Introduction

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CORPORATE GOVERNANCE – AN OVERVIEW

For a short while in 2008–09, as the wave of the Global Financial Crisis swept over us, it seemed that the world might change. The tenets that underpinned our economic systems were called into question, and faith in the invisible hand of the market wavered. When speculative credit derivatives business began to unravel at many large financial institutions, it threatened to destroy giant companies of long standing, such as Citigroup and American International Group (AIG). This sparked fears about a systemic collapse at the global level. The disaster, largely of human making, was averted by the 'bailouts' organized by the government of the United States in coordination with the Federal Reserve. Once the immediate crisis had passed leaving the rescued institutions intact, the immediacy of the need for fundamental change also seemed to pass.

Several years on, the world looks much the same. The clean-up after the acute emergency of the sudden meltdown continues. To cynics, the international response to the Financial Crisis has had a dreary predictability: much hand wringing, and regulatory responses that addressed symptoms of the Crisis without touching the underlying malaise. Indeed, writing in 2008 just before the onset of the Global Financial Crisis, La Porta et al. compared and contrasted the policy-implementing focus of civil law jurisdictions with the market-supporting focus of common law jurisdictions – to the latter's advantage. The paper concluded:

> The world economy in the last quarter century has been surprisingly calm, and has moved sharply toward capitalism and markets. In that environment, our framework suggests that the common law approach to social control of economic life performs better than the civil law approach. When markets do or can work well, it is better to support than to replace them. As long as the world economy remains free of war, major financial crises, or other extraordinary disturbances, the competitive pressures for market-supporting regulation will remain strong and we are likely to see continued liberalization. Of course, underlying this prediction is a hopeful assumption that nothing like World War

> II or the Great Depression will repeat itself. If it does, countries are likely to embrace civil law solutions, just as they did back then. (p. 327)

In fact, and as predicted, the response to the Financial Crisis of 2008–09 and the underlying events has been legislation. The US Congress enacted the *Dodd-Frank Act of 2010* – a formidable tome of over 1500 pages of closely printed text. The *Dodd-Frank Act*, reflecting its motivating drivers, targets a number of issues related to the Financial Crisis. These include setting up an agency to protect consumers against abusive lending practices, and regulation of credit rating agencies, trade in derivatives and hedge funds.

The sweep of the *Dodd-Frank Act* also extends to corporate governance. This can be interpreted as a strengthening of the trend for federal regulation of public corporations. The *Dodd-Frank Act* has adopted the principle of shareholder empowerment. The areas selected for reform are shareholder nomination of candidates for director positions (section 971) and a non-binding shareholder vote on executive compensation, or 'say on pay' (sections 951–7).

The principle of shareholder empowerment in the *Dodd-Frank Act* is, by and large, consistent with the theme of federal regulation since the 1930s. The concern of federal securities regulation has traditionally been with 'investors' – who are essentially shareholders. Federal regulation may be viewed as an attempt to set right the imbalance created under state incorporation laws that endow directors with most of the corporate powers. In this setup, federal securities regulation has generally made interventions on behalf of the shareholders.

The Securities Exchange Commission (SEC) has framed Rule 14a-11 to implement the directive under the *Dodd-Frank Act* to provide access to shareholders in nominating directorial candidates. But the rule has come under legal challenge by the US Chamber of Commerce and Business Roundtable, which have filed an action in the US Court of Appeals for the DC Circuit. These business groups attack the rule, among other things, on the ground that it does not consider the effects on 'efficiency, competition, and capital formation' (Allen 2010). Pending the decision of the court, the SEC has agreed not to implement the rule.

The other element in the *Dodd-Frank Act* is about shareholders having a 'say on the pay' of senior executives. This measure is significant for a number of reasons. First, it represents a response to the longstanding complaint that the executives, in effect, determine their own salaries. Recent innovations such as compensation committees of the board of directors and a majority of independent directors are apparently not considered adequate. Secondly, it reflects the idea that shareholders are the principals and managers are their agents. If this is so, then it is quite appropriate that shareholders are involved in determining executive pay.

Finally, there can be an economic justification for involving shareholders rather than anyone else in determining executive pay. Shareholders are the residual claimants in solvent corporations, as economic theory stresses. Executive pay is a charge on the residue and it is logical for shareholders to have a say on the quantum of the charge.

However shareholder intervention in executive pay – indeed the theme of shareholder empowerment – presents some difficulties. For instance, there is a complaint that shareholders' major concern is with share prices (see, for example, Ryterbrand 2010). Targeting share prices, they often act with short-term motives and might persuade managers to follow their bidding. Another issue is why shareholders should be treated any differently from other 'stakeholder' groups, such as employees or lenders. Stakeholder theorists argue that there is no justification for the proprietary idea associated with shareholders and for granting them special rights.

The difference that the 'say on pay' provision in the *Dodd-Frank Act* will make to the culture of high executive pay and the recent growth in imbalances in pay structures between the lower and higher levels in corporate organizations (see, for example, McDonnell 2008) remains to be seen. Compensation committees with independent directors have been around for several years, and they are mandatory under the New York Stock Exchange Listing Rules (NYSE Rules 2010). To be fair, these mechanisms have had some impact but there is obviously a considerable distance to travel. There is now regulatory intervention in executive compensation through the non-binding shareholder vote provided in the *Dodd-Frank Act*.

In dealing with sensitive issues such as executive compensation, the character of business corporations and our understanding of the subject are crucial. A sound theoretical underpinning is essential in coming to terms with the phenomenon we call business corporations. We need greater clarity in our understanding and perception of these devices. To illustrate, in theorizing about the regulation of executive compensation we must necessarily consider a number of other longstanding issues. These include questions about the public or private character of business corporations, their relationship with the state, the legitimacy of regulation and its extent or reach. Finally, there is the issue of the impact of regulation on business initiative and enterprise and, consequently, general economic welfare.

The current round of governance failures in the financial companies has occurred just a few years after the equally sensational collapses seen in Enron, WorldCom and other companies in the early years of the new millennium. Similar to the discussion and debate that occurred after Enron, the Global Financial Crisis of 2008–09 presents an opportunity to examine afresh our assumptions about the prevailing economic framework. This examination may also cause us to ask whether Enron and the recent Financial Crisis were isolated events or in fact portents of a bigger wave to come.

The business practices, indeed the business culture, at the affected companies is a material issue in the Financial Crisis of 2008–09. Excessive leverage and risk taking, bonus payments to executives based on annual performance figures with little regard to the medium or long term, and failure to understand the complex derivative instruments properly are some factors that contributed to this crisis. The events underlying the Crisis have triggered a fresh round of debate about corporate governance.

Granted, the Financial Crisis was not just about corporate governance. It had its roots in the climate of financial liberalization and permissiveness which facilitated the financial industry to develop exotic and complex derivatives and trade in them in large volumes. Yet questions remain. Could the phenomenon have grown in size and seriousness to the extent that it actually did if better corporate governance had exercised a moderating influence? In other words, could an environment that emphasized a greater sense of responsibility in corporate governance have helped in avoiding the Financial Crisis, or at least mitigated it to some extent?

This book is a study of corporate governance in the emerging world. It explores potential new directions in corporate governance. It contains a collection of the papers presented at the *Corporate Governance in the Post, Post World* symposium hosted by the New Zealand Governance Centre at The University of Auckland, New Zealand, in April 2010. The title of the symposium reflected that we now live in the post-Enron, post-AIG world, and posed a question about the lessons learnt from these sobering experiences. The chapters included in the volume deal with a wide variety of subjects such as shareholder primacy, enlightened shareholder value, directors and their position, the stakeholder principle in corporate governance and business ethics. The range of jurisdictions covered is quite wide as well. The chapters deal with the United States, Canada, the United Kingdom, New Zealand, Malaysia and Taiwan.

Since the 1970s, the emphasis has been on private ordering as the best means of promoting economic efficiency. The shareholder value maxim, lack of restraints on executive compensation, and an emphasis on aligning the interests of managers with shareholders through stock options are among the more prominent prescriptions in the corporate governance discourse. Recent events call into question the validity of many of these ideas. They present an opportunity – indeed, an imperative – to revisit these principles of corporate governance which have been influential in the last few decades.

There is now a need to explore possible alternatives including a greater role for law and public regulation in shaping the governance practices of companies. Recent events also cause us to question several assumptions that are implicit in the discourse on corporate governance. These assumptions have influenced policy and practice. For example, is the relationship between shareholders and boards in fact agency based, and is shareholder primacy a gold standard ideal? The recent legislative attempts to boost the powers of shareholders as a check on management excess may prove to be misguided and futile if, in fact, the corporate entity does not benefit from increased shareholder control. In this volume, a chapter by Professor Lynn Stout raises these questions about the prevailing paradigm.

The aim of this volume is to introduce the new ideas animating the emerging universe of corporate governance in the post-Financial Crisis world. To understand the present better, looking to the past is essential. The chapters included in the volume are written from diverse perspectives and seek to accomplish a variety of goals. Some attempt to chart the path for the future, while some point out the limitations of the ideas and concepts that have proven to be influential in the recent past. A third set examines how globalization is promoting homogeneity in corporate governance and shaping the regulatory regime in countries like Malaysia and Taiwan.

THE CHAPTERS AND THEIR CONTENT – AN INTRODUCTION AND ANALYSIS

The volume has a total of twelve chapters and is divided into four parts. The first part deals with the 'Great Debate' in corporate law over whether directors should consider the interests of shareholders only (usually termed the 'shareholder primacy' rule) or a wider constituency of stakeholders that includes employees and consumers (the 'stakeholder principle'). Part I has seven chapters, just over half the number of chapters included in the volume. The next part examines the effectiveness of the private remedy model that is largely relied on in corporate law. It has a chapter that uses the decision *In re Citigroup Inc Shareholder Derivative Litigation* (2010) as a handle to analyse the issues with the private remedy model.

Part III is about globalization and its impact on corporate governance. It has two chapters that deal, respectively, with recent developments in Taiwan and Malaysia. The fourth and last part of the volume presents studies on recent developments in business ethics and corporate responsibility. It has two chapters. We summarize below the chapters included in the volume and, in doing so, also explain their contextual significance.

Part I – The 'Great Debate'

The 'Great Debate' in corporate law is over whether directors should consider the interests of shareholders only ('shareholder primacy') or a wider constituency of stakeholders that includes groups such as employees and consumers. It must be surprising to persons new to corporate law that such a fundamental question still remains unsettled. Equally, for those running companies it must be difficult to know who they should be thinking about when they make decisions. The messages are mixed, even within jurisdictions. For example, the UK is considered, more or less, a bastion of shareholder primacy. This is justified, in part, by the source of the powers of boards in UK companies being through the articles of association rather than being statutory, which is the case in most other jurisdictions. But it is the UK that has adopted, in section 172 of the *Companies Act 2006*, a statutory provision that appears to entertain stakeholder principles and, at the very least, adopts principles of enlightened shareholder value. Conversely in the US, directors derive their powers from statutory provisions. Nevertheless agency theory holds sway in the US.

The first part of the volume examines different dimensions of the Great Debate and has seven chapters.

Chapter 1: Lynn A. Stout – New thinking on 'shareholder primacy'

The first chapter, by Professor Lynn Stout, poses a trenchant challenge to shareholder primacy. The chapter is based on the keynote address delivered by Professor Stout at the *Corporate Governance in the Post, Post World* symposium in New Zealand. The chapter argues that shareholder primacy thinking, which reached its high watermark at the beginning of the new millennium when it acquired a quasi-scientific patina from law and economic theorists, is on the wane. The logical inconsistencies in the shareholder primacy model (for example, shareholders do not have ultimate control over directors, directors do not always seek to maximize share price) are borne out by empirical studies that reveal that it is in fact directors who run companies. The rights granted to shareholders are limited in scope and they do not enable shareholders, as a matter of fact or law, to insist that managers act as their agents serving only their interests.

US law does not give shareholders the power to control the board. Often promoters establish companies that weaken shareholder powers to a greater extent than is the case under the so-called default statutory provisions; yet shareholders, who from a shareholder primacy perspective are the owners, do not object. The chapter by Professor Stout sets out several theoretical arguments against shareholder primacy. It concludes that, given the serious flaws in shareholder primacy theory, regulators and policymakers should not move to boost the powers of shareholders in the belief that this will serve investors' interests. Incidentally, this prescription goes against the efforts made in the *Dodd-Frank Act*, outlined earlier, to enhance shareholder participation. According to Professor Stout, for the serious issues experienced with the way business corporations are run by their directors and managers, it is not a solution to expect shareholders to provide the correctives. Professor Stout also argues that the US should not export its shareholder-oriented model to other jurisdictions.

Chapter 2: Peter Watts – Shareholder primacy in corporate law – a response to Professor Stout

In the second chapter, Professor Peter Watts presents a brief response to Professor Stout's chapter. Interestingly, there is a degree of agreement between the two scholars. Professor Watts agrees with Professor Stout that shareholder involvement in day-to-day decision making should not be compulsory. Rather, his argument is for a model of the company that gives shareholders a choice to be so involved. Refuting the arguments against shareholder primacy, Professor Watts asserts that the rule of shareholder primacy is alive and well. Indeed he argues it is not just a post-1980s phenomenon, but dates back all the way to the nineteenth century.

Chapter 3: Susan Watson – Derivation of powers of boards of directors in UK companies

The third chapter, which is written by co-editor Professor Susan Watson, deals with an important dimension in the shareholder primacy framework. This is about the relationship between shareholders and directors in companies. In the conventional shareholder primacy model, shareholders are treated as the 'owners' of companies and assimilated to the position of principals. Directors, who are elected by shareholders, are quite logically understood as the delegates or 'agents' of the shareholders. There is a significant difference in this respect between the corporate law prevailing in North America and company law in most parts of the British Commonwealth. In North America, directors generally derive their corporate powers from the statutes. Therefore, their powers can be viewed as original and 'un-delegated'. In the British Commonwealth, however, directors' powers are usually granted under the articles of association, which are treated as contracts among companies and their shareholders. An issue is whether this feature in UK company law defines the position of directors as delegates of shareholders.

Professor Watson's chapter critically questions the true significance of the source of boards' powers in UK company law, and argues that the non-statutory source is more a historical anomaly. It does not speak to a fundamental difference in UK company law. The chapter makes a historical inquiry to determine the origin of the phenomenon and traces it to the deeds of settlement that existed before general incorporation became possible in UK under the *Joint Stock Companies Act 1844*. The statute provided for compulsory registration of the deeds of settlement.

During subsequent legislative amendments, the clause in the 1844 statute on boards' powers was simply adopted from the pre-existing deeds of settlement and included in the model articles of association appended to the statutes. This occurred in the late nineteenth century. The result is of no great significance, it is argued. Indeed boards of directors and their powers were clearly understood in the UK at the time without reference to the articles of association of companies. The result, Professor Watson argues, is that the powers of directors in UK company law are original and un-delegated – in no way materially different from the position across the Atlantic in North America.

Another important trend in this context is the 'enlightened shareholder value' model included in the *Companies Act 2006* (UK). Although the structure of UK company law is seemingly based on shareholder primacy, section 172 of the *Companies Act*, which enshrines the concept of enlightened shareholder value, requires directors to act in a way they consider will 'be most likely to promote the success of the company for the benefit of its members as a whole' while having regard to matters such as the interests of the company's employees and its business relationships with suppliers, customers and others.

Chapter 4: David Millon – Enlightened shareholder value, social responsibility and the redefinition of corporate purpose without law

The fourth chapter is by Professor David Millon, who has written about corporate purpose and a potential role for law in defining it. The chapter outlines the ideas emerging in the US about enlightened shareholder value (ESV). Enlightened shareholder value, which stresses the long-term value for the corporation, would naturally benefit shareholders. But the emphasis on the long term ensures that corporations are not driven by 'short termism' and a desire to stimulate rises in current share prices. Instead they develop policies and strategies that promote long-term corporate value, which automatically includes due consideration for other stakeholder groups such as employees, consumers and the environment.

More specifically, Professor Millon explores how market pressures are weaning American transnational corporations from 'narrowly focused shareholder primacy'. The chapter explains how risk management practices are helping in reinterpreting the corporate goal and in promoting the consideration of stakeholder interests in ways that resonate with notions of corporate social responsibility (CSR). Myopic labor and environmental policies that reduce operating expenses in the short term may carry litigation and reputational risks. These can lead to sizable litigation and settlements costs, as well as negative reputational effects in product, labor and capital markets. The result of the ongoing process, Professor Millon predicts, 'may be a richer, more socially-oriented notion of the corporate objective, shaped by public opinion rather than legal intervention'.

Having made the prediction about responsible governance impelled by market compulsions, the chapter by Professor Millon concludes on a note of caution on how far these pressures alone can shape the corporate objective. Quite probably, the policies and actions of business corporations will still be driven by considerations about the bottom line and little else. This might not be adequate to foster an acceptable level of socially responsible behavior. As a result, public policy and legislation may yet have a role in influencing corporate behavior if only to minimize the externalities of the operations of business corporations.

Chapter 5: Leonard I. Rotman – Re-evaluating the basis of corporate governance in the post, post-Enron era

Professor Rotman's chapter also provides a challenge to shareholder primacy orthodoxy, in particular the basis of Henry Hansmann and Reiner Kraakman's seminal 2001 article that the shareholder primacy norm had triumphed over all other conceptions of the company and that corporate history was at an end (Hansmann and Kraakman, 2001). Professor Rotman argues that subsequent events are inconsistent with that view and also challenges the arguments used by Hansmann and Kraakman. Presenting the Canadian angle, the chapter refers to *Peoples Department Stores v Wise* (2004) in which the Supreme Court of Canada expressly affirmed a broad, stakeholder framework of business corporation.

Hansmann and Kraakman assert that the five key characteristics of companies – namely, legal personality, limited liability, shared investor ownership, management delegated to a board, and transferable shares, which have existed in every major jurisdiction since 1900, provide for a firm that is strongly responsive to shareholder interests. Professor Rotman queries why, if these characteristics have been in place since 1900, has shareholder primacy triumphed only relatively recently? Also, Professor Rotman points out that it is especially ironic that the Hansmann/Kraakman article was published in the same year that Enron failed – a collapse which more than any other highlighted the failures of the shareholder primacy model. More significantly perhaps, the issues that have plagued corporate law such as corruption and abuse of managerial power have not been resolved with the supposed triumph of shareholder primacy. Also, the gauntlet thrown down by the 'end of history' article, with its assertion that progressive corporate law scholarship had become redundant, has been picked up by an increasing number of scholars, not just in the US but around the world.

Professor Rotman highlights the problems seen in Enron where market pressures and managerial incentivization cause directors to take unwarranted risks that benefit management and shareholders in the short term, but may ultimately lead to the demise of the corporation. Professor Rotman argues that shareholder primacy unduly skews the focus of corporate directors. A corporation is, as a matter of law, separate from its shareholders and theirs are not the only interests that should be considered.

The final section of the chapter by Professor Rotman has a discussion of corporate personality and a close examination of the *Dodge v Ford* (1919) and *Revlon* (1986) cases. In *Dodge*, the Michigan Supreme Court held that a business corporation is organized and carried on primarily for the profit of the stockholders. But Professor Rotman points out that the court also said that plans must be made for a long-term future and made several orders that sacrificed short-term profitability. These orders were not consistent with a short-term interest in maximizing shareholder profits under the shareholder primacy model. Also the context in which the decisions were made was important; investment in improved infrastructure and increased salaries would ultimately improve the competitive position of Ford Motor Company. The case should therefore be read as support for the view that the pursuit of shareholder profits does not exist in a vacuum.

In *Revlon* the directors engaged in defensive tactics that the Delaware Supreme Court held were improper because their focus should have been on obtaining the highest price for the benefit of the stockholders. The *Revlon* duties require directors to shift their focus from the best interests of the company to maximizing shareholder value when a company breakup is inevitable. As Professor Rotman points out, this necessarily means that in circumstances where the corporation is *not* under threat of a hostile takeover, the directors' duties are not restricted to a sole focus on shareholders.

Professor Rotman concludes that foundational corporate law issues around corporate identity and corporate purpose remain unresolved – the 'end of history' is not yet upon us.

Chapter 6: P.M. Vasudev – Corporate stakeholders in New Zealand: the present, and possibilities for the future

The contribution by Vasudev, co-editor of this volume, widens the discussion of the stakeholder principle to jurisdictions outside the US. A survey carried out in New Zealand showed that 91 of 130 companies listed on the New Zealand Stock Exchange had documentation that evidenced recognition of stakeholder interests in some form. Vasudev argues that a mechanism exists in the *Companies Act 1993* whereby companies could give stakeholders rights. That mechanism is the ability given to companies to extend the categories of entitled persons in their constitutions. Entitled persons have the right to bring actions for oppression and for unfairly discriminatory and unfairly prejudicial conduct. The court has access to a wide range of remedies, including regulating the future conduct of the company and ordering the payment of compensation.

Vasudev also discusses the stakeholder regime and its variants, in particular the directors' duty approach prevalent in the UK and the US, and the remedy-based version available in Canada. In the 'directors' duty' version of the stakeholder corporation, which has been developed in legislation since the 1980s, directors are authorized in statute to consider non-shareholder interests. One notable exception is Delaware – but the Delaware court has, in cases such as *Unocal* (1985) and *Paramount* (1989), recognized the stakeholder principle at times. However, other cases, such as *Revlon* (1986), which is also discussed by Professor Rotman, are inconsistent with a stakeholder conception of the company. But Vasudev argues that these cases are fact-specific and the inconsistencies highlight the risks in relying solely on judicial decisions to form corporate theory. Vasudev advocates public policy statement in the area through legislation, understood as the considered expression of the society, with due regard to all interests involved. In the UK, the position appears to be settled with the enshrining of stakeholder consideration in section 172 of the *Companies Act 2006*, discussed above.

Vasudev moves to a discussion of the stakeholder remedy approach seen in Canada. Non-shareholder groups can bring derivative actions and also actions for oppression. The Dickerson Committee in 1970 described the idea of giving shareholders some of the powers exercised by directors as misconceived. Shareholders were not viewed as having proprietary rights, nor were directors considered to be their elected surrogates. Despite the recommendations of the Dickerson Report being enshrined in the statute, and despite the Canadian Supreme Court's apparent affirmation of the stakeholder vision in *Peoples Department Stores v Wise* (2004), Vasudev questions if the outcomes in this and other cases have in fact endorsed the stakeholder view. He therefore discusses a third alternative – representation and empowerment of stakeholder groups as seen in Germany. The idea was rejected by the Dickerson Committee in Canada and has not been seriously considered in the US. The chapter concludes with a modest proposal for New Zealand – for the adoption of a stakeholder principle reflecting the unique features of the corporate landscape in New Zealand.

Chapter 7: Aviv Pichhadze – Institutional investors as blockholders

The concluding chapter in Part I, which deals with shareholder primacy, deals with another significant thread in the debate on this subject. This chapter by Aviv Pichhadze is about institutional investors as shareholders. Institutional investors, in particular pension funds, have been at the centre of the corporate governance debate for several decades now. In 1976, Peter Drucker proclaimed the 'unseen revolution' and the advent of 'pension fund socialism' in America. More recently, evidence of a similar spirit can be found in the work of Hawley and Williams (2000) about 'fiduciary capitalism'.

The chapter by Aviv Pichhadze offers a contrary perspective. Characterizing institutional investors as blockholders, Pichhadze points out that institutional investors are oriented towards capital markets. This can raise questions about their engagement in the governance of the corporations included in their portfolios. Proponents of the shareholder model of corporate governance usually refer to the emergence of institutional investors in recent decades and stress their potential to play the role of 'responsible' shareholders in accord with the democratic framework provided in corporate law. The chapter by Pichhadze presents the Market Oriented Blockholder Model (MOBM) as a more appropriate perspective for interpreting the dominant shareholding pattern in the US, and argues that the interests and priorities of institutional investors as blockholders do not necessarily coincide with those of other shareholders. After stressing the significance of the MOBM, the author cautions against failing to take note of the blockholder concept and developing policies that do not reflect the phenomenon, which may introduce systemic risks into the market.

Part II – Private Remedy in Corporate Law and Its Limits

This part consists of a chapter by Professor Franklin Gevurtz that examines the efficacy of the private remedy in corporate law. Specifically, it is about the law and the court of the state of Delaware, which is the preferred jurisdiction for public corporations in the US. Professor Gevurtz has selected the recent decision of the Delaware Chancery Court *In re Citigroup Inc Shareholder Derivative Litigation* (2008), rendered specifically in the context of the Financial Crisis and the derivatives business of Citigroup, to test the thesis about the private remedy in corporate law and its efficacy.

Chapter 8: Franklin A. Gevurtz – The role of corporate law in preventing a financial crisis – reflections on *In re Citigroup Inc Shareholder Derivative Litigation*

Delaware has an open structure of corporate law that permits corporations a high degree of freedom and flexibility, which has drawn complaints for a long time now (see, for example, Cary 1973). Within corporations, powers are significantly concentrated in the directors. In addition to these features, another important advantage Delaware is perceived to possess is 'a sophisticated and expert judicial system and bar, modern and flexible business entity laws, [and] a wealth of well-reasoned case law . . .' (Conaway 2008, p. 789).

The chapter by Professor Franklin Gevurtz deals directly with the Financial Crisis. It starts by explaining how unreasonable risk taking by financial corporations was a primary factor in producing the Financial Crisis, and then reviews the five basic methods by which law attempts to prevent such unreasonable risk taking – through banking regulation and corporate governance rules. These include control over compensation, liability of management for unreasonably risky conduct, and selection of management.

The chapter links the failure of corporate law to curb unreasonable risk taking by financial companies to other major themes in the book. It uses the decision of the Delaware court *In re Citigroup Shareholder Derivative Litigation* (2008) as a predicate for asking why laws regulating corporate governance are as weak as they are. The chapter advances the thesis that weakness in corporate law stems from its shareholder primacy orientation and this ties in with the debate in the prior part of the book. Corporate law, for example, allows shareholders to waive director liability for unreasonable risk taking, even though unreasonable risk taking harms depositors, taxpayers, and the broader economy. In addition, the chapter ties shareholder primacy in US corporate law to the ability of managers to choose the state that sets the rules of corporate governance, subject only to consent of shareholders. This concern with allowing selection of corporate laws in a marketplace of competing jurisdictions, in turn, segues into the discussion of globalization and corporate governance in the other parts of the book.

Part III – Corporate Governance and Globalization

Globalization is an important development of recent decades. Liberalized international trade, mobility of capital and the opening up of hitherto insular economies such as China, India and Russia have greatly altered the economic landscape. An important element in the process of globalization has been the rise of the stock market as a key institution and the adoption of the corporate form of business organization in countries the world over. To be fair, over the last two centuries the British Empire laid the foundation for this by spreading the company form in Asia and Africa. The current round of globalization has carried the process further.

The third part of the volume consists of two chapters which explain how ideas formed in Western countries are shaping regulation in emerging countries. Chapter 9 by Yu-Hsin Lin is about independent directors in Taiwan, and Chapter 10 by Aishah Bidin traces the developments in corporate law – in particular, corporate bankruptcy and insolvency – in Malaysia in response to the forces of globalization. Interestingly, an issue raised by Professor Stout in Chapter 1 about the wisdom of transplanting the American system of corporate governance into other regimes also animates the chapter by Yu-Hsin Lin about independent directors in Taiwan and their efficacy.

Chapter 9: Yu-Hsin Lin – How public regulation changes corporate governance practice – corporate board reform in Taiwan

This chapter by Yu-Hsin Lin examines how the mechanism of independent directors functions in Taiwanese companies. The role of independent directors in a traditional corporate governance framework informed by shareholder primacy views is to ensure that the board monitors the management of the company on behalf of the shareholders. Yet the evidence of the effectiveness of independent directors as a corporate governance mechanism is mixed at best. Empirical studies do not show that board independence improves performance (Bhagat and Romano, 2007).

In addition, the appointment of independent directors may not be appropriate or effective in regimes that are not characterized by strong stock markets with dispersed shareholding – an imperative for maximizing shareholder value. Research on corporate governance in emerging and mature economies as a result of the crisis has revealed that widely held corporations are rare outside the US and the UK. Many companies outside these two jurisdictions are family controlled. The reason why family control may not necessarily be a corporate governance problem is that close relationships between the business and political elites can equally develop in systems with widely dispersed shareholdings. In fact, as seen in Asia in the preceding 30 years and as seen in continental European countries, family dominated systems can work well. Family-owned companies perform as well as ones with dispersed shareholdings and professional managers.

The International Monetary Fund and the World Bank suggested that a major cause of the Asian financial crisis of the 1990s was, at least in part, the low level of development of the stock markets in the region, which forced corporations to borrow from banks. Despite high debt–equity ratios, it has been argued that close relationships between borrower corporations and banks meant that the banks did not carry out the monitoring role normally performed by a share market. For that reason, policies were introduced to boost investment in the share markets. These included generally accepted good governance measures like independent directors and independent audit committees (Glen and Singh 2004).

Ysu-Hsin Lin looks at the legal transplantation of independent directors into Taiwan, which has a two-tier board system. To align itself with the reforms introduced in the US by the *Sarbanes-Oxley Act of 2002*, the Taiwan Stock Exchange moved to encourage the appointment of independent directors. Yet in September 2011 – the date of study by Yu-Hsin Lin – 56.8 per cent of listed companies did not have independent directors.

The chapter discusses the characteristics of corporate governance in Taiwan, highlighting the fact that corporate ownership in that country is concentrated and family dominated. Business groups, in particular family business groups, dominate corporate ownership. The statutory responsibilities and the practice of independent directors in Taiwan are outlined before the chapter moves on to an interesting analysis of interviews with independent directors. The importance of *guan xi*, which roughly translates into connections or relationships, is highlighted, and the integrity of controlling shareholders and managers is seen as a key criterion for putative independent directors. Assessment of integrity is usually built on the personal relationships between the controlling shareholders and independent directors, but it raises issues about the true independence of the independent director. Conversely, it also means that companies usually select independent directors whom they know. In the survey only seven of the 40 independent directors interviewed did not know the controlling shareholders or other inside directors before they decided to join the board. The chapter concludes with a discussion of the risk of unintentional bias; the growing awareness of the impact of personal relationships on director independence makes this an issue not just in Taiwan but also in other Asian countries where similar links between controlling shareholders and independent directors are common.

Chapter 10: Aishah Bidin – Corporate law reform and corporate governance in Malaysia – responses to globalization

Professor Aishah Bidin turns the spotlight on to Malaysia with a chapter setting out the corporate governance reforms currently undertaken in her jurisdiction. These reforms are driven by the Malaysian Corporate Law Reform Committee and, unlike earlier 'piecemeal' amendments, are intended to result in a systematic and coherent review of the *Companies Act 1965*. The chapter begins with a discussion of the history and regulatory framework of company law in Malaysia, highlighting the influence of English common law, which provides the foundation of Malaysian company law. The corporate governance provisions that have been in place in some form since the enactment of the *Companies Act 1965* in Malaysia are modeled on practice in overseas jurisdictions such as the UK (Jenkins Committee 1962) and Australia (Eggleston Committee 1967). These are discussed. In Malaysia, a two-pronged approach has been adopted for the reforms involving amendments in the short term followed by a fundamental review of the core company law provisions in the long term. Again, practice in other jurisdictions will be used to refine and fine tune the reforms.

The second section of the chapter shifts to a discussion of the corporate rehabilitation framework. The current legal framework for corporate insolvency in Malaysia is discussed and some of the problems with that system, such as delays in the courts, are highlighted. The section explains mechanisms introduced after the Asian Financial Crisis of 1997, such as special administration, which operate outside the court system, and the Corporate Debt Restructuring Committee that acts as an intermediary in negotiations among creditors, banks and debtor companies. The corporate rehabilitation regimes in other jurisdictions – namely, Singapore, the UK and Australia — are discussed. The chapter concludes with an interesting discussion of the importance of corporate vehicles as the engines of growth for Malaysia. The influence of the state on business and the interrelationship between transplantation and evolution of corporate law are also highlighted by Professor Bidin in this chapter.

Part IV – Corporate Ethics and Responsibility

Ethics and social responsibility have emerged as significant themes in corporate governance. The trend was particularly strengthened after the revelations of accounting fraud and unethical business practices at Enron and a host of other companies during 2001–02. These events increased the level of sensitivity to the ethical dimension in business. Responsible governance is another related stream in contemporary governance. It stresses the importance of corporations adopting responsible business practices without being driven completely by myopic approaches and narrow profit motives. Corporate responsibility is about companies taking the initiative to do things right, even though it might have a financial cost in the short term. The final part of the volume covers the interrelated themes of ethics and responsible governance. The two chapters in this part both adopt an empirical approach to the study of corporate governance, although they deal with different jurisdictions, namely, the US and New Zealand.

Chapter 11: Peter A. Appel and T. Rick Irvin – Public regulatory encouragement to the adoption of private ordering systems to achieve environmental protection through sustainable commerce

Professors Peter Appel and Rick Irvin present a case in this chapter for a 'public/private' approach to the issues of environmental responsibility and sustainable commerce, particularly in the context of corporate governance. Pressures of the financial markets, supported by the law of corporations, encourage business enterprises to underperform in the increasingly vital area of environmental care. Faced with environmental issues, the US government has traditionally responded with 'command-and-control' regulation. There are problems with this variety of regulation that relies, predominantly, on coercion to achieve the desired ends. To begin with, it is archaic and outmoded. Secondly, its efficacy as policy is questionable. To be fair, Professors Appel and Irvin concede that the penalties provided in US environmental law *do* have a considerable deterrent effect. The question posed in the chapter is whether traditional methods of command-and-control regulation and adversarial litigation in tort are, by themselves, adequate.

Professors Appel and Irvin present 'sustainable commerce' as an emerging concept that has gained significant traction in recent times. At once, it captures the environmental concerns that become stronger every day and highlights the importance of balancing these concerns with the needs of business. The concept of sustainable commerce is about products and practices that minimize environmental impacts and optimize commercial value while also meeting environmental benchmarks, both private and public. In other words, it is about reducing the environmental impact of business operations and promoting products that are eco-friendly.

Many corporations are now aware that sound environmental practices can enhance their profitability. Professors Appel and Irvin point out that this sensitivity persuades corporations to be proactive in reducing the environmental impact of their operations and products, because they understand the advantages from a business standpoint. The chapter presents some case studies that demonstrate how enhanced environmental consciousness among businesses is making a real difference.

Murray Industries of Tennessee, a case cited by the authors, overhauled its production systems to meet the environmental standards stipulated by its UK buyer. Having climbed the learning curve, Murray Industries now applies the same systems for the products it sells in the US market as well. This has resulted in overall environmental improvement in its operations. Wal-Mart, which is another case discussed by Professors Appel and Irvin, has announced steps for independent verification of its efforts to reduce its carbon footprint. In a similar spirit, the Los Angles Port Authority has initiated action to ensure the quality of the trucks that enter its premises for delivery and pickup of cargo. This is to be achieved by the use of new zero-emission technologies. But this effort of the Los Angeles Port Authority to check emissions has run into legal complications and litigation.

Professors Appel and Irvin argue that the limitations of command-and-control regulation do not mean that the state has no role to play. They point out that the government is an effective agency to harness the power of the market to impel improvement through means such as setting aggressive standards for government procurement and requiring greater information exchange and disclosure. The chapter envisions a partnership between the government and private actors in which they work together in addressing environmental concerns. The chapter presents the public/private paradigm in the area of environmental governance, and it remains to be explored how far the model can be applied in other aspects of corporate governance.

Chapter 12: Trish Keeper – Codes of ethics and corporate governance – a study of New Zealand listed companies

The final chapter in the volume concerns New Zealand. Ethics has emerged as a major strand in corporate governance, although this development is not free from controversy. In any event, most leading jurisdictions now formally include ethics and ethical business practices among the benchmarks of good governance. In New Zealand, the Securities Commission and the New Zealand Stock Exchange Listing Rules deal with the issue of ethics. The Securities Commission requires listed companies to disclose in their annual reports how they achieve the goal of ethical behavior, and the Stock Exchange Listing Rules have included the adoption of a code of ethics in the checklist of 'best practices'.

Trish Keeper traces the development of codes of corporate ethics in the United States since the 1970s and she explains how over the subsequent decades companies in Canada, Germany and the UK have also increasingly adopted such codes. The chapter points out that the *Principles of*

Corporate Governance formulated by the Organisation for Economic Co-operation and Development (OECD 2004) provides a comprehensive framework of ethics for business corporations. These developments prepared the ground for New Zealand to adopt measures to promote ethical business behavior.

Trish Keeper is critical of the ambiguities of the 'soft law' regime on corporate ethics in New Zealand. She finds some inconsistency in the language between the Stock Exchange Listing Rules and the Best Practices Code, which is an appendix to the Rules. The rule that companies must merely disclose non-compliance with the prescribed benchmarks, which include having a code of ethics, is less rigorous than the 'comply or explain' rule prevailing in the UK and Australia. From a review of a limited number of codes, the chapter finds that they tend not to be robust. These codes are found to be rather formalistic and confine themselves strictly to the matters specified in the Stock Exchange Rules and Best Practices standards.

The chapter includes a survey of companies listed on the New Zealand Stock Exchange to determine how many of them have a code of ethics as recommended in the Best Practices standards. The survey found varying levels of compliance and the results are grouped into three categories – namely, substantial compliance, mid-level compliance and low-level compliance. Thirty-eight per cent of the companies fell within the 'substantial compliance' category formulated in the chapter, while 45 per cent were found to have 'mid-level compliance'. The remaining 17 per cent are placed in 'low-level compliance' category.

The chapter concludes that both the New Zealand regime on corporate ethics and the trends in companies' practices do not measure up to international standards. Hopefully, the survey and the results presented in the chapter can stimulate a debate on the issue and inspire New Zealand regulators and companies alike to consider reformative action.

CONCLUSION – THE SHAPE OF THINGS TO COME?

As we pointed out earlier, the persistent theme in corporate governance has been that corporations perform best when left alone. This idea has been vigorously advocated since the 1970s by scholars identified with the law-and-economics movement. As pointed out earlier, the tenets of the law-and-economics model of corporate governance have been thrown open to question by the developments of the last decade or so. In any case, it is now quite obvious that mono-dimensional approaches and single-point agendas, be they wedded to belief in market efficiency or 'strong' government regulation, are impracticable. Such doctrinaire notions are necessarily restrictive and they are inadequate to deal with the multi-faceted character of corporations and the complexities experienced in their governance. And at all times, we must also remember the primary objective of business corporations, which is to generate and distribute wealth through enterprise. This basic function has become more challenging in this age of globalization, mobility of capital, and international markets.

While the market may lack the self-corrective qualities attributed to it, it is apparent that regulation finds it equally hard to arrive at neat solutions. An example is the ongoing controversy, referred to earlier, regarding shareholder access to proxy in director nomination which is facilitated by the US *Dodd-Frank Act*. It remains to be seen how effective the 'say on pay' mechanism will prove to be in checking excessive managerial pay and promoting greater distributive equity among employees at different levels.

An important development in recent decades is the emergence of a plethora of codes of corporate governance. They represent a new source of materials on corporate governance, falling in the category of 'soft law'. Myriad agencies have been engaged with the subject, including the OECD, stock exchanges, United Nations, trade associations, investor councils and civil society organizations. They have all taken initiatives to develop norms that can influence the management practices of business corporations.

As a result, there appears to be a codification and institutionalization trend in corporate governance. Mechanisms such as independent directors, audit and compensation committees and codes of ethics have now emerged as norms in most jurisdictions and this can be traced to the efforts of several agencies to promote healthy and responsible corporate governance. These developments reflect the need, in this age of transnational corporations and global markets, for greater streamlining of corporate governance through the formulation and codification of standards.

The universe of corporate governance is now populated – some might say overcrowded – by a number of actors. In addition to the traditional elements – namely, market forces, government actors, business and professional groups and chambers of commerce – we now have multilateral agencies, such as the UN and OECD, civil society organizations and investor councils. Interest in corporate governance is now more widespread. This is not surprising considering the reach and influence of business corporations and their impact on our lives. Hopefully, the results from this rich interplay of forces will have a beneficial effect on corporate governance and help us to understand and manage these vehicles better as we emerge from the Financial Crisis.

The title selected for the volume reflects the wide-ranging changes that have occurred in the recent decades in corporate governance and thinking on the subject the world over. It adopts the time of the Financial Crisis (2008–09) as a catalyst for review and for making a critical analysis of emerging ideas. The volume weaves together several important strands of thought in the field.

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