PART I

Introduction and Overview

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Introduction

I. The Central Argument

This book seeks to reconceptualise the role of shareholders in listed companies as one that should include fiduciary duties, particularly the duty to act in good faith in the best interests of the company and the duty to avoid unauthorised conflicts of interest. The case study consists of listed companies in four common law jurisdictions in Asia – Hong Kong, Singapore, India and Malaysia. My central argument comprises three primary claims. First, because the general meeting is an agent of the company, it owes fiduciary duties to the company, the most important of which for the purposes of this book is to act in good faith in the company's best interests. I develop a theory of what these interests should be through a normative, legal and empirical analysis. Second, controlling shareholders in the common law systems in Asia should owe fiduciary duties to the company because: (a) the existing

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legal strategies for regulating extractions of private benefits of control by controlling shareholders are deficient; (b) the law does not regulate certain conflicts of interest between the company and controlling shareholders, and the latter could cause the company to take actions that benefit them but at the expense of the company and minority shareholders; and (c) the justifications for subjecting directors to fiduciary duties should also apply to controlling shareholders. Third, institutional investors in the common law systems in Asia should owe fiduciary duties to the company because: (a) failure to do so would defeat the operation of the fundamental principle of the stewardship codes governing institutional investors under which they have to protect and promote the long-term success of their investee companies; and (b) their interests could conflict with those of the company and they could cause the company to take actions that benefit them but at the expense of the company and other shareholders. Bearing in mind the different types of shareholders in the listed companies in these common law systems in Asia, I explain the rationale and contents of the duties, who should impose the duties, when and how the duties should be imposed, and finally, issues concerning enforcement.

II. Background: Two Problematic Views

To set the background for my argument, it is important to appreciate that the role of shareholders and the purpose of the general meeting have been shaped principally by two influential views, both of which are profoundly questionable. The first is that shareholders are regarded as owners or principals, whose interests diverge from their agents who are the management and board. The second is that shareholders can vote as they please because votes are property rights.

On the first view, shareholders owe no duties when they exercise their voting powers, unlike directors. After all, discretionary powers of management are vested in the board and management, not shareholders;[1] any powers held by shareholders are of a constricted and subordinated nature. Therefore, the separation of ownership (held by shareholders) and control (held by the directors and managers) means that directors are susceptible to act in their self-interests or can be negligent, to the detriment of

[1] See e.g. Article 3 of Schedule 3, UK Companies (Model Articles) Regulations 2008 (‘Subject to the articles, the directors are responsible for the management of the company’s business, for which purpose they may exercise all the powers of the company’); s 141(a) of the Delaware General Corporation Law (2009); s 8.01 of the Model Business Corporation Act (2008).

shareholders.[2] So duties have to be imposed on directors to ensure that they act for the shareholders' benefit. Further and crucially, shareholders are widely regarded as the owners of the company.[3] Moreover, shareholders are regarded as the principals, and directors their agents.[4] Directors thus are accountable to shareholders.[5] The prevailing picture is that shareholders are generally vulnerable and have to be protected from delinquent directors.[6] For all of these reasons and more, a central legal and policy issue in the Anglo-American world since the early twentieth century has been the 'agency' problem between board/management and the 'owners' (i.e. shareholders),[7] and the *ex ante* and *ex post* measures to address it. These measures include but are not limited to increasing and empowering shareholder engagement and monitoring of directors, augmenting and aligning the incentives given to management with shareholders' interests, the market for corporate control, directors' duties and the appointment of independent directors. In short, given the divergence of interests between directors and shareholders, the power of shareholders has to be augmented, and the role of shareholders is essentially to monitor and discipline directors to ensure that the latter act in their interests. And their interests are usually synonymous with the maximisation of share price.

However, the interests of shareholders, in which directors and management are pressurised and incentivised to act by maximising share price,

[2] Adolf A Berle, Jr and Gardiner C Means, *The Modern Corporation and Private Property* (Commerce House 1932). But see Ronald J Gilson and Jeffrey N Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights' (2013) 113 *Columbia Law Review* 863 (arguing that in the United States, in addition to the agency problem posed by the separation of ownership and control, there is the agency problem caused by the divergence of interests between the institutional shareholders and their beneficiaries).

[3] See e.g. Henry Hansmann, 'Ownership of the Firm' (1988) 4 *Journal of Law, Economics and Organization* 267; UK Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report) 1992 at [6.1], [6.6].

[4] See e.g. Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305.

[5] For a useful summary, see Andrew Keay, *Board Accountability in Corporate Governance* (Routledge 2015) at 72–83.

[6] But note hedge fund activism. On the different images of shareholders, see Jennifer G Hill, 'Images of the Shareholder' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar 2015) at 53–78.

[7] See e.g. Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe and Edward Rock, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) ch 2–3.

conflict with and adversely affect the company's interests; the latter include those of stakeholders such as creditors, employees, customers and even the community.[8] The other related issue is that the empowerment of shareholders through the strengthening of the rights of shareholders and advocating for the active exercise of these rights[9] was carried out without any corresponding legal obligation on the part of shareholders to consider the question of in whose interests or for whose benefit they ought to exercise them.[10]

Nevertheless, although there is extensive literature on insulating management from shareholder pressure, reforming managerial compensation, incentivising shareholders to act long-term,[11] suspending voting

[8] See Joseph L Bower and Lynn S Paine, 'The Error at the Heart of Corporate Leadership' (2017) 95 *Harvard Business Review* 50. One startling manifestation of the problem is that the financial institutions that performed the best in corporate governance (insofar as they have implemented the measures to reduce the agency problem) are the ones which performed the worst in the global financial crisis: Colin Mayer, *Firm Commitment: Why the Corporation Is Failing Us and How to Restore Trust in It* (Oxford University Press 2013) at 61–68. The increased power and influence exercised by shareholders over directors and management and the incentive-based compensation given to the latter caused them to exclusively or primarily maximise shareholder value, which conflicts with and harms the company's interests. The European Commission has stated that 'confidence in the model of shareholder-owner who contributes to the company's long-term viability has been severely shaken': EU Commission Green Paper on Corporate Governance and Remuneration Policies for Financial Institutions, COM (2010) 284 (2 June 2010). Regarding the dark side of hedge fund activism, from the EU perspective see Eilis Ferran, 'After the Crisis: the Regulation of Hedge Funds and Private Equity in the EU' (2011) 12 *European Business Organization Law Review* 379; Eddy Wymeersch, 'Shareholders in Action: Towards a New Company Paradigm?' (2007) 4 *European Law Journal* 50; April Klein and Emanuel Zur, 'Entrepreneurial Shareholder Activism: Hedge Funds and other Private Investors' (2009) 64 *Journal of Finance* 187. Regarding the US perspective, John C Coffee, Jr and Darius Palia, 'The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance' (2016) 1 *Annals of Corporate Governance* 1; cf Alon Brav, Wei Jiang, Frank Partnoy and Randall S Thomas, 'Hedge Fund Activism, Corporate Governance, and Firm Performance' in William W Bratton and Jospeh McCahery (eds), *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation* (Oxford University Press 2015) at 261–304.

[9] For example, see Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111–23, 124 Stat 1376 (2010) (shareholders are given voting rights with respect to say on pay and golden parachutes and proxy access); sections 226B, 226, 439 and 439A UK Companies Act 2006 (say on pay regulations); EU Shareholder Rights Directive.

[10] For example, the UK Stewardship Code and its analogue in Singapore, Hong Kong and Malaysia impose no legally enforceable obligation on institutional shareholders to comply with the code. At best, the UK Stewardship Code requires companies to comply with the code, but if they choose not to, they merely have to give an explanation.

[11] Incentives include giving enhanced voting rights, more dividends, cash payment or tax reduction to shareholders who hold their shares for a certain length of time. See e.g.

rights[12] and even revoking the privilege of limited liability,[13] little attention has been paid to the issue of whether shareholders should be subject to any duties, and if so, to whom they should owe the duties and what the contents of these duties are.[14]

However, it is not viable to impose duties on shareholders when they vote (let alone exert influence) if it conflicts with a well-established doctrine in company law. This brings us to the second influential view, which is that because votes are property rights, shareholders can generally vote as they please, even if doing so is entirely antithetical to the interests of the company;[15] these interests have been defined under the common law as the interests of the shareholders as a whole, i.e. the present and future shareholders and not the interests of a particular shareholder or one group of shareholders.[16] The rule that shareholders

Tamara Belinfanti, 'Shareholder Cultivation and New Governance' (2014) 38 *Delaware Journal of Corporate Law* 789 at 845 (suggesting weighted dividends dependent on length or quality of share ownership); Demetra Arsalidou, 'Shareholders and Corporate Scrutiny: The Role of the UK Stewardship Code' (2012) 9 *European Company and Financial Law Review* 342 at 376–77 (endorsing France's use of enhanced voting rights).

12 See e.g. Lynne Dallas, 'Short-Termism, the Financial Crisis and Corporate Governance (2011) 37 *Journal of Corporation Law* 264; Henry Hu and Bernard Black, 'Equity and Debt Decoupling and Empty Voting II: Importance and Extensions' (2008) 156 *University of Pennsylvania Law Review* 625 at 697.

13 Paddy W Ireland, 'Limited Liability, Shareholder Rights and the Problem of Corporate Irresponsibility' (2010) 34 *Cambridge Journal of Economics* 837.

14 The exceptions include Rob Flannigan, 'Shareholder Fiduciary Accountability' (2014) *Journal of Business Law*; Iman Anabtawi and Lynn Stout, 'Fiduciary Duties for Activist Shareholders' (2008) 60 *Stanford Law Review* 1255; Roberta S Karmel, 'Should a Duty to the Corporation Be Imposed on Institutional Shareholders' (2004) 60 *Business Lawyer* 1; Hanne S Birkmose (ed), *Shareholders' Duties* (Kluwer Law International 2017). Unfortunately, the literature is focused on the UK, United States and EU; nothing on the common law systems in Asia.

15 *Pender* v *Lushington* (1877) 6 Ch D 70 at 75 (Jessel MR): 'a man may be actuated in giving his vote by interests entirely adverse to the interests of the company as a whole. He may think it more for his particular interest that a certain course may be taken which may be in the opinion of others very adverse to the interests of the company as a whole, but he cannot be restrained from giving his vote in what way he pleases because he is influenced by that motive. There is, if I may say so, no obligation on a shareholder of a company to give his vote merely with a view to what other persons may consider the interests of the company at large. He has a right, if he thinks fit, to give his vote from motives or promptings of what he considers his own individual interest.'

16 *Brady* v *Brady* (1987) 3 BCC 535 at 552 (Nourse LJ): 'the interests of a company, an artificial person, cannot be distinguished from the interests of the persons who are interested in it. Who are those persons? Where a company is both going and solvent, first and foremost come the shareholders, present and no doubt future as well'; *Gaiman* v *National Association for Mental Health* [1971] Ch 317 at 330; *Greenhalgh* v *Ardene Cinemas Ltd* [1951] Ch 286 at 291.

can vote as they please has been repeatedly affirmed in subsequent English decisions[17] and also represents the law in the common law countries in Asia.[18] The implication is that shareholders, subject to certain narrow limitations, are under no duty to vote responsibly.

However, crucially, if we pay close attention to the fundamental principles of company law, as well as the key features of the corporate structure and governance of the jurisdictions outside of the Anglo-American world, the two views above become highly questionable. The first fundamental point is the foundational rule in company law: the separate legal personality doctrine, the most important corollary of which is that the general meeting is an agent of the company, and thus owes fiduciary duties to the company. The second point is that shareholders in the common law jurisdictions in Asia, whose company laws are based on or inspired by English law, do possess highly significant (albeit limited) powers. The third is a defining feature of the structure of listed companies in common law Asia: controlling shareholders in concentrated ownership companies. The fourth and final point is the role of institutional shareholders as stewards who are responsible for promoting the long-term success of the investee company. Each of these points is explained below and elaborated in subsequent chapters.

III. Four Fundamental Points

A. Separate Legal Personality

Regarding the first fundamental point, the separate legal personality doctrine entails two critical corollaries, the first of which is the trite law that shareholders do not own the company, and the second is that the general meeting is an agent of the company and therefore owes fiduciary duties to it.

The first corollary is that because the company is a legal entity that is distinct and separate from its shareholders and directors, it can enter into contracts in its own name, own properties, sue and be sued in its own name.

[17] See e.g. *North-West Transportation Co Ltd* v *Beatty* (1887) 12 App Cas 589 at 593 (PC) (Sir Richard Baggallay): ‘every shareholder has a perfect right to vote . . . although he may have a personal interest in the subject-matter opposed to, or different from, the general or particular interests of the company.’ *Burland* v *Earle* [1902] AC 83 at 94 (PC) (Lord Davey); *Northern Counties Securities Ltd* v *Jackson & Steeple Ltd* [1974] 2 All ER 625; *Multinational Gas and Petrochemical Co* v *Multinational Gas and Petrochemical Services Ltd* [1983] 2 All ER 563.

[18] See e.g. *Hiew Fook Siong* v *Fung Tak Keung* [2006] 3 HKLRD 762.

Its assets and liabilities are its own, not the shareholders or directors. Thus, shareholders have no right to the company's assets. If shareholders do not own the assets of the company, they are likewise not liable for the company's debts in a limited liability company. They are liable insofar as they have not fully paid up for their shares.

Shareholders, however, own shares which confer voting rights, but these rights are not conferred automatically as of right. Whether shareholders have voting rights depends on the subscription contract and the company's constitution. The shares also confer on shareholders the right to receive dividends, but only if it is provided for in the constitution and only when the directors make a declaration of dividends; shareholders do not have an automatic right to receive dividends.

To state the obvious: it is therefore erroneous to say that shareholders are the owners of the company, a central tenet under the first view. They do not own the company any more than directors or creditors do. Yet the rhetoric of shareholders as owners has persisted and is pervasive, resulting in confusion and distortion.[19] It is misconceived to use the proposition under the first view – shareholders are owners – to justify why directors should owe duties for the shareholders' benefit, or to supply the rationale for why directors should be accountable to shareholders. Equally important, to the extent that the proposition shareholders are owners has provided the basis for why shareholders should be given voting powers, it is fallacious. And insofar as the ownership proposition has been used to equate the interests of the company with those of the shareholders, it is erroneous. As recognised by Professor Colin Mayer, the distinguished economist and former dean of the Said Business School at Oxford:

> What underlies . . . the whole of modern corporate finance, is the direct identification of the corporation with its owners, the shareholders. It is not just that the corporation is run in the interests of its shareholders; the corporation is its shareholders . . . The basic proposition of this book is that this principle is fundamentally wrong.[20]

The second critical corollary of the separate legal personality doctrine is that the general meeting, like the board of directors, is an agent of the

[19] For a forceful critique, see Paddy Ireland, 'Company Law and the Myth of Shareholder Ownership' (1999) 62 *Modern Law Review* 32.

[20] Colin Mayer, *Firm Commitment: Why the Corporation Is Failing Us and How to Restore Trust in It* (Oxford University Press 2013) at 173.

company when it acts on behalf of the company.[21] A company being an artificial entity can only act through its agents.[22] When the company is legally incorporated, the company is legally treated as having assented to the board and the general meeting to act on its behalf. Thus, under the company's constitution and the statute, the board and the general meeting are empowered or required to make decisions on behalf of the company. The decisions of the board and the general meeting alter the legal position of the company and affect its rights and liabilities vis-à-vis internal and external parties. The company therefore has two agents: the board of directors and the general meeting. If the general meeting, like the board, is an agent of the company, it is axiomatic that an agent owes fiduciary duties.[23] Thus, to deny that the general meeting owes duties to the company is contrary to the principle that it is the company's agent, which is contrary to a corollary of the separate legal personality rule. Therefore, the claim under the first view that directors are the shareholders' agents is legally wrong (even if it is defensible from an economic perspective).

The principle that the general meeting is an agent of the company and hence owes fiduciary duties to it poses a fundamental challenge to the first view, under which the role of shareholders is to monitor and discipline the board/management in order that the latter can act for the benefit of the shareholders. The first view rests on the false assumption that the separate legal personality rule is either immaterial or irrelevant to the characterisation of the role of shareholders and corporate governance.

Crucially, the proposition under the second view that shareholders can vote as they please even if their interests are 'entirely adverse to the interests of the company as a whole'[24] is contrary to the principle that because the general meeting is an agent, it owes fiduciary duties to act in the interests of its principal, the company. Suggestion to the effect that the general meeting is generally not accountable (as opposed to directors), as implied by the first and second view, is misplaced.

The importance of the principle of the general meeting as an agent of the company, and therefore owing fiduciary duties, is elaborated in

[21] Peter G Watts and FMB Reynolds, *Bowstead and Reynolds on Agency*, (20th edn, Sweet & Maxwell 2014) at [1–024]; Peter G Watts, *Bowstead and Reynolds on Agency* (21st edn, Sweet & Maxwell 2017) at [1–028].

[22] See Chapter 3B.

[23] Watts and Reynolds, *Bowstead* at [1–001]; American Law Institute, *Restatement of the Law of Agency*, vol. 1 (3rd edn, American Law Institute Publishers 2006) at [1.01].

[24] *Pender* v *Lushington* (1877) 6 Ch D 70 at 75 (Jessel MR).