taipei appealed this conviction, seeking a 20-year prison term and a TWD 500 million (USD 16 million) criminal fine (the original sanctions they had sought in the district court). Under Chinese Taipei’s Civil Law and Code of Criminal Procedure, prosecutors can make such appeals if they think the lower courts err in the sentencing part of the judgment.

Chairman Walter Lin of Waterland Financial Holding, the husband of Chairman Sophie Yeh of Procomp, was removed in June 2005 by an order of the FSC after it came to be known that he had received remittances for about TWD 2 billion (USD 61 million) from his wife for reasons and uses which he could not plausibly explain.

The two lead accountants who worked on the Procomp audit were suspended from practice for six months, a sanction unheard of in the past, considering its adverse reputation impact and the potential loss of future employment opportunities. The underwriters received written warnings from the FSC. These were only the administrative sanctions arising from the Procomp case.

The FSC also mobilised the Securities and Futures Investors Protection Centre (SFIPC) to bring civil litigation against the offenders and the third parties involved. The SFIPC is a government supported, public interest, non-profit foundation which had been spun off in 2003 from the Securities and Futures Institute, another government supported, public interest, non-profit foundation charged with training securities industry professionals, and conducting securities market related research and other outreach programmes. The SFIPC spin-off from the SFI came about because of the passage of the Securities and Futures and Investor Protection Law in 2003, which formally recognised “representative civil litigation” for a group of victims harmed by the same set of offences. This is the equivalent to class actions in Chinese Taipei.3

The SFIPC brought direct litigation on behalf of 10,056 investors in Procomp, and sought TWD 5.6 billion in damages. In these lawsuits, directors, supervisors, managers of Procomp as well as the audit firms, attorneys and underwriting firms were named as defendants. The four underwriters then settled with the SFIPC for TWD 78 million (USD 2.4 million). The two audit firms also settled with the SFIPC for about TWD 90 million (USD 2.8 million). The internal allocation of the settlement amongst the four underwriters and the two auditors is not a matter of public record.
5. The impact of the Procomp case

Procomp will have a profound impact on the development of corporate governance in Chinese Taipei. First, the SFIPC has become an important enforcement arm of the government, through civil litigation to recoup as much as possible from those who are both responsible and who have substantial assets.

The Procomp litigation and settlement has become a model for the SFIPC to pursue in other similar fraud cases in Chinese Taipei. It now has had a total of 41 securities cases under its management, in which it acts for over 57,000 investors claiming over TWD 24 billion (USD 738 million) in damages. The largest claim so far involves Pacific Electric Wire and Cable, in which the SFIPC acts for over 25,000 investors seeking over TWD 8 billion (USD 250 million) in damages.

Second, underwriters and auditors are on notice that they are gatekeepers, and that they will suffer liabilities if they are not careful. They now face the prospect of increased damages for negligent sponsorship or negligent certification of financial statements. Meanwhile, the impact of Procomp has been felt throughout the market. For this and other non-economic reasons, the market in Chinese Taipei has been flabby. Underwriters now focus more on secondary offerings of more seasoned companies, rather than initial public offerings by new applicants. A new underwriting system which charges underwriters with more responsibilities (like market stabilisation during the public offering period, and keeping negative points for rejections by the stock exchange), has affected the IPO market.

Third, forward-looking statements had been mandatory in Chinese Taipei. In the Procomp case the criminals turned the table on investors and the public by using this requirement to manipulate stock prices. This mandatory rule was amended in 2005 to become voluntary, in part because of the moral hazards painfully illustrated in the Procomp case.

Fourth, the Company Law was amended in 2005 to provide that subsidiaries may not enjoy any voting rights for the shares of the parent company held by them. It was a common practice among the land mine companies in 1998-99 to use subsidiaries to churn the stock of their parent. The 2001 amendment to the Company Law prohibited further purchases of parent company stock by subsidiaries. But it did not address the voting rights issue until 2005. In addition, the 2005 amendment also included a shareholders proposal rule that allows shareholders owning 1% to table one shareholder proposal at the annual general meeting.
Fifth, the most important legal change affected by Procomp was the Securities and Exchange Law amendment of 2006. For the first time, it created the legal basis for creating and mandating independent directors and audit committees (for public reporting and listed financial services companies and large-cap companies). Chinese Taipei has had a binary board system similar to the Japanese system, though it was wavering between the binary and unitary board systems. This new system will be ushered in over the course of three years (which is the maximum term for directors in Chinese Taipei) beginning in 2007. The amendment also prohibited the same legal persons from being elected through their representatives as both a director and a supervisor of the company, thereby alleviating the problem presented by Chinese Taipei’s representative director/supervisor system for decades.

The 2006 amendment to the Securities and Exchange Law also enhanced the integrity and honesty requirements for company officers and representatives. The responsible persons (that is, the chairman and the general managers of issuers) will have to certify financial statements. They and the issuers will be strictly liable for material misstatements in reports and filings made with regulators. Other employees and auditors are subject to proportional liability for misstatements. In addition to the intensification of the civil liability provisions, provisions in the Securities and Exchange Law governing criminal and administrative penalties were also strengthened.

Notes

1. TWD=New Taiwan dollar.
2. USD=United States dollar.
3. See paper by Lawrence Liu entitled “The Merits of Shareholder Collective Actions (Class Action Suits) in Chinese Taipei”, also in this publication.
Chapter 3.

Ensuring Judicial Infrastructure: The Theory and Practice of Specialised Courts

by

Maarten Kroeze*

1. Introduction

A developed set of corporate governance rules can only be successful with an effective enforcement framework. This notion is also present in the OECD White Paper on Corporate Governance in Asia. The second priority in the White Paper is that “[A]ll jurisdictions should strive for effective implementation and enforcement of corporate governance laws and regulations”.

Enforcement of corporate governance rules is a weak spot in many developed market economies. It is therefore no surprise that this is also the current situation in transition and developing economies. During this roundtable some of the most important enforcement mechanisms are addressed. These mechanisms cannot succeed without a developed judicial infrastructure. This is also emphasised in the first OECD Principle. A key factor in each judicial infrastructure is a court system with competent, capable and impartial judges. The White Paper mentions the following concerning courts:

“Court systems should further strengthen their expertise and capacity to adjudicate corporate governance disputes efficiently and impartially, including through establishment of specialised commercial courts and promotion of alternative dispute

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resolution.\textsuperscript{2}\(^2\) (…) “Areas for active experimentation should include specialised company law courts and investigatory and prosecutorial teams.”\textsuperscript{3}\(^3\)

This paper focuses on the role of specialised courts as a means of establishing a well functioning corporate governance system. The first part addresses the theory of specialised courts and will lead to an answer to the question: Are specialised courts a good idea? The second part of the paper is dedicated to the functioning of some specialised business courts in practice. This will lead to practical recommendations concerning the establishment of specialised courts for business matters.

As a preliminary remark, it should be mentioned that almost all the literature and practical experience with specialised business courts is in civil litigation. In general, civil litigation in business matters plays a larger role in Europe and the United States than in Asia. Some arguments, however, can be applied likewise to specialised criminal litigation.

2. The theory of specialised courts

2.1 What is a specialised court?

Most jurisdictions in the world have specialised courts. A specialised court can either be set up as an independently functioning court or as an administratively created specialised division of an already existing general court.\textsuperscript{4}\(^4\) The way a specialised court is organised is not the essential question as long as there are safeguards for its proper and independent functioning. For example, many European countries have assigned adjudication of commercial cases or bankruptcy cases to a specialised division of an existing general court.

A specialised court can be described as a court or an independent division within a general court with limited and usually exclusive jurisdiction in one or more specific fields of the law. Judges who serve in a specialised court are experts in the fields of law that fall within the court’s jurisdiction.\textsuperscript{5}\(^5\)

Fields of law that are frequently assigned to specialised courts are juvenile and tax cases. But specialised courts for cases on bankruptcy law, labour law, patent law, commercial law and anti-corruption law are not uncommon. There is a good deal of literature on the advantages and disadvantages of specialised courts.\textsuperscript{6}\(^6\) An overview of their advantages and disadvantages follows.
2.2 Advantages of specialised courts

There are some strong arguments in favour of establishing specialised courts:

1. Specialised courts can resolve questions of law more efficiently and effectively. The judges in a specialised court are experts in their field with experience in handling matters in that field.

2. Specialised courts make better quality decisions leading to more predictability.

3. Specialised courts can devote more time to individual matters, without having to give priority to other cases, such as criminal cases.

4. Specialised courts tend to adopt an informal approach to procedural matters. They are therefore better equipped to adjust the procedure to individual aspects of a case.

5. Specialised courts have a significantly higher percentage of settlements. The reason is probably because specialist judges can give better directions with more authority.

6. An argument that was raised in the US is that general courts and other litigants can also benefit from transferring highly complex litigation to specialised courts, so that the dockets of general courts are not drained by complex business cases.

These arguments are traditional arguments. They were raised when competition was almost completely national. In today’s world with a global economy and opportunities to invest in different countries or economies, another very important argument has evolved in favour of establishing specialised courts for commercial and business matters:

7. A business court can play an important role in the economic development of regions or countries. It can be used as a tool to attract companies, businesses, investors and investments to a given jurisdiction or to prevent them from leaving. A prerequisite is that the specialised court give added value to companies and investors. The argument of competitive advantage from specialised courts is of special importance for courts that specialise in business law and fields of law that are related to business, such as patent law, bankruptcy law or labour law.

Global competition between economies has recently been used as an argument in favour of business courts in the United States and the Netherlands. This illustrates that the argument of competition is used in
developed economies. The argument is even more appealing for transition and developing economies.

2.3 Empirical data

There is substantial research that supports the assertion that enforcement is a key to effective corporate governance in transition and developing countries. It has even been suggested that enforcement is perhaps “the, central functional difference between developed market economies and developing countries”. There is also research that indicates that shareholder and creditor rights are being undermined by weak judicial systems in some Asian countries. The court system is an important feature of any judicial system. For private enforcement to succeed it is necessary to establish a set of civil procedures that allow for efficient, expedient and just litigation. Investors have remarked that many of the deficiencies in the legal environment are caused by the weaknesses of a judiciary which in many countries is underfunded, lacks commercial experience and is prone to being influenced by powerful local interests. This weak enforcement environment is to the detriment of economic growth because foreign investors avoid jurisdictions with a weak enforcement environment or demand higher returns on their investments. Economists have also pointed to the effect of weak enforcement on the quality of investments. Investments in a weak enforcement environment tend to be direct investments. Better enforcement will attract a larger short-term portfolio of equity and bond flows.

2.4 Disadvantages of specialised courts

Strong objections have been raised against specialised courts:

1. The US judge Rifkind expressed the view that, in time, the body of law that is addressed by a specialised court, secluded from the rest, “develops a jargon of its own, thought patterns that are unique, internal policies which it subserves and which are different from and sometimes at odds with the policies pursued by the general law”. Specialisation “intensifies the seclusiveness of that branch of the law and that further immunises it against the refreshment of new ideas, suggestions, adjustments and compromises which constitute the very tissue of any living system in law”. In a principle statement he puts forward that “[t]he very essence of the judicial function” is not close familiarity, but “a detachment from, a dispassionateness about the activity under scrutiny”.
2. An objection that is somewhat connected to the objection of Judge Rifkind is that forcing specialist advocates to argue before generalist judges ensures that the law will remain intelligible, at least to the average lawyer. Basic assumptions will not be taken for granted, and questions will be seen in a context broader than that of narrow specialist concerns. It is also argued that legal thought may benefit if legal issues are considered by different courts. A specialised court is often the only one of its kind.

3. Another serious concern that has been put forward in US legal literature (which is probably connected to the electoral system of state judges in the United States) is that a specialised court is more vulnerable to influence by special interest groups than general courts are. This is because there are usually more general courts and it is not worthwhile for special interest groups to lobby if there are only a few cases in every single general court.

4. An argument that was recently raised with success to oppose the institution of business courts in Pennsylvania and California is that a specialised court gives a higher quality judicial resource to certain categories of cases at the expense of other cases. No litigants should have “better” justice than others.

3. The practice of specialised business courts

3.1 Introduction

This section of the paper describes the practice of specialised business courts. It begins with a brief description of some existing business courts in the world and concludes with practical recommendations for the establishment of business courts.

3.2 The Chancery Court of Delaware

Probably the most famous business court in the world is the Chancery Court of Delaware. The Chancery Court is not a specialised court by appointment but by chance. Its specialisation is the result of the incorporation of a large number of US companies in Delaware. Although the Chancery Court also hears cases in other fields of law including cases on trusts, real property, civil rights and commercial and contractual matters in general, it is especially renowned as a highly specialised court for corporate issues. Also, some of the judges of the Supreme Court of Delaware are experts in corporate law matters.
Legal scholars regularly debate the origin of Delaware’s success as a state of incorporation. More than half of the 500 biggest US companies are incorporated in Delaware. About 40 percent of all listed companies on the New York Stock Exchange are Delaware corporations. One of the explanations for this success is the important role of the Chancery Court in shaping corporate law rules flexibly, effectively and efficiently.

It is noteworthy that the objection of Judge Rifkind that specialisation intensifies the exclusiveness of a given field of law and immunises it against the refreshment of new ideas is attenuated by the fact that the Chancery Court also hears cases in other fields of law. In addition, the Chancery Court hears cases on three different locations with different judges. The objection that a specialised court leads to one-sidedness may be largely neutralised by the fact that a handful of different specialised judges hear cases. It appears that the organisation of the Chancery Court has some inherent characteristics that defuse some of the objections against specialised courts.

### 3.3 Other business courts in the United States of America

There has been a recent movement in other states within the United States to establish business courts. This movement was the result of concerns that have been expressed in American business and legal communities regarding the efficiency, predictability, experience and knowledge of courts with respect to complex corporate and commercial disputes. At this moment there are more than ten states in the US that have introduced a business court. Two of them are described below:

#### 3.3.1 New York

As of 1 January 1993, the State of New York established four specialised commercial departments to hear complex commercial and business cases. Experienced judges were assigned to these commercial departments. The result was a 35 percent increase in productivity in complex business cases in the first year. Also, the settlement rate of cases increased. In 1995, the New York Supreme Court (which, despite its name, is a court of first instance) set up its Commercial Division, which now adjudicates business cases in seven counties in the State of New York. The Commercial Division is a successful example of a business court. The American Bar Association called the New York Commercial Division “a model of a specialised court devoted to the resolution of business disputes”. It has been said that the business court is popular because it has demonstrated that it can provide efficient, cost-effective and timely
processing of commercial cases, and has improved the quality and predictability of judicial decisions.\textsuperscript{24}

\subsection*{3.3.2 Maryland}
Maryland created its Business and Technology Court in 2002. The court focuses on business disputes in general and on issues important to companies in the technology industry. Why was the subject matter of the business court extended to technology law issues? The reason is as obvious as it is pragmatic. Information technology is Maryland’s largest field of economic activity. It has one of the largest concentrations of bioscience and aerospace companies and the highest percentage of technological workers in the US.\textsuperscript{25} Maryland made a pragmatic and sensible choice by assigning fields of law to the specialised court that would have the largest impact on its economic position.

\subsection*{3.4 The Business Court of the Netherlands}
The paper now turns to some experiences in the Netherlands.\textsuperscript{26} In 1971, the Business Court of the Netherlands was established. This specialised court is a division of the Court of Appeal in Amsterdam. An exceptional feature of the Business Court is that it hears cases with three judges and two outside members. The outside members have experience as auditors, as members of the boards of large companies, or as trade union officials.

The Business Court does not adjudicate all corporate matters. For example, director liability cases are left to the civil or commercial divisions of general courts. As a generalisation one could say that the court has jurisdiction over conflicts within companies. The court can, for example, at the request of shareholders or trade unions, order an inquiry into the conduct and policies of the company if there are well-founded reasons to doubt the correctness of the policy. The investigators (for example, attorneys, legal scholars or auditors) will produce a report. This report not only serves transparency, but can also lead to a second procedure in which the court may order specific measures to redress incorrect policies. The court can declare that the company was mismanaged and who is to blame for that mismanagement. Remedial measures include dismissal of directors, temporary appointment of other directors, temporary deviation from the articles of association and nullification of resolutions.

In addition, the court can take provisional measures at any stage of the inquiry procedure. It can make almost any order it considers appropriate in the interest of the company. The president of the Business Court stated that this authority comes close to the equitable jurisdiction of the courts in
common law countries. The court also adjudicates minority squeeze-out procedures, financial statement procedures and matters of co-determination law. The Business Court has been very successful. The procedure is informal, efficient and effective. The court adheres to strict timetables. If necessary, a case will be heard and decided within a few days. The court adjudicates almost all tender and takeover conflicts in big listed companies. Conflicts in smaller companies have also been solved successfully.

The main reason for establishing the Business Court in 1971 was that the Dutch financial statement procedure and the inquiry procedure demanded expert adjudication and an expert insight into the needs of companies and into the relationships within the business community. It is worth mentioning that the Dutch Minister of Justice in September 2004 produced a memorandum on the modernisation of Dutch company law. He expressly stated that the presence of the Business Court as a specialised court could enhance the attractiveness of the Netherlands as a place of business.

3.5 The Intellectual Property Court in Thailand

Although initially not set up as a business court, the establishment of the Thai Central Intellectual Property and International Trade Court at the end of 1997 is worth mentioning. The International Intellectual Property Alliance stated that with the establishment of this court the Thai government had taken steps to address the structural problems of inefficiency, security breaches, inter-agency rivalry and general lack of co-ordination that plagued Thai enforcement efforts in the past. The specialised court is seen as the single most important factor in creating a legal environment that is friendly to international trade and investment and to establish a recovery of the Thai economy as a whole.

The court hears civil and criminal cases on the enforcement of intellectual property rights throughout the country. It also has exclusive jurisdiction on matters of international trade. This includes matters of international sale, carriage, payment, insurance and anti-dumping. The court also has exclusive jurisdiction in the enforcement of arbitral awards in these matters. The procedural rules are aimed at facilitating an efficient forum. One of the reasons to group intellectual property rights and international trade together was that a sufficiently large workload had to be created to warrant a separate court system.
4. Concluding remarks and recommendations

What lessons can be drawn from the theory and practice of specialised courts?

4.1 Are specialised business courts a good idea?

1. Specialised business courts can improve the enforcement of corporate governance rules. Better enforcement attracts investment and companies. This contributes to economic growth. A specialised business court is, however, not a panacea for every enforcement problem. It is one of the measures that can contribute to better enforcement, but it has to be complemented by other enforcement mechanisms.34

2. The question whether the advantages of a business court outweigh the disadvantages cannot be answered in general. This question has to be answered for each individual situation. The argument that specialised business courts can contribute to economic growth, however, carries much weight for transition and developing economies. This argument can be decisive for these economies because they have much to gain from a specialised court. Practical experience, however, illustrates that developed countries also establish business courts or justify business courts with the argument of economic development.

3. A business court can only be successful if certain necessary conditions are satisfied. These conditions vary from well-trained judges and well-balanced procedures that guarantees impartial adjudication, to a working system of notifying parties of court dates and a transport infrastructure to get parties to courtrooms.35 These necessary conditions are available or can be made available in most Asian countries.

4. It is easier to control and develop the quality of the handful of specialised court judges than of the many judges of general courts. It is worth considering adding one or more expert laypersons to the bench as is done in the Netherlands Business Court and the Thai specialised court.

5. The disadvantages of specialised courts have to be taken seriously. They are, however, inconclusive for each field of law and within each jurisdiction or economy. The ethical argument that no litigants should have better justice than others is too absolute. It neglects that there may be valid reasons justifying some litigants getting better
justice than others as long as the minimum standards are good enough. This is especially the case if a clear line can be drawn between business cases and other civil cases. Every potential litigant in an economy, especially in a transition or developing economy, may benefit as a citizen from the economic development that may be derived from the establishment of a business court.

6. The argument that special interest groups can influence the specialised court has to be taken very seriously. However, the establishment of a specialised business court can also be used to shield the court from the influence of special interest groups or local interests by a rigorous selection of judges and by offering attractive terms of service and a proper salary.\textsuperscript{36} The economic advantages of a business court will most certainly outweigh the additional costs of attractive terms of service.

7. With these reservations, the establishment of business courts seems a promising idea for transition and developing economies in the Asian region. Practice shows that business courts can also be useful in developed economies.

4.2 What practical lessons can be drawn from the use of specialised business courts?

8. The objection that specialisation leads to immunisation of the law against refreshment through new ideas, may be addressed (as the Delaware example indicates) by extending the subject matter of the court to other fields of law. It is noteworthy in this respect that the Intellectual Property Court of Thailand has a broad jurisdiction. Other solutions might be the incidental participation of specialised judges in hearings of general courts or constituting different benches within one specialised court.

9. The business courts addressed here have flexible procedural rules and an efficient way of dealing with cases. This seems to be an important condition for a successful specialised court.\textsuperscript{37}

10. The Business and Technology Court of Maryland illustrates that it is worthwhile considering extending the jurisdiction of the specialised court to fields of law that have an impact on economic development in a given jurisdiction. The Thai example shows that it is also important to create a sufficient workload to warrant a separate court system.
11. Often a specialised court is the only one of its kind. The obvious location of the court is the economic capital of a country or region. In large jurisdictions this can cause practical obstacles, especially for domestic cases. The establishment of a few specialised courts in large jurisdictions, or the authorisation of general courts at the discretion of both parties to adjudicate business matters instead of the specialised court, deserve consideration. Another possibility might be to limit the subject matter of the specialised court to cases with international aspects (for example, because one of the parties is foreign). Thailand chose this last solution.

12. The Business Court of the Netherlands does not prohibit parties from conducting their oral pleadings in English or documents from being produced in English without translation (upon approval of both parties). It is worth considering allowing procedures in the English language or minimising the compulsory translation of documents. This presupposes that the judges (and the parties and/or their attorneys) have a good command of the English language.

13. Some thought has to be devoted to the possibilities of appeal. For practical reasons it is possible to exclude the possibility of appeal. Decisions of the Dutch Business Court are not eligible for appeal; there is, however, the possibility to go to the court of cassation (court of last resort). One could also allow for rectification by the specialised court in order to correct evident mistakes. If there is a competent general court of appeal, it may be worth considering the possibility of appeal. This also addresses the immunisation of the law against its refreshment through new ideas. For example, general courts of appeal are competent to hear complaints against the decisions of US business courts.

14. An outstanding question is whether it is a good idea to authorise the specialised court to hear criminal cases. This would also depend on the extent to which violations in the field of business law create a criminal offence and to what extent the enforcement of, for example, corporate governance rules is in the hands of private parties. An informal approach to procedural matters (one of the advantages of specialised courts) is out of the question in criminal cases.

15. Arbitration will remain an important way of getting justice. It is worth considering (as did the Thai government) extending the jurisdiction of the business court to the enforcement of arbitral awards. Although almost all countries are parties to the Convention of New York on the Recognition and Enforcement of Foreign
Arbitral Awards, it is sometimes difficult for parties to enforce arbitral awards.

16. And last but not least: the need for specialised courts decreases if the general enforcement infrastructure is better developed. It is therefore of great importance to improve the general enforcement infrastructure. This applies to transition and developing countries in the Asian region. It applies likewise to developed countries in Asia and in other regions. For example, in Europe much effort is put and has to be put into the recognition and enforcement of decisions within the European Union in cross-border disputes.

Notes

2. *Idem*, §41.


31. Idem, p. 363. The author is a judge in the Specialised International Property Court.

32. See the judicial statistics of the court at: www.geocities.com/cipit_ejournal/.


Chapter 4.

Relations between Regulators and Prosecutors in Korea

by

Yong-Jin Jung*

1. Acts and regulations on corporate governance

The acts covering corporate governance in Korea include Part III Companies of the Commercial Act, the Securities and Exchange Act, and the Monopoly Regulation and Fair Trade Act (MRFTA).

With the greater recognition of the importance of corporate governance after the financial crisis of 1997, Korea has continuously pursued the amendment of each of these acts. As a consequence, most of the OECD Principles of Corporate Governance has become legislated and is now either being enforced or is scheduled for enforcement. The types of violations and the punishments for violations under each act are described further below.

2. Administrative bodies regulating corporate governance

The administrative bodies monitoring and regulating corporate governance in Korea are the Korea Fair Trade Commission (KFTC) and the Financial Supervisory Committee (FSC). This paper focuses on the regulation of corporate governance by the KTFC. Regulation by the FSC will be touched upon briefly.

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The KFTC’s tasks

The KFTC is the Korean competition authority, which works to promote fair and free competition in the markets. The regulations of corporate governance among business conglomerates is not traditionally regarded as a role for a competition authority. However, since the governance of Korea’s business conglomerates (or chaebols) may potentially trigger harmful effects on market competition, the KFTC takes a lead here as well.

Problems of control structures in business conglomerates

Korea’s business conglomerates allow control of entire groups with only 4% of the share ownership by means of cross-shareholdings between affiliates and the control of executives in affiliates.

Table 1: Internal share ownership ratio of 10 private business groups as of April 2004

<table>
<thead>
<tr>
<th>The Same Person</th>
<th>Related Parties</th>
<th>Affiliates</th>
<th>Total (Internal Ownership Ratio)</th>
<th>External Ownership Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.5%</td>
<td>2.5%</td>
<td>40.8%</td>
<td>44.8%</td>
<td>55.2%</td>
</tr>
</tbody>
</table>

These structures cause a number of problems. Cross shareholdings between affiliates cause excessive gaps between cash flow rights and voting rights. As a consequence, they can: i) enable the dominance of large business groups with a small amount of capital, and; ii) allow owners and related parties to pursue personal profits at the expense of minority shareholders by blocking internal and external monitoring mechanisms.

In addition, cross-shareholdings between affiliates lead to behaviour that keeps insolvent companies in the market and excludes potential competitors from entering the market. This hampers fair competition and can trigger a chain of bankruptcies among affiliates.

Since minority shareholders have little interest in monitoring and replacing executives through hostile takeovers, the regulation of business conglomerates by administrative body’s is required.
What to regulate?

Companies under business conglomerates whose total amount of assets of affiliates surpass KRW\(^1\) 2 trillion shall:

- Not own shares of affiliates that hold their own shares;
- Not guarantee the debt of other domestic affiliates;
- Disclose large scale internal trading with related parties at the shareholders’ meeting;
  - Related parties means an owner who actually controls the company concerned, or any relative who has a relationship with an owner.
  - Undue internal trading or preferential dealing in capital, assets and personnel to related parties is prohibited. Such practices often occur within large business conglomerates.
- Financial affiliates shall not exercise voting rights over their own shares in other domestic affiliates (though there are several exceptions).

Next, companies under business conglomerates with more than KRW 5 trillion of total assets shall not hold shares of other domestic companies surpassing 25% of their own net assets (the amount deducting the shareholdings in affiliates from the total amount of capital in the company concerned). However, equity investments that are necessary for business activities are excepted.

- The draft amendment of the MRFTA is under deliberation in the National Assembly.

The KFTC examines large business conglomerates annually under the above regulations and reports its findings. As of January 2004, there were 48 business conglomerates (with 847 affiliates in total) that fell under the restraint on cross shareholdings, and 15 business groups (with 342 affiliates in total) that were subject to the ceiling on the total amount of shareholdings in other domestic companies.

Preventive and corrective measures, and criminal punishment

In order to prevent any violation of competition law, the KFTC requires companies to report and make notifications to the KFTC. The KFTC has a

\(^1\) KRW=Korean won.
number of authorities including investigative powers, and the right to correct violations, order share disposals, prohibit the exercise of voting rights, and impose surcharges and administrative fines.

The KFTC’s investigative powers include the right to ask suspected offenders to come to the KFTC office, listen to the opinion, request documents and information, and confirm the information. However, the KFTC is not empowered with any coercive rights, such as search and seizure, or imprisonment.

Among the corrective measures, the ability to impose large fines has proven effective against large companies with strong capital bases. In response to illegal internal trading, the KFTC can impose fines of up to 5% of the average of three year’s of revenues of the company concerned.

Criminal punishment can be imposed separately from administrative measures for most of the violations cited above. However, prosecutors can only take a public action when there is a complaint filed by the KFTC. When corporate violations require severe punishment, the KFTC can file a complaint with the Prosecutor’s Office or the Prosecutor’s Office can ask the KFTC to do so.

The regulations of the FSC

The FSC supervises activities in the financial arena. In particular, the Securities and Future Committee under the FSC handles unfair trade investigations in the securities and futures markets, business accounting standards, and accounting supervision. The supervisory and regulatory means available to the FSC are similar to those that are available to the KFTC. On the other hand, unfair trade practices (such as insider trading, the falsification of financial statement, and violations of accounting standards) are subject to criminal punishment. An FSC complaint to the Prosecutor’s Office is not needed to begin a public action against criminal activities.

3. Korea’s prosecutorial system and its relations with administrative bodies

Characteristics of the prosecutorial system

Korea’s prosecutors have the right to investigate crimes and take public action. Even though the judicial police also have investigative rights, these fall under the control of the prosecutor. Only prosecutors have the right to request warrants of judges for coercive investigations, such as search and
seizure and arrest. Judicial police must address requests for warrants to prosecutors.

Korea does not have private prosecution as it exists in the UK or the US. Rather, it has public prosecution by the state where only prosecutors have the right to take public action. In addition, Korea has discretionary indictment (when prosecutors cannot take public action after considering the motives and situation of the crime), even though the behaviour concerned can be regarded as a crime.

Relations between prosecutors and administrative bodies

Both administrative bodies and prosecutors are national bodies with separate goals. As administrative investigations are not criminal investigations, they do not, in principle, need to be controlled by prosecutors. Exceptions are allowed when the Securities and Futures Committee investigates unfair trading practices under the Securities and Exchange Act. In practice, administrative bodies and prosecutors work closely together to carry out their tasks.

In other words, when the administrative body finds indications of crime through its investigative process, it files a complaint, asks for further investigation, or provides a notice to the Prosecutor’s Office. In this case, the information and documents in the possession of the KFTC and the FSC can be used for the prosecutor’s investigation. However, the use of information obtained during the questioning of suspects by the two organisations is circumscribed under the Criminal Procedure Act. In addition, it requires a complementary investigation by prosecutors.

- The FSC investigated 214 cases of alleged unfair trade practices under the Securities and Exchange Act in 2003. Among these, 56 cases were filed as complaints and 77 cases were asked to be investigated.
- The KFTC filed 23 complaints in 2001, 11 cases in 2002 and 18 cases in 2003 with prosecutors. Among these, were six complaints of insider trading.

On the other hand, if prosecutors think that administrative measures are required according to the results of their criminal investigations, they report this to the relevant administrative body. In addition, if the KFTC and/or FSC are conducting investigations at the same time as prosecutors, the Prosecutor’s Office and the relevant administrative body work closely together by exchanging information and apprising the other parties of the results of their investigations.
It is, however, hard for administrative bodies to co-operate effectively with prosecutors due to their lack of legal experts. While in the US, both the Department of Justice and the Prosecutors’ Office are in charge of giving legal advice to national organisations, this is not the case in Korea. For this reason, prosecutors are seconded to relevant administrative bodies in order to enhance their efficiency in handling certain tasks. Currently, one senior prosecutor and one prosecutor have been seconded to the KFTC, while another prosecutor has been seconded to the FSC where he is carrying out similar tasks.

**Team investigations in Korea’s Prosecutor’s Office**

Investigative teams are formed if: i) there are many relevant suspects in a complicated case, and its investigation needs to be completed within a short period of time, or; ii) a concentrated and unified investigation is required based on expert investigative capabilities. Investigative teams are generally formed of either: i) the department under the Chief Public Prosecutor in the District Public Prosecutor’s Office, or; ii) prosecutors seconded from the District Public Prosecutors’ Office and prosecutors under the Central Investigation Department in the Supreme Public Prosecutors’ Office. If necessary, the investigative team can be formed of tax officials under the National Tax Service and accountants under the FSC. Experts from the private sector can be on the team as contract based workers. There are increasing numbers of team investigations, in particular in cases that require special levels of expertise and special attention to integrity.

After the Financial Crisis of 1997, the Korean government formed a public fund to restructure financial institutions and protect depositors by issuing bonds through the Korea Deposit Insurance Corporation. In order to hold owners and senior business executives responsible for causing financial instability, a joint investigative team was formed for the public fund under the Central Investigation Department of the Supreme Public Prosecutors’ Office. One senior prosecutor and three prosecutors were seconded to the special investigative team for insolvent companies, which is an adhoc body under the Chairman and President of the Korea Deposit Insurance Corporation. The Chairman and President oversees the investigative team, which consists of representatives of the judicial police, tax officials, public accountants, and staff of the Korea Deposit Insurance Corporation. This team is working to identify and punish illegal practices such as the embezzlement of corporate capital or fraudulent loans.
4. A real investigation: The case of S Group

The control structure of S Group

Illustration 1: The control structure of S Group
(As of the end of March in 2002)

The facts of the crime
The facts of the crime are as follows:

- The owner of S Group and the CEO of Company B, along with the head of the Restructuring Committee of the group signed a share swap contract between Company W’s unlisted shares (owned by S Group’s owner) and Company A’s (a holding company of S Group) shares owned by Company B (the owner of S Group is the controlling shareholder of this company).

- The contents of the contract were as follows:
  - The object of the exchange was shares in Company W and in Company A.
  - The exchange ratio of shares in Company W to shares in Company A was equal to 2:1.

- However, the exchange contract had the following problems:
The correct estimated value of shares in Company W compared to shares in Company A was really 1:2.

Because of the skewed valuation of shares, the owner could gain three quarters of the share value of Company A, and Company B had to accept that amount of loss.

- Such behaviour is considered misappropriation under the Criminal Law.
- The reasons that such a contract was possible in the first place can be attributed to the following factors:
  - There was no clear valuation standard for non-listed shares.
  - Since the owner of S Group controlled Company B, the CEO of the company could not act independently from the owner of the group. As a consequence, the CEO of Company B signed the contract benefitting the owner even though it was to the detriment of his own company.

There were other criminal cases related to S Group. However, this explanation focuses on the part related to the governance of the enterprise.

**The goal of the crime**

As illustrated above, Company A served as a holding company for S Group. Although the owner of S Group hardly had any shares in Company A, he could control Company A through his shares in Company B. In addition, the owner came to control the overall group through this kind of circular shareholding. However, as of 1 April 2002, pursuant to the regulation setting a ceiling on the total amount of shareholdings in other domestic companies, the owner could only exercise his voting rights in 2% of the shares in Company A held by Company B, all of which amounted to 10.8%. As a result, the control of the S Group became more difficult. Faced with this situation, the owner of S Group committed a crime in order to maintain the control over the group by directly acquiring shares of Company A by way of the flawed exchange contract.

**Progress on the investigation and co-operation with administrative bodies**

In early December 2002, the Prosecutor’s Office received information on criminal acts in the case. After the prosecutors formed the investigative team (which consisted of 11 members, including prosecutors and
accountants under the FSC), it confirmed the basic facts through various documents on S Group and investigations conducted by working level officials. Prosecutors carried out two searches and seizures, thereby securing documents, which related the group owner, the head of the Restructuring Committee and the CEOs of affiliates to the abovementioned criminal activities. As a consequence, prosecutors could get confessions from all of the suspects. The KFTC and the FSC had simultaneously taken measures against administrative violations related to the acts based on the documents discovered by prosecutors.

Even though a leniency programme exists under the Administration Law in Korea, there is no regulation like arraignment, or plea bargaining under US criminal law. In other words, there is no special institutional tool to encourage “whistleblowing” on improper behaviour among senior executives. Since Korea has discretionary indictments, it can encourage confessions from suspects by suspending indictments against an internal informant or a collaborator in the investigation. However, the best way to encourage statements on the violations of senior executives from subordinates is to secure evidence through search and seizure, thorough analysis of the evidence, and objective and reasoned persuasion.

5. The significance of the investigation

By taking advantage of the fact that there is no clear valuation method for non-listed shares, owners of chaebols with small amounts of share ownership, could create conditions that were more favourable to themselves. They strengthened their control over the group and caused losses to minority shareholders. This investigation is significant in that it takes strong action by prosecuting and confining the owner of the group and the head of the Restructuring Committee.
Chapter 5.

The Prospects for Arbitration and Alternative Dispute Resolution

by

Michael Hwang*

1. Why arbitration?

There are a number of reasons for considering arbitration in the resolution of company law disputes:

- Arbitration is confidential and private.
- Arbitration is viewed as a more neutral process than litigation, especially in developing countries, where there is greater distrust by foreign investors of national courts. This is especially so if the arbitration is conducted under the auspices of an established arbitration institute (e.g. the International Chamber of Commerce, the London Court of International Commercial Arbitration in Europe, the Singapore International Arbitration Centre, and the Hong Kong International Arbitration Centre in Asia).
- An established arbitration system can lead to an increase in foreign investments because of investors’ distrust of local courts and local laws. This is especially so in emerging markets.
- Arbitration allows parties to choose the governing law of the dispute.
- Arbitration allows parties to appoint arbitrators with specialist backgrounds, for example, arbitrators with an accounting background.

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• Arbitration is more flexible compared to national court procedures and, therefore, more suitable for company disputes, which often require creative remedies.

• Arbitration is viewed as more cost effective and timely compared to litigation in national courts (which may take a longer time because of the appeals system).

• Arbitration allows parties to select the language of the dispute resolution process as well as their preferred lawyers.

2. Suitability of arbitration in company law disputes

Some kinds of company law disputes are more or less suitable for resolution through arbitration:

(i) What kinds of company law disputes are particularly suited for arbitration?

− In general, actions which involve financial relief are more suitable for arbitration than actions which involve requests for injunctive relief or declarations of status.

− In some jurisdictions, a number of company law disputes have been held to be suitable for arbitration. One example of this is executive employment agreements.

− Other kinds of company law disputes which are suitable for arbitration include shareholder disputes in privately held companies and breaches of joint venture agreements, particularly foreign joint ventures.

(ii) What kinds of company law disputes are not suitable for arbitration?

− In general, actions which require orders in rem1 rather than orders in personam2 are less suitable for arbitration, i.e. actions in which declaratory rights are to be made in respect of the status of the company or matters under national company law which require a court order, such as winding-up actions, reduction of capital and schemes of arrangement, declarations of validity of corporate acts, granting of relief from officers’ liabilities for breaches of duties.
3. Difficulties of arbitration in company law disputes

The root of the difficulties of arbitration in company law disputes is that arbitration is contractual in nature. Arbitration in company law disputes therefore requires parties to the arbitration to have signed up for arbitration in advance. This also explains why disputes involving joint venture agreements are more suitable for arbitration.

Although disputes involving members of a privately held company are particularly suitable for arbitration, arbitration of such disputes first requires a valid arbitration clause in the charter (i.e. the memorandum and articles of association) of the company. Therefore, unless there is a valid arbitration clause in the charter, arbitration will not be available as a remedy for intra-company disputes.

Where the dispute involves the company itself, the company itself must be a party to the arbitration agreement or arbitration clause in the charter of the company or, as in the case of disputes involving joint venture agreements, in the joint venture agreement itself. This is especially so in the case of joint ventures, where the company is usually not a party to the joint venture agreement which contains the arbitration clause.

Another difficulty in arbitration of company law disputes lies in the common law qua member principle, i.e. that the charter of the company only binds shareholders in their capacity as shareholders. This is particularly difficult where the disputes relate to, for example, a director of the company who is alleged to have breached fiduciary duties even if he is also a shareholder and the charter allows the arbitration of disputes between shareholders and directors. The problem with arbitrating such a dispute is that it may be difficult to join the director as a party to the arbitration because he is being joined in his capacity as a director (since the directors are not usually parties to the company’s charter), and not as a shareholder of the company.

In the case of minority oppression, there is again the problem of whether such actions and minority rights may be enforced where such rights are not specified in the charter of the company or the joint venture agreement. Further, one of the remedies a national court may order is the winding-up of the company where it finds that there has been minority oppression. However, arbitrators are not usually able to make an order of winding-up. This leaves the minority shareholders with one less remedy.
arbitral tribunal can make an order directing a shareholder to take steps to wind up a company or to sell his shares or buy another shareholder’s shares.

There is also the issue of what might be a valid arbitration agreement, where such an agreement is found in the company’s charter. Under the New York Convention, an arbitration agreement is defined as including “an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams”. The problem with an arbitration clause in a company’s charter is that it is not signed by subsequent shareholders (although as members of the company they are bound by the charter by the operation of law), and therefore, the question is whether or not such an arbitration clause amounts to an arbitration agreement under the New York Convention. This problem has yet to be resolved.

As for publicly listed companies, the difficulty of arbitrating disputes lies in the fact that the shareholders are potentially vast and geographically dispersed. This gives rise to concerns over whether these shareholders have given binding consent to arbitration, and whether they have been given sufficient notice when arbitration has begun. Further, there is also the question of whether consent procedures which are developed in favour of arbitration of company law disputes (especially in developed markets) are unconscionable because they are coercive, represent contracts of adhesion and effectively deny investors access to a dispute-resolution forum.

Policy concerns, such as the inherent state interest in applying and interpreting its own company law, the perceived value in judicial enforcement of standards for publicly listed companies and the likely intersection of company law issues with issues such as employment, insolvency and tax law, which have a high public interest element, have resulted in difficulties in the acceptance of arbitration of company law disputes in some countries.

On a practical level, there are concerns over the adequacy of arbitration in complex cases as well as the sufficiency of incentives for plaintiff’s lawyers to pursue claims before an arbitral tribunal.

4. Enforcement

Lastly, an arbitral award has little value unless it can be enforced. The New York Convention (with 134 signatories) provides for the recognition and enforcement of foreign arbitral awards by national courts, unless one of the limited exceptions applies. The difficulty here lies in the interpretation of these exceptions. How national courts interpret these exceptions varies widely, and expansive interpretations arising from ignorance, bias or
corruption on the part of national courts (especially in emerging markets where the legal system is less developed) can result in the setting aside of arbitral awards and the effective gutting of shareholder rights. In this respect, there is a need for training and education of judges, particularly in emerging markets.

5. Conclusion

Notwithstanding the various legal, policy and practical difficulties, there is a growing interest in enlarging the scope of arbitration in company law disputes. This is a task being explored with the assistance of international organisations and other arbitration institutions.

Notes

1. Against a thing, such as property, status, or a right, rather than against a person.
2. Against a person rather than against property.
3. However, some national legal systems do allow such actions to be arbitrated. These types of actions have been held to be arbitrable in the United States. See the case of Re Salomon Inc. Shareholders’ Derivative Litigation, No. 91 Civ. 5500 (RPP), 1994 WL 533595 (SDNY Sept. 30 1994) and Green Tree Financial Corp. v. Bazzle, 2003 WL 21433403 (US). In contrast, the Singapore High Court has held that a derivative action can only be brought in court and not in arbitration. See Kiyue Company Limited v. Aquagen International Pte Ltd. (2003) 3 SLR 130 (This decision has been affirmed by the Singapore Court of Appeal).
4. This is because of the well-established principle in English law that a shareholder may not enforce rights in a capacity other than as a shareholder. See for example Eley v. Positive Government Life Assurance Co (1876) 1 Ex D 88.
5. Under section 12 of Singapore’s International Arbitration Act (Cap 143A), arbitrators are given powers to “award any remedy or relief that could have been ordered by the High Court if the dispute had been the subject of civil proceedings in that Court”, although no court decision has
yet to interpret the scope of this provision, and whether this power extends to the making of a winding-up order by an arbitrator.

6. Article II (2)

7. For example, in some states of the United States, it has been held that an arbitration clause in an employment contract is unconstitutional because the right of the employee to a jury trial is effectively taken away by the arbitration process.
Chapter 6.

Implementation and Enforcement of Rules in Singapore
and the Case of China Aviation Oil

by

Yuen Teen Mak, Luh Luh Lan and Azrudi Bin Buang*

The last few years have seen a number of high profile corporate scandals involving listed companies in Singapore, the biggest of which was the case involving large undisclosed derivative losses suffered by China Aviation Oil (CAO). More recently, a number of charities have also been plagued by allegations of poor corporate governance and mismanagement and, in one of these cases, legal action was initiated by both the authorities and the new board of directors against the old board of directors and the former CEO. This paper discusses the legal framework in Singapore as it applies to cases of commercial misconduct or white collar crimes, describes the enforcement of rules in these cases with a specific emphasis on the China Aviation Oil case, and provides some suggestions for further improvement to enhance the enforcement of rules.

1. Singapore’s legal system

Singapore’s legal system is based on the common law system, where the decisions of higher courts constitute binding precedent upon equal or lower status courts within the jurisdiction. Thus, the law is derived from judgments made in prior cases over the years and is given the force of law. In some

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cases, statutes were introduced which restated the common law position in order to codify such case laws.

In Singapore, the Penal Code (Cap. 224) was adapted from the Indian Penal Code (1863) and was introduced to consolidate laws related to criminal offences. In the context of white collar or economic crimes, this covers offences such as criminal breach of trust (§405), cheating (§420), falsification of accounts (§477) and forgery (§463).

Other statutes related to specific types of offences were also introduced. With reference to white collar crimes, these include the Companies Act (Cap. 50), the Securities and Futures Act (Cap. 289) and the Prevention of Corruption Act (Cap. 241).

1.1 The Companies Act

The Companies Act governs companies in Singapore and is generally based on principles established in England. Over the years, Singapore has also adopted principles drawn from corresponding statutes in Australia, New Zealand (e.g. share buybacks, abolishing of par value, etc.) and Canada (e.g. statutory derivative actions). As such, decisions in these jurisdictions are often cited in Singapore. However, case laws from overseas jurisdictions made after Singapore’s independence in 1965 are only persuasive and are not binding to the courts in Singapore.

1.1.1 Duties of a director

Of particular interest to this paper are §157 of the Singapore Companies Act, which states the duties of a director, and §216A, which covers derivative or representative action for minority shareholders. §157 is the statutory statement of the duties of a director and was derived from the Australian Companies Act. The effect of §157 is to make mandatory the duties of a director. It is in addition to any other law on the duties of a director. It requires that a director shall act honestly and use reasonable diligence in the discharge of his duties.

In Singapore, the civil standards of skill and diligence expected of a director mean whether he exercises the standards expected of a director in his position. This varies with his role in the company, the type of decisions made, and the size and business of the company. A director, however, is expected to take as much care in the affairs of his company as he would reasonably take in his own affairs. That said, a director is not in breach of director’s duties if he entered a commercial decision bona fide in the best interest of the company, even if the decision proves to be a bad one.
Under common law, a member of a company can commence an action in his own name to enforce the company’s rights after certain procedural requirements have been met. This is known as a derivative action. As the right is derived from the company, any benefit would accrue to the company. This would allow minority shareholders to enforce the company’s rights when the majority shareholders or directors fail or choose not to do so, such as in the case of fraud against minority shareholders. However, there are several obstacles, such as the stringent procedural hurdles, the high cost involved and the lack of evidence, which the company may be unwilling to provide.

1.1.2 Statutory derivative action

§216A, adapted from similar provisions in the Canada Business Corporations Act, allows a member of the company to take an action on behalf of the company and overcomes many of the obstacles to derivative actions under common law. However, this statutory derivative action does not apply to listed companies. This exclusion was intended to prevent manipulation of share prices through the filing of frivolous applications to harass listed companies. In addition, it is believed that shareholders of listed companies can always resort to alternative avenues to seek redress, such as selling their shares. As such, minority shareholders of listed companies in the recent high profile corporate scandals in Singapore would have to turn to derivative action under common law if they would want to take any legal action to correct any breach of duties of management or directors.

1.2 The Securities and Futures Act

The Securities and Futures Act (SFA), which replaced the Securities Industry Act in 2001, regulates the securities industry in Singapore. The SFA governs matters such as securities offerings, licensing, insider trading, disclosure requirements, auditing and other related matters. The SFA has generally improved law and regulation and eased the burden on prosecution. The sections which have been most relevant to recent cases are discussed below.

1.2.1 Making and disseminating false or misleading statements

Under the SFA, §199 states that no persons shall make a statement or disseminate information that is false or misleading and that is likely to induce others to buy, sell or subscribe for securities or affect the prices of securities. A contravention would be an offence and be punishable under the SFA.
1.2. **Insider trading**

In the case of insider trading, the SFA introduced various changes to insider trading regulations which overcame difficulties faced in prosecution of insider trading cases. A major change was to widen insider trading to include persons not connected to the corporation. Thus, as long as a person possesses information which is not generally available and is materially price sensitive, they would be liable for inside trading. It would not matter how the individual came to possess such information. In addition, in the case of persons connected to the corporation, there is an assumption that the person knew that the information is not generally available and is materially price sensitive. These changes reduced the burden on the prosecution in proving insider trading.

Other improvements include a broader definition of securities to include futures and derivatives, provision of a non-exhaustive definition of information, prohibition on insiders from communicating information to others and the assumption of intent to use the insider information when a person trades.

1.2.3 **Civil penalty**

Despite the improvements in the SFA with regards to insider trading and other market offences, difficulties in prosecution still exist as a balance was sought to prevent innocent parties from facing prosecution. To overcome this, the civil penalty under §232 of the SFA was introduced. It allows the Monetary Authority of Singapore (MAS) to impose a civil penalty for a breach of the SFA. This eases the burden on prosecution, as the balance of probability in prosecution is lower. It is not a criminal action and, as such, does not attract criminal sanctions.

1.3 **Prevention of Corruption Act**

The Prevention of Corruption Act (PCA) was enacted in 1960 to more effectively prevent corruption. It empowers the Corrupt Practices Investigation Bureau (CPIB) to investigate corruption in both the private and public sectors. Bribes received are forfeited in the form of a penalty, equal to the amount of bribes received under the charges if convicted. If other bribery charges are taken into consideration in sentencing, the penalty may be increased by the bribes under these additional charges.
1.4 Regulatory bodies

Besides the CPIB, investigations and enforcement of commercial misconduct in Singapore are primarily conducted by the Commercial Affairs Department, in conjunction with the MAS. The MAS is playing an increasingly important role, being responsible for civil penalties under the SFA. The Singapore Exchange (SGX) manages day-to-day regulation of companies listed on the exchange. The Attorney General’s Chambers advise the government on legal matters and act as the public prosecutor. Deputy Public Prosecutors conduct criminal prosecution and direct investigations by the law enforcement agencies, evaluating if offences have been committed and what charges should be made against the offenders.

The Accounting and Corporate Regulatory Authority (ACRA) was established in 2004, through a merger of the Registrar of Companies and Businesses, and the Public Accountants Board. ACRA administers and enforces the Companies Act, monitors company compliance with accounting standards and regulates public accountants.

2. Recent commercial misconduct cases

2.1 Criminal actions

In recent years there has been a spate of corporate scandals and actions taken against commercial misconduct. This paper reviews the high profile cases, which involved public listed companies and a well-known charity group. Some other cases are also highlighted to complete a discussion of the issues. The largest company had a market capitalisation of close to SGD 1 billion prior to the revelation of the scandal. These companies were from diverse industries, ranging from oil and related products, education and waste metal recycling to non-profit charity organisations. Details relating to these cases are shown in the appendix to this paper.

Prosecution has focused primarily on top management, in particular the Chief Executive Officer and the Chief Financial Officer. Actions taken against the board of directors were limited, and no action was taken against the independent directors. In most cases, no action was taken against the company itself for the breaches, despite the involvement of top management. Actions have also been taken against lower-level employees who were involved in the offences.

The offenders have been prosecuted under a range of offences. The most common offences include: 1) making false statements in annual reports or earnings statements; 2) falsifying documents; 3) insider trading; 4) corruption, and; 5) cheating. Other charges include breach of director’s
duties, failure to produce a balance sheet at an annual general meeting, employment of manipulative and deceptive devices in share trading, criminal breach of trust, and failure to continuously disclose information to the stock exchange. Among the directors who faced prosecution, making false statements in the annual reports was the most common violation. Notably, however, only three directors from two companies faced prosecution for breach of director’s duties.

The sentences meted out ranged from 20 weeks to 8 years of jail. The latter was imposed on Citiraya’s assistant general manager for corruption, falsification of documents and criminal breach of trust. Fines ranged from SGD 10 000 to SGD 1.6 million. This last sum was imposed for accepting a total of SGD 1.7 million in bribes.

In most cases, the defendants pleaded guilty to the charges. Few defendants contested the charges, and all of the cases which have concluded resulted in successful convictions. In the cases reviewed, the time taken for offenders to be charged after the scandal first came to light ranged from 5 to 19 months. The convictions and sentencing occurred 1 day to 10 months after the charges were first filed. Therefore, enforcement actions have generally been prompt.

2.2 Civil penalty

§232 of the SFA gives the MAS the power to impose a civil penalty on offenders. It is noted that the frequency of use of civil penalties has been increasing, particularly for insider trading cases. The lower burden of proof is likely a key reason why regulators have increasingly turned to the use of civil penalty. In most civil penalty cases, the offenders have co-operated with regulators and agreed to the penalty without court action, thus avoiding possible criminal sanctions.

Thus far, all but two cases under §232 have been for insider trading. One of these cases involved Trek 2000 International which was fined for breaching continuous disclosure requirements under the SFA §203(2). In the other case, a trader was fined for contravening the false trading provisions under §197(1)(b) of the SFA after he carried out purchases to increase the share price of the ASA Group Holdings in order to maintain or increase the value of his margin account to avoid margin calls.

For insider trading cases, the most notable case was the SGD 8 million penalty paid by China Aviation Oil Holding Corporation (CAOHC) when they sold 15% of their stake in China Aviation Oil (CAO) while possessing the generally unavailable and materially price sensitive information that CAO was facing financial difficulties relating to derivative losses.
2.3 Civil action

Civil action is uncommon in Singapore. In the high profile cases described in this paper, the companies incurred huge losses that, in the case of CAO, wiped out close to SGD 1 billion in market value. However, civil action was taken only in the case of the National Kidney Foundation (NKF). In the NKF case, the newly elected board of directors took action against the old board of directors, claiming an estimated SGD 12 million for breach of director’s duties and other damages. This case is currently pending. The only other action taken by shareholders was where some shareholders of CAO filed a class action suit in the US to recover losses. However, it was dismissed by the US court, for lack of jurisdiction over a Singapore case.

However, there were other cases where directors were taken to court. In Vita Health Laboratories Pte. Ltd. and Others v. Pang Seng Meng [2004] 2 SLR 162, the defendant was held liable for causing accounts to be misstated, abusing his position as executive director and breaching corporate duties. He was ordered to pay damages to the plaintiffs.

In this case, as well as in the case of ECRC Land Pte. Ltd. v. Wing On Ho Christopher [2004] 1 SLR 105, the defendants were not held liable for entering into a commercial decision which turned out to be a money losing venture. The court upheld earlier case law which stated that a director is not in breach of his duties simply because a commercial decision turned out to be a bad one, if the decision was made in the honest and reasonable belief that it was in the best interest of the company.

3. China Aviation Oil – A case study

3.1 Overview

China Aviation Oil was incorporated in Singapore on 26 May 1993 and listed on the Singapore Exchange on 6 December 2001. China Aviation Oil Supply Corporation (CAOSC), one of the largest state-owned enterprises in China, was the largest shareholder. Following a restructuring, the shareholding of CAOSC was transferred to China Aviation Oil Holding Company (CAOHC). CAO’s main business included jet fuel procurement, international oil trading and oil-related investment. CAO traded globally in fuel oil, gas oil, crude oil, petrochemical products and oil derivatives and handled virtually 100% of China’s total jet fuel imports. Annual sales revenue was SGD 1.7 billion in 2002 and market scope had expanded beyond China to ASEAN, the Far East and the US.

CAO was responsible for purchasing all of China’s jet fuel requirements. In 2002, it began trading oil-related derivatives (futures and
It subsequently started speculative trading in futures and swaps, and later, back-to-back trades involving options. By late March 2003, CAO had begun speculative trading in options. Its initial entry into derivatives trading was profitable, as they correctly bet that oil prices would rise. In the 4th quarter of 2003, it predicted that oil prices would fall. It bought put options and sold call options. However, its strategy proved to be flawed as oil prices continued to rise, from USD2.35 to USD55 per barrel. As its losses mounted, it rolled over its position by selling even larger call options with longer expirations in the hope that oil prices would fall. In October 2004, CAO’s inability to meet its margin calls forced it to close off a number of these derivative contracts.

At the end of November 2004, CAO disclosed that it had trading losses of USD 550 million. Trading in the company shares was suspended and the SGX directed CAO to undertake an investigation, which was carried out by PricewaterhouseCoopers. In the months that followed, it was revealed that there was a general failure in corporate governance and risk management at CAO. Amongst other issues, it was also alleged that CAOHC had made a placement of shares to two institutional investors while being aware of at least some of the derivative losses and that, about two weeks prior to the public disclosure of the large derivative losses, the company had released a statement that it was expected to remain profitable.

Prosecutions followed, with the CEO and Head of Finance getting jail terms of 4 years 3 months and 2 years respectively. Fines were imposed on them, as well as the other directors who were aware of the losses and made false and misleading statements.

However, the prosecution chose not to proceed with a second criminal charge against CAO director, Gu Yanfei who was alleged to have failed to use reasonable diligence in the discharge of her duties as a director by failing to disclose CAO’s losses to the board. This was despite evidence that she was aware of the losses, having been convicted of failing to notify SGX of the same losses. It is unclear why the charge was dropped.

3.2 Corporate governance in CAO: The presence of form

Information in the prospectus from the initial public offer and the annual reports gave details on how corporate governance and risk management was expected to be practised in the company.

As is the usual practice, day-to-day operations were delegated by the board of directors to the management led by the CEO, who was the only executive director. The Risk Management Committee reported aggregate swaps) to hedge its jet fuel purchases against fluctuations in the price of oil.
risk exposure arising from oil-related physical and derivative trading activities to the CEO. Once losses exceeded USD 5 million, authorisation from the CEO was required before trading could continue. Unfortunately, in this case, trading was allowed to continue after passing the loss limit, finally closing at USD 550 million, over one hundred times the limit.

The CAO Audit Committee was composed of two independent directors and one non-executive director and was created to oversee the internal audit. The internal audit department was to support the audit committee in ensuring that there was a system of internal controls and processes to manage business risk. Thus, a basic risk management and corporate governance structure was in place.

3.3 Corporate governance in CAO: The absence of substance

As the massive losses suggest, the risk management procedures failed to perform as proposed. The accumulated losses were reported to the CEO in a marked-to-market report. However, the information on losses was not circulated to the board of directors. To compound this, the internal audit and the audit committee failed to identify the poor risk management controls or detect the losses incurred.

Under common law, the mere fact that the company suffered losses from speculating in oil options does not translate into a breach of director’s duties. Directors are not liable simply because a commercial decision, made in the honest and reasonable belief that it was in the best interest of the company, resulted in losses.

The issue here is why the losses were not properly detected and reported, and why trading was not stopped after passing loss limits. The directors ought to have been aware that CAO was speculating in options since both the annual report and the company’s website had disclosed the trading of options for speculative purposes to increase profit. Given the oversight responsibility of the board of directors, the board, and the audit committee, in particular, should have ensured that appropriate risk management policies and internal controls were implemented by management.

However, the investigations suggested that the entry into speculative trading of options was not formally approved by the board in line with its risk management policies and that the risk management policies were not adapted to the speculative trading of options. The investigations also raised many other issues, including the suitability of the accounting policy for derivatives and inconsistencies between the risk management policies described in public documents and the actual practices within the company.
The investigations report was critical of many parties, including the board of directors, the audit committee, the CEO, the finance department, the internal auditor and the external auditor.

It appears that the directors in CAO delegated essentially all responsibilities to their subordinates, trusting that the CEO and management would act honestly. §157C of the Companies Act allows directors to rely on the reports and information provided by their employees, other directors and professional advisors. However, this does not mean that directors can delegate responsibility to the point of abdication of their responsibilities.

This issue was raised in the English Court of Appeal in the case of Re Barings plc (No. 5) [2001] 1 BCLC 523. The court held that although directors can “delegate particular functions to those below them in the management chain… the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions”. Directors, especially independent directors, are intended to supervise management. The CAO case begs the question whether the delegation of supervisory duties (that amounts to the abdication of duties to the parties that were meant to be supervised), represents a breach of duties.

However, prosecution will prove difficult. Delegation of duties is a common practice. A non-executive director will generally delegate his duties, as they are not involved in the day-to-day management and must rely on his subordinates or other directors. In Huckerby v. Elliot [1970] All ER 189, a director is not liable for breach of duty because he trusted another director or manager who lied. In this case, the only executive director was Chen Jiulin, who was the CEO. As such, all the other directors would have relied on the CEO or other managers to perform their duty. This delegation and reliance on other persons would not lead to liability on their part. However, as the learned judges in Re Barings plc stated, delegation does not mean directors are not required to supervise the delegated functions. Questions remain regarding whether the directors were performing their duties and, more generally, what is expected of directors in supervising delegated functions. In the CAO case, only the CEO, who was a director of the company, was charged for breach of director’s duties.

4. Proposed reforms

4.1 Criminal action

In the recent cases reviewed, there was limited action taken against the board of directors for breaching their duties as directors, whether executive or non-executive. Crucially, no action was taken against any independent...
directors by the authorities. Independent directors, particularly those on the audit committee, play a crucial role as a counterbalance to the excesses of management. In addition, the board of directors is appointed by the shareholders to safeguard the assets of the company with which it has been entrusted. Firm action against directors is therefore necessary to send a clear signal on the duties of directors and their role in corporate governance.

Currently, the Singapore Exchange listing manual requires companies to follow a code of corporate governance on a comply or explain basis. The code details the role and responsibilities of the board and directors. In addition, the Companies Act sets out the responsibilities of directors, particularly on matters such as accounting records and internal controls. Perhaps clearer guidelines need to be in place, in particular with respect to the role of independent and non-executive directors in audit and remuneration committees, and with regards to risk management.

Another issue that merits consideration is what actions should be taken against directors whose dealings, decisions or inactions that fall short of the more serious crimes, such as fraud, cause detriment to the company through negligence or incompetence. It is submitted that in today’s environment, all directors appointed to the board, including the independent directors, will have to play a greater role in corporate governance.

On the other hand, it is important to thoroughly assess the impact of corrective measures. Placing excessive expectations on directors and enforcing them with criminal sanctions may deter qualified people from taking up the position and may result in a shortage of qualified directors. In the authors’ view, a preferred measure is to allow the court or another regulator to disqualify directors for a certain period for serious breaches of duties, without criminalising their actions. This could be used for cases of gross negligence, where criminal actions may be too draconian.

Another issue raised in one of the recent cases is whether criminal actions for breaches of director’s duties can actually be pursued against someone who is not named as a director, but is in fact a de facto or “shadow” director. Under §4 of the Companies Act, a director includes a de facto director and a shadow director. In one of the cases, the CEO was sued for breach of fiduciary duty as a director under a civil action, even though he was not named as a director, because investigations strongly suggest that he could be a shadow or de facto director. However, whilst criminal action for breach of fiduciary duty was taken against two named directors, no such action was taken against him for breach of fiduciary duty.

Cases exist of companies attempting to amend their articles to allow a CEO to not be a director of the company. While there may be other reasons for such a change, anecdotal evidence suggests that it may be an attempt to
shield the CEO from criminal action for breach of director’s duties. Therefore, the difficulty and reluctance to take criminal actions against shadow or de facto directors may encourage companies to use creative means to shield their CEOs from criminal liability.

4.2 Civil action

§216A of the Companies Act, which provides for statutory derivative action, is limited to unlisted companies. As such, shareholders of listed companies who wish to sue in Singapore would have to do so using derivative action under common law. Derivative action is rare in Singapore. The only civil action against the directors occurred in the case of the National Kidney Foundation. The lack of civil action can be attributed to various factors such as its high cost, the difficulty in proving a breach of duty and the expected recovery of damages. In the case of CAO, other considerations could have affected the decision not to sue directors, as several of them were also employees of CAOHC, the largest shareholder. The lack of civil action is a concern as it is one mechanism to deter breach of director’s duties, as directors would be held liable for the losses the company faced.

4.3 Disqualification of directors

The Companies Act disqualifies a person from being a director of a company under certain circumstances. §149 disqualifies a person from being a director if he was a director within the three years prior to the company going insolvent or if the court is satisfied that the person’s conduct as a director makes him unfit to be a director or to take part in the management of a company. §154 states that a person is disqualified if he breaches his duties as a director and is convicted under §157.

In the cases reviewed in this paper, only the CEO of CAO was convicted under §157 while the other companies were restructured and did not go into insolvency. As such, none of the directors were disqualified from being a director, though several were removed from the board. The only concession made was that some directors pledged not to be a director of listed companies for a period of time. In the case of CAO, one of the directors remained in charge of restructuring the company and continued to sit on the board of directors. CAO defended the retention, arguing that the director was capable, knew how business worked in China and was the bridge between CAO and its parent company. The director has since resigned from the board of directors after the restructuring, although she remains as a special advisor.
Critics have argued that allowing directors to retain their positions after such incidents hurts investor confidence, violates the spirit of good corporate governance in Singapore and sends a poor signal to investors on how serious these companies take the responsibilities of a director. The authors submit that companies should be proactive in replacing their board of directors when there are hints that they have failed to perform their duties and that these directors be disqualified from holding future positions as directors.

Another suggestion is that Singapore could adopt §8 of the UK Company Directors Disqualification Act 1986 which allows the Secretary of State, after receiving a report from an inspector appointed under certain sections that confer investigatory power, to apply to court to make an order disqualifying any person in the public interest. This would permit the relevant authority to weed out in the public interest directors who may not have committed a sufficiently grave crime to be convicted, but have clearly been negligent or incompetent.

Currently, directors are only punished in the most egregious cases, usually involving dishonesty or fraud. Gross negligence, either through action or inaction, is generally not punished by the authorities or through civil action pursued by shareholders, even though it constitutes a breach of the director’s duty to act with reasonable diligence. While there may be concerns that enforcement actions against gross negligence may exacerbate the shortage of qualified directors, the absence of any form of sanctions may create moral hazard and encourage a mindset of “see no evil, hear no evil and speak no evil” amongst directors, including independent directors. In this case, one could legitimately question the rationale for having independent directors to enhance the corporate governance of companies.

4.4 Transparency in investigations and enforcement actions

In the recent cases described in this paper, special auditors were appointed to investigate and report to the board of directors and to regulators on what went wrong. However, at most, only summarised versions of reports have been placed in the public domain due, in part, to concerns about libel. Consequently, it is difficult for investors and other stakeholders to properly judge whether enforcement actions have always been pursued vigorously and applied even-handedly without fear or favour. More complete disclosures of investigations can also hold those who have failed in their duties to be held more accountable for their actions or inaction, even if difficulty in proving breaches prevents regulators or others from taking enforcement actions. Public shaming can be a useful deterrent against wilful incompetence or negligence.
The authors also believe that the libel laws in Singapore make the media risk averse and discourage reporting on poor corporate governance and mismanagement. In the National Kidney Foundation case, it was actually the decision of the CEO and board to take out a defamation suit against one of the major newspapers that led to the unavailing of the scandal. This was, however, an exception.

4.5 Jurisdictional issues

The recent cases have highlighted potential problems of jurisdiction. The Singapore Exchange has increasingly been targeting overseas companies to list on the SGX. As at end of June 2006, 33% of total listings were foreign companies. By May 2006, there were around 100 Chinese companies listed on the SGX. Most of these companies are incorporated overseas and are therefore not subject to the Companies Act in Singapore (except in limited circumstances), although listed companies are subject to the Securities and Futures Act. In most of these companies, most of the management, operations and directors are based overseas. This raises questions of enforcement and regulation, as jurisdictional issues can delay or even prevent action from being taken. For example, Singapore has no extradition treaty with China. This could prevent Singapore’s law enforcement agencies from getting information from the management and board of directors of overseas companies or extraditing offenders for prosecution in Singapore. This will be an issue that may arise more in the future. Regulators in different countries need to work together to resolve such cross-border issues as, otherwise, enforcement of rules could be highly problematic.

5. Conclusion

Singapore has been proactive in the last few years in enacting relevant laws and regulations to curb the growth of white collar crime. In addition, many recent cases have shown that the measures have been effective, in particular with criminal sanctions. Enforcement actions have generally been swift. The introduction of the civil penalty in 2002 has been especially useful in seeking redress from concerned parties as it allows the MAS to expedite the process without having to go through litigation.

As can be seen from the CAO case, there is still room for improvement especially in terms of enforcement under civil actions. Of particular concern is the lack of enforcement action against directors, including independent directors, who have arguably breached their duties through their gross negligence. This may be due to the difficulty in proving breaches, especially
where criminal action is contemplated, and possibly the fear that more stringent enforcement against independent directors will increase the costs of recruiting these directors and aggravate the shortage (perceived or real) of directors.

The danger of lack of enforcement actions against directors who may have been grossly negligent is that it creates moral hazard and is not consistent with the role played by the board of directors and the importance of directors’ fiduciary, common law and statutory duties. Over time, it may send the wrong signals to the markets that as long as directors are merely incompetent and negligent (and not dishonest), there will be no sanctions against them. This would not augur well for corporate governance in Singapore.

Notes

1. SGD=Singapore dollar.
2. USD=United States dollar.
3. The report by PwC can be obtained from http://caosco.com/investor.htm
### APPENDIX

#### Table 1: Accord Customer Care Solutions as of 19 February 2005

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§109</th>
<th>§417</th>
<th>§420</th>
<th>§477</th>
<th>§199 SFA</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company - Accord Customer Care Solutions (ACCS)</td>
<td>24 Sep 05</td>
<td>21 July 06</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>4 years 3 months jail</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
<td>24 Sep 05</td>
<td>21 Feb 06</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>4 years 4 months jail</td>
</tr>
<tr>
<td>Director of CSL Customer Care Centre (M), a subsidiary of ACCS</td>
<td>11 Nov 05</td>
<td>31 August 06</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>2 years jail</td>
</tr>
<tr>
<td>Chief Financial Officer</td>
<td>26 July 06</td>
<td>------</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Defendant’s Position</td>
<td>Charged</td>
<td>Convicted</td>
<td>§109</td>
<td>§417</td>
<td>§420</td>
<td>§477</td>
<td>§199 SFA</td>
<td>Status</td>
</tr>
<tr>
<td>--------------------------</td>
<td>----------</td>
<td>-----------</td>
<td>------</td>
<td>------</td>
<td>------</td>
<td>------</td>
<td>----------</td>
<td>-----------------------</td>
</tr>
<tr>
<td>General Manager</td>
<td>24 Sep 05</td>
<td>21 July 06</td>
<td>x</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>3 years 6 months jail</td>
</tr>
<tr>
<td>Senior Manager</td>
<td>24 Sep 05</td>
<td>16 Feb 06</td>
<td>x</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td>8 months jail</td>
</tr>
<tr>
<td>Regional General Manager</td>
<td>11 Nov 05</td>
<td>16 Feb 06</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>3 months jail</td>
</tr>
<tr>
<td>Centre Manager</td>
<td>24 Sep 05</td>
<td>23 Feb 06</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>20 weeks jail</td>
</tr>
<tr>
<td>Centre Manager</td>
<td>24 Sep 05</td>
<td>16 Feb 06</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>20 weeks jail</td>
</tr>
<tr>
<td>Centre Manager</td>
<td>24 Sep 05</td>
<td>16 Feb 06</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>20 weeks jail</td>
</tr>
<tr>
<td>Centre Manager</td>
<td>24 Sep 05</td>
<td>16 Feb 06</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>18 weeks jail</td>
</tr>
<tr>
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<td>24 Sep 05</td>
<td>18 Jan 06</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>Fined SGD 10 000</td>
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<tr>
<td>Centre Manager</td>
<td>24 Sep 05</td>
<td>18 Jan 06</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>Fined SGD 10 000</td>
</tr>
<tr>
<td>Centre Manager</td>
<td>24 Sep 05</td>
<td>17 May 06</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>18 weeks jail</td>
</tr>
</tbody>
</table>
### Table 2: Auston International Group as of 8 December 2004

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§477</th>
<th>§199 SFA</th>
<th>§201 CA</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>28 July 06</td>
<td>----</td>
<td></td>
<td>x</td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
<td>28 July 06</td>
<td>----</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>Case pending</td>
</tr>
<tr>
<td>Chief Financial Officer</td>
<td>28 July 06</td>
<td>----</td>
<td>x</td>
<td></td>
<td></td>
<td>Case pending</td>
</tr>
</tbody>
</table>

### Table 3: Informatics Holdings as of 14 April 2004

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§199 SFA</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>----</td>
<td>----</td>
<td></td>
<td>Not charged</td>
</tr>
<tr>
<td>Chairman</td>
<td>29 Nov 05</td>
<td>1 September 2006</td>
<td>x</td>
<td>Fined SGD 240 000</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
<td>29 Nov 05</td>
<td>----</td>
<td>x</td>
<td>Case pending</td>
</tr>
</tbody>
</table>
### Table 4: Citiraya Industries as of 4 January 2005

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§477</th>
<th>§408</th>
<th>§6(a) PCA</th>
<th>§6(b) PCA</th>
<th>§201(b) SFA</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>----</td>
<td>----</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Not charged</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
<td>----</td>
<td>----</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Missing, not charged</td>
</tr>
<tr>
<td>Assistant General Manager</td>
<td>15 July 05</td>
<td>14 Dec 05</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td></td>
<td>8 years jail</td>
</tr>
<tr>
<td>Accounts Clerk</td>
<td>28 Sep 05</td>
<td>1 Aug 06</td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>8 months jail</td>
</tr>
<tr>
<td>Citiraya Transport Supervisor</td>
<td>7 Sep 05</td>
<td>11 Nov 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>8 months jail and fined SGD 86 000</td>
</tr>
<tr>
<td>Citiraya Mechanical Crushing Plant Supervisor</td>
<td>7 Sep 05</td>
<td>27 Nov 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>5 months jail and fined SGD 11 000</td>
</tr>
<tr>
<td>Defendant’s Position</td>
<td>Charged</td>
<td>Convicted</td>
<td>§477</td>
<td>§408</td>
<td>§6(a) PCA</td>
<td>§6(b) PCA</td>
<td>§201(b) SFA</td>
<td>Status</td>
</tr>
<tr>
<td>------------------------------</td>
<td>-----------</td>
<td>------------</td>
<td>------</td>
<td>------</td>
<td>-----------</td>
<td>-----------</td>
<td>------------</td>
<td>---------------------------------------------</td>
</tr>
<tr>
<td>Citiraya Materials Supervisor</td>
<td>7 Sep 05</td>
<td>27 Nov 05</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td>8 months jail and fined SGD 18 000</td>
</tr>
<tr>
<td>Director of Client</td>
<td>28 Sep 05</td>
<td>10 Apr 06</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>3 years 9 months jail</td>
</tr>
<tr>
<td>Relationship Unknown</td>
<td>28 Mar 06</td>
<td>29 Jun 06</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Fined SGD 50 000</td>
</tr>
<tr>
<td>Relationship Unknown</td>
<td>28 Mar 06</td>
<td>29 Jun 06</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Fined SGD 40 000</td>
</tr>
<tr>
<td>Relationship Unknown</td>
<td>28 Mar 06</td>
<td>29 Jun 06</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Fined SGD 20 000</td>
</tr>
<tr>
<td>Relationship Unknown</td>
<td>28 Mar 06</td>
<td>29 Jun 06</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Fined SGD 20 000</td>
</tr>
<tr>
<td>Employee of Client</td>
<td>23 Jun 05</td>
<td>28 Sep 05</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>3 years 3 months jail and fined</td>
</tr>
<tr>
<td>Defendant’s Position</td>
<td>Charged</td>
<td>Convicted</td>
<td>§477</td>
<td>§408</td>
<td>§6(a) PCA</td>
<td>§6(b) PCA</td>
<td>§201(b) SFA</td>
<td>Status</td>
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<tr>
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<td>-------------</td>
<td>------------</td>
<td>------</td>
<td>------</td>
<td>-----------</td>
<td>-----------</td>
<td>-------------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td>Employee of Client</td>
<td>23 Jun 05</td>
<td>28 Sep 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>SGD 1.6 million</td>
</tr>
<tr>
<td>Employee of Client</td>
<td>23 Jun 05</td>
<td>28 Sep 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>1 month jail and fined SGD 20 000</td>
</tr>
<tr>
<td>Employee of Client</td>
<td>23 Jun 05</td>
<td>28 Sep 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>13 months jail and fined SGD 24 000</td>
</tr>
<tr>
<td>Employee of Client</td>
<td>23 Jun 05</td>
<td>28 Sep 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>30 weeks jail and fined SGD 24 000</td>
</tr>
<tr>
<td>Employee of Client</td>
<td>26 July 05</td>
<td>26 July 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>7 months jail and fined SGD 32 000</td>
</tr>
</tbody>
</table>
### Table 5: China Aviation Oil as of 30 November 2004

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§420</th>
<th>§471</th>
<th>§157(1) CA</th>
<th>§199 SFA</th>
<th>§203 (2) SFA</th>
<th>§218 SFA</th>
<th>§232 SFA</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>----</td>
<td>----</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Not charged</td>
</tr>
<tr>
<td>Parent Company</td>
<td>19 Aug 05</td>
<td>19 Aug 05</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>SGD 8 million civil penalty</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
<td>9 Jun 05</td>
<td>21 Mar 06</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td>x</td>
<td></td>
<td>4 years 3 months jail and fined SGD 335 000</td>
</tr>
<tr>
<td>Non-Executive Chairman</td>
<td>9 Jun 05</td>
<td>2 Mar 06</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>Fined SGD 400 000</td>
</tr>
<tr>
<td>Non-Executive Director</td>
<td>9 Jun 05</td>
<td>2 Mar 06</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>Fined SGD 150 000</td>
</tr>
<tr>
<td>Defendant’s Position</td>
<td>Charged</td>
<td>Convicted</td>
<td>§420</td>
<td>§471</td>
<td>§157(1) CA</td>
<td>§199 SFA</td>
<td>§203 (2) SFA</td>
<td>§218 SFA</td>
<td>§232 SFA</td>
<td>Status</td>
</tr>
<tr>
<td>--------------------------</td>
<td>----------</td>
<td>-----------</td>
<td>------</td>
<td>------</td>
<td>------------</td>
<td>----------</td>
<td>--------------</td>
<td>----------</td>
<td>----------</td>
<td>--------------------------</td>
</tr>
<tr>
<td>Non-Executive Director</td>
<td>9 Jun 05</td>
<td>2 Mar 06</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Fined SGD 150 000</td>
</tr>
<tr>
<td>Head of Finance</td>
<td>9 Jun 05</td>
<td>21 Feb 06</td>
<td>x</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>2 years jail and fined SGD 150 000</td>
</tr>
<tr>
<td>Senior Trader</td>
<td>19 May 06</td>
<td>18 July 06</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Fined SGD 40 000</td>
</tr>
</tbody>
</table>
### Table 6: National Kidney Foundation as of 11 July 2005

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§477</th>
<th>§157(1) CA</th>
<th>§6(c) PCA</th>
<th>Civil Lawsuit (Breach of Director’s Duties)</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company</td>
<td>----</td>
<td>----</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Not charged</td>
</tr>
<tr>
<td>Chief Executive Officer</td>
<td>18 Apr 06/ 24 Apr 06</td>
<td>----</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Chairman</td>
<td>18 Apr 06/ 24 Apr 06</td>
<td>----</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Director</td>
<td>18 Apr 06/ 24 Apr 06</td>
<td>----</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Director</td>
<td>18 Apr 06/ 24 Apr 06</td>
<td>----</td>
<td></td>
<td>x</td>
<td></td>
<td></td>
<td>Case pending</td>
</tr>
</tbody>
</table>
### Defendant’s Position

<table>
<thead>
<tr>
<th>Defendant’s Position</th>
<th>Charged</th>
<th>Convicted</th>
<th>§477</th>
<th>§157(1) CA</th>
<th>§6(c) PCA</th>
<th>Civil Lawsuit (Breach of Director’s Duties)</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director</td>
<td>19 Jun 06</td>
<td>-----</td>
<td></td>
<td></td>
<td></td>
<td>x</td>
<td>Case pending</td>
</tr>
<tr>
<td>Director</td>
<td>19 Jun 06</td>
<td>-----</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Director</td>
<td>19 Jun 06</td>
<td>-----</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Director</td>
<td>19 Jun 06</td>
<td>-----</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Case pending</td>
</tr>
<tr>
<td>Vendor</td>
<td>24 Apr 06</td>
<td>-----</td>
<td></td>
<td></td>
<td>x</td>
<td></td>
<td>Case pending</td>
</tr>
</tbody>
</table>
Table 7: Other cases of insider trading

<table>
<thead>
<tr>
<th>Facts of Case</th>
<th>Charged</th>
<th>Convicted</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Former Company Secretary and Group Accountant, G.K. Goh Holdings Limited. Made gains of about SGD 42 000.</td>
<td>20 Feb 06</td>
<td>20 Feb 06</td>
<td>Civil penalty of SGD 130,500</td>
</tr>
<tr>
<td>General Manager, Breadtalk. Made gains of about SGD 35 000</td>
<td>7 Feb 06</td>
<td>7 Feb 06</td>
<td>Civil penalty of SGD 200 000</td>
</tr>
<tr>
<td>Procured by General Manager of Breadtalk to trade in the shares. Made gains of about SGD 81 000</td>
<td>7 Feb 06</td>
<td>7 Feb 06</td>
<td>Civil penalty of SGD 105 000</td>
</tr>
<tr>
<td>Shareholder of Nucleus Electronics Limited. Sold shares while in possession of insider information about a pending share placement, which would cause share price to drop. Made gains of approximately SGD 16 000</td>
<td>22 Sep 05</td>
<td>22 Sep 05</td>
<td>Civil penalty of SGD 50 000</td>
</tr>
<tr>
<td>Financial controller of Nucleus Electronics Limited. Knew Nucleus about to buy ATM Electronics</td>
<td>10 June 05</td>
<td>3 Feb 06</td>
<td>Fined SGD 120 000</td>
</tr>
<tr>
<td>Sales director of Nucleus Electronics Limited. Knew Nucleus about to buy ATM Electronics</td>
<td>10 June 05</td>
<td>3 Feb 06</td>
<td>Fined SGD 80 000</td>
</tr>
</tbody>
</table>
## Facts of Case

<table>
<thead>
<tr>
<th>Facts of Case</th>
<th>Charged</th>
<th>Convicted</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lawyer, part of legal team advising I-Comm Technology Ltd on a merger and acquisition. Communicated insider information to Soh See Teck Patrick</td>
<td>2 Feb 05</td>
<td>4 July 05</td>
<td>Fined SGD 60 000</td>
</tr>
<tr>
<td>Husband of lawyer advising I-Comm Technology Ltd. Traded in I-Comm Technology Ltd shares, making a gain of SGD 2 598.47.</td>
<td>2 Feb 05</td>
<td>4 July 05</td>
<td>Fined SGD 80 000</td>
</tr>
<tr>
<td>Founder of Amtek Engineering. Bought warrants of Amtek shares while aware of potential investors. Made gains of SGD 10 850.</td>
<td>1 Feb 05</td>
<td>24 Mar 05</td>
<td>Fined SGD 50 000</td>
</tr>
<tr>
<td>Former chief financial officer and executive director of Asiatravel.com Holdings. Knew Asiatravel.com about to invest in Valuair</td>
<td>15 Feb 05</td>
<td>15 Apr 05</td>
<td>Fined SGD 60 000</td>
</tr>
<tr>
<td>Executive chairman and managing director of Brilliant Manufacturing. Knew Brilliant about to report rise in 2003 net profit</td>
<td>6 Sep 05</td>
<td>24 Apr 06</td>
<td>Fined SGD 593 000</td>
</tr>
</tbody>
</table>
### Table 8: Explanation of offences

<table>
<thead>
<tr>
<th>Section</th>
<th>Offence Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>§109 Penal Code</td>
<td>Abetment of an offence amounts to committing the offence</td>
</tr>
<tr>
<td>§408 Penal Code</td>
<td>Criminal breach of trust by clerk or servant</td>
</tr>
<tr>
<td>§417 Penal Code</td>
<td>Penalty for cheating</td>
</tr>
<tr>
<td>§420 Penal Code</td>
<td>Cheating and dishonestly inducing a delivery of property</td>
</tr>
<tr>
<td>§471 Penal Code</td>
<td>Using as genuine a forged document.</td>
</tr>
<tr>
<td>§477 Penal Code</td>
<td>Falsification of accounts</td>
</tr>
<tr>
<td>§157(1) Companies Act</td>
<td>Breach of director’s duties</td>
</tr>
<tr>
<td>§201 Companies Act</td>
<td>Failure to produce accounts at annual general meeting</td>
</tr>
<tr>
<td>§199 Securities and Futures Act</td>
<td>Making or disseminating false or misleading statement</td>
</tr>
<tr>
<td>§201(b) Securities and Futures Act</td>
<td>Employment of manipulative and deceptive devices in shares trading</td>
</tr>
<tr>
<td>§203(2) Securities and Futures Act</td>
<td>Failure to continuously disclose information to Singapore Exchange</td>
</tr>
<tr>
<td>§218 Securities and Futures Act</td>
<td>Insider trading for connected persons</td>
</tr>
<tr>
<td>§232 Securities and Futures Act</td>
<td>Civil penalty</td>
</tr>
<tr>
<td>§6 Prevention of Corruption Act</td>
<td>Corrupt transactions with agents – accepting, making bribes</td>
</tr>
</tbody>
</table>
Corporate Governance in Emerging Markets

Enforcement of Corporate Governance in Asia

THE UNFINISHED AGENDA

Over the past few years, most Asian jurisdictions have substantially revamped their laws, regulations and other corporate governance norms. In many cases, Asian rules now reflect the most developed thinking on established corporate governance systems. However, enforcement remains a significant challenge and “an unfinished agenda”. This publication offers a unique snapshot of how corporate governance is being enforced in Asia. It provides policy makers, judges, investors, board members and stakeholders with case studies and analyses that illustrate how regulators deal with enforcement in practice.

The six articles compiled in this publication cover a number of important sub-themes. Liu describes civil enforcement in Chinese Taipei, illustrated by a case study of a well-known corporate governance scandal. Kroeze looks at the pros and cons of setting up specialised business courts to deal with governance issues within Asia. Jung discusses co-operation between regulators and public prosecutors in Korea, and Hwang reviews the growing interest in Singapore for enlarging the role of arbitration in corporate law disputes. Finally, Mak, Lan and Buang present an enforcement case study that highlights director negligence. All papers were presented and discussed at the Asian Corporate Governance Roundtable, a high-level policy forum that comprises Asian policy makers, regulators, stock exchanges, academics and private sector leaders, as well as international experts.