



Asia Roundtable on Corporate Governance

Fighting Abusive Related Party Transactions in Asia

Workshop on Implementation

BACKGROUND DOCUMENT

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(The views expressed in this paper are those of the author and do not necessarily reflect those of the OECD).

Related-Party Transactions in Asia

Background paper for OECD Asian Roundtable on Corporate Governance,
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The objective of this paper is to give examples of the various types of related party transactions across Asia, highlighting the inadequacies of regulations, company disclosures and board practices to curb abusive RPTs.

Introduction

Many listed Asian companies that have enough size and liquidity to be on the radar of foreign investors are likely to be a part of a larger business group, either as its flagship or as one of its affiliates. (Some affiliates may also be listed, and others may be privately held.) Consequently, investors must be vigilant about related-party transactions, but understanding the implications of all the relationships is a difficult task.

The ownership of a typical Asian conglomerate is likely to be concentrated in a single group: a family or the state. In family-controlled entities, senior management and board positions (including chair and chief executive) are often filled by family members. In state-controlled entities, these roles are filled by political appointees. These affiliations, which are formed under the umbrella of common ownership, can be exploited as needed. The dominant control structure makes it easy for related-party transactions to take place, especially when some of the entities complement—or exist to support—the operations of others.

In corporate structures that do not separate ownership and control, related-party transactions can be tainted with conflicts of interest that could short-change unwitting investors. A listed company could deposit its surplus cash with its unlisted parent, denying itself and its minority shareholders the opportunity to generate higher returns through strategic investments. Or it could buy assets from an unlisted affiliate at an inflated price, a clear form of channelling the fortunes of a public entity into the private interests of the same controlling shareholder. Indeed, connected transactions in Asia have been known as a common tool for dominant shareholders to expropriate wealth from minority investors.

Not surprisingly, related-party transactions have also been proven to undermine corporate value. A 2004 study of mainland Chinese companies found that the more frequently a company engaged in connected transactions the lower its firm value¹. According to a 2005 study, companies that granted loans to related parties also received lower market valuations than companies that either minimized or

¹ Ming Jian and T.J. Wong, "Earnings Management and Tunneling through Related Party Transactions: Evidence from China's Listed Companies," Hong Kong University of Science and Technology working paper (February 2004).

avoided the practice entirely². Moreover, research published in 2006 concluded that Hong Kong-listed companies earned “significantly negative abnormal returns” simply as a result of announcing a connected transaction³. These studies suggest that although related-party transactions are not necessarily abusive, their presence can negatively affect shareholder value.

Motivations for Abusive Related-Party Transactions

The misuse of related-party transactions tends to be associated with the abuse of independent shareholders’ rights. The cases below support that observation. In general, each of them exposed investors to at least one of two distinct but related risks: **expropriation of wealth** and **deprivation of wealth opportunity**. These risks, in turn, arise from two incentives. The first is wealth formation, achieved through the transfer of assets and profits of a publicly traded company to the private interest of its controlling shareholder. The second, which derives from the first, is appropriation of control, realized by the dilution of minority ownership, or the usurpation of corporate opportunity.

1. Asset sales and purchases between related parties

Satyam Computer Services Limited (Now called Mahindra Satyam)

Was listed on the Bombay Stock Exchange (BSE), National Stock Exchange of India (NSE) and American Depository Shares were listed on the New York Stock Exchange (NYSE).

² Guohua Jiang et al., “Tunneling in China: The Surprisingly Pervasive Use of Corporate Loans to Extract Funds from Chinese Listed Companies,” Research Paper Series #31-06, Cornell University Johnson School of Management (November 2005).

³ Yan-leung Cheung et al., “Tunneling, Propping and Expropriation: Evidence from Connected Party Transactions in Hong Kong,” Journal of Financial Economics (Nov. 2006).

Satyam, one of India's largest software service providers had an amazing fall from grace from December 2008 to April 2009, when it made an announcement that would see the stock price drop 78%⁴, its chairman and founder resign and the eventually the company sold. Satyam was thought of as a company with strong corporate governance practices after being awarded a Golden Peacock by World Council of Corporate Governance in September 2008, however its golden age did not last long as it was stripped of the award in January 2009⁵.

It all started when Mr Ramalinga Raju, chairman and founder of Satyam tried to pass an abusive related-party transaction (RPT) worth US\$1.6 billion as a deal that would "deliver greater shareholder value"⁶. Satyam wanted to buy Maytas Properties Ltd and a controlling interest in Maytas Infra Ltd however, Mr Raju and his brother Rama Raju, CEO, together owned more than 20% of Maytas Infra and Mr Raju's immediate family owned more than about 35% of Maytas Properties⁷. It was later found out that the deal, estimated to only be worth US\$225 million⁸, was a last ditch effort by the chairman to 'fill the fictitious assets with real ones.'⁹

Investors knew something was not right when the company announced the deal because:

- The purchase of property and infrastructure assets was completely unrelated to the current business operations;
- The board unanimously approved the deal without shareholder approval even though it was a RPT¹⁰; and
- The company was very evasive on the conference call after the announcement not even releasing the name of the advisor to the deal.

⁴ Return shows the fall in price on the NSE from the date of the announcement to April 13 2009 when Tech Mahindra submitted the highest takeover bid for Satyam.

⁵ Beverly Behan, "Governance lesions from India's Satyam" Business Week, 16 January 2009. (http://www.businessweek.com/managing/content/jan2009/ca20090116_465633.htm)

⁶ Bloomberg, Satyam analyst conference call - transcript, 16 December 2008 – Ramalinga Raju quoted.

⁷ The Raju brothers had a deemed interest of 8.31% in Satyam through SRSR Holdings Private Ltd as at 31 March 2008.

⁸ James Fontanella-Khan, "Satyam faces risk of losing governance award", FT.com, 5 January 2009 (http://www.ft.com/cms/s/0/2378069a-dac8-11dd-8c28-000077b07658.html?nclick_check=1)

⁹ B Ramalinga Raju, Resignation Letter to board of directors, 7 January 2009

¹⁰ Currently in India, The Companies Act, 1956 and Clause 49 of the Listing Agreement on RPTs only require board approval and do not require independent shareholder approval.

The timeline of events is illustrated in Figure 3. As of August 2010, Mr Raju, his brother and several others are still awaiting trial on fraud and other charges.

Timeline of events from Dec 2008 to June 2009

<ul style="list-style-type: none"> • Dec 16: Satyam board approves the purchase of 100% of Maytas Properties Ltd for US\$1.3 billion and 51% of Maytas Infra Ltd for US\$300 million. 	<ul style="list-style-type: none"> • Jan 7: Chairman Raju resigns after admitting to falsifying the financial statements creating a fictitious cash balance of more than US\$1 billion. 	<ul style="list-style-type: none"> • Jan 27: Satyam announces its intention to sell the company
<ul style="list-style-type: none"> • Dec 17: Satyam share price falls 30% on the Bombay Stock Exchange as shareholders dump the stock. The deal is called off less than 12 hours after its announcement. 	<ul style="list-style-type: none"> • Jan 9: Police arrest Mr Raju and his brother Rama Raju who are charged with forgery, cheating and fraud. Indian government's Company Law Board removes remaining directors. 	<ul style="list-style-type: none"> • Apr 7: Police file charges of cheating and forgery against former chairman Raju and eight others including his brother and the auditors.
<ul style="list-style-type: none"> • Dec 26-29: Three of the five INEDs on the board resign 	<ul style="list-style-type: none"> • Jan 16: Indian government appoints an independent board to oversee the company. 	<ul style="list-style-type: none"> • Apr 13: Tech Mahindra submits highest bid for Satyam at 58 rupees.
	<ul style="list-style-type: none"> • Jan 24: Police arrest Pricewaterhouse auditors 	<ul style="list-style-type: none"> • Apr 16: The Company Law Board approves Tech Mahindra Ltd.'s proposal to buy a controlling stake in Satyam.
		<ul style="list-style-type: none"> • June 22: Satyam renamed to Mahindra Satyam

Source: Adapted from Wall Street Journal, April 14, 2009 and CFA Institute

2. Financial assistance through provisions of loans, guarantees and collateral

CNOOC Limited

Hong Kong Stock Exchange (883.HK) and the New York Stock Exchange (CEO.US)

In 2007, minority shareholders of CNOOC Ltd., Chinese-owned oil explorer that tried to acquire Unocal in 2005, voted down the company's proposal to deposit up to RMB 6.8 billion (US\$997.5 million) of its cash to an unlisted, Beijing-based sister company, CNOOC Finance. The vote came two years after the Hong Kong Exchange issued a public censure of CNOOC for breaching disclosure rules in light of its "financial assistance" to CNOOC Finance, of which it owned 31.8 percent. HKEx found that from 2002 to 2004, CNOOC deposited cash in the finance unit and received interest

without the requisite disclosure and shareholder approval. Including interest income, its outstanding balance with the finance affiliate reached RMB 6.6 billion, equivalent to 16.6 percent of its net tangible assets¹¹ and well above the 3 percent threshold for disclosure under HKEx rules.

Nanjing Panda Electronics

Hong Kong Stock Exchange (553.HK) and the Shanghai Stock Exchange (600775.CH)

In May 2008, Hong Kong-listed Nanjing Panda Electronics, a satellite-communications equipment manufacturer, announced that a court in China had frozen 192.8 million of its shares – about 30 percent of total – until 2010. The order came as its parent company Panda Electronics, which owned the frozen shares, became entangled in a contractual dispute with its lender, Bank of China.¹² The parent had used its shares in the listed company as collateral for the loans. While details of the dispute were scant, Nanjing Panda disclosed to the Hong Kong Exchange in June 2007 that its parent had been trying to “fulfill its obligations under the relevant loans and to proactively liaise with the relevant parties so that the frozen shares could be free from encumbrances and the shares pledges could be redeemed.”¹³

While Nanjing Panda assured investors that the freezing of the shares had no impact on its operations, it represented deep financial troubles at the parent company that could potentially risk its own assets. In August 2007, the Hong Kong Exchange censured Nanjing Panda for its failure to disclose and seek shareholders’ approval for the RMB 2.18 billion (US\$320 million) in unsecured loans it extended to three of its China-based affiliates.¹⁴ The risks are especially significant given that Nanjing Panda’s chairman and vice chairman are also the chairman and party secretary, respectively, of its state-owned parent.¹⁵

At any rate, it would not have been Nanjing Panda’s first trouble with an affiliate. In 2005, a Chinese court ordered it to give up its 51 percent stake in a mobile communications subsidiary, and 95 percent in another, to repay the combined RMB 120 million (US\$17.6 million) in debts the subsidiaries had incurred. Nanjing Panda’s stock plunged 44 percent on its first trading day after it made the announcement.¹⁶

Asia Pulp & Paper

Delisted from the New York Stock Exchange

One case that encapsulated the rise and fall of the Asian family-business model was the Sinar Mas Group of the Widjaja family of Indonesia. Its founder started the business in 1969 by investing in a

¹¹ Hong Kong Exchange Listing Enforcement Notices/Announcements (06 October 2005). Available at <http://www.hkex.com.hk/news/hkexnews/051006news.htm>

¹² “Nanjing Panda’s 193M shares frozen for further 2 years,” Infocast News (06 May 2008)

¹³ Nanjing Panda Electronics Ltd Announcement, available at www.panda.cn/panda/admin/news/edit/uploadfile/200773115119246.pdf

¹⁴ Hong Kong Exchange Listing Enforcement Notices/Announcements (08 August 2007). Available at <http://www.hkex.com.hk/news/hkexnews/070809news.htm>

¹⁵ “Court Freezes Nanjing Panda Shares,” South China Morning Post (03 November 2005)

¹⁶ “Panda Dives on First Day Back from Trading Halt,” The Standard (13 September 2005)

cooking-oil plant, then diversified gradually into palm oil, pulp and paper, and financial services. In 1999, the Jakarta-listed Bank Internasional Indonesia, of which the family had owned 89 percent, was recapitalized and taken over by the government after it collapsed under the weight of bad loans. At the time of its recapitalization, the bank was found to have US\$1.2 billion in outstanding loans to subsidiaries of the Sinar Mas Group, equivalent to 52 percent of its total loans.¹⁷ Another Widjaja bank, the privately held BII Bank, faced a liquidity crunch when it was unable to return the deposits of two Singapore-listed affiliates because it had lent them on to two other struggling affiliates.

In 2001, Asia Pulp & Paper, the group's flagship that was then listed at the New York Stock Exchange, defaulted on a staggering US\$13.4 billion in debt. The company had an attractive profile: with US\$3 billion in sales and state-of-the-art facilities throughout Asia, it was then the largest player in its industry. But a 20 percent drop in global paper prices drove it to default on its loans, which then caused the crash of its stock price to 12 cents (from US\$15 in 1995)¹⁸, its eventual delisting, and its litigious restructuring.

During the restructuring, the auditing firm KPMG reported numerous questionable connected transactions within the group. In 2000, advances worth US\$504 million were made by APP subsidiaries to two others, which then paid US\$182 million to buy tracts of land from the Widjaja family at a time when they told creditors they were facing a cash crunch. In 2001, two subsidiaries renewed pulpwood purchase agreements with two others at agreed prices that weren't pegged to production cost. One subsidiary was also not allowed to offset the loans it extended to the subsidiary from which it bought pulpwood. It was also found that five companies registered in the British Virgin Islands, later discovered to be APP affiliates, owed the company US\$1 billion, but APP discontinued its claims against them because "it was better to focus our efforts on more substantial claims."¹⁹

APP completed its restructuring in April 2005, and remains one of the largest pulp-and-paper producers in the world.

3. Bailout

SK Group

Listed on the Korea Stock Exchange, SK Corp (003600:KS) and SK Networks Co Ltd (001740:KS)

The bailout of SK Global (renamed SK Networks) by its parent, the energy-to-telecommunications *chaebol* SK Corp, is perhaps Asia's most remarkable case of conflict between a controlling shareholder and its independent investors. The year-long saga highlighted the biggest risk investors face when dealing with family-controlled business groups: their limited ability to influence corporate decisions regardless of the size of their investment. Sovereign Asset Management was no ordinary investor in SK Corp: with 14.99 percent of outstanding shares, the Monaco-based fund was its single largest shareholder. The controlling family, represented by chairman Chey Tae-Won, owned fewer

¹⁷ Bambang Setiono, "Debt Settlement of Indonesian Forestry Companies", Center for International Forestry Research (2007). Available at www.cifor.cgiar.org/publications/pdf_files/Books/BSetiono0701.pdf

¹⁸ Michael Shari, "Asia's Worst Deal," BusinessWeek (August 13, 2001)

¹⁹ Asian Development Bank, *Promoting Regional Cooperation in the Development of Insolvency Law Reforms (2008)*. Available at <http://www.adb.org/Documents/Reports/Insolvency-Law-Final-Report/part03.pdf>

shares, but because of the *chaebol's* circular ownership, its voting rights were in excess of 30 percent.²⁰

The timeline below illustrates how Sovereign and other investors persevered in exercising their rights to prevent the parent company from throwing a lifeline to an ill-fated affiliate. The case started in March 2003 when government investigators discovered accounting irregularities at the *chaebol's* trading arm, SK Global, including US\$1.2 billion in inflated profits and US\$5.6 billion in hidden losses.²¹ As the subsidiary faltered, SK Corp came under pressure from SK Global's creditors to provide assistance, and by June, its board of directors approved a bailout plan that earned the ire of its investors. The plan involved swapping 850 billion won (\$741 million) in debt SK Global owed to SK Corp for newly issued shares in SK Global.²² The deal was meant to improve the subsidiary's balance sheet to limit the reduction in the value of the loans creditors could recover.

In December, SK Corp dealt a double blow to its shareholders. It announced that it was setting aside 143 billion won (US\$125 million) to lend to another subsidiary, SK Shipping, and that it could not rule out further loans when the company faced a cash shortage of 170 billion won (US\$148 million) in 2004.²³ (Earlier that year, SK Shipping had written off 239.2 billion won [US\$209 million] in unaccounted-for commercial paper, in what analysts believed was an improper support of SK Global.²⁴) On top of that, SK Corp announced it was selling treasury shares equivalent to a 10.4 percent stake in the company to a handful of local financial institutions, including lenders of SK Global. Sovereign filed an injunction against the plan, calling it a move to further diminish its voting rights. The court, however, sided with SK Corp, which claimed that the deal was meant to boost the company's financial position.²⁵

A Test of Wills: A foreign fund manager's battle against a chaebol's related-party transaction.

SK Corp: A Series of Unfortunate Events	
27 Feb 03	Prosecutors announce USD 1.2 billion account manipulation by SK Global (now SK Network).
11 Mar 03	SK Chairman was charged on account manipulation.
17 Mar 03	Moody's downgrades group's credit rating to Ba2. SK Corp.'s share price falls by half in a week.
3 April 03	Sovereign Asset Management announces acquisition of 8.6% interest.
14 Apr 03	Sovereign publicly asks for corporate governance improvements.
16 Apr 03	Sovereign discloses its expanded interest of 14.99% in SK Corp.
4 Jun 03	Sovereign opposes SK Corp.'s financial support for SK Network.
10 Jun 03	Hermes Pension petitions court for voting right suspension of three directors.
13 Jun 03	Chey Tae-Won, chairman of SK Corp., sentenced to three years in jail.
14 Jun 03	Hermes' court petition succeeds.

²⁰ E. Han Kim (see footnote 28)

²¹ "Court backs proposed SK Corp stock sale," Financial Times (24 December 2003)

²² "SK Corp. Backs Affiliate's Bailout," Asian Wall Street Journal (16 June 2003)

²³ "SK Corp to lend 143.4 billion won to support SK Shipping," AFX Asia (18 December 2003)

²⁴ "Sovereign Moves To Distance SK Corp From SK Global," Dow Jones International News (28 April 2003)

²⁵ "Sovereign Files Injunction Against SK Corp's Treasury Stock Sale," Dow Jones International News (23 December 2003)

15 Jun 03	SK Corp.'s board approves bailout of SK Network including a USD 800m debt-to-equity swap.
17 Jun 03	Sovereign asks for resignation of 3 directors.
11 Aug 03	Lazard, Sovereign's advisor, demands replacement of three directors and spin-off of SK Telecom.
22 Sep 03	Chey released on bail.
24 Sep 03	Lazard opposes Chey's return to work.
26 Oct 03	SK Corp. resolves details of 15 Jun 03 bailout decision.
20 Nov 03	Sovereign announces its plan to oust three directors at AGM.
11 Dec 03	Sovereign begins to solicit support from institutional investors.
22 Dec 03	Local minority shareholder groups declare support for Sovereign.
26 Dec 03	SK Corp. sells 10% treasury shares to friendly parties. Share price declines reflecting end of proxy fight; chairman had acquired enough support at the forthcoming AGM.
9 Jan 04	Son Kil-Seung, CEO of SK Corp., arrested on misappropriation of SK Shipping's corporate fund.
30 Jan 04	SK Corp. proposes to increase outside directors to over half of the board.
30 Jan 04	SK Corp. announces 2003 results – net earnings declined by almost 90% due to losses of affiliates.
2 Feb 04	Templeton and Wellington each disclosed 5% stakes. Foreigners owned more than 50% of SK Corp.'s shares.
22 Feb 04	SK Corp. proposes six new directors. Outside directors make up 70% of board.
12 Mar 04	Sovereign loses at AGM.
15 Mar 04	Sovereign reiterates request for Chey to resign.
26 Mar 04	SK Corp. establishes a special committee to improve corporate governance.

Source: Franklin Templeton

Deprivation of wealth opportunity

Deprivation of wealth opportunity refers to actions by controlling shareholders to either enlarge the amount of control they already have over listed entities, or take exclusive advantage of wealth-creating opportunities derived from listed entities.

The former, appropriation of control, can happen through transactions such as mergers with related parties, or issuance of new shares, convertible bonds or other equity-linked instruments to related parties. While valuations in these deals may (or may not) be fairly determined, the ulterior motive is for controlling shareholders to reinforce or consolidate their influence in the listed company. In consequence, minority investors suffer not only from short-term erosion in the value of their shares in cases of dilution, but their interests also get marginalized since the long-term outcome is management entrenchment – in Asia's case, the long-term domination of controlling shareholders in the company's board.

The latter, usurpation of corporate opportunity, occurs when a controlling shareholder creates a business opportunity out of the listed company's operations, but as a private endeavor. The result is that minority shareholders are robbed of an opportunity from which the company as a whole should have had the priority to benefit. In the United States, usurpation "might be considered a damage caused by a director to potential interest of the company by diverting any company's business opportunities on his own or third parties' account."²⁶ Where separation of ownership and control exists, the act is a breach of fiduciary duty by a director, and where litigation is necessary; the case is often brought by the company that lost the opportunity.²⁷ In Asia, the legal framework for these cases is a blur, since commercial codes tend to stipulate that directors owe fiduciary duty to the company – in other words, to themselves.

Deprivation of wealth opportunity also occurs when the majority shareholder takes away the most valuable asset of a company through privatization or the sale of its core assets. While independent shareholders almost always have to vote on these related transactions, they sometimes end up getting the raw end of the deal by being offered an unattractive valuation with no recourse to a clear alternative strategy. Knowing that the controlling shareholder has an intention to sell, they carry the burden of uncertainty as to the future of the company if they rejected the deal. The case raises the issue of the independence of shareholders who are allowed to vote on such transactions, and open the possibility of related parties (who are not allowed to vote) to then lend their shares to others who will vote in their favor.

1. Usurpation of corporate opportunity

Shinsegae Group

Listed on the Korea Stock Exchange, Shinsegae Co Ltd (004170:KS) and GwangjuShinsegae Co Ltd (037710:KS)

In 2006, tax authorities in Korea began an investigation on Shinsegae Department Store (SDS) based on allegations of unfair wealth transfer to its controlling shareholder, the Chung family (not related to the Chungs of Hyundai). SDS owns seven department stores in Korea and in 1995 it established Gwangju Shinsegae, to operate a department store with similar operations and using the Shinsegae brand. In 1998, Gwangju sought an increase in paid-up capital, to which SDS gave up its right to subscribe. The Chung family took up the slack, becoming its largest shareholder with an 83 percent stake, and made further investments in 1999 when Gwangju was worth about 4,000 won (US\$3.5) per

²⁶ Christian Campbell, "International Liability of Corporate Directors," Vol. II, 2007 ed., Yorkhill Law Publishing, p. 137

²⁷ Lisa Peters, "Corporate Opportunity - A Primer", Lawson & Lundell, 2001

share. Gwangju Shinsegae has since listed, and its shares were trading at 156,000 won (US\$136) as of August 2010.²⁸

SDS set up a second company which directly competes with its own stores at the expense of the minority shareholders in SDS. In 1998, SDS did not take up its rights in the share issue, therefore shareholders in SDS were robbed of the opportunity to participate in the growth of Gwangju. Instead of including minority shareholders, SDS allowed the Chung family to increase its private stake in Gwangju and enlarge the family's wealth.

The Peoples Solidarity for Party Democracy (PSPD) filed criminal charges against the board of directors for condoning the unfair deals.

2. Privatization and buyout of strategic assets

Henderson Group

Listed on Hong Kong Stock Exchange, Henderson Land Development Company (12:HK) and Henderson Investment Limited (97:HK)

In December 2007, minority investors of Henderson Investment Ltd (HIL), a diversified company with interests in utilities, infrastructure and real estate, approved a proposal by controlling shareholder Henderson Land Development (HLD) to buy out its entire 39 percent stake in Hong Kong and China Gas (HKCG). The sole supplier of piped gas in Hong Kong was a key asset in HIL's portfolio. In the 2007 buyout of HIL's shares in HKCG, HLD offered a cash-and-share deal equivalent to the average closing price of HKCG in the 10 previous trading days, which investors accepted. Shareholder activist and former HKEx independent director David Webb deemed the price as substandard for not adding a control premium for an asset with a proven cash-generation record. As a monopoly, HKCG has stable earnings and steady dividends, which had been held at 32 cents a share since 2002. After the HLD acquisition, HKCG announced it was raising its dividend to 35 cents a share.

The buyout of HKGC was the closest the parent company has gone to enjoying the benefits of the subsidiary's investment returns without sharing them with minority investors. In 2002 and 2005, HLD tried and failed to buy the 32 percent of HIL shares it didn't already own.

In its first attempt, HLD made an all-cash offer of HK\$7.60 (US\$0.97) per HIL share, which minority shareholders promptly criticized for being too low. In a statement, Templeton Asset Management claimed it was even less than the HK\$7.76-per-share value of Henderson Investment's stake in

²⁸ Bloomberg.com

HKGC, let alone its other assets. Estimating HIL's fair value at HK\$11 a share, Templeton denounced its controlling shareholders – the family of Lee Shau-Kei, Hong Kong's second richest man – for “taking advantage of the current poor market sentiments to buy up the company cheaply ... at the expense of the minority shareholders.”²⁹

In 2005, HLD took a different tack, offering one of its shares for every 2.5 HIL shares, effectively valuing the latter at HK\$13.23 (US\$1.15). Investors again rejected the offer, which some had determined to be a 19 percent discount to the company's net asset value.³⁰

Conclusions

These cases highlight the inadequacies in regulations on related-party transactions throughout Asia. Many Asian countries already have some degree of rules and regulations in place to govern related-party transactions. These are found in listing rules, accounting standards, company law, and corporate governance codes. A system of checks and balances is built around these rules and regulations to make sure transactions are conducted within the specified limits.

To further strengthen monitoring and implementation of relevant rules, the Organisation for Economic Co-operation and Development (OECD) Asian Roundtable on Corporate Governance developed its “Guide to Fighting Abusive Related-Party Transactions in Asia,” released in September 2009³¹. This guide provides a framework for any jurisdiction to monitor and regulate related-party transactions and recommends attention to nine areas: (1) definitions of connected persons and related parties, (2) thresholds for board and shareholders' approval, (3) disclosure policies of related-party transactions to investors, (4) role of external auditor, (5) role of independent directors and independent advisers, (6) effective independent directors, (7) shareholder voting mechanism and processes, (8) legal redress for minority shareholders, (9) a coherent legal system to facilitate implementation and enforcement.

Although these comprehensive OECD Asian Round -table guide principles are followed by select economies, many countries currently fall short of setting an effective framework for requiring shareholder approval. In fact, as seen the cases from Korea and India, regulations in these countries do

²⁹ David Webb, “Templeton Opposes Henderson Offer,” [webb-site.com](#) (11 November 2002)

³⁰ “Henderson arm buyout collapses as investors rebel,” South China Morning Post (21 January 2006)

³¹ To view the OECD's report, “Guide on Fighting Abusive Related-Party Transactions in Asia,” go to www.oecd.org/dataoecd/39/57/43626507.pdf.

not even require shareholder approval; therefore, much needs to be done to harmonize regulations in this area.

The lack of adequate regulation, and even ineffective practices at the board level, are clearly demonstrated in the recent Satyam case. A couple of lessons can be learned from the Satyam case. First, there was no requirement for shareholder approval, despite the size of the transaction. The events could have turned out quite differently had shareholder approval been required. Second, the independent directors had a key role to play in approving the deals at the board meeting. The independence of the INEDs and their willingness and ability to act independently in such situations is pivotal to the success of the checks-and-balances system over the controlling shareholder. Board independence not only helps ensure that investors and minority shareholders are not exploited but can also help identify other potential risks.