



The 6th Asian Roundtable on Corporate Governance
Implementation and Enforcement in Corporate Governance

Lawrence Liu

**Executive Vice President and Chief Strategies Officer
China Development Financial Holding Corporation
Chinese Taipei**

Theme III – Session 1
The Merit of Shareholders Collective Actions
(Class Action Suits)

Seoul, Korea
2-3 November 2004

*The views expressed in this paper are those of the author and do not necessarily represent the opinions of the
OECD or its Member countries or the World Bank*

MERITS OF SHAREHOLDERS COLLECTIVE ACTIONS: THE CASE IN CHINESE TAIPEI

Lawrence S. Liu¹

Securities Class Actions in Chinese Taipei and Its Relevance

In the wake of the Asian financial crisis, there has been much discussion on improving corporate governance in Asia, including enhancement of mechanisms for securities class actions.² This article examines how Chinese Taipei tries to simulate the securities class actions prevalent elsewhere like, say, the United States. Even though these simulating efforts have met many challenges, there are some preliminary successes, including innovative ways to engineer partial reform.

Chinese Taipei is a Civil Law jurisdiction as well as a strong economy with a robust capital market not much affected by the Asian financial crisis. These two features make it more interesting to examine Chinese Taipei's case because, like Japan and Korea, traditionally Chinese Taipei has not been strong on corporate laws.³ Unlike the distressed Asian economies, it is not susceptible to as much external pressure to enhance shareholders protection.

Chinese Taipei's case is also most interesting and relevant to China, which shares the same cultural affinity and has shown a strong (albeit quiet) interest in Chinese Taipei as a way to benchmark or compare reforms to strengthen economic legal infrastructure, including

¹ Executive Vice President and Chief Strategies Officer, China Development Financial Holding Corporation, Chinese Taipei, and Professor, Soochow University Law School and National Taiwan University Business School, Taipei. The views herein should not be attributed to any institution with which the author is affiliated. For convenience's sake, the amounts indicated in this article are converted roughly on the basis of US\$1=NT\$34. Copyright and All Rights Reserved, 2004.

² 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 Mark D. West, "The Pricing of Shareholder Derivative Actions in Japan and the United States," *Northwestern University Law Review*, vol.88, no. 4, p. 1436 (1994); Joogi Kim, "Recent Amendments to the Korean Commercial Code and Their Effects on International Competition," *University of Pennsylvania Journal of International Economic Law*, vol. 21, no. 2, pp. 273 (Summer 2000).

corporate laws.⁴ 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.⁵

As this paper will show, despite the emergence of a civil society in Chinese Taipei and its transplant of many substantive corporate and securities law rules from abroad, securities law enforcement largely relies on the public sector, that is, regulators and prosecutors. Public agency enforcement thus far has subsidized the private enforcement of corporate and securities laws because of inadequate procedural laws, which create high information cost, coordination cost and significant court costs for private enforcement. To reduce these costs, claimants in Chinese Taipei and government-supported organizations have adopted an amazing resolution recently: simulating American-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 mobilization.

Rigid Civil Law Approach Weakens 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.⁶ Chinese Taipei's Company Law was enacted by the Nationalist government in Mainland China back in 1928 and largely has followed the German and Japanese models. Despite some initial influence on Chinese Taipei's Securities and Exchange Law [SEL] of 1968, the SEL's enforcement is closer to the Japanese than American model. Transplanting Chinese Taipei's corporate and securities laws from Civil Law countries without a strong history of capital market has

⁴ China's Company Law of 1994 is very similar to Chinese Taipei's Company Law. Although China's Securities Law of 1999 tries to follow American securities laws, it still shows some remarkable similarity to Chinese Taipei's Securities and Exchange Law, such as the definition of securities encompassed by this legislation.

⁵ See "Getting their skates on," *Economist*, pp. 86, 89 (June 3, 2000) (Neoh was interviewed and suggested, according to this article, that "regulators have proposed copying another Taiwanese idea, a shareholders' institute that buys a share in every listed company. That gives the government the power to challenge abuses to shareholders' rights.") See also, Anthony Neoh, "Helping China's Private Sector," *Far Eastern Economic Review*, p. 49 (December 16, 1999), and ___, "The Ethical and Cultural Dimensions of Corporate Governance," *Corporate Governance International*, vol. 2, issue 2, pp. 141, 144 (June 1999).

⁶ Rafael La Porta, Florencio Lopez-de-Silaneses, Robert W. Vishny and Andrei Schleifer, "Law and Finance", National Bureau of Economic Research Working Paper no. 5661 (July 1996).

affected their effectiveness.

One important feature of this “Civil Law approach” is that, as a byproduct of the codification culture, there is more emphasis on form than substance. One classic example of exalting form over substance is the inflexible way in which codified rules are written, making adaptation to new market conditions or new behavioral patterns difficult. Examples of the lack of emphasis on 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, including Chinese Taipei.

The rigidity of this approach is even stronger in procedural laws. In my view, 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.

Regulatory Competition Splinters 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 in order 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 even the SFB has lost patience sometimes. It has sponsored, for example, amendments to the SEL embodying essentially basic corporate law rules, thereby pre-empting the Company Law.⁷ Even though this approach solves short-term problems, over the long term it splinters corporate law enforcement.

Insufficient Supervision of Directors by Supervisors

Under Chinese Taipei's Company Law there is a concept of 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

⁷ The most recent example is the SEL amendment in mid-2000 to permit warrants, options and corporate buybacks and strengthens the control of related party transactions.

that largely grew out of the Common Law world. It should nevertheless be noted that there is a criminal offense 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 for 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. For example, they can bring suit against directors but 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.⁸ 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 such, 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 for incentive reasons private enforcement of corporate and securities law in Chinese Taipei has been difficult.

Institutional Barriers to Class Actions in Taiwan

The Company Law allows derivative actions by shareholders owning 3% (reduced from 5% in the 2001 amendment) of a company continuously for a year, who may petition supervisors to sue directors and bring such suits directly if supervisors fail to do so.⁹ 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 right-consciousness. It was not until the early 1990s that ingredients for a

⁸ 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 supervisors. A year later, however, this provision was repealed under industry pressure.

⁹ Company Law, article 214.

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 in" to a collective action plan. In other words, they have to be specific, known parties acting under rigid jointer 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 case under the Code of Civil Procedure.

For the same reasons, the shareholder derivative suit mechanism authorized under the Company Law does not work very well. To this author's knowledge, it has not been invoked when the minority ownership is diverse, as in the case of public companies. And 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 coordination cost to organizing a class of plaintiffs. As a result, virtually no mechanism similar to the American class actions exists, whereby parties can be represented even without the knowledge of a law suit and that 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: they 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 scale-down fee schedule) at the district court and appellate court levels, and again a 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 pays for his own attorney fees. As a result, even though attorney fees would be less than, say, in the United States, the requirement to advance exorbitant court fees (potentially a total of 3.5 percentage of the claim before the 2002 amendment!) makes it virtually impossible for small plaintiffs to assert large claims. One could also point to the low level of practitioners admitted to practice law as a reason.¹⁰ In addition, until recently, there were no punitive damages, which otherwise could offset somewhat such disincentives to sue. Even though some consumer protection, securities and antitrust statutes now provide for treble, punitive

¹⁰ Since World War II, this admission rate has averaged just slightly over 1% annually. It has 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. But they avoid litigation so as not to be challenged in court.

damages, actual award of such damages is rare.

Fourth, there is no civil discovery in Chinese. As a result, information cost to plaintiffs can be high. Plaintiffs often would have to rely upon whatever evidence they can gather to conduct the proceedings. To be sure, under the inquisitorial system of “trials” in Chinese Taipei, judges can compel testimonies and production of evidence.¹¹ However, judges’ case load makes it difficult for them to conduct thorough fact finding. Therefore, the high information cost to plaintiffs discourages class actions.

Fifth, securities class actions often involve some expertise without which judges find it difficult to examine the legal and factual issues. Corporate misbehavior, unfair related party transactions, and insider or manipulative securities trading have been classic examples of difficult cases to Chinese Taipei judges. These judges are professionally trained, become judges usually early in life, and they do not have much other social or business experience in life. With economic growth in recent years Chinese Taipei’s judges have come to know more about business practices and even stock trading. But still it is not easy to determine fair market value or the legality of some commercial practices.¹² 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 American case of *Basic v. Levinson* in 1988.

Reliance on Criminal Enforcement

If it is difficult to impose civil liabilities, what recourse would potential victims resort to? 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.¹³ The second involves a public interest foundation charged to bring actions on its behalf or on behalf of other similarly situated victims.

¹¹ Since 2004 Chinese Taipei has introduced the adversarial system and cross examinations in criminal cases.

¹² 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.

¹³ 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.

If an act injures multiple victims, there is enough public interest to make it a crime. Some violations of the Company Law and 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 such duties may constitute a breach of trust under Chinese Taipei's Criminal Code. Prosecutors may proceed with criminal indictment and bring to bear their formidable subpoena and other investigative powers.

Simulating Class Actions through Piggyback Civil Actions

Importantly, once a prosecutor has made an indictment, victims of the crime may bring a civil action in tandem with such criminal prosecution.¹⁴ In other words, the victims may piggyback on the efforts of the prosecutor and reduce the informative cost to them. Indeed, they may ride on the coattails of *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.¹⁵ If such a ruling is made, the hefty court fees that otherwise would have to be advanced by the plaintiff will be waived!¹⁶ 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 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 victimized investors multiple. Criminal court judges would rather "get rid of" the piggyback civil actions, which are more tedious than just convicting the culprits. And 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 guilty feelings criminal court judges may have by not handling the civil cases herself. Considering that this German inspired piggyback civil action rule was not intended at all to

¹⁴ Code of Criminal Procedure, article 487. Like the private prosecution rule mentioned above, this "piggyback rule" can be inspired by comparable rules in Germany.

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).

accommodate public interest litigation, the result is amazing. The chemistry among this historical accident, litigation economics and judicial behavior has inadvertently created a unique Chinese Taipei style of public interest litigation.

Role of the Government-Sponsored Foundation as De Facto Plaintiff

Even if it is possible to organize piggyback civil actions, multiple actions by diverse plaintiffs are still inefficient. A good Samaritan organizer is needed to reduce coordination costs. One alternative, therefore, is to install a foundation to enhance civil enforcement. Such a mechanism hopefully will solve or reduce the collective action problem in group litigation. In Chinese Taipei, until 2003 this foundation was the Securities and Futures Market Development Institute. 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 still receiving SFC grants and directives to carry out financial market studies and personnel training, the Institute has also developed the practice of owning at least one trading unit in each company which becomes publicly listed in Chinese Taipei. By doing so, the Institute 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 center, which is functionally similar to a public interest law firm, in March 1998. 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 “opting in” method mentioned above. Although this could be a time consuming and tedious process, the recent enforcement cases summarized below demonstrate that the Institute has done a good job of managing these mass litigation cases.

In May 1999, the Institute formalized its procedures governing acceptance of engagement by investors for civil liabilities in securities cases after they were approved by the SFC.¹⁷ 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 fees and lawyers’ fees when necessary. In other words, the Institute (and its funding agency, the SFC) was willing to subsidize the cost for civil enforcement.

¹⁷ See Commercial Times, May 8, 1999, “SFC to Pay for Cost in Claims by Small Investors” (Taipei)

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.¹⁸ Like in the United States where this rule originated, civil liabilities for such trading are not based upon fault, and thus are easier to establish. However, there is one major difference: in Chinese Taipei a publicly listed company is *required* under the SEL to seek such 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 the insiders, fails 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 breach of trust, potentially a criminal affair.

The Institute has maintained an active enforcement program in this area.¹⁹ 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 programs at the Institute was transferred to a new foundation, discussed later.

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 much affected by the Asian financial crisis, these irregularities occurred around the same time, thereby creating an implosion-type of petit, domestic financial crisis. Most of these companies are family controlled and operate in the more traditional sectors of the economy like food, metal steel, automobile distribution, construction and the like.

Often the behavioral pattern of these irregularities was similar: a few insiders used corporate funds, funneled through wholly owned subsidiaries of the issuer, to play company stock or

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 such cases, 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).

speculate in real estate. By using captive subsidiaries to engage in *de facto*, secretive market buybacks, they also shored up the valuation of their personal holdings, if not cashing in at the same time. Some company insiders simply doctored financial accounts or embezzled corporate funds.

Typically in these cases, the scandal led to public prosecution, thereby setting the stage for piggyback civil actions organized by the Institute. At the end of this paper, an appendix shows a list of cases still pending. The more representative cases are summarized below.²⁰

An April 2000 research study by the Taiwan Stock Exchange of the companies and their insiders that engaged in such irregular activities suggests that the board of these companies were captured by the controlling family. The study found that, on the average, the family members and affiliates controlled about 28% of the voting right 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.²¹

Tong Lung Metal Industry

Fan brothers were the chairman and president of this metal company. As a result of 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 US\$70 million as of late 1998, was thrown into corporate reorganization, and trading of its shares has since been suspended.²²

Pulling off one of the first of such "land mine" cases in the late 1990s, the defendants were

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

²¹ See Economic Daily News, August 21, 2000 p. 13 (Taipei).

²² Tong Lung has reduced its capital by more than US\$90 million so as to realize the losses, and increased concurrently the capital by more than US\$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 the par value. Thus, for a loss making company this complicated recapitalization procedure has to be followed.

convicted within four months of their indictment for three and eight years in jail. 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 the insiders, and the general tort provision of the Civil Code.²³ Based on the Institute's assessment, 3,516 investors in the piggyback civil actions would qualify for total claims of more than US\$40 million based on improper financial disclosures. About 274 investors would qualify for total claims of more than US\$7 million based on insider trading violations.

Chinese Automobile

One of the Chang brothers of the founding family involved in this case, having been adjudicated bankrupt, now apparently sells beef noodles in Taipei. Before, however, he and cohorts were convicted of securities fraud and violations of the Company Law, Financial Accounting Law. Their company, one of the largest automobile distributors in Chinese Taipei, was through into corporate reorganization. The Institute is acting for 37 persons in a piggyback civil action for about US\$6.6 million.

Kuoyang Construction

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

Taiyu Products

²³ 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)

Mr. Tseng and his associates were rumored to use their political connections to get into commercial deals. He and about 35 associates were prosecuted for 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 US\$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 US\$7 million.

Ban Yu Paper

One of the well established paper companies in Chinese Taipei, this company has deteriorated in the increasing 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 reorganization. The Institute acted for 400 investors in a piggyback group litigation for a total claim of almost US\$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 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 US\$7 million from a distributor default. The chairman nevertheless suppressed this material adverse information, and privately sold company inventory and engaged in fraudulent account keeping practice for five subsequent years.

In February 1997 trading of Cheng-I shares was suspended, and it was delisted 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-chairman, Mr. Shieh, and other officers were prosecuted for criminal embezzlement and this company has been delisted since May 2000. The Institute has brought a piggyback action and has solicited other claimants by public notice to join in this action.

Ta-Chung Steel

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

King-Wei Textile

This piggyback action arose from criminal prosecution against 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 US\$2 million.

Investors Protection Law of 2003

The high-profile mass securities claims arising from these cases generated much public attention to the inadequacy of the current civil justice system in Chinese Taipei for class actions and lack of board accountability. In a series of meetings of an MOF-empanelled, blue ribbon Financial Reform Task Force held in 1998-99, a decision was made to rectify such inadequacies.²⁴ 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 1994.²⁵ Acting on this recommendation, in December 1999 Chinese Taipei's 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.

²⁴ The author was a member of this Task Force and advocated this approach.

²⁵ CPL, article 52 (deemed ceiling of NT\$600,000 for consumer group litigation, meaning the court fees will be capped at 1% thereof or NT\$6,000, which is about US\$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 ill-constructed apartment building in Taipei that tumbled in the September 21, 1999 earth quake 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.

The Protection Law authorizes the establishment of a foundation called the Securities and Futures Investors Protection Center, thereby formally recognizing the important work of the Institute.²⁶ Spun off from the Institute and now operating independently, the Center has set up an Investor Protection Fund, which is funded primarily from mandatory contributions by securities and futures firms, and self-regulatory organizations like the stock exchange, futures exchange and other self-regulatory organizations.²⁷ This “war chest”, now valued over NT\$ 1 billion (or about US\$ 30 million), is used in part to defray mediation and litigation cost and payment to investors for their losses arising from violations of the SEL and Futures Trading Law.²⁸

The Protection Law also authorizes the Center 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 any repudiation of this decision in time.²⁹ Should a party refuse to accept this preliminary decision, the mediation panel may publicize its decision as appropriate.³⁰ 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 other preferential treatment for investors and the center. 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.³¹ But once parties agree to the mediation decision, it is as binding as a final, non-appealable judgment.³²

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 Center in its own name if they are on behalf of at least 20 more victimized investors arising from any single dispute against culprits in the securities and futures markets.³³

²⁶ Protection Law, article 5.

²⁷ Id., article 18

²⁸ Id., articles 20, 21.

²⁹ Id., articles 22, 25.

³⁰ Id., article 25.

³¹ Id., article 25. Despite the apparent equality of this provision in its treatment of the parties, only investors can enjoy this flexibility.

³² Id., article 26.

³³ Id., article 28. However, the 20-claimant requirement applies only at the beginning of the litigation or arbitration. If

The centerpiece of the Protection Law, this representative action and representative arbitration rule is intended to formalize and improve proceedings in the *de facto* class actions described above. One may not be surprised by the attempt to formalize group litigation. However, this rule offers group arbitration as an unusual mechanism for alternative dispute resolution.

The Center may not charge investors any separate compensation, suggesting the public interest nature of this program.³⁴ However, it will receive some other 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.³⁵ For assessing court fees, the amount of investor claims which serves as the basis of calculation will be deemed to not exceed NT\$100 million (about US\$3.3 million).³⁶ This would substantially reduce the court fees which will have to be advanced by the Center as plaintiff. By the same token, if the Center 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 center funded through a legislatively authorized levy on the securities market brings public-interest securities class actions in Chinese Taipei. No ambulance-chasing, self-interested lawyers of the American style are needed. It works like the Hong Kong Association of Minority Shareholders (of HAMS) proposal, made by corporate governance activist David Webb but 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 the People's Solidarity for Participatory Democracy. Therefore, even though the PSPD in Korea offers perhaps the only meaningful securities class action enforcement experience by any nonprofit organization in Asia, Chinese Taipei's experience with the Institute and the Center demonstrates another interesting path of semi-governmental enforcement of civil claims from securities violations.³⁷ Of course, it

some claimants withdraw later and the total number of plaintiff is reduced below 20, the case may still proceed with respect to the remaining claimants. *Id.*, article 29.

³⁴ *Id.*, article 33.

³⁵ *Id.*, articles 34, 36.

³⁶ *Id.*, article 25. This would essentially cap the court fees for, say, district court proceedings, to NT\$1 million (about US\$33,000), even for exponentially high claims.

³⁷ For a somewhat different theory but fascinating study, see Curtis Milhaupt, "Nonprofit Organizations as Investor Protection:

remains to be examined how successful and sustainable this model will be.

New Experience under the Investors Protection Law

Since 2003, the Center has strengthened its work. For example, when the Institute brought suits in the late 1990s, it relied on piggybacking the civil claims on top of the criminal prosecution. The Center has brought independent civil suits because of the more favorable 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 waiting for hearings until the criminal proceeding has produced a conviction.

There are already preliminary successful judgments in the *Taiyu* and *Ta Chung Steel* cases, handed down in 2004. In the *Taiyu* case, the ringleader was held liable for a significant sum of damages (NT\$202 million, or about US\$ 6 million). A similar success was obtained in the *King Yuan* securities fraud case decided in 2004, even though it does not involve a class action. However, in these cases, the court did not find external auditors liable, because the applicable provisions in section 20 the SEL focus on issuer liability. This result is essentially similar to the United States Supreme Court's 1994 decision in the *Central Bank* case to not recognize "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*.

With a new wave of securities fraud incidents in 2004 implicating the senior management and external auditors, like the Procomp, Summit Computer and Infodisc cases, the Center is actively preparing suits against the issuer, directors and officers of the company, and other "gatekeepers." Informal accounts indicate that more than four thousand claimants may be mobilized by the Center to join in a class action.

CONCLUSIONS

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

Attachment 1

List of Securities Class Action and Criminal Prosecution Cases in Chinese Taipei

No.	Company name	Date of activity in question	Type of activity				Defendants			Compensations demanded (in NT\$1,000)	Number of plaintiffs	Type of suit		Date on which the Center filed civil suit	Status						Court
			Misrepresentations in financial statements	Misrepresentations prospectus	price manipulation	Insider trading	Defendants of criminal case	Directors / supervisors	Accountants			Status of criminal case			Civil case attached to criminal case	Independent civil suit	Status of criminal case			Civil case	
												1	2				3	Latest development of case	Court date		
Guilty	Not guilty	Confirm	Reverse																		
1	Cheng I Food Co. Ltd.	1995		1			1	1	1	71,018	389		1		1	1		1	December 2, 2003 High Court reversed district court ruling. Case appealed to Supreme Court.	Jan-98	Taipei District Court
2	Chinese Automobile Co. Ltd.	1998	1		1		1	1	1	14,983	33		1		1	1		1	June 5, 2003 High Court reversed district court ruling. Case appealed to Supreme Court.	Mar-00	Taipei District Court
3	Kuo Yang Construction Co. Ltd	1998		1			1	1	1	1,924,074	1,154		1		1				October 7, 2002 Ruling by High Court. Case appealed to Supreme Court.	Sep-00	Taipei District Court
4	Tong Lung Metal Industry Co. Ltd.	1997-1998	1	1		1	1	1	1	369,630	827		1		1			1	July 31, 2003 High Court reversed district court ruling. Case appealed to Supreme Court.	Jul-03	Taipei District Court
5	Tai Yu Products	1997-1998			1	1	1	1		59,348	130				1				August 29, 2003 Ruling by High Court. Case appealed to Supreme Court.	Jun-01	Taichung District Court

6	Baw Yu Paper Mill Co. Ltd.	1998				1	1			17,155	400		1	2000.02	1					October 29, 2003 Ruling by District Court.	—	Yunlin District Court
7	Master Home Furniture	1998	1				1	1	1	152,648	145		1	2000.06	1					November 19, 2003 High Court hearing in progress.	Mar-03	Changhua District Court
8	Tah Chung Steel Corp.	1998	1				1	1	1	199,252	976		1	2000.07	1		1			April 30, 2003 Supreme Court turned down request for further hearing.	Aug-01	Taichung District Court
9	Tai Yu Products	1998	1	1			1	1	1	202,015	591		1	2000.08	1		1			August 29, 2003 Ruling by High Court. Case appealed to Supreme Court.	Jun-01	Taichung District Court
10	Taiwan Pineapple	1997-1998			1	1	1			231,424	215		1	2000.12	1					May 3, 2004 High Court hearing in progress.	May-03	Taipei District Court
11	Hsin Ju Chun Group	1998	1	1	1		1	1	1	48,599	252		1	2000.12	1					February 25, 2004 High Court hearing in progress.	Sep-03	Taipei District Court
12	Kuei Hung Co.	1998-2000	1				1	1	1	29,193	82		1	2001.01	1		1			May 29, 2003 Ruling by High Court. Case appealed to Supreme Court.	Mar-02	Tainan District Court
13	Taiwan Fluorescent Lamp	1997-1998	1		1		1	1	1	131,065	252		1	2001.02						May 7, 2004 District Court hearing in progress.	—	Taipei District Court
14	Fong An Steel	1997	1				1	1	1	23,647	117		1	2001.02	1					December 15, 2003 Ruling by District Court.	Dec-03	Kaohsiung District Court
15	Taiwan Development & Trust Corp.	1998	1				1			40	1		1	2001.02	1					March 1, 2004 High Court hearing in progress.	Dec-02	Taipei District Court
16	Syntek Semiconductor Co. Ltd.	1997				1	1			10,258	72		1	2001.07		1				April 20, 2004 High Court hearing in progress.	—	Taipei District Court

17	Kent World Co. Ltd.	1998					1	1			8,600	65		1	2001.07	1	1			October 30, 2002 Ruling by High Court. Case appealed to Supreme Court.	Apr-02	Taipei District Court
18	China Container Terminal Corp.	1999			1			1			385	36		1	2001.07					May 21, 2004 District Court hearing in progress.	—	Taipei District Court
19	Chief Construction Corp.	1998	1				1	1	1	1	42,823	128		1	2001.09		1			Case appealed to High Court.	—	Taichung District Court
20	ET Internet Technology Corp.	1998	1					1			666	13		1	2001.10	the same as No. 15				August 2, 2004 High Court hearing in progress.	Dec-02	Taipei District Court
21	Lee Tah Farm Industries Co. Ltd.	1999	1					1	1	1	9,030	70		1	2002.04	1	1			June 30, 2003 Ruling by High Court. Case appealed to Supreme Court.	Apr-02	Kaohsiung District Court
22	Hung Fu Construction Co. Ltd.	1998			1			1			20,511	11		1	2002.05					May 3, 2004 District Court hearing in progress.	—	Taipei District Court
23	Unicap Electronics Industrial Corp.	2001					1	1			195	55		1	2002.12		1	1		Not Guilty.	Dec-02	Taipei District Court
24	Hwa-Hsia Leasing Corp.	1998			1				1		20,537	77		1	2003.04					June 1, 2004 District Court hearing in progress.	—	Taipei District Court
25	New Sun Metal Industry Co.	1998	1					1	1	1	393,825	759		1	2003.08					August 22, 2003 District Court hearing in progress.	Aug-03	Kaohsiung District Court
26	Yang Iron Works Co., Ltd. & Nan Kang Rubber Tire Corp., Ltd.	1998	1						1		22,592	80		1	2003.12					April 15, 2004 Ruling by District Court.	Dec-03	Taipei District Court

27	Chung Yo Department Store Co., Ltd.	1998	1			1			2,820	31	1	1	2003.12						February 12, 2004 District Court hearing in progress.	Dec-03	Taichung District Court
28	Taiwan Fertilizer Co., Ltd.	1999			1				27,736	103	1		2004.01						January 12, 2004 High Court hearing in progress.	Jan-04	Taipei District Court
29	Infodisc Technology Co., Ltd.	2000				1	1		314,266	2,040	1		2004.03	1					April 26, 2004 High court hearing in progress.	Mar-04	Pahchiao District Court
30	Ahin Co., Ltd. & Yanin Leather Co., Ltd. & Yishin Engineering Co., Ltd.	1999	1		1				292,857	577			2004.03						June 16, 2004 District Court hearing in progress.	Mar-04	Taipei District Court
31	King Yuan Electronics Co., LTD.	2001		1			1	1	25,351	55	1		2004.06								Hsinchu District Court
Total			18	6	9	9	30	15	4,666,543	9,736	9	23		17	3	10	1	0	4		

*Chart arranged by the date on which the Center 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 development of civil case, the number in parenthesis after the court date indicates the number of court hearings.

Source: Securities and Futures Investors Protection Center, Chinese Taipei (October 2004).

Attachment 2

10/21/2004

Lawrence S. Liu

Lawrence S. Liu is Executive Vice President and Chief Strategy Officer of China Development Financial Holding Corporation, one of the largest listed companies in Chinese Taipei, since August 2004. CDFHC is a financial group with corporate banking, venture capital, buyout, M&A, and securities businesses.

A graduate of University of Chicago, University of Pennsylvania and National Taiwan University, Mr. Liu practiced corporate, securities, financial and competition laws for over two decades in Chinese Taipei and the U.S. He is also a professor at NTU Business School and Soochow University Law School, and a Visiting Professor at Stanford Law School.

In 1995 Mr. Liu served in the Chinese Taipei government and was in charge of economic reform legislation and policy implementation, including financial reform and telecom market opening. He advises Chinese Taipei government on privatization, economic and financial law reform, corporate governance, insolvency system, and competition policy issues. Mr. Liu was Adviser to Chinese Taipei's Economic Leader in the APEC Leaders Summit. He was also the chief draftsman of several laws and policy initiatives in Taiwan, such as the BOT Basic Law, Financial Holding Company Law, Corporate Mergers and Acquisitions Law, and the Accountability for Companies in Taiwan ("ACT") Initiative to improve corporate governance.

Mr. Liu is a frequent speaker in international conferences on economic issues affecting Asia. He is a permanent core member of OECD's Asian Corporate Governance Roundtable forum, an adviser to the Asian Corporate Governance Association, a participant in OECD's Forum on Asian Insolvency Regime. He is the author or editor of more than one hundred academic, professional, and news column papers, including books on corporate governance, mergers and acquisitions and competition policies.

Contact information: Executive Vice President and Chief Strategy Officer
China Development Financial Holding Corporation
125 Nanking East Road, Section 5
Taipei 105, Taiwan, Chinese Taipei
Tel.: 2-2766-7511 or 2-2763-8800 ext.1722
Fax.: 2-2766-9096
Email: lawrenceliu@cdibh.com