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Corporate Governance and Taiwan's Capital Markets

TAIPEI WORLD TRADE CENTER • **April 6 and 7, 2006**

Report on the Conference on

Corporate Governance and Taiwan's Capital Markets

TAIPEI WORLD TRADE CENTER
April 6 and 7, 2006
Taipei, Taiwan, ROC

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The Conference in Brief

The Conference on Corporate Governance and Taiwan's Capital Markets was held at the Taipei World Trade Center on April 6 and 7, 2006. The conference was co-sponsored by the Fuhwa Cultural and Educational Foundation, the Taiwan Securities Association, and the University of Wisconsin Law School.

The principal purpose of the conference was to discuss the role of corporate governance in improving Taiwan's capital markets. To ensure that the conference was focused on the realities of Taiwan's investment environment, the conference participants included representatives of the diverse interests involved in or influencing Taiwan's capital markets. Also, the conference format was deliberately structured to promote an active dialogue among all the participants. The conference participants included:

A complete list of the conference participants is attached as Appendix B of this report.

- International and domestic institutional investors.
- International and Taiwanese investor service organizations with special expertise in corporate governance.
- Taiwanese business and financial leaders.
- Government regulators of the securities industry.
- Taiwanese accountants and lawyers.
- International and Taiwanese academics from accounting economics, finance, and law.

An Agenda for the Future

Based on the substantive program of the conference and discussions among the participants during and after the conference, the conference rapporteurs have divided the future agenda into two sections. The first section consists of specific corporate governance reforms to be undertaken in the near and medium term. The principal recommendations for reform are focused on:

- Shareholders' voting procedures, including proxy voting and the timing of shareholder notices.
- Officers and directors' liability.
- Improving the effectiveness of independent directors, nominating committees, compensation committees, and audit or supervisory committees.
- The market for corporate control, with special attention to the appropriate level of government intervention in mergers and acquisitions.

Because the agenda for reform is based on more than the conference proceedings, it is included as Appendix A of this report.

The second section then discusses the mechanisms for implementing the proposed reforms. These include a roundtable discussion, by invitation only, on shareholders' voting procedures and officers and directors' liability; and integration of new director training programs into existing institutions designed to improve the effectiveness of independent directors and supervisors. The rapporteurs concluded that the market for corporate control was a sufficiently new and significant topic that it should be a component of the *Conference on Financial Sector Reform* proposed for July, 2007.

The Conference Program — A Narrative

Opening Ceremonies

Chairman *Yen Ching Chang* opened the conference by welcoming the many international and local participants. Chairman Yen said that he personally was committed to good corporate governance procedures because of the close relationship between good governance and improved corporate performance. He also believes that good governance is an important part of the current efforts at consolidation of the financial sector and plays a significant role in attracting foreign investment into Taiwan's capital markets.

University of Wisconsin Law School Dean *Kenneth B. Davis, Jr* thanked Fuhwa and the Taiwan Securities Association for co-sponsoring the conference and added his welcome to the participants. He observed that his Law School had a reputation for studying the law "in action," and that this conference was a wonderful example of that approach.

In his opening remarks, *Jaw-Sheng Kong,* the Chairperson of the Financial Supervisory Commission, emphasized Taiwan's commitment to good corporate governance as an antidote to financial crises and corporate scandals, such as the 1997 Asian Financial crises and the Enron and WorldCom scandals. Chairperson Kong briefly outlined the measures Taiwan has recently introduced to improve corporate governance and he pledged to implement these measures, but in a way that maintains the delicate balance between regulation and flexibility.

The Keynote Address by Dean Kenneth B. Davis, Jr.

Corporate Governance in Taiwan—The Road Ahead

Kenneth B. Davis, Jr.
Dean
George H. Young
Chair in Law
University of
Wisconsin
Law School
Madison
Wisconsin
USA

Chairman Yen and Chairperson Kong, I am honored to serve as the keynote speaker for this important conference. I want to express my gratitude to Fuhwa Financial Holding Co. for organizing these sessions and inviting my institution, the University of Wisconsin Law School, to participate. Our Law School is very proud of its reputation as the home of "law in action," and this conference is very much in that tradition.

This conference brings together investors, business leaders and government regulators for a candid discussion of what is not only desirable but more importantly, realistic in furthering Taiwan's corporate governance initiative over the years ahead. In that spirit I want to begin my remarks with two fundamental propositions, framed to encourage us to think critically about the role of corporate governance in today's world. With those propositions in mind, I will offer some perspectives on the state of capital market development and corporate governance in Taiwan today. Finally, I will close with some personal observations on each of the four themes that are the focus of our efforts over these two days.

Two Propositions

What are my two fundamental propositions?

First, it is not inevitable that stronger corporate governance increases value for a corporation's shareholders as a whole. We must therefore be mindful of the circumstances under which that increase is likely to occur, and those under which it is not. In particular we need to recognize the critical distinction between the workings of corporate governance in the West (especially the US and UK), where shareholdings tend to be widely dispersed and control is in the hands of hired management, and East Asia, where shareholdings are more concentrated and control is often in the hands of the founders and their families.

By way of illustration, assume that X Corporation is controlled by its founder, who is able to use that control to employ a number of family members as the corporation's senior managers, and to extract a variety of private benefits in the form of excess salary or perquisites or profits from self-dealing. What happens if governance is suddenly strengthened and the opportunity to extract those benefits terminated? The founder receives less, and the outside shareholders receive more. Those outside shareholders will no doubt applaud this as enlightened reform. But are shareholders as a whole really any better off? Not really; we have simply shifted money from one set of shareholder pockets to another. In the terminology of economics, eliminating these control benefits is not a source of enhanced "efficiency." Nor is it clear that this result is any more just or fair. The founder no doubt put considerable effort and energy into the company over the years, partially in expectation of the benefits of control. By the same token, the outside shareholders likely paid a much lower price for their shares in recognition of the fact that their investment would be subject to another's control.

What happens, though, as X Corporation expands and needs to raise additional equity capital? Will new investors be willing to assume the risk of the founder's ongoing self-enrichment? And even if so, how can they reasonably predict and "price" the consequences? If sufficient slack exists to allow the founder and his family to extract $1 million in benefits, how can investors be sure that they will stop there? Why not $2 or $5 million instead? True, some insiders will be more inclined than others to exercise self-restraint, out of caution or ethics. But can prospective investors identify them in advance? Unable to do so, investors may respond by assuming the worst and either heavily discounting the amount they are willing to pay for the shares, or refusing to buy them altogether. Economists refer to this as a "market for lemons," based on the US nickname for defective second-hand automobiles.

For companies in mature or stagnant lines of business, with little need for additional equity capital, this may not be so much a problem. But for companies with attractive opportunities for growth and investment, some of those opportunities may fall by the wayside for lack of financing. Weak corporate governance in such circumstances does in fact lead to the erosion of corporate value. Or put differently, stronger corporate governance enhances value by facilitating the sale of outside equity to

finance growth. This conclusion is certainly consistent with the body of empirical evidence showing that strong corporate governance is positively correlated, internationally, with larger capital markets and more dispersed shareholding.

Parallel observations can be made about the fact that X Corporation's senior management team consists mostly of family members. So long as the company remains in its traditional business, their experience and network of relationships may be entirely sufficient for the company's success. Indeed, in a climate where business is typically done on the basis of personal relationships rather than active competition, family members may be more effective than hired outsiders. But as the competitive environment changes, or new technologies and opportunities for expansion and diversification emerge, outside expertise will become more and more important. Stronger governance may then prove valuable in encouraging the founder and his family to turn over some of their management responsibility.

In sum, we are far more likely to find circumstances in which corporate governance is merely value-neutral in economies that are static and rigid. For dynamic and growing economies, in contrast, enhanced corporate governance will more often be value-enhancing.

My *second* proposition is an offshoot: Even when stronger corporate governance does contribute to overall shareholder value, we still must be mindful of the associated wealth transfers. Suppose B Company is worth $100 million and its founder owns 30 percent of the stock, more than enough to assure working control. His shares will certainly be worth more than $30 million. Control comes at a premium in any country, and in some developing countries that premium has been estimated to represent as much as 65 percent of total firm value.[1] In B Company's case, let us assume a more modest 30 percent. As a result the founder's interest is worth $51 million (the $30 million premium plus 30 percent of the remaining $70 million in value), and the outside shares $49 million.

Now, assume that by improving corporate governance, we can make controlling shareholders more accountable, with the result that control premiums fall to 10 percent. Further, because of this enhanced accountability, B Company finds it easier to raise equity capital to pursue profitable new opportunities, so is worth 20 percent more overall, for the reasons we discussed above. Notwithstanding this overall increase, the value of the founder's holdings decline. His control premium is now worth only $12 million, reducing his shares to $44.4 million. The value of the outside shares, in contrast, climbs to $75.6 million, as the holders benefit both from the reduced value of control and the increased value of the firm. Again, since these investors knowingly bought their shares under circumstances when a minority stake was worth considerably less, much of this gain might be seen as a windfall.

[1] Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 Journal of Finance 537, 538 (April).

Given these consequences, we can expect the founder to strongly resist any efforts to change the rules to dilute the value of his control. That is unfortunate, for it might mean that the $20 million of potential firm-wide gain is lost to all. Were the shareholders able to get together and bargain, there would be numerous ways to divide up that $20 million and make everyone better off. That is rarely possible, though, when shareholdings are widely dispersed.

This is a recurring problem in corporate law. So-called "golden parachutes"—that is, contracts to give senior management a generous severance bonus if they lose their jobs following a change in control—can be seen as a compensation mechanism to assure they act in the shareholders' best interests if confronted with a hostile takeover. But all too often, inefficient control arrangements persist because of the law's understandable reluctance to legitimize direct compensation for the foregone benefits of de facto control. Any realistic agenda for corporate governance reform needs to anticipate and cope with this problem

.

Taiwan's Capital Markets and the Current State of Corporate Governance

Let me move now to some observations, as an outsider, about the present state of Taiwanese corporate finance and corporate governance. What I see is a vibrant, active and growing capital market. If there is an issue, though, it is one of breadth. Taiwan's leading corporations rely heavily on external finance and have made credible commitments to improve their governance systems. There remain a substantial number of listed companies, however, that exhibit vestiges of the past.

The most common measure of the strength of a nation's capital markets is the total market capitalization of its stock exchange in relation to gross domestic product (GDP). As Table One reveals, the Taiwan Stock Exchange is quite strong by that measure—both absolutely, and in relation to other developing and recently developed countries throughout East Asia. Its ratio of 1.446 compares quite favorably with the US, where aggregating the New York and American Stock Exchanges with NASDAQ results in a ratio of 1.391. One potential limitation in applying this measure to East Asian capital markets, however, is the large proportion of the shares of many listed companies that remain in private hands and are never traded. It would therefore be more useful to look only at the "float"—that is, the market value of the shares actually eligible for trading by the general public. Lacking reliable float data for the markets in Table One, I have turned instead to annual trading volume as a rough gauge of the shares realistically available to the trading public. The results for Taiwan are striking—its ratio of trading volume to GDP rivals that of even Hong Kong—great news, I am sure, for all the stock brokerage firms represented here.

Table One. Market Capitalization and Volume, December 31, 2004

	Market Cap (millions US)	Market Cap/ GDP	Volume (millions US)	Volume/ GDP
China (PRC)	$639,765	0.387	$748,274	0.452
Hong Kong	$861,463	5.248	$438,966	2.674
Indonesia	$73,251	0.284	$27,561	0.107
Malaysia	$190,011	1.606	$59,878	0.506
Philippines	$28,948	0.341	$3,664	0.043
Singapore	$171,555	1.606	$81,314	0.761
South Korea	$428,649	0.630	$638,891	0.939
Taiwan	**$441,436**	**1.446**	**$718,619**	**2.355**
Thailand	$115,400	0.706	$109,949	0.672

So much for overall strength. What about the attractiveness and accessibility of Taiwan's capital markets for foreign investors? Here a slightly different picture emerges. Over the last two decades, Taiwan has increasingly opened its markets to foreign portfolio investment. The most important recent development has been the abolition of the Qualified Foreign Institutional Investor (QFII) system of regulation in October 2003.

At this conference, we are fortunate to have major investors from around the world, who can each offer their respective thoughts on this issue. I will confine myself to the US experience, because it is the data with which I am most familiar. Table Two reports US holdings of East Asian equity securities as of December 31, 2004. Pay particular attention to the column on the right. It measures US holdings in relation to each country's share of global market cap. In other words, suppose that US investors weighted their foreign stock portfolios to mirror each foreign country's equity market capitalization relative to all others. The ratio in the right-hand column would then be exactly 1.0 for each country. Actual ratios above 1 therefore indicate overweighting; that is, investing in that country's equity markets is particularly attractive to US investors. A US-neighbor like Mexico, for example, has a ratio as high as 1.9. Conversely, ratios below 1 signify underweighting, as is the case for most of the East Asian countries listed in Table Two. Taiwan falls roughly in the middle, but is well below countries such as South Korea. What Table Two suggests is that there remains ample room forTaiwan companies to expand in obtaining equity capital from US investors interested in attaining full global diversification with their portfolios.

Table Two. US Holdings, December 31, 2004

	Amount (millions US)	Ratio to Relative Market Cap
China (PRC)	$11,645	0.161
Hong Kong	$35,395	0.362
Indonesia	$6,116	0.736
Malaysia	$6,474	0.300
Philippines	$2,222	0.677
Singapore	$23,968	1.232
South Korea	$66,639	1.371
Taiwan	**$34,554**	**0.690**
Thailand	$5,961	0.456

Perhaps some of that growth is already occurring, especially as the effects of eliminating the QFII requirements begin to materialize. The figures in Table Two are compiled by the US Treasury Department, with 2004 the most recent available. As for 2005, the FSC has reported that net purchases by foreigners on the Taiwan Stock Exchange reached a record level of NT$719.41 billion (US$21.9 billion), with foreign holdings now representing 31.8 percent of overall Taiwan market capitalization.

One major reason for the growing strength of Taiwan's capital markets is that many of its leading corporations have come to look to external finance far more than in the past. In terms of the implications for corporate governance, contrast the four major sources of corporate financing—internal equity (the founder's original investment and subsequent capital contributions, along with reinvested earnings), external equity, bonds and loans. Strong corporate governance, while valuable to all types of outside investors, is most important for external equity and, to a lesser extent, bonds, because the targeted purchasers of those securities will usually be passive investors. Bank lenders, in contrast, are in a better position to monitor the company on a one-to-one basis. Thus, as the quality of a company's corporate governance improves, we would expect its cost of equity capital to decrease relative to other sources of financing. Or to put the matter differently, as companies become more dependent on external financing in general, and equity financing in particular, the need for credible corporate governance becomes more critical.

Traditionally, Taiwanese corporations have relied principally on internal equity, with the consequence that corporate governance was of little moment. Data from World Bank studies of the 1997 Asian Financial Crisis reveal that the Taiwan economy was characterized by much less leverage (that is, corporate debt in relation to equity) than most of its neighbors. The principal reasons were the prevalence of small- and medium-sized business enterprises and the state-dominated and highly regulated

financial sector, which had the effect of limiting the availability of funding to the private sector for all but the largest firms. For small- and medium-sized businesses, outside financing was generally available only through the informal, or "curb" market.[2]

In recent years, however, privatization and liberalization of the financial system, coupled with the continued growth of Taiwan's high-tech industries, have led to a dramatic increase in external finance. The top part of Table Three shows that in the years following the 1997 crisis, external corporate financing (as measured by the IMF) across the rest of ex-Japan East Asia has averaged about 2.5 percent of GDP. For Taiwan, however, that figure jumped from 1.49 percent for the first half of the period to 5.29 percent for the recent half.

Table Three. External Finance

	1998-2001	2002-2005 Q2
East Asia (excluding Japan)		
External Finance (US millions)	$216,886.5	$270,757.3
Percent of GDP	2.51%	2.59%
Taiwan		
External Finance (US millions)	$16,956.4	$54,945.7
Percent of GDP	1.49%	5.29%
East Asia (excluding Japan)		
Equity	24.61%	23.96%
Bonds	41.71%	37.85%
Syndicated Loans	33.69%	8.19%
Taiwan		
Equity	46.78%	31.41%
Bonds	31.65%	41.23%
Syndicated Loans	21.57%	27.36%

There remain, though, some important questions about the relative role equity will play in financing Taiwan's future business growth. And the answers to these questions necessarily bear on the relative contributions to be made by stronger corporate governance. First, it is noteworthy that the dramatic expansion in external financing over the last few years has brought with it a significant change in the sources of that

[2] One study calculates the curb market as accounting for 23.8 percent of total business sector finance in Taiwan for the period from 1964 through 1990. *See* Jia-Dong Shea, *Taiwan: Development and Structural Change of the Financial System*, in *The Financial Development of Japan, Korea, and Taiwan: Growth, Repression, and Liberalization* 222, 233 (1994).

financing. The lower portion of Table Three reveals that while Taiwan continues to rely more on equity than do its neighbors, debt financing, and bonds in particular, now plays a much greater role than in years past.[3] Has that been due to lower interest rates and more available credit, or to limits on the amount of readily available new equity; and how might improving corporate governance alter that equation? Perhaps these are topics we can address over these two days.

Second, when it comes to access to external equity, Taiwan has traditionally been very much a two-tier capital market—more so than most of its neighbors. The data in Table Four are taken from a 2000 study of patterns of control among publicly-traded firms throughout East Asia.[4] A company is deemed "family controlled" if its largest shareholder is a family with 20 percent or more of the voting rights.

Table Four. Family-Controlled Firms

	All Firms	Largest 20	Smallest 50
Hong Kong	66.7%	72.5%	57.0%
Indonesia	71.5%	60.0%	93.0%
Japan	9.7%	5.0%	57.0%
Malaysia	67.2%	35.0%	84.0%
Philippines	44.6%	40.0%	45.0%
Singapore	55.4%	32.5%	67.0%
South Korea	48.4%	20.0%	97.0%
Taiwan	**48.2%**	**15.0%**	**80.0%**
Thailand	61.6%	57.5%	76.7%

What the data show is that while family control remains common throughout East Asia, even for listed firms, there is a significant difference in Taiwan between the smallest and largest firms. For the latter, family control is rare. Among the other nations listed, only South Korea has as marked a difference between the two ends of the spectrum. Recognize, however, that the data in the study is almost 10 years old. Thus, an important question for us is whether Taiwan's increased reliance on external finance has diminished the level of family control among its small- and medium-size firms, and—consistent with my two introductory propositions—make them better candidates for improved corporate governance.

[3] At the time of this Keynote Address, IMF data on external financing was available only through the second quarter of 2005. Subsequent data reveals that in the third quarter of that year, the volume of Taiwan's external equity financing soared to $4.8 billion, due to global offerings by Chunghwa Telecom and TSMC. When the second half of 2005 is included, equity represented 39.7 percent of Taiwan's external financing for 2002-2005, but still well below its share in the earlier period.

[4] Stijn Claessens, Simeon Djankov & Larry H.P. Lang, *The Separation of Ownership and Control in East Asian Corporations*, 58 Journal of Financial Economics 81, 106 (Oct./Nov. 2000).

Before concluding this "data comparison" section of my remarks, it might be useful to see how Taiwan fares in some of the efforts to assign a numerical score to the quality of a country's corporate governance. The World Bank recently expanded its criteria for measuring investor protection, so I'll use that as an example. Table Five reports the results. Taiwan falls roughly in the middle, receiving a good score for the quality of disclosure to investors, but lower scores on the liability of directors and availability of shareholder litigation.

Table Five. World Bank Investor Protection Index

	Disclosure	Director Liability	Shareholder Suits	Overall
China (PRC)	10	1	2	4.3
Hong Kong	10	8	8	8.7
Indonesia	8	5	3	5.3
Japan	6	7	7	6.7
Malaysia	10	9	7	8.7
Philippines	1	2	7	3.3
Singapore	10	9	9	9.3
South Korea	7	2	5	4.7
Taiwan	**8**	**4**	**4**	**5.3**
Thailand	10	2	6	6.0

There are a number of other organizations preparing such annual ratings, each with its own criteria. As a result, a country will end up doing better in some than others. Generally, however, Singapore and Hong Kong end up leading the way for East Asia, and, as with the World Bank, Taiwan falls somewhere in the middle.

As helpful as these numerical evaluations are in facilitating broad international comparisons, they can never succeed in capturing the full institutional detail of a country's corporate governance, good or bad. Conferences such as this one seek to fill that gap.

The Components of Enhanced Governance

Let me conclude my remarks with some thoughts about the four specific topics around which this conference is organized. Three are at the center of the corporate governance debate in developed and developing countries alike. They are independent directors, transparency in financial reporting and the market for corporate control. The fourth has special application to Taiwan—stock-based bonuses for employees.

Let us begin with the institution at the heart of virtually every set of proposals for governance reform—the independent board of directors. In Taiwan, this was a principal focus of January's amendments to the Securities & Exchange Act, which require Taiwan's public companies to have at least two independent directors and an independent audit committee. No doubt this measure will result in higher corporate governance scores for Taiwan when the various numerical evaluations are next compiled.

Do not get me wrong. I remain a proponent of strong and independent corporate boards. Indeed, recent studies of Taiwanese firms confirm that directors and supervisors unaffiliated with the controlling shareholders can enhance shareholder value.[5] But I worry that our expectations for what these independent directors and supervisors can accomplish may be unrealistically high. They are a means to an end, not an end in itself; and to be most effective they must work in conjunction with other, viable governance institutions. To give context to these characterizations, I offer three observations.

First, no matter how independent they may be, directors are necessarily a product of the local business culture, and bring to the boardroom that culture's prevalent practices, integrity and ethics. Too often, we want to see independent directors as "change agents." But if the problem is with the underlying business culture itself, independent directors are ill equipped to change it on their own. Certainly, there will be a few crusaders. Yet even if they can find a way to be elected or appointed to the board, how effective will they be in persuading a majority of their colleagues to join them? Changing the underlying business culture requires concerted effort by whatever institutions have credibility with the business community. Depending upon the particular society, these might include business and commerce associations, the courts, the financial and business press, business and law schools, the banking community, regulatory authorities, or the accounting and legal professions. Once change begins to emerge, then (but probably only then) can independent directors be effective in persuading inside management to heed that change.

That leads to my second observation. Most important changes in the quality of corporate governance—at least in the US experience—have not come at the initiation of the independent directors. Rather, they have been the product of some other group, such as institutional investors or lawmakers. The independent directors' role has been in deciding whether to resist and protect inside management from these outside pressures or to go along with them. Let me offer an example in each direction. In my view, the single biggest change that the corporate governance movement has produced in the US is removing from office under-performing CEOs at many of our largest corporations. And yes, in these cases the ultimate call to step down came from the board, but typically it was institutional investors or other large shareholders who created the pressure. True, without an independent board, these shareholder concerns would likely have been rebuffed. But without the shareholder pressure, would the board have initiated action on its own?

[5] See Igor Filatotchev, Yung-Chih Lien & Jenifer Piesse, *Corporate Governance and Performance in Publicly Listed, Family-Controlled Firms: Evidence from Taiwan*, 22 Asia Pacific Journal of Management 257 (Sept. 2005); Yin-Hua Yeh & Tracie Woidtke, *Commitment or Entrenchment?: Controlling Shareholders and Board Composition*, 29 Journal of Banking & Finance 1857 (July 2005).

That is the success story; now for the failure. For several years in the US, there has been an almost universal outcry over the level of CEO compensation. It grows exponentially each year, with little relation to the corporation's performance or profitability. Assigning compensation decisions to board committees consisting solely of independent directors, empowered to engage outside experts, has made no real difference. The outside pressure has not reached the level necessary to induce the independent directors to act.

My final observation is that the actions independent directors do not take are just as important as those that they do. Suppose that we could succeed in developing a set of corporate governance rules that eliminate the risk of insider fraud and self-enrichment altogether? Would shareholders necessarily be better off? The answer depends on the cost of enforcing those rules, along with the number of value-creating activities they discourage in the process. Corporate governance, after all, is ultimately about maximizing shareholder value.

Again, let me draw from the US experience. After Sarbanes-Oxley, we have come to regard the independent director principally as a kind of antifraud detective. But in my view the independent director's principal contribution to shareholder value over the last three decades has been something quite different. It lies in fostering deference from the courts, which have become increasingly willing to entrust independent board committees with difficult corporate issues that in earlier times would have invited rigorous judicial scrutiny. This result was gradual in the making—the cumulative product of many years of case law and professional commentary. When other countries seek to emulate the US model and mandate into place independent boards, they do so on a much shorter timeline, and without the accompanying historical context. I worry that some of this will come at the cost of flexibility. Will these new board members feel the confidence and authority to take on a risky, controversial or otherwise suspect transaction and, upon fully vetting it, take the position that it truly is in the shareholders' best interest to allow the transaction to proceed? And if so, will that position be honored by outside reviewing agencies?

By way of contrast, our second major topic, financial reporting and transparency, features a unique mechanism for preserving flexibility. This is because the rules governing financial reporting and disclosure are typically set by the jurisdiction in which the corporation's securities are traded. Thus, by choosing whether to list its shares solely on the local exchange, or to cross-list in New York, London or Hong Kong, the issuer enjoys considerable freedom to select the standards by which it will be governed. Given my earlier observation that the value-enhancing potential of corporate governance will vary from firm to firm, this would seem like an entirely desirable result. Thus, we need to consider the following argument: Given the number of small- and medium-sized firms listed on the Taiwan Stock Exchange that still may be substantially controlled by their founding families, the rules governing financial reporting and transparency should be kept flexible. Corporations interested in guaranteeing investors a high-level disclosure and transparency can do so by listing on an exchange like New York and thereby submit themselves to the rules and juris-

diction of the US SEC. That is the path taken by several of Taiwan's leading corporations, including AU Optronics, Chunghwa Telecom, TSMC and United Microelectronics.

Recent experience has brought home, however, the difficulties with this line of reasoning. First, listing on a foreign exchange is an all-or-nothing proposition, and may well come with costs and regulatory requirements that the corporation finds unduly burdensome. The recent effort by many foreign issuers to drop their US listing and deregister from the SEC in response to the demands of the Sarbanes-Oxley Act is an obvious case in point. Further, the substantial cost of listing on a market such as the New York Exchange or NASDAQ puts this strategy beyond the reach of those small and mid-size businesses who are also interested in reassuring investors about the quality of their corporate governance.

Second, cross-listing necessarily entails some loss of sovereignty. The issuer becomes dependent on the business and financial developments, the political trends and the regulatory agenda of the host market. At the same time, there is little reason to expect host regulators to be sensitive to the unique features and sensitivities of the issuer's home country. Exceptions and exemptions are occasionally adopted, but tend to be confined to those circumstances common to a number of foreign countries.

As the recent problems confronting United Microelectronics reveal, there is also the problem of equitable treatment between investors in the issuer's home and cross-listed market. Last December, when UMC revised its financial statements to meet US accounting standards, it took the position that its unrevised financials continued to satisfy Taiwan's requirements, so made no comparable disclosure to the TSE until five hours later.

Lastly, to the extent that a country's largest and most important corporations increasingly list on foreign exchanges, participation and liquidity in the local market may erode, as more and more of the trading volume in these stocks migrates to the cross-listed exchange. This has been the experience in some Latin American countries.[6] Thus, local companies too small to pursue cross-listing may face even greater difficulties in attracting new equity capital.

For all these reasons, cross-listing is at best a very partial answer to the local need for effective financial reporting and transparency.

Before I leave the topic of financial transparency, let me offer one additional comment. In my opinion, the single most important feature of US securities regulation is the doctrine that it is not enough for companies to avoid falsehoods; they also must disclose any additional material facts necessary to make their reports not misleading. This assures investors that they are getting the entire and complete story. My understanding is that Taiwan has a comparable rule on the books. We are fortunate to have a number of representatives from the FSC among our participants, and I will

[6] *See* John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 Colum. L. Rev. 1757, 1773-75 (Nov. 2002).

be eager to learn their thoughts on interpreting and enforcing this rule. In my experience, just as corporate culture is important in shaping the performance of directors and boards, it is likewise important in shaping attitudes on what must be disclosed to investors. Only in a corporate culture that recognizes that investors are entitled to the entire story can transparency be fully realized.

Our final two topics, the market for corporate control and stock-based compensation, have a common dimension. They are both the potential source of market-based incentives for corporate managers to act in the best interests of shareholders, and thereby can provide powerful supplements to traditional legal regulation. Yet they also both have the potential for abuse. So the challenge is one of striking the right balance. I have no easy answers on this score, for these are issues on which we in the US have continued to go back and forth for many years.

The market for corporate control is premised on the concept that unless management operates the company's business in the most efficient manner it will face takeover and ouster by others who will. Given the increased efficiencies, the bidder will be able to pay more for the shares than their current market price. Certainly this idea is still in its fledgling stages in Taiwan, which only recently witnessed its first hostile takeover attempt. But there has been a dramatic escalation in the number of cross-border takeover attempts across the globe, and I'm sure people are very conscious of recent developments in Korea.

So with that in mind, let me offer one thought based on the US experience. A viable takeover market is slow to develop, but once is does it quickly takes on a life of its own. The reason is that the market for corporate control requires not only an acceptable legal climate, but also the willing participation of a variety of private institutions, including investment banks, commercial banks and law firms. For any number of reasons, these institutions may lack the expertise or be unwilling to participate in a hostile bid for a prominent local firm. Once they cross that line and develop the expertise, however, they become eager for additional business of the same vain. Moreover, as Taiwan and others open their financial services markets to foreign firms as part of the WTO, many of these new firms will bring with them experience in mergers and acquisition financing, which they would no doubt be more than happy to market. Thus, I see this as a very propitious time to be discussing the market for corporate control in Taiwan.

In closing, let me say how excited I am by the diverse and knowledgeable group assembled here, all with a common interest in Taiwan's corporate governance. Chairman Yen, I know how committed you and your organization are to good governance. I value your leadership and thank you once again for making this conference possible.

– *Kenneth B. Davis, Jr.*, Dean
University of Wisconsin Law School

SESSION 1

Taiwan's Financial Reforms: What has been done, what lies ahead?

The emphasis in the first session of the conference was on the evolution of recent financial reforms. After the Asian financial crises in 1997, the initial focus of the Taiwan government was on non-performing loans in the banking industry. By 2004 the problem of non-performing loans became less severe, so the government focused on reorganizing regulatory control over the financial services sector. This resulted in the establishment of the Financial Supervisory Commission in July, 2004.

The government also was very concerned about the highly fragmented banking industry where consolidation was badly needed. To provide a favorable environment for consolidation and integration, a major overhaul of the laws governing Taiwan's financial sector was undertaken. This resulted in several new laws being enacted, such as the *Merger Law on Financial Institutions of 2000,* which removed tax barriers and other restrictions on mergers, and the *Financial Holding Company Law of 2001*, which sanctioned the creation of financial holding companies to allow cross-selling of different financial products. The latter law also opened up the opportunity for existing foreign financial holding companies to acquire local financial institutions with the necessity of establishing an independent presence in Taiwan.

In order for banking consolidation to proceed efficiently, however, corporate governance had to be improved. So, as the government has adopted policies encouraging banking mergers, it also has promoted improved corporate governance. Still, there was some criticism of the government's lack of guidance for minority shareholders in mergers involving banks where the government had majority ownership.

SESSION 2

Independent Directors, Supervisory Commissions and Beyond

In the second session, the panelists described the complicated forces that need to be accommodated in balancing effective management and the entrepreneurial spirit on the one hand and the need for effective oversight of management to protect shareholders, especially minority shareholders, on the other hand. Directors and supervisors play a different role than management in a corporation's governance. Overly-intrusive behavior or micro-management by independent directors or supervisors may be counterproductive and inhibit management's effectiveness.

In 1998, in the wake of the Asian financial crises, the Taiwan Securities and Futures Commission ("TSFC"—the predecessor of the Taiwan Financial Supervisory Commission or "FSC"), began to emphasize the importance of corporate governance for publicly held companies. Since then Taiwan has introduced a number of new meas-

ures affecting the structure of corporate boards and supervisory commissions. These new measures generally have been introduced for the purpose of enhancing corporate governance so as to improve corporate performance and prevent self-dealing and fraudulent misconduct. In looking at the internal monitoring mechanisms, the TSFC recognized that four forces interactively monitor the performance of the board of directors and management: (1) exercising shareholders' rights and votes at shareholders' meetings; (2) corporate supervisory commissions; (3) internal audit and control systems; and (4) independent directors and/or audit committees.

Most of the reforms, which were begun in earnest in early 2002, have focused on greater independence for the board of director, audit committees and supervisory commissions. The current law, which took effect on January 11, 2006 by Presidential order, sets out the following requirements for publicly listed companies::

- Companies are given the option to appoint independent directors or not, but the FSC has the power to require that certain companies appoint independent directors.
- Companies are required to have at least five directors, and if they also are required to have independent directors, at least two of the directors and not less than 20 percent must be independent.
- Independent directors and the audit committee do not have veto power over important corporate resolutions, but the dissenting views or abstentions of independent directors should be recorded.
- Companies have the option to establish audit committees in lieu of supervisory commissions, but the FSC is empowered to require an audit committee.
- The audit committee, if required, should be composed of no less than three independent directors and at least one of them must be specialized in finance or accounting.

As indicated above, several of the newly introduced corporate governance reforms are voluntary. Transparency in reporting compliance, as in done in some European jurisdictions, may improve the investment climate. Even disclosure only by companies in compliance with new voluntary reforms will put market pressure on the non-complying companies to adopt the reforms.

A final point that echoed one of the central themes of the keynote address was the recognition that there are limits to what a good governance structure can do. The mere presence of independent directors may in theory promote effective oversight, but the skills of those directors, as well as the corporate culture and personal relations among the directors, supervisors and management, may be more important in determining the effectiveness of director and supervisor oversight than the structure of the board of directors or the supervisory commissions. Independent directors and supervisors, it was widely agreed, should not be regarded as the complete answer to good governance. The Taiwan securities regulators recognize that improved corporate governance goes well beyond board independence, as evidenced by the attention now being given to possible reforms of shareholder voting procedures.

SESSION 3

The Market for Corporate Control

Session 3 dealt with the market for corporate control, which traditionally refers to the use of take-overs to transfer corporate ownership. Corporate take-overs, especially hostile take-overs, are a relatively uncommon phenomenon in Asia, including Taiwan. As a result, in Taiwan and other parts of Asia, the mechanics of the take-over process are not well developed; the effects of take-overs on subsequent performance of the target are not well documented; and the government's regulatory role in corporate take-overs is still evolving.

Corporate governance has become embedded as a part of the regular investment decision-making process. One of the major reasons for close attention to corporate governance is risk management, with the scandals at Livedoor, WorldCom, and Global Crossing serving as cautionary tales. Based on research by Institutional Shareholder Services, companies with fully independent nominating committees have experienced better financial performance. Proxy voting procedures, independent directors and supervisors, and audit committees are being improved throughout Asia, but it is not yet clear whether the reforms have substance or not. As mentioned in earlier sessions and the keynote address, director/supervisor effectiveness, cultural factors and a corporate environment supporting good governance may be more important contributors to good governance practices than the most modern corporate/shareholder structures. Still, voting procedures may limit the ability of shareholders to protect their interests and have a voice on important proposals, such as share tender offers. In fact, the reality of the proxy voting process in many jurisdictions, including Taiwan, is that the shareholders are effectively disenfranchised because of vote processing deadlines.

An important issue raised in this session is the effect of a take-over on the target corporation. The evidence in Taiwan is not comforting. A study that examined 51 take-overs between 1991 and 2000 found that the performance of target companies was inferior to their industry benchmarks prior to the take-overs. This supports the prevailing view in Taiwan and elsewhere that underperforming companies are more likely targets of acquisitions. Unfortunately, the Taiwan study also found that the post-acquisition performances of many target companies remained below the industry benchmarks. In addition, the Taiwan study showed that the higher the proportion of inside directors and supervisors, the lower the post-acquisition performance, but that the post-acquisition performance was positively related to the level of ownership by the controlling shareholder. The generally negative effects on target corporations are not necessarily an indication that the acquisitions were failures. Instead, the poor performances may suggest that the corporate acquisitions were driven by more than the desire to turn around an underperforming enterprise, with the shareholders of the acquiring corporation being the real losers.

The corporate culture in Asia, including Taiwan, is sometimes hostile to an open market for corporate control. This is not surprising given that a few families, the government and political parties often have controlling stakes in major listed companies and they are reluctant to open their ownership interests to market disciplines.

The lack of tolerance for take-overs partly explains why governments have often intervened in take-over attempts

The importance and need for ongoing study of takeovers in Taiwan is confirmed by developments following the conference. It is not surprising that the Taiwan government's recent rules on mergers and acquisitions reflect the protective attitude referred to above. On September 7, 2006, the Financial Supervisory Commission announced a series of new regulations ostensibly designed to strengthen financial transparency, minimize uncertainties, and expand the FSC's review of financial institutions' merger and acquisition applications. The new regulations were consistent with a consensus reached at a national economic conference in July, 2006, which was intended to facilitate consolidation in Taiwan's fragmented financial sector; but the regulations also are likely to diminish the likelihood of hostile acquisitions.

SESSION 4

Financial Reporting and Transparency

The dependability and accessibility of financial reports have a major effect on the attractiveness of capital markets. The purpose of Session 4 was to look at Taiwan's financial reporting and transparency standards, especially in comparison to the capital markets of Taiwan's competitors. Four questions seemed especially relevant:

- Is the right information available on a timely basis?
- Is the information understandable, especially for purposes of cross-border comparisons?
- Is the information reliable, with an important component of reliability being the imposition of liability for investor losses due to disclosure of inaccurate information?
- Is the information being provided in the most cost effective fashion?

Within Asia, Taiwan ranks below Singapore, Hong Kong, Korea, and China in the implementation of international accounting and auditing standards. This suggests that Taiwan's financial reporting requirements do not require the right kind of information in a fashion understandable to the international investment community. Taiwan's major departures from the International Financial Reporting Standards ("IFRS") are:

- Accounting for share-based payments to employees. Under IFRS, share based payments to employees are reported at market prices and expenses as salaries for the period in which they are distributed. Under the ROC GAAP, however, the share-based payments are treated as distributions of earnings and neither expensed nor capitalized.
- Accounting for past service costs. Under IFRS, if the past service costs are fully vested, they must be recognized immediately. Under ROC GAAP, past service costs are amortized over the remaining service lives of the employees.

During the fourth session it was reported that Taiwanese financial accounting standards were moving towards international standards. As a stimulus for more rapid movement toward international standards, the government believes that investors will pay a premium for well governed companies and that in Taiwan the premium seems to be about 20 percent.

SESSION 5

Good Governance and Employee Compensation (Bonus Share, etc.)

Both the amount of employee compensation and the form of such compensation are significant concerns of shareholders, especially minority shareholders. In many cases, however, the compensation packages are major determinants of the continuing competitiveness of the enterprise. The principal purpose of Session 5 was to open a dialogue between investors concerned about dilution of their shares and corporate managers who view bonus shares and other compensation incentives as critical to the continuing success of their enterprise.

Share-based compensation is one of the most contentious issues in Taiwan's corporate governance. Beginning in 1983, employee profit sharing and stock ownership plans ("EPSSOPs") were introduced as a way of encouraging employees' loyalty to the enterprise while preserving cash for future business expansion. Under the typical EPSSOP, a percentage of the surplus profits is distributed to the employees , most commonly in the form of additional shares which are distributed at par value (NT$10) even though the market value is much greater. According to one study, approximately 70 percent of the listed and OTC companies in the electronics industry have adopted EPSSOPs and many commentators have suggested that EPSSOPs are a major factor in the overall competitiveness of Taiwan's high tech industries.

On the other hand, domestic and international institutional investors expressed concerns about the dilution of profits caused by the issuance of share bonuses. Evidence presented during the 5th session also supported the investors' concerns, as share bonuses in Taiwan have sometimes consumed the entire profits of an enterprise. From 1992 to 2001, the accumulated dilution ratio of the top 15 companies that suffered the most serious dilution was in excess of 11 percent.

The basic problems for investors go beyond dilution of profits, however. Investors are concerned that the share bonuses have a distorting effect on financial statements because the shares are treated as distributions of retained earnings rather than as expenses. If the shares had been accounted for as expenses, the net profits of some hi-tech listed companies would have been reduced by 50 percent.

In recent years, the FSC has attempted to deal with the problem of bonus shares in two significant ways. First, since 2004, the FSC has said that shares distributions in excess of 50 percent of net profits may not be approved. Importantly, in valuing the share distributions, the FSC requires that the shares are to be valued at their

actual fair market value, not par value. So, the FSC has responded to the dilution problem by limiting the amount of shares distributed. Second, to strengthen information disclosure and improve transparency, the annual report and prospectuses of public companies are required to provide much more information about shares distributions.

Finally, in April, 2006, the Ministry of Economic Affairs announced that EPSSOPs would be booked as expenses starting in January, 2007. It is still unclear, however, whether shares will be valued by par or market value although the more appropriate accounting should be at fair market value. There is, however, opposition in the hi-tech industry to expensing on the basis of fair market value because of concerns about a loss of global competitiveness.

SESSION 6

Where to go from here?

In looking at the future of corporate governance in Taiwan and its effects on Taiwan's capital markets, the panelists in the 6th session encouraged Taiwan to move towards "best practices" based on international standards. In addition, they said that Taiwan needs to work to create a culture of accountability where the directors feel a responsibility to all of the shareholders. One step in the right direction, it was said, would be the adoption of "best practices" and then requiring disclosure of whether the company conforms, and, if not, why not.

Based on discussions during the conference and several communications afterwards, the rapporteurs recommend that future programs consider the following issues:

- A comparative analysis of corporate governance: new developments in corporate governance in Singapore, Hong Kong and Korea. How does Taiwan compare with the investment climate in these three jurisdictions?
- Officers and directors' liability.
- Shareholders voting procedures, including proxy voting and the timing of shareholder notices.
- The market for corporate control, with special attention to the appropriate level of government intervention in mergers and acquisitions.
- Improving the effectiveness of independent directors and audit committees: The introduction of professional seminars for independent directors.

Consistent with this future agenda, Chairman Yen Ching Chang concluded the conference by saying that Taiwan should first establish benchmarks for improved corporate governance and then work toward the adoption of mandatory guidelines based on international practices.

Respectfully submitted for the Wisconsin International Corporate Governance Initiative

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An Agenda for Reform

Conference on Corporate Governance and Taiwan's Capital Markets

TAIPEI WORLD TRADE CENTER

April 6 and 7, 2006
Taipei, Taiwan, ROC

An Agenda for Reform

Based on the substantive program of the conference and discussions among the participants during and after the conference, the conference rapporteurs have divided the future agenda into two sections. The first section consists of specific corporate governance reforms to be undertaken in the near and medium term. The second section discusses the mechanisms for implementing the proposed reforms.

Corporate Governance Reforms

In recent years, Taiwan has adopted major corporate governance reforms. But corporate governance reform is a continuous process that needs to evolve as business enterprises and capital markets change. Therefore, even as Taiwan has introduced important reforms, more needs to be done. The principal recommendations for reform are focused on:

- Shareholders' voting procedures, including proxy voting and the timing of shareholder notices.
- Improving the effectiveness of directors and supervisors.
- The market for corporate control, with special attention to the appropriate level of government intervention in mergers and acquisitions.

Shareholder Voting Procedures

Shareholder voting procedures have two components. The first part is the flow of information to the shareholders prior to general meetings. The second part is the delivery, collating and counting and verification of shareholder votes. Taiwan's procedures on both halves have been judged to be among the least adequate in the East and Southeast Asian region. They also are regarded as markedly inferior to the voting procedures in more developed capital markets, such as Australia, the UK, and the US.

Getting information to the shareholders: Investors and investor service organizations are critical of the manner in which information is made available to shareholders. The principal criticisms are:

- Taiwanese companies generally do not provide detailed notices and agenda of shareholder general meetings early enough for outside investors to respond in a timely fashion. In Taiwan, the rule is 30 days for preliminary notice and 10 days for the detailed and final agenda. Although Taiwanese companies tend to send out the preliminary notice well in advance of the 30 day minimum, the initial notices usually contain little information about the shareholder meeting or the agenda. As a consequence, the timing of meaningful shareholder notices and detailed agenda in Taiwan usually is much less than the standard practices in Hong Kong (21 days) or Singapore (14 days), and considerably below the timing of detailed notices and agenda in the US (30 days), the UK (21 days) and Australia (28 days). The timing practices in Taiwan are such that outside investors often have too little time to vote.
- A related criticism is that the late publication of full agendas coupled with tight voting deadlines set by custodians give outside investors little time in which to vote. According to a survey by Institutional Shareholder Services, custodian banks in Taiwan have voting deadlines of 10-14 days. As a result, if a listed company in Taiwan publishes its detailed agenda as required 10 days before a meeting, there would be no time for the agenda to be translated and transmitted to the outside investors. Even where the custodian banks are flexible with their deadlines, as some are, there still is no time to vote. In Taiwan, the manual processing of proxy votes by the sub-custodians greatly slows down the whole system. In addition, because foreign shareholders holding more than 300,000 shares of a company must attend (in person or through a representative) the shareholder meeting and vote, the pressure to get timely information to the outside shareholders is especially acute.
- The major criticism about the flow of information to outside investors is that the information available is often inadequate to make an informed voting decision. On this issue, the *ACGA Asian Proxy Voting Survey 2006* concluded:

  > *Companies in …Taiwan are known for changing their meeting agendas right up until (and even during) the meeting. … [R]esearch by Institutional Shareholder Services in 2004 found that [in Taiwan] the preliminary agenda changed about 70% of the time.*
  >
  > *In Taiwan, Article 5 of the "Regulations Governing Content and Supplemental Requirements for Shareholders Meeting Handbooks of Public Companies" states that public companies shall transmit, 30 days prior to their annual shareholder meetings and 15 days prior to a special shareholders meeting, the digital file of the shareholders meeting agenda including the notice of meeting, form of proxy, proposals for discussion, recognition, election of directors or supervisors, and description (parts of the meeting handbook) to the Market Observation Post System (MOPS).*
  >
  > *In practice, the 'summary and details' proposed for discussion 30 days in advance does not generally include much by way of details. Article 6 of the same regulation requires that the full meeting handbook—i.e., the full agenda—and all supplementary materials must be posted on MOPS 10 days prior to both annual and special shareholders meetings. However, this clashes with voting deadlines set by global custodians*

… . Further, the names of directors being nominated are often released only five (or less) days before the meeting date, even though this information is required by shareholders to cast a valid vote. [at page 48.]

- A criticism voiced by some outside investors is the inadequate translation of shareholder meeting information. Some investors, custodians and companies take the opposite view and claim that language capabilities are the investors' responsibility, but it generally is conceded that companies with more translated information may have a competitive edge in capital markets than those without translations. This also should hold true for outside investors—those with foreign language capabilities are likely to have a broader range of investment options than investors lacking such expertise.

The voting process: Outside investors and (sometimes) their supporting service providers also are critical of the actual shareholder voting process in Taiwan. According to the discussions at the April Conference and the conclusions of the *ACGA Asian Proxy Voting Survey 2006*, the major criticisms are the following:

- Confirmation that votes have been received. Taiwan is not alone, but a common criticism of the voting process in Asia and elsewhere is that there is no confirmation that votes have been received by the share registrar or transfer agent. In this respect, Taiwanese practices are no worse than in other Asian countries.
- Voting by a show of hands instead of by ballot or poll is prevalent in Taiwan. This system is criticized for several reasons:
  - Voting by a show of hands gives each person attending the meeting an equal vote, irrespective of the number of shares that person represents.
  - Voting by a show of hands creates a bias in favor of management since they will attend the meeting in person and arrange for their supporters to be in attendance as well.
  - With voting by a show of hands, proxy votes often are not accounted for.
  - Voting by a show of hands also highlights and thus discourages opposition votes. A sub-custodian bank in Taiwan has reported being intimidated by Taiwanese managers when the bank has attempted to vote in opposition to a proposal. As a consequence, the sub-custodian now routinely sends outside investors the following notice:

    In cases where the client instructs us to vote against any proposal to be discussed at a shareholder's meeting and the voting with respect to such proposal is done by ballot, we or our designee will fill out the ballot in respect of such proposal in accordance with the client's instruction. However, if the voting at the shareholders meeting is done by acclamation, we/our designee will not take any action in respect of the relevant proposal. [ACGA Asian Proxy Voting Survey 2006 at p. 58.]

- Many listed companies in Taiwan concentrate their annual general meetings over a few days during the annual general meeting season. Taiwan's clustering of annual meetings is among the worst in Asia, according to the *ACGA Asian Proxy Voting Survey 2006*, and for outside investors with multiple investments the clustering makes careful consideration of voting decisions practically impossible.
- Taiwanese companies do not usually publish a detailed account of the voting results. Publication of the voting results is suggested because it gives outside investors a clear idea of the voting process and the margins by which the various proposals passed or failed. The increased transparency is especially appropriate in securities markets seeking significant participation by outside investors.
- A related criticism is that the voting results seldom are audited. The lack of audited voting results was the greatest source of concern among investors, custodians and other investment support providers who responded to the *ACGA Asian Proxy Voting Survey 2006*.

Improving the Effectiveness of Directors and Supervisors

Independent directors are at the heart of any corporate governance reform. As Dean Kenneth B. Davis, Jr. recognized in the Conference's keynote address, independent directors were the principal emphasis of the January, 2006 amendments to Taiwan's Securities & Exchange Act. As a result of those amendments, beginning in January, 2007, most publicly held companies, including listed companies and those prescribed by orders of the Financial Supervisory Commission, will be required to include independent directors on the board of directors and they may also be required to establish an audit committee to replace the corporate supervisors.

The existence of independent directors is only the beginning of improved governance; additional reforms need to be undertaken to complement the presence of independent directors. Once independent directors are included on corporate boards, for example, additional steps need to be taken to insure that independent directors are able to function effectively and in the manner anticipated when the corporate governance reforms were introduced. It is apparent that no matter how independent the directors may be, their

range of action will be substantially influenced by the local business culture. Independent directors may be viewed as "agents for change," but it is possible that they will be thwarted by obstacles to greateraccountability and transparency that lie deep within the underlying business culture. Therefore, even as independent directors become commonplace in corporate boardrooms, there is a need for continuing education of all directors and supervisors to help them fulfill their evolving responsibilities.

Organizations within Taiwan have already begun providing educational programs for directors and supervisors on their legal responsibilities within a system of stronger corporate governance. Conference participants applauded these efforts. Given the open-ended nature of Tawian's current laws, however, more comprehensive initiatives are needed to develop and familiarize directors and supervisors with clearer guidelines for how to discharge those responsibilities.

Taiwan's recent approach to the responsibilities of directors and supervisors is consistent with the Anglo-American model of analyzing those responsibilities under the separate headings of the duty of care and the duty of loyalty. But taken by themselves, these two duties are simply general concepts, with substantial room for interpretation and debate in how they are applied. Experience has shown that applying these duties involves a delicate balancing act: If they are applied too strictly, highly qualified outsiders may be deterred from serving on the board or, if they do serve, from taking legitimate business risks. On the other hand, duties that are too lax invite a lack of diligence and the risk of self-serving behavior. To appreciate what this means for Taiwan, consider both the duties of care and loyalty in more detail.

Taiwanese law creates no separate duty of care for directors. Rather, it imposes that duty indirectly, by specifying that the relationship between the company and its directors is to be governed by the Civil Code's law of mandate. As a result, there is no formal statutory recognition of the special problems facing corporate directors in general, and outside directors in particular, and how they may differ from more conventional employees and agents. In particular, there is no equivalent of the business judgment rule, so critical to the workings of US boards, or other protection from the potentially ruinous personal liability that might result if a good faith business decision turns out poorly.

The directors' and supervisors' duty of loyalty, in contrast, is relatively recent—enacted in 2001, based on the Anglo-American concept of fiduciary duty. Courts in the US and UK have found over the years that literal enforcement of that duty is awkward, for it rests entirely on the director's subjective intent, and any well counseled director can always advance some plausible justification for his or her conduct. Necessarily, therefore, these courts have turned to an objective approach instead—is the decision or transaction being challenged consistent with what an honest and reasonable director would approve? This simple question has generated a complex jurisprudence. Take for example transactions between the company and parties related to one of the directors. Among the issues courts have regularly been forced to address are: (i) Should such transactions be prohibited per se or only if unfair? (ii) If fairness is the test, (a) which party carries the burden of proof, and (b) does fairness apply to the terms of the transaction, the process that approved it, or both? and (iii) What degree of relationship should trigger this special scrutiny?

In the US and UK, this necessary balance between strictness and laxity has been fashioned over time, through decades of judge-made case law assessing a rich variety of factual situations. Given their background and lack of experience with business litigation, Taiwan's courts cannot be expected to develop a comparable body of rules and guidelines, especially within a short time frame. In response, Taiwan's business and legal communities may need to play a greater role in this development. This is a good topic for continuing discussion among all of the parties interested in improved corporate governance in Taiwan.

The Market for Corporate Control

The market for corporate control traditionally refers to the use of take-overs to transfer corporate ownership. Corporate take-overs, including hostile take-overs, are widespread in North America and Europe, but they are a relatively uncommon occurrence in Taiwan and other parts of Asia. As a result, in Taiwan and other parts of Asia, the mechanics of the take-over process are not well developed; the effects of take-overs on subsequent performance of the target are not well known; and the government's role in regulating corporate take-overs is still in its embryonic stage.

The market for corporate control is a significant issue in the current efforts at consolidation and privatization in Taiwan's financial sector. For this reason, the topic is being included in the Conference on Taiwan's Financial reforms scheduled for August, 2007 in Taipei.

Mechanisms for Implementing the Corporate Governance Reforms

Implementing the corporate governance reforms discussed in the preceding section will require a variety of different measures. In some instances, such as with some of the voting reforms, the necessary changes are within the power of individual companies or custodians. In other instances, the changes will require regulatory action.

Roundtable on Corporate Governance Reforms

To enhance their credibility, the reform recommendations dealing with shareholder voting and improving the effectiveness of directors and supervisors need to face the realities of an open discussion among the major parties concerned with corporate governance issues. Such a discussion also can act as a forum for the development of a consensus for reform through voluntary action in the private sector. As a result, the rapporteurs recommend as a follow-up to the Conference a roundtable discussion, by invitation only, on shareholder voting procedures and the new directors and supervisors training initiatives. The roundtable could be held as early as late March, 2007, with possible invitees including chairmen and secretaries of the major Taiwanese companies, local and international institutional investors, custodians, and investor services, and the stock exchanges and major regulatory agencies.

The agenda of the Roundtable on Corporate Governance Reforms will include the following reform proposals:

- On the issues of the timing and adequacy of shareholder notices, the proposal is that shareholder notices accompanied by a detailed agenda be sent at least 28 days prior to annual general meeting and that the agenda not be changed after the notices are sent. Custodians and sub-custodians can help on the timing problem by modernizing their systems for transmitting and receiving shareholder information, but a 28 day period with a firm and detailed agenda will go a long way toward enabling outside investors to make meaningful contributions to the shareholder meetings.
- On the availability of translated materials, Taiwanese companies should recognize, and outside investors should recognize that both have a competitive interest in accommodating the other. Taiwanese companies with easier access to translated information are likely to have a wider market for their shares, just as outside investors with local language capabilities are likely to have more investment options.
- The confirmation that votes have been received, publication of voting results, and an independent audit of the voting results all should be part of a process of greater transparency and accountability by the Taiwanese companies. If they want favored access to a broader investment community, these improvements in transparency and accountability would seem to be in their own self interest.
- Voting by a show of hands should be replaced quickly by voting by ballot. The common practice of voting by a show of hands in Taiwan is well known to international investors and does not reflect well on the attractiveness of Taiwan's capital markets.
- Organizations within Taiwan have already begun providing educational programs for directors and supervisors on their legal responsibilities within a system of stronger corporate governance. Our recommendation is that these groups organize conferences and seminars for existing and prospective directors and supervisors with the objective of developing, in consultation with institutional investor groups, workable guidelines for how directors and supervisors are to discharge their responsibilities in various factual situations. While Taiwan may ultimately favor different resolutions than those adopted by the US and UK, we suggest that the participants in these programs look to the substantial body of US and UK case law as the starting point for identifying the kinds of factual scenarios that are likely to arise, and the various issues and arguments they present.

Finally, because the market for corporate control is an important matter with the major issues not yet fully developed, it is reserved for future work. Specifically, the market for corporate control will be taken up in the conference on Taiwan's financial sector reforms scheduled for August, 2007.

Participant List & Conference Schedule

Conference on Corporate Governance and Taiwan's Capital Markets

TAIPEI WORLD TRADE CENTER

April 6 and 7, 2006
Taipei, Taiwan, ROC

Guests of Honor and Panelists

A special meeting of business leaders, international investors, and government regulators

From Taiwan

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Chairperson
Financial Supervisory Commission
Executive Yuan

Chang, Lee L.C. 張立秋
President
Yuanta Core Pacific Securities

Chang, Wu-Yee 張五益
Chairman
KPMG Taiwan

Chen, Sean C. 陳冲
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Chin, Amy 金文悅
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Fuhwa Financial Holding Company

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Lee, Chi-Hsien 李啟賢
Deputy Director-General of Securities and Futures Bureau
Financial Supervisory Commission
Executive Yuan

Lee, Shyan-Yuan 李賢源
Commissioner
Financial Supervisory Commission
Executive Yuan

Lee, Tsun-Siou 李存修
Professor of Finance
National Taiwan University

Li, Ko-Ming 李克明
Chairman
Fuhwa Asset Management Company

Lin, Andrew 林仁光
Assistant *Professor* of Law
National Taiwan University

Lin, Tien-Fu 林添富
President
Fuhwa Securities Company

Liu, Tseng-Hwa 劉曾華
Chairman
Fuhwa Leasing Company

Ma, Rudy 馬志玲
CEO
Yuanta Securities Group

Ma, Victor 馬維建
Chairman
Fuhwa Securities Finance Company

Ma, Michael 馬維辰
Vice Chairman
Fuhwa Commercial Bank Company

Ma Tu, Judy 杜麗莊
Chairperson
Yuanta Core Pacific Securities Company

Seetoo, Dah-hsian 司徒達賢
Professor of Business Administration
National Cheng-Chi University

Tesng, Gary K.L. 曾國烈
Director-General of Banking Bureau
Financial Supervisory Commission
Executive Yuan

Wei, Mark Pao-Shing 魏寶生
Secretary General
Taiwan Financial Services Roundtable

Wu, Ching-Sung 吳青松
Professor of International Business
National Taiwan University

Wu, Chung-Fern Rebecca 吳琮璠
Commissioner
Financial Supervisory Commission
Executive Yuan

Wu, Nai-Jen 吳乃仁
Chairman
Taiwan Stock Exchange Corporation

Wu, Tang-Chieh 吳當傑
Director-General of Securities and Futures Bureau
Financial Supervisory Commission
Executive Yuan

Yeh, Yin-Hua 葉銀華
Professor and Director at the Graduate institute of Finance
Fu Jen Catholic University

Yen, Ching-Chang 顏慶章
Chairman
Fuhwa Financial Holding Company

From other countries

Jamie Allen
Secretary General of the Asian Corporate Governance Association (ACGA) located in Hong Kong. The ACGA is an independent, non-profit membership organization dedicated to working on implementation of effective corporate governance practices throughout Asia. It has more than 50 member organizations, including institutional investors that manage about US $5 trillion in assets.

Hye-Won Choi
Corporate Governance Director and Senior Counsel at TIAA-CREF in New York. TIAA-CREF operates one of the world's largest retirement systems, with over US $360 billion in combined assets under management.

Kenneth B. Davis, Jr.
Dean and George Young Professor of Law of the University of Wisconsin Law School. Dean Davis research and teaching interests focus principally on corporate law, especially corporate governance.

Marc Goldstein
Attorney who serves as Head of Research in the Tokyo office of Institutional Shareholder Services (ISS). ISS provides proxy voting advice and corporate governance services on a global basis to more than 1,600 institutional investor and corporate clients.

Charles R. Irish
Director of the East Asian Legal Studies Center and Volkman-Bascom Professor of Law at the University of Wisconsin Law School. Professor Irish's teaching and research are in the areas of international tax and trade laws.

Keith Johnson
Former Chief Legal Counsel of the State of Wisconsin Investment Board, where he was responsible for corporate governance activities at the US $75 billion public pension fund manager. He is currently Program Director for the Wisconsin International Corporate Governance Initiative and an Adjunct Professor of Corporate Governance at the University of Wisconsin Law School and Chair of Reinhart Institutional Investor Services.

Kha Loon Lee
CFA, is Head of the CFA Centre for Financial Market Integrity, Asia Pacific, in Hong Kong. The Centre for Financial Market Integrity is sponsored by the CFA Institute, a non-profit Organization with more than 76,000 Chartered Financial Analyst members worldwide. The Centre's mission is to promote fairness, efficiency, integrity and investor protection in the global capital markets.

Colin Melvin
Director of Corporate Governance for Hermes Investment Management. Hermes is headquartered in London and is owned by the British Telecom and Post Office pension scheme, which is also its largest client. Hermes manages over US $105 billion for more than 230 pension funds, insurance companies, government agencies and financial institutions.

Jelle Mensonides
Director of ABP Investments US, which is a New York subsidiary of Stichting Pensioenfonds ABP of the Netherlands. ABP is the largest pension fund in Europe, with over US $225 billion in assets.

Anne Pang
Executive Director and Head of Investor Relations at Citigate Dewe Rogerson North Asia. Citigate Dewe Rogerson is the Investor Relations Consultancy arm of the Huntsworth Group in London. Anne specialises in advisory services for corporates to improve governance standards and investor communications. She also conducts research on governance standards for Chinese stocks.

Agenda — April 6

09:15–09:45 AM *Opening Ceremony*
Ching Chang Yen 顏慶章
Chairman
Fuhwa Financial Holding Company

Dean Kenneth B. Davis, Jr.
University of Wisconsin Law School

Chairperson
Jaw-Sheng Kong 龔照勝
Financial Supervisory Commission
Executive Yuan
U.S. Representative
American Institute in Taiwan

09:45–10:45 AM *Keynote Address*
"Corporate Governance in Taiwan–The Road Ahead"
Dean Kenneth B. Davis, Jr.
University of Wisconsin Law School

10:45–11:00 AM *Tea Time*

11:00–12:00 AM SESSION 1
Taiwan's Financial Reforms
What has been done, what lies ahead? The purposes of this session are to review the recent laws and regulations affecting corporate governance and to discuss changes now under consideration and the direction of future reforms.

MODERATOR
Chen-en Ko 柯承
President
Chung Hua Institute for Economic Research

PANELISTS
Amy Chin 金文悦
Commissioner
Financial Supervisory Commission
Executive Yuan

Shyan-Yuan Lee 李賢
Commissioner
Financial Supervisory Commission
Executive Yuan

Victor Ma 馬維建
Chairman, Fuhwa Securities Finance Company

12:00–01:30 PM *Lunch*

01:30–03:30 PM SESSION 2
Independent Directors, Supervisory Commissions and Beyond. Independent directors and supervisory commissions play important roles in improving corporate governance, but, as the US financial scandals have made abundantly clear, independent directors and supervisory commissions are not the complete answer. The purpose of this panel is to explore the limits of independent directors and supervisory commissions and consider what additional elements are necessary to enhance corporate governance without impinging on the entrepreneurial spirit of corporate officers.

MODERATOR
Tain-Jy Chen 陳添枝
Professor of Economics, National Taiwan University

PANELISTS
Chi-Hsien Lee 李啟賢
Deputy Director-General of Securities and Futures Bureau
Financial Supervisory Commission
Executive Yuan

Jamie Allen
Secretary General
Asian Corporate Governance Association

Jelle Mensonides
Director
ABP Investments US

Andrew Lin 林仁光
Assistant Professor of Law
National Taiwan University

03:30–04:00 PM *Tea Time*

04:00 –05:00 PM SESSION 3
The Market for Corporate Control
MODERATOR
Ching-Sung Wu 吳青松
Professor of International Business
National Taiwan University

PANELISTS
Yin-Hua Yeh 葉銀華
Professor and Director of the Graduate Institute of Finance
Fu Jen Catholic University

Marc Goldstein
Head of Research
Tokyo Office
Institutional Shareholder Services

Ko-Ming Li 李克明
Chairman
Fuhwa Asset Management Company

Agenda — April 7

09:00–11:00 AM SESSION 4

Financial Reporting and Transparency

The dependability and accessibility of financial reports have a major effect on the attractiveness of capital markets. The purpose of this session is to look at Taiwan's financial reporting and transparency standards, especially in comparison to the capital markets often in competition with Taiwan.

MODERATOR

Charles Irish
Professor and Director of the East Asian Legal Studies Center
University of Wisconsin

PANELISTS

Chung-Fern Wu Rebecca 吳琮璠
Commissioner
Financial Supervisory Commission
Executive Yuan

Kha Loon Lee
Head, CFA Centre for Financial Market Integrity

Wu-Yee Chang 張五益
Chairman
KPMG Taiwan

11:00–11:15 AM *Tea Time*

11:15–12:15 PM SESSION 5

Good Governance and Employee Compensation (Bonus Shares, etc.)

Both the amount of employee compensation and the form of such compensation are major concerns of minority shareholders, but in many cases they also are major determinants of the success of the enterprise. The principal purpose of this session is to establish a dialogue between investors concerned about dilution of their shares and the corporate officers who view bonus shares and other compensation incentives as critical to the continuing competitiveness of their enterprise.

MODERATOR

Keith Johnson
Former senior counsel for the State of Wisconsin Investment Board, Chair of Reinhart Institutional Investor Services and Program Director for the Wisconsin International Corporate Governance Initiative.

PANELISTS

Mark Pao-Shing Wei 魏寶生
Secretary General
Taiwan Financial Services Roundtable

Tsun-Siou Lee 李存修
Professor of Finance
National Taiwan University

Anne Pang 彭可欣
Executive Director and
Head of Investor Relations
Citigate Dewe Rogerson

Colin Melvin, Director of Corporate Governance
Hermes Investment Management

12:15–1:30 PM *Lunch*

1:30–3:30 PM SESSION 6

A panel discussion: Where to go from here?

MODERATOR

Ching-Chang Yen 顏慶章
Chairman
Fuhwa Financial Holding Company

PANELISTS

Gary K.L. Tseng 曾國烈
Director-General of
Banking Bureau
Financial Supervisory Commission
Executive Yuan

Colin Melvin
Director of Corporate Governance
Hermes Investment Management

Hye-Won Choi
Corporate Governance Director
TIAA-CREF

Kennon Koay
Vice President
AIG Global Investment Corp (Asia)

Background Papers

Conference on Corporate Governance and Taiwan's Capital Markets

TAIPEI WORLD TRADE CENTER

April 6 and 7, 2006
Taipei, Taiwan, ROC

Background Paper

YEN CHING CHANG

YEN CHING CHANG

Developments on Taiwan's Financial Reform

Most of the Asian countries suffered badly during the financial crisis between 1997 and 1998.[7] Taiwan, however, safely maneuvered its way out of the situation and came out relatively unscathed in comparison.[8] The secrets behind this success could be generalized into several factors.

The macroeconomic fundamentals of Taiwan at that time were in good shape. Dynamic international trade activities continued to flourish in exports, which not only created a long-term trade surplus, but also accumulated for Taiwan an impressive sum of foreign exchange reserves.[9] At the same time, there were practically no foreign debts for Taiwan which provided a safety cushion for Taiwan to respond to the ever-changing external economic conditions.

Small- and medium-sized enterprises also played an essential role in maintaining Taiwan's booming economy. As a matter of fact, exports by these unsung heroes of Taiwan account for about 50% of all Taiwan's export income. Because of their highly flexible mode of operations, they could easily adjust to changing economic conditions and withdraw from the market quickly should they fail, thereby incurring very low socio-economic costs. In addition, since the 1990s Taiwan has been successful in transforming its industry from a labor intensive to a capital and technology intensive economy. This transformation has added substantial wealth and buffered Taiwan from the regional financial turmoil.

High savings rate during that period further immunized Taiwan from the "Asian contagion" because its stock market transactions came mostly from local sources. Foreign funds accounted for less than 4% of the total market trading value. As a result, the negative impact of quick withdrawal of foreign capital from the Taiwan market was minimal compared with the other Asian securities markets that had been inundated with foreign funds.

Moreover, a healthy credit regulatory regime created by the Ministry of Finance and the Central Bank led the banking institutions to take a more cautious approach in making credit loans. In fact, the equity-debt ratio of the private sector in Taiwan was by far lower than those countries most affected by the crisis. Compared with South Korea whose average equity-debt ratio for all industries was 450% and going up as high as 900% for super-sized enterprises, Taiwan's record was indeed admirable with a ratio that stood at 180% for small- and medium-sized companies and 108% for large corporations.

Because it was not hit by the crisis, the average asset quality of Taiwan's banking sector has remained in good standing, which in turn has maintained its financial stability and growth over the years. In general, the capital market of Taiwan has also been vibrant. Since the companies listed on the securities exchange in Taiwan could easily get funds from the market, they appear to have reduced their borrowings from the banks, as reflected in the above figures for equity-debt ratio.

Nonetheless, Taiwan's financial market was over-banked and fragmented. Prior to the 1990s, the financial sector of Taiwan was a heavily regulated industry with special licensing rules. Under such "protection" set against a backdrop of Taiwan's economic boom at the time, the financial industry was the envy of all for being a star money-maker.

Beginning from the 1990s and onwards, liberalization of Taiwan's financial market appeared to be an inevitable trend. As a result, the government began to lift the restrictions, particularly in the banking sector, which made it possible for private individuals to own banks. Although initially started to demonstrate Taiwan's effort in liberalizing the financial sector, the quick growth in the number of banks ultimately resulted in over-banking. Under such circumstances, banks had to "fight" for business survival by offering comparatively lower interest rates that resulted in narrower profit margins.

The adverse effect of fierce competition among local Taiwanese banks is discerned in the downward trend of their ROA and ROE performance figures. In 1990, the average ROA for local Taiwanese banks was 0.9%; however, by 2000 it had already gone down to a record low of 0.39%.[10] The average ROE for local banks between the periods of 1988 to 1991 ranged between 14%-21%, but it also reached as low as 4.9% by 2000. Likewise, the average ROE of local banks dropped to as low as 4.9% in 2000 as opposed to 14-21% between the periods of 1988 to 1991 ("the protective era").[11]

When comparing the above figures with that of their international counterparts, it would appear Taiwan's banks lacked competitiveness from a long-term operational perspective. According to the June 2001 issue of *Euromoney* magazine, the ROEs for the majority of international financial groups and banks in 2000 were well ahead of Taiwan. To name a few, the ROE of Bank of America was 15.8% and that of HSBC was 12.5%. As for Citigroup, it had already reached as high as 20.4%.

Thus, in order to sharpen the competitive edge of Taiwan's financial market and to secure its future growth, consolidation appeared to be the way forward and was indeed undertaken as a top priority by the government.[12] During the period of 2000-2002, the first-ever comprehensive financial reform in the history of Taiwan was initiated.[13]

To provide a stimulating environment for consolidation and integration, it was considered that a major overhaul of Taiwan's financial legal regime should be performed. Consequently, various laws were enacted such as the *Financial Institutions Merger Act*[14] in 2000. This removes tax obstacles and restrictions on mergers[15] and permits the establishment of asset management companies to assist in the disposition of non-performing loans by financial institutions.[16] In addition, the *Financial Holding Company Act*[17] in 2001 enables the creation of financial holding companies for engaging in the cross-selling[18] of various financial products.[19] The latter law, under Article 23, also opens up the opportunity for existing foreign financial holding companies to acquire local financial institutions even without having to set up a presence in Taiwan. Such enactment of related laws has triggered a series of unprecedented consolidation and integration activities in Taiwan's financial sector. This allows the institutions concerned not only to attain economies of scale, but also to enjoy the synergistic effect from such consolidation and integration.

Utilizing the public capital pursuant to the *Statute for the Establishment and Management of the Executive Yuan's Financial Restructuring Fund*,[20] speedy measures were also undertaken to clean up 36 under-performing financial institutions and arrangements were made for them to be taken over by other more capable financial institutions within a month. This not only facilitated the smooth exits of those under-performing banks without causing any adverse impact on the market, but also alerted those still remaining in the market of the importance of maintaining a reasonable quality of their assets.

In carrying out the above reform measures, a good beginning has been set which serves as a model for subsequent financial consolidation and integration. Such consolidation and integration of Taiwan's financial institutions not only has improved their overall asset quality, but will also pave the way for them to be world-class financial players in the future.

Taiwan's Problems in Financial Reform

Nevertheless, Taiwan has its own inherent problems which must be resolved before the government's initiatives in financial reform can be turned into a success story and that earlier efforts are not wasted.

Taiwan's financial market is still over-banked. Considering just financial holding companies alone, there are already 14 players in existence. Although their original licenses were granted in my former capacity as the Finance Minister, further consolidation of these players is still crucial for a healthy development of Taiwan's financial market. However, in relation to what that optimal number should be, the market mechanism should be the one to decide.[21]

Moreover, the financial market of Taiwan is small in scale when compared with its international counterparts.[22] This is partly attributable to the fact that a majority of Taiwanese financial institutions are family-owned, a cultural phenomenon prevalent in the Asian countries.[23] However, to expand their market share, such family-owned financial institutions will eventually be forced to stand at a crossroads. They will have to decide whether to embrace the possibility of strategic investments at home or from abroad, but as a result will face the inevitable consequence of losing its dominance over the board and management which they presently enjoy. At this stage, it is not clear what actions these family-owned enterprises will take in this regard to stay competitive nationally and/or internationally when the time comes.

Government's Challenges in the Financial Reform

Privatization of state-owned banks or banks whose major shareholder is the government poses a great challenge for Taiwan's financial reform.[24] At present, Bank of Taiwan and Land Bank of Taiwan are still 100% state-owned. Other financial institutions, like the Taiwan Cooperative Bank, First Financial Holdings, Mega Financial Holdings, and Hua Nan Financial Holdings, are those in which the government has controlling stakes. Given that the aggregate market share of these banks and financial holding companies based on their assets amounts to a hefty 50.28%,[25] it becomes necessary for the government to undertake affirmative actions in order to enable better development of the capital market.

Further, even if the government carried out such actions, many ancillary issues would still need to be addressed. For example, in relation to employees' rights, more favorable terms are usually offered to the employees of state-owned banks. This offering, however, often goes against the ethos of private financial institutions that operate on the basis of business results and costs. It can be foreseen that employee-held protests against privatization or their interference with the process is likely, which could stifle the process and add extra costs to it.[26]

Another possible impediment to the privatization process is the fact that any disposal of assets involving the aforementioned banks and financial holding companies shall be subject to the approval of the Legislative Yuan (LY).[27] Although such approval procedure serves as a check-and-balance mechanism in our constitutional system, it may open up the possibility for the LY to influence the outcome of the process, which is then against the market mechanism principle. Thus, any kind of undue interference by the lawmakers of the LY with the government's plan to dispose of its shareholding in the relevant financial institutions would do no good, but would create additional uncertainty and instability to the market.

In fact, Fuhwa has been the victim of such interference. Since July 2005, Yuanta has taken over the management of Fuhwa by virtue of its shareholding and has been working enthusiastically towards the final merger of the two entities. Foreign institutional investors and other investors of the local market have also looked upon this prospective "marriage" positively as an excellent model for synergy. However, in October 2005, while the Finance Committee of the LY reviewed the annual budget, it resolved by way of a

supplementary resolution, that "Fuhwa's share swap price cannot be lower than NT$19.84." Further, in January 2006, when the LY reviewed the total annual budget, it resolved, by way of a legally binding resolution, that "Fuhwa's shares owned by the government and national banks should be disposed of by public sale and not by private negotiation of price or merger…." The problem was exacerbated by the fact that the executive branch appeared to have yielded to the pressure of some lawmakers and so far has not taken up a stance against such inappropriate interruption of the market mechanism.

Fortunately, after the extraordinary shareholders' meeting held on 8 September this year, Yuanta now holds a weighted majority control (two-thirds) of the Board of Directors. With such leverage, Yuanta will be able to get a resolution on the merger passed in the Board of Directors' meeting before putting it forth to the shareholders' meeting for final approval pursuant to the *Company Act*.[28] Thus, in light of such reshuffling of the board seats, the present impasse created by the LY in the Fuhwa-Yuanta merger case may be resolved in favor of Yuanta after all. However, if the LY were to remain skeptical and persist in their interference with the other merger cases, such interference to the market mechanism principle would only be harmful to the healthy development of Taiwan's financial market.

Thus, unless the LY and the executive branch recognize the fact that such matters are best determined by the market mechanism, it is hard to predict either the speed or the extent of the disposal of these state-owned shares which would subsequently slow down the financial reform in Taiwan.

Conclusions

In today's world of accelerating financial integration, the penalties for having a fragile financial system are severe and the time available for correcting structural weakness is limited.

Looking back, Taiwan has so far managed to construct the legal infrastructure for comprehensive financial reform through the promulgation of laws. Actions have also been taken to restore the competitive edge of the financial industry. Based on my long-time involvement in GATT/WTO law and serving as Taiwan's first Ambassador to the WTO, Taiwan's decision to carry out such reform measures prior to its membership at the WTO was indeed a step in the right direction. Notwithstanding, there is still more to be done.

In October 2004, President Chen publicly announced his goals for the financial reform, amongst which is the cutting of the current 14 financial holding companies down to 7. Such proclamation is good at the level of policy-making; however, in practice, it would be difficult to implement since mergers should take place based on the market mechanism.

As previously stated, financial consolidation has been a key goal of Taiwan's financial reform. During this process, active pursuit of privatization, in particular by the Ministry of Finance, will be critical. Although the Ministry of Finance has recently made certain proclamations and taken various steps that demonstrate both the right direction and inject a new momentum for the consolidation process; ultimately the attitude of the LY about the disposal of state-owned shares will once more determine the outcome of privatization. At this stage, while expressing our heartfelt praise of the Ministry of Finance for its recent proclamations privatizing state-owned shares in the banking sector, I remain with great expectations to its approach in getting the necessary approval from the LY for the disposal of state-owned shares.

Although foreign funds accounted for less than 4% of the total market trading value for stock market transactions in Taiwan during the financial crisis, today it has already risen to around 32%. Such upsurge is hard evidence that earlier government reform endeavors to rebuild Taiwan's financial market at par with its international counterparts are being acknowledged by and have won the confidence of the foreign investors. Although it is satisfying to see foreign investors choose Taiwan as one of their destinations for capital allocation, the government should continue the commendable work it has done so far to support the plan to turn Taiwan into the hub of asset management for the Asia-Pacific region.

To ensure long-term and proper functioning of the capital market, it is vital to promote the quality of corporate governance in companies. In particular, the quality of corporate governance of listed companies not only serves as a benchmark for foreign investors to determine the soundness of a company, but also safeguards the shareholders' interests. Taiwan's government deserves to be congratulated on its efforts to amend the *Securities Exchange Act* in December 2005, which directs listed companies to incorporate the system of independent directors[29] and set up independent auditors committees[30] within their organizational structure.[31] Nevertheless, the road of reform should not end just here.

The implementation of such systems is only a preliminary step, albeit a major one, to concretize the corporate governance philosophy. More importantly, an effective monitoring system should be established, since that would determine, in substance, whether a company has good corporate governance or not. At the same time, financial institutions should learn to be more open and voluntarily disclose information on, *inter alia*, corporate governance. With such a degree of transparency, the investors will in turn be more willing to place their trust and invest their capital into these companies.

To sum up, the success of these financial reforms will create a sounder environment for the financial industry and lay the cornerstone for Taiwan's economic development in the future.

Independent Directors, Supervisory Commissions and Beyond

ANDREW JEN-GUANG LIN

Introduction

Taiwan's recent regulatory reform was a response to a series of corporate scandals which happened in Taiwan, and was heavily influenced by the recent development of securities and corporate legislations in other countries, particularly the US Sarbanes-Oxley Act of 2002.[32] In the past couple of years, many corporate scandals have exploded in different securities markets. The notorious cases, such as Enron Corporation, WorldCom, Inc., and HealthSouth Corporation in the US; the Parmalat in Italy; Livedoor in Japan; and Procomp Informatics Ltd Corporation in Taiwan; have incurred huge losses to investors, seriously destroyed investors' confidence in the securities market, and consequently damaged opportunities of honest and sound enterprises to raise funds from the securities market. It is observed that these corporate scandals involve several types of misconduct. Among them, misrepresentation in the financial statements, release of overly optimistic financial forecasts, insider trading, misappropriation of corporate assets, self-dealing, etc. are the most frequently occurring wrongdoings. These misconducts share certain common characteristics, such as the breach of fiduciary duty to protect the interests of the corporation and shareholders; the abuse of managerial power or influence by the corporate insiders; and the pursuit of personal interests by those in control at the cost of the corporation, shareholders, and creditors. These issues of misconduct attracted the attention of Taiwanese securities regulators and as a result, the competent authorities quickly responded with the proposal to amend Taiwan's Securities and Exchange Act (hereinafter TSEA) to include several corporate governance requirements.

After one-and-a-half year's legislative process, the legislation regarding the amendment of the TSEA was passed by the Legislative Yuan in December 2005 and was subsequently signed into law on January 11, 2006 by the President.[33] The amendment includes a revolutionary regulatory reform on corporate governance, particularly focusing on the introduction of the independent directors and audit committees into the publicly held corporations. Beginning from January 2007, most publicly held corporations, especially listed companies and those prescribed by the orders of the Financial Supervisory Commission of the Executive Yuan (hereinafter the FSC), will be required to include independent directors on the board of directors and may also be required to establish an audit committee to replace the corporate supervisors that currently serve as the supervisory organ of all corporations.[34] This amendment will significantly affect the board structure, operating structure, and corporate governance of most publicly held corporations.

The purpose of the recent regulatory reform puts emphasis not only on the enhancement of corporate governance itself, but also on restoration of investors' confidence. To increase unnecessary or unreasonable burdens or costs to publicly held corporations is by no means the aim of the regulatory reform. Ideally, one of the major goals of the securities law amendment is to emphasize the importance of the corporate governance that will maximize the interests of investors and the efficiency of corporate management without incurring undue burden to the corporations.

The expertise and ability to manage the corporation are the fundamentals of successful management. From the shareholders' point of view, it is also critical to ensure that directors and officers will manage the corporation with due care and loyalty, in addition to their managerial expertise and ability. To enhance the monitoring and supervisory functions is so far one of the major viable mechanisms to solve this issue. Monitoring and supervisory functions can be performed by the internal organs of the corporation or by external mechanisms. Corporate supervisors, a supervisory board, or independent directors are the most common corporate organs that perform internal monitoring and supervisory functions. Examples of external monitoring mechanisms include the competent authorities, self-regulators, outside auditors, creditors, and the securities market. This paper will focus discussions on how an internal supervisory mechanism could effectively monitor the management to ensure that the corporation is managed with due care, loyalty, and good faith.

The goals of corporate governance are similar in different countries. However, the detailed rules and requirements vary in different jurisdictions. Most countries respond to the corporate scandals with tighter supervision which heavily burdens the directors and officicers with a higher level of liability. Moreover, regulatory reforms also focus on the independence of the board of directors or supervisory committees. The requirements may be implemented by the amendment of the securities laws, promulgation of regulations by the competent authority, or by SRO rules.[35] While Taiwan is following the same direction to enact laws and make rules to enhance the corporate governance, it is important and high time for us to evaluate the current legislation to see whether the current rules and mechanisms adopted are appropriate. Have we found any problems so far regarding the independence of the board, the board members, and the members of the supervisory committees? While Taiwan is adopting rules to enhance corporate governance for the purpose of investor protection and to restore investors' confidence in the securities market, will the measures adopted adversely and materially affect the management and operation of the corporation and incur heavy and undue burdens to the corporation? The improvement of investor protection and the facilitation of a friendly

ANDREW JEN-GUANG LIN

operating and regulatory environment are equally important. To sum up, the critical issue is whether these measures adopted could indeed prevent or at least reduce the probability of corporate scandals and improve the efficiency of corporate management, or whether it only increases the burdens and cost to the corporation in complying with the new requirements?

In order to have a better understanding of the evolution of Taiwan's corporate governance system, to have a more meaningful discussion regarding the current status and future prospects, and to attract more valuable thoughts and opinions, this article will include the three major parts. Part II will first provide some historical background and the current state of Taiwan's new legislation regarding independent directors and audit committees. Several issues will be included in the discussion, such as the qualification of independent directors and members of the audit committee; the composition of the board of directors and the audit committee; roles, missions, and duties of independent directors, audit committees, and other functional committees; and personal liability and disclosure requirements. Part III provides opportunities for comparisons with Taiwan's neighboring or comparable countries or jurisdictions, such as Hong Kong, Korea, and Singapore regarding the independence of the board of directors. It is hoped that through comparison, we will be able to see more clearly how good corporate governance benefits business and is in the best interests of investors. In Part IV, the paper identifies issues and questions surrounding our main theme—how to make the board more independent in oreder to perform good governance.

Corporate Governance Reform in Taiwan—

State of Law Regarding Composition of the Board, Independent Directors, and Supervisory Committees

At the end of 2005, the Legislative Yuan completed the three-reading procedure for the TSEA amendment that is considered a major regulatory reform on corporate governance of publicly held corporations. Because of a series of corporate scandals in Taiwan, as well as in other parts of the world, Taiwan awoke to the importance of corporate governance. Although listed companies have been required to appoint independent directors, it has been at the level of self-regulation. The US Sarbine-Oxley Act of 2002 heavily influenced a major part of the TSEA amendment in January 2006 regarding corporate governance. It is the first time that independent directors and audit committees are introduced into the law.

A couple of years ago, Taiwan began to engage in the regulatory reform of the corporate governance system. Several mechanisms have been implemented or enhanced since then. Among the most notable reforms are the introduction of independent directors into listed companies by the Taiwan Stock Exchange (TSE) and GreTai Securities Market (GTSM), and the enhancement of the internal audit system of publicly held corporations. The securities regulator took further steps to draft a bill to amend the Securities and Exchange Act (TSEA) and the bill, with some modification, has gone through the three-reading legislative process and became law on January 11, 2006. Among the amended provisions, those regarding independent directors and audit committees will come into force on January 1, 2007. It is crucial to discuss whether it is on the right track to introduce the independent directors into the securities regulation or corporate law. What is wrong with the current corporate structure? Is the introduction of independent directors aiming to strengthen the monitoring function of corporate supervisors or to strengthen the managerial and decision-making power of the board of directors? If that is inevitable to introduce independent directors onto the boards of Taiwan's corporations, what else must be included into the package besides the requirement to appoint independent directors?

Background for Introducing Independent Directors into Taiwan's Corporation

Since 1998, the Securities and Futures Commission (TSFC), the competent authority at that time, has begun to advocate the importance of corporate governance on publicly held corporations. Among many mechanisms to improve the corporate governance system, two important measures are the requirements to set up internal audit program and to reform the monitoring function of corporate supervisors. These two mechanisms share a common characteristic, i.e., the enhancement of the monitoring function. One function is via a corporate supervisor to monitor the board of directors and the management, and the other is via the establishment of the internal control and internal audit program to engage in self-monitoring and self-evaluation by the board and management.

Upon exposure of several corporate scandals involving fraud, misappropriation of corporate assets, and self-dealing by directors or officers of listed companies, the question of whether the corporate supervisors can effectively perform their duties to monitor the board of directors and management again becomes the focus of the regulatory policies. It is high time to evaluate the functions of the corporate supervisors. If corporate supervisors can function well, would the corporate scandals be prevented or at minimum would the probability of their occurrence be reduced? Moreover, would the new system that introduces independent directors and audit committees help publicly held corporations refrain from similar corporate scandals?

The Proposed and New Models for Enhancing Internal Monitoring Mechanisms

Corporate governance reform was initiated by the TSFC and co-sponsored by the TSE, GreTai Securities Market (GTSM), Securities and Futures Institute, and Corporate Governance Association. With the focus of attention on the corporate governance of publicly held corporations, the question of how to enhance the monitoring function of the board of directors and management to, at least, prevent self-dealing and fraudulent misconduct has been a central point of the corporate governance reform in Taiwan. Regarding internal monitoring mechanisms, four major forces interactively monitor the performance of the board of

directors and management. They are: 1) exercising shareholders' rights and votes at shareholders' meetings; 2) corporate supervisors; 3) self-evaluation via internal control and internal audit system; 4) independent directors and/or audit committee (currently applying to listed companies and will apply to all publicly held corporations as required by the competent authority from January 1, 2007). The following will discuss the evolution of the corporate governance reform.

In addition to the exercise of shareholders' rights and monitoring functions of corporate supervisors, the competent authority, as well as self-regulators, has made efforts to enhance the corporate governance system. From the initial stage of corporate governance reform which began in 2002, the monitring mechanism has included three major mechanisms. First, listed companies are required to appoint at least five directors.[36] Among them, at least two directors must be independent directors, and at least one independent director must be specialized in finance or accounting. Second, listed companies must have at minimum three supervisors.[37] Among them, at least one must be an independent supervisor and a specialist in finance or accounting. Third, publicly held corporations are required to set up an internal audit system. This is arranged by the board of directors and management to ensure that the company has complied with the law; that it has made full, timely, and adequate financial disclosures; and has taken necessary measures to maximize interest due to shareholders and other stakeholders[38]

In addition to the shareholders' rights and the internal audit systems that are provided or required by the TSEA and the Company Law, there are requirements that listed companies must have at least five directors and three supervisors, including independent directors and independent supervisors. These are imposed by the rules of the TSE and the GTSM. The initial efforts to introduce independent directors and independent supervisors are a good attempt to enhance the corporate governance system of listed companies. However, because these requirements are by their nature self-regulation, the question remains whether the independent directors role can function well without the accommodated amendments of the relevant provisions of the corporate and securities laws. As a result, a TSEA amendment bill (2004 Proposed Reform), proposed by the TSFB of the FSC in July, 2004 was adopted by the Executive Yuan and was sent to the Legislative Yuan. Unfortunately, the 2004 Proposed Reform requiring publicly held corporations to appoint independent directors and set up audit committees did not go through the legislative process and was aborted.

In April 2005, the TSFB of the FSC resubmitted a new TSEA amendment bill (2005 Proposed Reform) that was sent by the Executive Yuan and to the Legislative Yuan in July 2005. With some revisions to the 2005 Proposed Reform, the Legislative Yuan completed the three-reading process on December 20, 2005 and it took effect on January 11, 2006 by Presidential Order. It is valuable to examine the previously aborted *2004 Proposed Reform*, *2005 Proposed Reform*, and the adopted provisions of the new law regarding the independent directors and audit committees. On the one hand, it provides an indication of what is in the mind of the competent authority with regard to the design of the independent directors regime. On the other hand, the discussion also provides the responses to the proposed reform from the industries and legislators. Hopefully it would also provide valuable reference for the practitioners, scholars, and market participants to know the evolution of the corporate governance system in Taiwan and the possible influence on Taiwan's publicly held corporations and what the corporations shall do in the transition period.

The *2004 Proposed Reform* regarding independent directors and audit committees includes the following features:[39]

- The board of directors of a publicly held corporation must be composed of at least one quarter independent directors.[40]
- The Board of a publicly held corporation must be composed of at least five directors. The number of seats and the rule for the election of independent directors must be stated in the articles of incorporation.[41]
- The requirements of independence and expertise for independent directors.[42]
- Imposition of positive and negative qualifications for independent directors.[43]
- While independent directors are not majority members of the board, how they exercise their rights becomes critical because it will affect the role and function of independent directors. The proposed amendment requires that when the board of directors adopts an important resolution, it must also obtain majority votes of independent directors.[44] The proposed amendment also specifies the scope of matters that must follow this requirement.
- Currently, corporations must elect supervisors to monitor the board and management. The proposed amendment intends to eventually replace supervisors with an audit committee composed of purely independent directors. However, at the initial stage following the passage of the proposed amendment, publicly held corporations may elect to form an audit committee or stay with their current supervisors system.[45]
- The proposed amendment also specifies the scope of responsibilities of the audit committees.[46]

The following will specify major changes in the *2005 Proposed Reform* regarding independent directors and audit committees as compared with the previous *2004 Proposed Reform:*

- The board of directors of a publicly held corporation must be composed of at least two independent directors.[47]
- The 2005 proposed reform requires that when the board of directors adopts an important resolution, the minutes of the board meeting must record the opinions of the independent directors if they dissent or have any reservation about the proposed resolution.[48]
- The general rule is that a company has the right to decide whether to appoint independent direc-

tors and has the option either to keep corporate supervisors or adopt an audit committee. However, the competent authority may require a company to appoint independent directors and to adopt audit committee instead of corporate supervisors if the FSC deems necessary.

The recently amended TSEA has some differences on the following aspects:

First, it modifies the wording about whether to appoint independent directors. As a result, the TSEA grants publicly held corporations an option to decide whether to appoint independent directors to the board. However, the FSC is authorized to require certain corporations or certain categories of corporations to appoint independent directors. Second, Article 26-3 of the TSEA requires that the board must have at least five directors and Article 14-2 sets forth both a minimum number and a percentage of the independent directors. If the company is required to include independent directors on the board, the new law requires the board to have at least two independent directors that constitute not less than 20 percent of all board members. It is predictable and understandable that, with few exceptions, most corporations will structure the board to comprise minority independent directors. Third, both independent directors and the audit committee will not have the veto power on major corporate resolutions as listed on Articles 14-3 and 14-5 of the TSEA.[49]

Table 1: Comparison of Proposed Reform on Independent Directors and Audit Committees

	2004 Proposed Reform	2005 Proposed Reform	TSEA 2006
Whether to appoint independent directors?	Required unless exempted by the FSC.		Optional unless required by the FSC.
Number of independent directors	At least 25% of the board members.	At least 2.	At least 2 and not less than 20% of the board members.
Independent directors' power when there are supervisors	Important resolutions must obtain majority votes from independent directors.	Record independent directors' dissenting or reserved opinions.	
Whether to establish audit committee or maintain supervisors?	Corporation's Option but the FSC may require setting up audit committee.		
Composition of the audit committee	All independent directors (minimum of three and at least one specialized on finance or accounting).		
Audit committee's power	Important resolutions must obtain majority votes from all committee members.	Important resolutions must obtain super votes from all committee members. Disregarding disapproval of audit committee, the board may still adopt the resolution with super majority votes.	

Table by Andrew Lin

Short Comment

After several revisions to the originally proposed TSEA amendment (TSEA 2004) regarding the independent directors and audit committee, the current TSEA (TSEA 2006) has finally come up with provisions that are acceptable to both the Financial Supervisory Commission and the industry. However, it may be more appropriately described that these provisions are compromised, and that not many persons are actually satisfied with the provisions as a whole. Some of the standards or requirements set forth in the TSEA 2006 for the composition of the board and the establishment of an audit committee have been lowered or loosened from the originally proposed standards and requirements. The following discussion points out the important and distinct aspect of the newly amended TSEA.

First of all, whether a publicly held corporation must appoint independent directors onto the board and establish an audit committee depends on the overall evaluation and discretion of the competent authority. The TSEA empowers the competent authority to decide which companies must appoint independent directors and establish audit committees. Accordingly, the Financial Supervisory Commission has promulgated regulations regarding the appointment of independent directors and the duties of the audit committee.[50] The Financial Supervisory Commission has designated certain types of companies to appoint independent directors to the board. According to the FSC Order, beginning from January 2007, financial institutions and listed companies with more than NT$50 billion of paid-in capital will be required to appoint independent directors.[51] However, the FSC has not yet required companies to establish an audit

committee and leaves it to each individual company to decide whether it wants to establish an audit committee to replace the supervisors.

Secondly, under the newly amended TSEA, the corporate structure could either be a one-tier board system or maintain the traditional two-tier board system. Under the 2006 TSEA, a publicly held corporation can appoint independent directors to the board and maintain supervisors. This is the two-tier board system under which the managerial and supervisory powers belong to the board of directors and supervisors respectively. In addition, a publicly held corporation may also choose to appoint independent directors and establish an audit committee to replace supervisors, This is the one-tier board system under which the board of directors possesses the managerial power, and the audit committee is a functional committee of the board that exercises the supervisory power. It is perceived that the former setting maintains the traditional two-tier board system by adding independent directors to the board of directors, while the latter setting transforms the two-tier board system into the one-tier board system. The former setting has only slight changes and influences on the traditional corporate structure. On the other hand, the latter setting dramatically changes the traditional corporate structure, particularly the change of the supervisory organ and the way that the supervisory power is exercised.

Thirdly, with regard to the composition of the board, the 2006 TSEA requires that the board of a publicly held corporation be composed of at least five directors. If a company is designated to appoint or voluntarily appoints independent directors and maintains supervisors, the minimum number of independent directors is two and the number of independent directors must exceed one fifth of the board members.[52] If a company is designated to establish or voluntarily establishes an audit committee, it must appoint at least three independent directors because an audit committee must be composed of at least three independent directors, and of course, the total number of independent directors must exceed one fifth of the total board members.[53]

The 2006 TSEA has made the corporate structure of publicly held corporations more complicated than ever. However, we must appreciate the efforts of the competent authority in drafting the TSEA amendment bill and leading the regulatory reform. In addition to the rules regulating the corporate structure and the composition of the board, the success of the corporate governance depends on the willingness of the company to execute the program together with the coordination of many other regimes. For example, we need to pay attention to the legal liabilities of directors and managers in the case where the financial reports disclosed by the company contain materially misrepresented information. From the past court judgements, the courts have taken different views on the same issues. Part of the reason is that some of the language used in the old TSEA is ambiguous and leaves plenty of room for the courts to make different interpretations. Because of the lack of precedents, some of the courts refer to the authorities of other jurisdictions, such as the decisions of the US courts. Some courts do not look beyond the language of the TSEA and strictly abide by the wording of the provisions when interpreting and applying the provisions. This phenomenon indeed will impact the implementation of the corporate governance system. With respect to this issue, the 2006 TSEA has made some of the liability provisions more understandable than the language used in the old TSEA. However, the problems have not been solved yet. The 2006 TSEA creates a new problem while the old one still exists. The 2006 TSEA imposes strict liability on the chairperson and general manager if the financial reports disclosed by the company contain misrepresentation or omission of material information. This would seriously affect the willingness of a capable person as manager of the company. Whether the strict liability provisions indeed benefit all stakeholders need to be observed in the future. To be sure, the interpretation and application of such provisions by the courts and its impact on corporate management are important aspects to observe.

Comparison of Experiences from Other Jurisdictions

In the globalized world, Taiwan's companies are competing with both domestic, as well as foreign rivals. The Taiwanese government, too, is competing with neighboring nations to provide better investment and financial environments for Taiwan's enterprises and multinational enterprises. In addition, under severe regulatory competition in the region and internationally, the Taiwanese government must provide a better regulatory regime in order to attract enterprises to do business in Taiwan and to attract investors. Therefore, the competent authorities of the Company Act and Securities and Exchange Act are responsible for reform of the corporate and securities regulatory system to rebuild and reinforce domestic and foreign investors' confidence in the local securities market. This in turn will help publicly held corporations to finance from the securities market. Indeed, many factors, such as political stability, the cross-strait relationship and its development, and the occurrence of unsound corporate management will affect investors' confidence on making long-term investment in Taiwan's securities market. Among these factors, whether a company has a good corporate governance system will directly and significantly influence investors' investment intent and confidence. How to enhance corporate governance of publicly held corporations has become one of the most important tasks for corporations, competent authorities, and the legislative department. The following discussion in this section will examine and compare the corporate governance regimes in other competing jurisdictions, such as Hong Kong, South Korea (hereinafter Korea), and Singapore. Particularly, Hong Kong and Singapore have been recognized by institutional investors and multinational corporations as the financial centers in Asia. Special attentions of our discussion under this section will focus on the composition and independence requirements of the board and independent committee members, the missions and duties of the independent directors and independent committees, and the liabilities of independent directors or members of the independent committees.

Hong Kong

Recently, some Taiwanese corporations with business operations in the greater China area have chosen to make their initial public offerings (IPOs) or secondary listings in Hong Kong. Hong Kong's capital market is also attracting foreign issuers to list their shares in its stock exchange.[54] Obviously, how to secure their funding in a more convenient and cost-effective way, how to easily enter the securities market, and how much of a burden it is to comply with the legal requirements are some major concerns for well-managed enterprises to consider while looking for a suitable capital market.

Hong Kong's regulatory framework for the securities market is composed of the Securities and Futures Commission (HKSFC)[55], an independent statutory body; and the Stock Exchange of Hong Kong Limited (HKSE)[56], a self-regulatory organization. The Securities and Futures Ordinance (SFO) that consolidates ten previous ordinances regulating the securities market is the major piece of legislation that governs Hong Kong's securities market. Besides, subsidiary legislation promulgated by the HKSFC and rules of the HKSE are also very important. While many stock markets have been seriously injured by corporate scandals, the Hong Kong stock market too has suffered damages resulting from corporate scandals, though not as serious as what has happened in other markets in terms of the scale of corporate scandals.[57] These scandals have resulted in huge losses to many small investors and seriously destroyed investors' confidence on the stock market. Similar to other jurisdictions, Hong Kong has adopted regulatory reforms on the corporate governance system in several aspects. The following discussions will include the legal requirements regarding Hong Kong's corporate governance, particularly in regard to the independence of the board of directors and independent committees.

The Stock Exchange of Hong Kong Limited has promulgated the "Code on Corporate Governance Practices" (Corporate Governance Code) that provides general principles and guidelines on corporate governance policies.[58] The HKSE further implements the Corporate Governance Code in its Listing Rules.[59] Although listed companies are expected to comply with the Corporate Governance Code, the Code is not compulsory. Listed companies may choose to deviate from the provision of the Code. However, the board of directors of listed companies are required to prepare a Corporate Governance Report to be included in their annual reports to disclose whether they have complied with the Code or not.[60] The form and the mandatory disclosure requirements of the Corporate Governance Report are set forth in Appendix 23 of the Main Board Listing Rules.[61]

With regard to each major theme, such as the separation of the chairman and the chief executive officer, the content of the Corporate Governance Code is divided into three parts, including the principles, the code provisions, and the recommended practices.[62] It first set forth the general principle regarding the theme. For example, under the title of "Chairman and Chief Executive Officer," the principle that is clearly recognized is that the chairman is responsible for the management of the board and that the CEO is responsible for the daily operation of the company's business and that these powers should be clearly and appropriately separated.[63]

After the principle, it sets forth the "code provisions."[64] Listed companies are expected to comply with code provisions but are permitted to deviate from compliance.[65] If a listed company chooses to deviate from compliance, the board of directors is required to disclose each deviation, along with and the reasons, in the Corporate Governance Report. This then becomes part of the annual report. The listed company that chooses to deviate from the Corporate Governance Code must also disclose and discuss each deviation and provide rationale in the semi-annual report.[66] For example, the code provisions under "Chairman and Chief Executive Officer" stipulate that the chairman of the Board and the CEO should be separate and should not be performed by the same person. Ideally, a listed company must separate the chairman from the CEO. However, if one person performs both roles, the issuer must disclose any deviation from the code provision and provide the reasons for the deviation.[67]

After the code provisions, the next part contains "recommended practices."[68] It is the choice of a listed company either to follow the recommended practices or to create its own practices. Disclosure of deviation from the recommended practices is not required but it is recommended. For example, under "Chairman and Chief Executive Officer," it recommends that the chairman "should encourage all directors to make a full and active contribution to the board's affairs" and should hold meetings with non-executive directors at least once annually without the presence of the executive directors.[69] However, if a company does not follow these recommended practices, the company does not have the obligation to disclose such status. Of course, a company may voluntarily disclose such information.

The following discussions examine the corporate governance requirements of both Main Board Listing Rules and the Growth Enterprise Market (GEM) Listing Rules. Some rules or requirements applied to companies listed on the Main Board and the GEM are the same but some are different.

Independent Directors The requirements for the qualification and appointment of independent directors are principally governed by the Listing Rules of the HKSE and supplemented with the HKSE Corporate Governance Code. According to the principle set out in the HKSE Corporate Governance Code, there should be a "balanced composition" of the executive and non-executive directors in the board.[70] However, no specific ratio is stipulated in the Corporate Governance Code or in the Listing Rules. The Listing Rules only require that those companies intending to have their shares listed on the Main Board or the Growth Enterprise Market of the HKSE to appoint at least three "independent non-executive directors" to the board of directors.[71] Among all independent non-executive directors, at least one of them

must have sufficient professional qualifications or have expertise in accounting or financial management.[72] If the number of independent non-executive directors falls below the minimum requirement, the company should notify the HKSE promptly.[73] Beginning from September 30, 2004, all listed companies, including both newly listed and already listed, must comply with this requirement.[74]

According to the amendment of the HKSE Corporate Governance Code that took effect in July 2005 (partially took effect in January), it is recommended that a listed company's board of directors be composed of at least one third of independent non-executive directors. This is the recommended practice instead of code provision and therefore is not compulsory. A company is not required to have majority independent non-executive directors on the board. However, a listed issuer is required to disclose detailed information regarding the board composition in the Corporate Governance Report to be included in the annual report.[75] Specifically, the composition of the board (by category of directors), and name of the chairman, executive directors, non-executive directors, and independent non-executive directors must be disclosed in the Corporate Governance Report.[76]

The Listing Rules also set forth the qualification for the independent non-executive directors. Particularly regarding how to assess the independence of a director, the HKSE adopts similar approaches to other jurisdictions in evaluating whether a director is qualified as an independent director. The independent director in Hong Kong is called the "independent non-executive director."[77] By its name, the independent non-executive director is a non-executive director who satisfies the criteria of independence. In fact, the listing rules do not draw a clear picture or positive condition to illustrate the qualification of independence. Instead, it sets out a list of factors that disqualify a non-executive director from being an independent director. The following will list a number of important factors that help the issuer and the HKSE to assess whether a non-executive director is disqualified as an independent director:

Holding Too Many Shares (1% & 5% Tests) Although there has not been any agreement on the percentage of shares held which would preclude a non-executive director from being independent, most jurisdictions agree that the more shares a non-executive director holds, the more possibility to reduce the independence of a non-executive director when performing his duties.[78] In this aspect, the HKSE sets forth one percent and five percent as two thresholds when assessing the independence of a non-executive director. Generally, if a non-executive director holds more than one percent of the listed issuer's shares, his independence will be questioned.[79] However, the listed issuer may still appoint him as the independent non-executive director but must prove and satisfy the HKSE that he is independent.[80] In any event, the HKSE will not accept a person holding more than five percent of the outstanding shares as the independent non-executive director.[81]

Receiving Securities of the Listed Issuer or Other Benefits from a Connected Person or the Listed Issuer Apart from his regular or reasonable director compensation, a non-executive director will not be considered independent if he receives securities of the listed issuer as a gift or any form of financial assistance from the listed issuer or a connected person.[82]

Being a Director, Partner or Principal of a Professional Advisor who Provides Service to the Listed Issuer The independence of a non-executive director will be questioned if the director is also director, partner, or principal of a professional advisor that is currently providing or has in the preceding year provided services to the listed issuer, its parent or subsidiaries, controlling shareholder, CEO, their associates, or connected persons.[83]

Having Material Interest in the Principal Business of the Listed Issuer, Its Parent, Subsidiaries or Connected Persons If a non-executive director has material interest in the core business activities of the listed issuers, its parent or subsidiaries, or any connected persons, his independence will be questioned.[84] While a person has material personal interest involved, this basically will affect a person's ability to make independent judgements that are in the best interest of the company and all shareholders collectively. Therefore, if the director is involved in any material business dealings with the aforesaid persons, his independence will also be questioned.[85]

Being on the Board to Protect the Interest of Other Person Instead of the Shareholders If the purpose of a non-executive director on the board is to protect the interest of any entity whose interest is different from that of the shareholders collectively, his independence will be challenged.[86]

Having Close Tie with a Director, CEO, or a Major Shareholder If a non-executive director is or was connected with a director, the CEO, or a major shareholder of the listed issuer in the preceding two years prior to the appointment as an independent non-executive director, his independence will be challenged and will not be accepted by the HKSE as an independent director.[87]

Having Been an Executive or Non Independent Director of the Listed Issuer, Its Parent, Subsidiaries, or Connected Persons If the candidate of an independent non-executive director has, in the preceding two years prior to the appointment, been an executive officer, company secretary, or a non-independent director of the listed issuer, its parent, subsidiaries, or connected persons, he will not be eligible as an independent non-executive director.[88]

Financially Relying on the Listed Issuer, Its Parent, Subsidiaries, or Connected Persons If a director is financially relying on the listed issuer, its parent, subsidiaries, or connected persons, he will not be eligible as an independent non-executive director.[89]

If the any of the above factors exist, a non-executive director will not be eligible as an independent director because of the potential conflict of interest. In order to ensure that a non-executive director is qualified as an independent director, the HKSE emphasizes that the above stated factors are not exhaustive and are listed for the purpose of guidance only.[90] The independent non-executive director is required to submit a "written confirmation" to the HKSE with regard to each of the above factors to declare his independence upon the appointment and also submit this to the listed issuer on an annual basis.[91] The listed issuer must confirm the receipt of the written confirmation of the independence from the independent non-executive director in the Annual Report.[92] If there is any change of the status regarding the factors that would affect the independence of the independent non-executive director, that director has the obligation to notify the HKSE.[93]

Audit Committee Hong Kong's listed companies are required to set up an audit committee. The HKSE Listing Rules require the listed company to establish an audit committee composed of at least three members that are "non-executive directors."[94] Only non-executive directors are eligible to be members of the audit committee. However, those members of the audit committee are not necessarily "independent non-executive directors." It does require that at least one of the committee members is an independent non-executive director who must have sufficient (or adequate) professional quality or who has expertise in accounting or financial management.[95] In order to prevent potential conflict of interest and to enhance the independence of the member of the audit committee, the Corporate Governance Code prohibits the former partner of the listed issuer's current accounting firm that audits the listed issuer's financial statements from serving as the member of the audit committee for a period of one year after leaving the accounting firm.[96]

Unlike Taiwan, Hong Kong does not require that the audit committee be composed of only independent non-executive directors. However, it does require that the majority members of the audit committee be independent non-executive directors and that the chairperson must also be an independent non-executive director.[97] In comparison, *Article 14-4 of Taiwan's Securities and Exchange Act* imposes a higher standard requiring that the audit committee be composed of all and at least three independent directors. Beginning from September 30, 2004, all HKSE listed companies, including newly listed and already listed, must establish the audit committee.[98]

Responsibilities and Liabilities Currently, the requirements of listed companies to appoint independent non-executive directors and establish the audit committee are not based on the Companies Ordinance or the Securities and Futures Ordinance, but are based on the HKSE Listing Rules and the HKSE Corporate Governance Code. The Companies Ordinance and the Securities and Futures Ordinance do not have the term "independent director" or "audit committee." Therefore, the only place that possibly mentions the responsibilities is in the HKSE Listing Rules and the HKSE Corporate Governance Code. Non-executive directors are expected to participate in the board meetings and provide their independent judgment on all issues. The general principle states that all directors, including non-executive directors, shall have the same care and fiduciary duty.[99] However, the HKSE also points out that, when assessing whether a director has exercised his due care and fiduciary duty, the courts look into many factors, for instance, the functions, professional skill and knowledge, and whether he is a full-time executive director or part-time non-executive director.[100]

With regard to the liabilities of the independent director, we need to check on the legislation level, particularly the Companies Ordinance and the Securities and Futures Ordinance, to see whether there are provisions imposing liabilities on directors. For example, the liability for inclusion of untrue statements in the prospectus is imposed in the Companies Ordinance.[101] In addition, the Securities and Futures Ordinance imposes civil liability against anyone who fraudulently, recklessly, or negligently makes misrepresentation by which another is induced to enter into a securities transaction and incurs losses.[102]

Unlike Delaware law and Japanese law that allows a company to exempt the liability of its director by incorporating an exculpatory provision in the articles of incorporation or in a contract, Hong Kong's Companies Ordinance explicitly prohibits the company from exempting the director's liability or indemnifying the director who is intentionally, recklessly, or negligently liable to the company or its related company.[103] However, the Companies Ordinance permits the company to indemnify the director for the legal expense in defending the criminal or civil case against him if the judgment is eventually rendered in his favor.[104] Moreover, a company may also purchase liability insurance for its directors.[105]

Full-time Accountant and Compliance Officer There are two special requirements worth mentioning regarding Hong Kong's corporate governance system—one is that a listed company must employ a full-time qualified accountant. Secondly, the listed company must appoint a compliance officer. For the purpose of ensuring the quality of financial reporting, listed companies are required by the HKSE to employ a full-time "qualified accountant" to oversee the financial reporting procedure and internal control system, and to ensure that the company's financial reporting complies with the Listing Rules of the HKSE.[106] In terms of the appointment of the compliance officer, companies listed on the Growth Enterprise Market are required to designate an "executive director" as the compliance officer to ensure that the company has complied with relevant laws and regulations.[107] The compliance officer is also responsible for communication with the HKSE and for prompt response to KKSE inquiries.

Short Comment From the above discussion, it is perceived that Hong Kong's rules regarding corporate governance provide a relatively friendly and flexible regulatory regime. The competent authority basically considers the nature of the corporate governance regime as an ethical issue. Technical mandate and compliance are not equivalent to the success of the corporate governance.

Currently, the corporate governance issue is mainly handled by the HKSE through its listing rules. The rules reflect the importance of corporate governance. Listed companies are urged to establish independent committees. The rules focus on the independence of the committees but do not require that members of the independent committees be composed of all independent non-executive directors. The HKSE strongly urges listed companies to comply with the corporate governance requirements but supplements information with the disclosure requirement that asks companies to disclose the status and reasons of non-compliance. However, it is necessary to note that the HKSE is taking seriously the enforcement of the listing rules, but is cautious in determining whether to take disciplinary action.[108]

There have been opinions voiced that there should be stronger government intervention to elevate the corporate governance regime from the level of self-regulation to the level of administrative order or law in order to create a more effective and efficient corporate governance system. Hong Kong has in fact gradually enhanced its legislation to regulate corporate misconducts. In 2003, the Securities and Futures Ordinance was amended to impose new disclosure requirements and require listed companies to file disclosure documents to both the Stock Exchange of Hong Kong and the SFC.[109] However, it is necessary to note that the approach of self-regulation has to some extent worked smoothly in the past and has taken on an important role. For example, in addition to the Listing Rules and Corporate Governance Code, the Standing Committee on Company Law Reform of the Hong Kong Company Registry issued "Non-statutory Guidelines on Directors' Duties" that will help directors comply and for the court to determine whether directors have carried out their duties.[110] Additionally, the "Guidelines for Directors" and the "Guidelines for Independent Non-Executive Directors" issued by the Hong Kong Institute of Directors, are also important pieces of self-regulation. To be sure, in order to maintain the integrity of the securities market, noncompliance of securities and corporate law could incur civil and criminal liabilities.

Korea

Korea's capital market was seriously damaged during 1997 financial crisis. Some of the business conglomerates went bankrupt. In order to revive the economy and rebuild the securities market, Korea has engaged several regulatory reforms since then. To enhance the corporate governance system is one of the important parts of the regulatory reforms. Both the Commercial Act and the Securities and Exchange Act set forth requirements regarding outside directors and an audit committee.[111] Companies have to choose from supervisors or an audit committee as their internal supervisory organ.[112] However, listed companies, as prescribed by the Presidential Decree, shall establish an audit committee.[113] The audit committee shall consist of at least three directors and at least two thirds of its members must be outside directors.[114]

Independent Directors In Korea's Securities and Exchange Act (KSEA), the term "outside director" is used instead of "independent director." The term "outside director" first appears under Section 2 (19) of the KSEA. According to the definition, the outside director is a director "who does not engage in the regular business of the relevant company and is selected and appointed according to the procedure and requirements set forth under Article 54-5 or 191-16 of the KSEA.[115] In Korea, from the requirements regarding the qualification of an outside director, the term "outside director" is used to represent the similar meaning like "independent director" in Taiwan or in the United States or "independent non-executive director" in Hong Kong.

Under the Korean Commercial Act and the KSEA,[116] any person who falls into any of the following tests will not be eligible as an outside director, or will be disqualified:[117]

- A minor, an incapacitated person, or quasi-incapacitated person;
- A bankrupt person who has not been reinstated;
- A person who has been sentenced to imprisonment and has not elapsed for two years since he has served the full term of the sentence, or since the final judgment was rendered that the punishment on such person would not be executed;
- A person who was discharged or dismissed from a listed company and two years have not elapsed since the date of such discharge or dismissal;
- A person together with related persons hold the largest percentage of the outstanding voting stocks;
- A person who has special a relationship with the largest shareholder;
- A person together with his spouse and lineal ascendant and descendant own more than ten percent of the outstanding voting stocks;
- A person who is or worked as an officer or employee of the company or its affiliate in the preceding two years;
- A person who is the spouse or lineal ascendant or descendant of the officer;
- The officer or employee of a corporation that has an important business relationship, a competitive relationship, or a cooperative relationship with the concerned company in the preceding two years;
- A person who has difficulty in faithfully performing his duties as an outside director.

The KSEA also sets forth the procedural requirements for the nominations of candidates for outside directors. If a company is required to appoint outside directors, it must first establish a special committee titled "Outside Director Candidate Nominating Committee" (Nominating Committee) to recommend the candidates for outside directors.[118] The Nominating Committee is established by the board of directors according to the Commercial Act.[119] The list of outside director candidates recommended by the Nominating Committee shall include the candidates recommended by shareholders. This nomination process is in accordance with the shareholders' rights

to propose certain matters to be included in the agenda of the shareholders' meeting.[120]

It is necessary to note that according to Article 191-16 paragraph (1) of the KSEA, some of the listed companies are required to have a board of directors composed of at least one quarter of outside directors. When appointing outside directors, these companies must comply with the requirements set forth under the Articles 54-5 paragraph (4) of the KSEA for disqualification of outside directors as stated above and paragraph (5) for reporting requirements.[121] According to the proviso of the Article 191-16 paragraph (1), some of the listed companies may be required to appoint at least three outside directors to the board and more than fifty percent of the board members must be outside directors. When appointing outside directors, according to Article 54-5 paragraphs (2) and (3), these companies must establish the Nominating Committee and include the candidates recommended by shareholders.

Audit Committee In Korea, the Commercial Act sets forth the basic principle that a company may choose from supervisors or establish an audit committee as the monitoring organ. Traditionally, Korean company law adopts the two-tier board system, under which the supervisors act as the monitoring organ. The Commercial Act was amended to introduce the audit committee into Korean corporate structure. Accordingly, a company may specify in its articles of incorporation that it will either appoint supervisors or establish an audit committee to replace supervisors.[122] If a company decides to establish an audit committee, the committee shall have at least three members, and connected persons cannot exceed one third of the total committee members.[123] The Commercial Act does not require that at least two thirds of the committee members be outside directors. Moreover, according to the Commercial Act, it is the option of the company to decide whether it wants supervisors or an audit committee. In contrast, the Korean Securities and Exchange Act does require that listed companies having assets that reach a certain size, as prescribed by the Presidential Decree, must establish an audit committee.

The KSEA sets forth that securities companies and companies listed on the Korea Stock Exchange or registered with the Korea Securities Dealers Association (KSDA or KOSDAQ), as prescribed by the Presidential Decree, are required to establish an audit committee.[124] If a company is required to establish an audit committee, its composition must be at least two thirds outside directors.[125] Listed companies, including listed securities companies, must appoint an outside director as the representative of the audit committee.[126] In addition, the KSEA imposes an expert requirement to include at least one committee member who is a specialist in accounting or finance in order to ensure the function of the audit committee.[127] In order to avoid the situation where both executive directors and supervisors (auditors) or outside directors of the audit committee are controlled by the large shareholders, any shareholder who holds more than three percent of outstanding shares is prohibited from voting the shares in excess of three percent when electing the supervisors (auditors) or the outside directors who become the members of the audit committee.[128]

Responsibilities and Liabilities Korea's Commercial Act imposes fiduciary duty on all directors. Article 382-3 of the Commercial Act sets forth directors' duty of loyalty. It requires that directors faithfully perform their duties in compliance with relevant laws, subsidiary legislation, and the articles of incorporation, and for the benefit of the company. While in the position as director or upon retirement, directors have the duty to maintain insider company business information.[129] Similar to her neighboring nations, the Korean Commercial Act regulates and imposes sanctions on the conduct of directors concerning conflict of interest with the corporation.

Directors are responsible for the management of corporate affairs, particularly for important corporate affairs, such as disposal and transfer of important corporate assets, and appointment and dismissal of managers.[130] A director's liabilities may be liable to the company or to a third person. With regard to the director's liability to the company, directors will be held jointly and severally liable for the damages to the company if they violate any statutes, subsidiary legislation, or articles of incorporation, or do not exercise their duty of care.[131] If the wrongdoing is the product of a resolution of the board of directors, those who assented to the resolution will be held jointly and severally liable to the company as well.[132] A director can be excused only if he dissented from the resolution and his dissenting opinion is recorded in the minutes of the board meeting.[133] It is interesting to note that directors' liabilities to the company can be released with the consent of all shareholders.[134]

With regard to the director's liability to third persons, directors will be held jointly and severally liable for the damages to third persons if they intentionally or recklessly do not exercise their duty of care and cause damages to third persons.[135] Similarly, a director who assents to the resolution of the board that causes damages to third persons will be held jointly and severally liable with the directors who execute the resolution, and only those who dissented to the resolution and whose dissenting opinions have been recorded in the minutes of the board meeting can be exempt from liabilities.[136]

Short Comment Korea enhances the corporate governance program with the assistance and influence of the developed western countries, particularly influenced by the US model. However, Korea also takes into consideration the local corporate business culture when introducing independent directors and the audit committee into Korea's legal system. Similar to Taiwan's 2006 TSEA, Korean companies' traditional corporate structure belongs to the two-tier board structure where supervisors are considered as the supervisory organ. However, after the regulatory reform that introduces outsider directors and the audit committee into Korean corporations, the two-tier board and the one-tier board corporate structure coexist in Korean corporations. A Korean company must choose from either supervisors or the audit committee as the company's supervisory organ. However, listed companies are required to establish an audit committee to replace supervisors as the supervisory

organ. Comparatively, Taiwan has not yet required any company to establish an audit committee.

With regard to the composition of the board, some of the listed companies are required to appoint outside directors constituting at least one quarter of the total board members. Some of the larger listed companies are required to appoint three outside directors and the number of outside directors must exceed fifty percent of the board. These different requirements make the corporate structures more complicated and make it more difficult to discern the corporate structure of a company and the composition of its board if one is not provided with information regarding the capital size and other financial information. Comparatively, Taiwan's FSC has designated certain publicly held corporations to appoint directors. If a company is required to appoint independent directors, the minimum requirement is that such company must appoint only two independent directors, and the number of independent directors shall exceed only one fifth of the total board members.

If a company is required to establish an audit committee, the KSEA requires that at least two thirds of the committee members be outside directors and the chairperson must be an outside director. Comparatively, Taiwan requires that all members of the audit committee be independent directors.

Singapore

Singapore companies operate on a unitary board system. There is only one board of directors responsible for the daily business operations and business decisions. There is no requirement for appointing supervisors or establishing a supervisory board as the internal monitoring organ in Singapore companies. Instead, the Companies Act was recently amended to add Article 201B to require listed companies to establish an audit committee.[137] In addition, listed companies are required by the Securities and Futures Act to comply with rules of the Stock Exchange of Singapore. Some of the corporate governance matters are set forth in the Listing Manual of the Stock Exchange of Singapore. In addition, the Ministry of Finance issued the *Code of Corporate Governance 2005–Board Matters* on July 14, 2005.[138] A listed company will begin to comply with the Code beginning from January 1, 2007 when its annual general shareholders' meeting is held after that date.

Independent Directors In the Singapore Companies Act and the Securities and Futures Act, no relevant provisions directly govern the appointment of independent directors. However, Article 201B of the newly amended Companies Act precludes certain types of persons, such as executive directors of the company or any related corporation, from taking up the majority seats of the audit committee.[139] The rules governing the independent directors are found in the *Code of Corporate Governance 2005–Board Matters* promulgated by the Ministry of Finance. It provides principles and guidelines regarding the composition of the board, audit committee, independent directors, and the relationship between the board and the management. In the Code, it explicitly points out that the board must be independent from the management and should not be dominated by any individuals.[140] In Singapore, companies, particularly listed companies, shall have a board of directors that at least one third of it members are independent directors.[141] The chairperson of the board of directors and the chief executive officer should be different persons to ensure that the board can independently make business decisions and exercise its monitoring and supervisory power over the management.[142] The Code provides a list of non-exhaustive situations in which a director is not considered independent:[143]

- A director who is employed by the company or any of its related companies currently or in the preceding three financial years;
- A director who has an immediate family member who is or was in the previous three financial years employed by the company or any of its related companies as a senior executive officer whose remuneration is determined by the remuneration committee;
- A director or any of his immediate family members who accepts any compensation from the company or any of its subsidiaries other than compensation for serving as a board member for the current or past financial year;
- A director, or any of his immediate family members who is a major shareholder (with more than 5% shareholding) or an executive officer, or a director of any business organization to which the company or any of its subsidiaries made or received significant payments (aggregate exceeding S$200,000 over any financial year) in the current of preceding financial year.

Audit Committee According to the *Companies Act*, listed companies in Singapore must establish an audit committee by resolution of the board of directors.[144] The audit committee is composed of at least three or more directors, of whom the majority must be independent directors.[145] Moreover, the Companies Act requires that an executive director or employee of the company or any related company be prohibited from serving as the chairperson of the audit committee.[146]

The Code of Corporate Governance 2005 specifies that companies should establish formal and transparent procedures regarding the nominating and appointment of new directors into the board, the remuneration of executives, and the financial reporting. The Code of Corporate Governance provides similar requirements that all members of the audit committee must be non-executive directors, and the majority members and the chairperson of the audit committee must be independent directors.[147] The Code also requires companies to establish a nominating committee and a remuneration committee. The requirements for the composition of these two committees are the same as that of the audit committee.[148]

Responsibilities and Liabilities The Code of Corporate Governance specifies the scope of the duties of the audit committee. The major duties of the audit committee include:[149]

- To review the audit, the independence, objectivity, and relevant matters of the external auditors;

- To review significant financial reporting issues to ensure the integrity of the financial statements and other financial disclosure-related matters of the company;
- To review the company's internal control and internal audit functions;
- To recommend to the board of directors regarding the appointment and removal of the external auditor, and to approve the remuneration and terms of the appointment of the external auditor.

Short Comment Singapore's regulatory approach is relatively different in comparison with the regulatory approaches of Taiwan, Hong Kong and Korea. Most of the corporate governance matters, including the appointment of independent directors and the establishment of the audit committee are set forth in the Code of Corporate Governance and the rules of the Stock Exchange of Singapore. At the statutory level, the Companies Act does stipulate that certain types of persons shall not take up the majority seats of the audit committee. No other provisions stipulate the details regarding independent directors and the audit committee. However, the Securities and Futures Act requires that listed companies comply with the rules of the Stock Exchange of Singapore where the detailed rules of the corporate governance are found. It is more flexible to adopt this approach because the procedure to revise the rules of the stock exchange is much easier and faster than amending the statutes.

Issues and Questions

The 2006 Amendment of Taiwan's Securities and Exchange Act regarding independent directors and audit committee will take effect on January 1, 2007. Before that date, according to the current practice as required by the TSE and the GTSM, listed companies must appoint independent directors to sit on the board. However, several issues regarding the functions and responsibilities of independent director remain unsettled. These issues can roughly be divided into three major aspects.

The first aspect is regarding the role of independent directors in Taiwan's corporations—i.e., whether the independent director is acting as a monitoring organ to oversee the performance of the board of directors and the management, or as an managerial or executive organ to enhance the managerial function, or a hybrid one. Does the term "independent director" have the same meaning and substance in different jurisdictions? Do independent directors in different jurisdictions bear the same powers, duties and responsibilities? What do we expect from independent directors to perform and to enhance the corporate governance? All of these questions are relevant and need be considered carefully.

Before introducing a new regulatory program, it is appropriate to consider the following questions. First, when a country decides to introduce "independent directors" into its corporate structure, shall we begin with identifying the role and functions of the independent directors, and then determine the detailed rules of independent directors, or vise versa? In other words, if independent director means the same in different jurisdictions, could we or should we borrow the statutes regarding independent directors from other jurisdictions and then try to figure out what an independent director can do? Second, if the role of independent directors can be identified, how can they perform their responsibilities and carry out their functions? Does the law equip independent directors with adequate weapons to carry out their missions? Third, is it appropriate to allow companies to opt out of corporate supervisors and audit committees as the internal monitoring mechanism, or should the competent authority be empowered to designate those certain types of companies to establish an audit committee? If the audit committee replaces supervisors, how could independent directors play their role in the audit committee and in the board of directors to carry out the monitoring functions? Would independent directors do better than the supervisors?

The second aspect is regarding the establishment of the audit committee. Because supervisors have long been criticized as not being able to effectively perform the monitoring function, the audit committee became one of the topic choices of the competent authority as an alternative mechanism to rectify the problem in the recent securities law. Nevertheless, while introducing this new regulatory mechanism into Taiwan's corporations, it is necessary to take a moment to consider the following questions. The basic question is whether it is better for a company to establish an audit committee or to use supervisors as the monitoring mechanism. If the purpose of the securities law reform is to push publicly held corporations to adopt the new audit committee system as a replacement for the current supervisors system, there is a question whether the newly amended TSEA has provided adequate provisions to regulate and whether it has equipped the audit committee and/or its members, who must be independent directors, with adequate powers to carry out its missions. Under the 2006 TSEA, the competent authority is authorized to designate publicly held corporations to establish an audit committee if it is considered to be necessary and appropriate for the protection of the investing public. The question that follows will be what policies and attitudes of the competent authority are employed in implementing the newly amended TSEA regarding the audit committee. Moreover, it is relevant to consider whether independent directors fit in the unitary board system or are workable in the two-tier board system. Because the role of independent director was initially invented in US corporations where the unitary board system had been adopted, should we abandon the two-tier board corporate structure and adopt unitary board corporate structure, or could we put independent directors into our two-tier board corporate structure and make it work as it is in the unitary board system? While the 2006 TSEA allows independent directors to exist in both unitary and two-tier board corporate structures, are the independent directors in different corporate structures working in the same way?

The third aspect is regarding the liability of directors in case of breach of fiduciary duty or making false disclosure. Taiwan amended the Companies Act to add fiduciary duty on corporate directors in 2001. In addition, the TSEA was amended in January 2006 to add Section 20-1 that imposes civil liabilities on those

who prepare or contribute to fraudulent or misleading financial or business reports. Particularly, it is necessary to emphasize that the chairperson and the general manager will be held strictly liable for untrue disclosure. This new provision has been heatedly debated already. Moreover, because Taiwan has not officially adopted business judgment rule, it becomes important to consider the issue of whether the TSEA has imposed appropriate level of liabilities on directors. Is it appropriate to impose strict liability on the chairperson and general manager if the financial report disclosed by the issuer contains omission or misrepresentation of material information? Has the new legislation laid too heavy a burden on the chairperson of the board of directors and general managers? Besides the chairperson and the general manager, Section 20-1 of the TSEA sets forth that other directors are presumably liable for the untrue disclosure. Therefore, the following issue to consider is whether it is appropriate to presume that other directors are negligent and liable for the untrue or misleading statement. Additionally, it is also worth thinking about whether the liabilities of executive directors and independent directors should be differentiated because too heavy liabilities might in reality deter the willingness of capable and qualified people from serving as independent directors.

Before we jump into the discussion of the independent directors and audit committee, it is important to conduct a general analysis of why the corporation should establish internal supervisory mechanisms; and what are the appropriate internal supervisory mechanisms, what approaches or methodologies have been adopted by Taiwan's legislation, and how do they work in practice? Have the courts consistently interpreted and applied the provisions of the TSEA in assessing the liability of directors and supervisors if there involves untrue corporate disclosures?

General Analysis of the Internal Supervisory Mechanisms—Solving the Agency Problems

It has been widely discussed and recognized that corporate governance is important to protect and maximize the best interests of the company and all shareholders. Most shareholders, especially those of publicly held corporations, who contribute their funds into the corporation's capital, expect that the management will perform well and generate enough revenue so that they can share the profits of the company after the close of each accounting year. After appointing directors, most business decision-making and managerial powers are delegated to the board of directors.[150] The board is also authorized to procure managers to manage the corporate affairs, including business and financial matters.[151] Shareholders, whether or not participating in the corporate management, have limited rights reserved by the laws and the articles of incorporation to approve material business decisions, such as mergers and acquisitions, in the shareholders' meeting.[152] Because most shareholders do not participate in corporate management, issues arising from agency phenomena, such as whether directors and the management will make business decisions that are in the best interests of most shareholders, and how to prevent directors from engaging in self-dealings and in conflict-of-interest activities, are critical and important for the protection of shareholders and could also affect the intention of investors to invest.

Because shareholders are not themselves capable of supervising directors and management effectively on a continuing basis regarding the daily operation, it becomes necessary and important to design an effective and efficient supervisory and monitoring mechanism.[153] Depending on whether the supervisory and monitoring mechanisms are performed by organs within the corporate structure or by institutions or forces outside the corporation, these mechanisms can roughly be divided into two categories: the internal and the external supervisory mechanisms. Internal organs, including the shareholders' meeting, supervisors, audit committees, and internal controls and internal audit system, play various degrees of supervisory and monitoring functions. In terms of external supervisory mechanisms, the competent authority, self-regulators, accountants, lawyers, creditors, and the securities market also perform various degrees of supervisory and monitoring functions.

Among those supervisory mechanisms, comparatively speaking, internal supervisory mechanisms, particularly supervisors, an audit committee, and internal control and audit systems are better situated to closely, continuously, and effectively supervise and monitor the management if these mechanisms are properly designed and implemented. Internal controls and internal audit system is a mechanism adopted by the board of directors and the management themselves for self-discipline and self-evaluation.[154] Whether an internal control system is a successful supervisory mechanism partially depends on whether the management is willing to enforce the system in good faith, and partially depends on how much other internal mechanisms and external forces can effectively watch it. If the internal control and internal audit program is designed by the board and the management for the mere purpose of complying with the requirements but is not implemented seriously by the board and the management, the effectiveness of this program is in doubt.[155] Since an internal control system is also governed by the law and subsidiary legislation or the SRO rules,[156] if in the event that the internal control system is evaluated by independent outside auditors, it is hoped that the effectiveness of the internal control system can be elevated by the auditing and evaluation process performed by the outside auditors. In addition, the requirement that a company must appoint a compliance officer who is responsible to report the potential wrongdoing and communicate with the competent authority and self-regulators can also better the effectiveness of the internal control system.[157] However, because internal control heavily relies on the willingness of the board and management to implement the program, the nature and functions of the internal control system are better classified as self-discipline or self-evaluation.

The other two internal supervisory mechanisms, i.e., the supervisors and the audit committee, are the most important internal supervisory mechanisms adopted in most jurisdictions. Supervisors or the board of supervisors have been the official internal supervisory

mechanism in Taiwan, Korea, Japan, and most European countries. In contrast, the audit committee under the unitary board system is mainly used by the US companies. However, many countries that formerly adopted supervisors as the corporation's internal supervisory mechanism have recently introduced independent directors and an audit committee as a result of the corporate governance reforms which are heavily influenced by the US and the OECD models of corporate governance.[158] Whether or not it is a correct movement, it is observed that in many countries the corporate internal supervisory mechanism, especially those of publicly held corporations, is moving toward using the unitary board of director system and an audit committee to replace supervisors, or adding independent directors to the existing two-tier board corporate structure.

In the studied countries, supervisors and audit committees are structured in the following combinations:

MODEL I: **Independent Board of Directors and Independent Audit Committee** Under this model, the board of directors plays partly as a managing organ and partly as a monitoring organ of the management. The board is considered as a managing organ because business decision power is delegated to the board. Unless the law or the articles of incorporation clearly reserve the corporate affairs to be decided by the shareholders' meeting, the board has the power to make business decisions by resolutions made at a meeting of the board. On the other hand, because of the complexity and heavy load of business operations, the board rarely will manage everything by itself and frequently will delegate the managerial power to the management. The board, composed of a majority of independent directors, will then act as a monitoring organ to supervise the management. Part of the board functions, such as auditing, nominating, and remuneration, are delegated to the independent committees under the board. It is emphasized that, under this model, the board and the subcommittees are independent and separated from the management. Under this model, the focus is on the separation of the board and the management. Some countries further require that the chairperson of the board and the independent committee is made up of independent directors or at least that they are different from the CEO or the general manager.

After the enaction of the SOA 2002, companies listed on the NYSE or the NASDAQ are required to have a board of directors composed of a majority of independent directors to ensure the independence of the board.[159] In addition, listed companies are required to set up an audit committee composed of at least three independent directors. Similarly, in Korea, if the size of the assets of a securities company is above a certain amount as prescribed by the Presidential Decree, it is required to have an independent board composed of a majority of outside directors, and an independent audit committee composed of at least two thirds outside directors.[160]

MODEL II: **Board of Directors and Independent Audit Committee** Under this model, the board may or may not be an independent board. Usually the board is not an independent board because the law requires only the minimum numbers or a minority percentage of independent directors to be included on the board. However, the audit committee is required to be composed of either all independent directors or a majority of independent directors to ensure its independence. Therefore, under this model, the board normally dominated by a majority of executive directors is considered as the managing organ, while the independent audit committee is considered as the monitoring organ. It will then be critical to watch the relationship and responsibilities of both the audit committee and the board.

Beginning from January 2007, if a publicly held corporation in Taiwan chooses or is designated by the Financial Supervisory Commission to set up an audit committee to replace supervisors, the company usually will be a board with minority independent directors because the TSEA requires the board be composed of at least 20 percent of independent directors and, in past experiences, companies normally comply with only the minimum requirements. However, the audit committee is required to be composed of all or at least three independent directors.[161] Therefore, unless the company voluntarily appoints majority independent directors to the board, it will have a board with minority independent directors and an independent audit committee.

In Korea, if a listed or OTC registered company as prescribed by the Presidential Decree is required to appoint outside directors and establish an audit committee, the KSEA requires that the board be composed of at least one quarter (not majority) of outside directors, but some are required to have an independent board composed of majority outside directors.[162] However, the audit committee must be composed of a super majority (at least two thirds) outside directors.[163]

MODEL III: **Supervisors and Independent Directors** Under this model, supervisors are officially playing the role of a monitoring organ. Independent directors are introduced onto the board to enhance the board's monitoring function over the management's business decisions. Because the board is still composed of or controlled by the majority executive directors, the board is still considered as the managing organ. Whether independent directors can perform the minimum monitoring function depends on how much power is delegated by the law or the articles of incorporation.

A publicly held corporation in Taiwan, if not required by the FSC, may choose to maintain supervisors and appoint independent directors to the board. Under this setting, supervisors are still the responsible organ to supervise the board and the management. Independent directors do not hold themselves as the supervisory organ but are introduced onto the board to provide their independent and professional opinions to improve the quality of business decisions.

MODEL IV: **Supervisors Only** Under this model, supervisors are the delegated supervisory and monitoring functions. Because there is no requirement for appointing independent directors, the board of directors are normally composed of or dominated by the executive directors. There is no distinct separation between the board and the management. The function of the board is in reality a managing organ and, in

many cases, considered a formality or the rubber stamp of the management's business decisions.

In Taiwan, according to the newly amended TSEA, if a publicly held corporation is not designated by the FSC to appoint independent directors and to establish an audit committee, such company may maintain supervisors to perform the supervisory functions. Currently, because all listed companies are required to appoint at least two independent directors, only non-listed companies may have this option.

The Role of Independent Directors in Taiwan's Corporations

What is the role of independent directors in Taiwan? To set aside the personal preference, the answer to this issue is that independent directors, coupled with the audit committee, might eventually take over the monitoring function of corporate supervisors. From the introduction of independent directors into Taiwan's listed companies and the evolution of the regulatory policies (including the 2004, 2005 Proposed Reform, and the 2006 Amendment), the role of independent directors was initially aiming to enhance the quality of the business decision process of the board of directors. It has been geared toward the monitoring agency and will eventually replace the role of corporate supervisors. This conclusion is derived from the observation of the "Corporate Governance Best-Practice Principles for TSE/GTSM Listed Companies" (Corporate Governance Code) announced by the TSE and the GTSM.[164] In the Corporate Governance Code, it encourages listed companies to set up an audit committee whose membership must have at least one independent director.[165] When the board of directors deliberates on the internal control system, proposals of acquisition or disposition of assets, lending, making endorsements, providing guarantees, and other material business decisions, the board should take serious and sufficient consideration of the opinion of the audit committee or that of the independent directors.[166] In addition to independent directors, listed companies must appoint independent supervisors. Therefore, if there is no duplication of monitoring agencies, independent directors take a major role to enhance the functioning of the board of directors in the process of business decisions. However, this role has moved toward the role of a monitoring agency. In the *2004 Proposed Reform*, when the board of directors deliberates material business decisions, a majority vote of the independent directors is required. In addition, the audit committee composed of purely independent directors will replace corporate supervisors in the long run.

Independence Requirement for Independent Directors

Once the role of the independent directors becomes clear, it is then important to examine whether independent directors can perform their responsibilities and carry out their functions under the provisions of the 2006 Amendment. In order to carry out the monitoring function, it is pivotal to structure the framework well. For example, it is important to ensure the independence and expertise of independent directors. In addition, the number of independent directors must exceed a certain percentage of the board members so that they can effectively monitor the management. Additionally, if a portion of the board's responsibilities is delegated to functional committees, such as audit committees, compensation committees, nomination committees, and legal compliance committees, how independent directors play their role in these committees is crucial as to whether the management can effectively be monitored.

Similar to the corporate governance regime in other jurisdictions, Taiwan's securities law requires that an independent director comply with the requirements of "independence" and have relevant expertise, such as finance or accounting. Currently, as part of the listing requirements, the TSE and the GTSM have promulgated standards for determining whether a director should be disqualified as an independent director. A director will not be considered as independent if any of the following circumstances (incomplete list) occur:[167]

1) If a director is also an employee of the applicant company or a director, supervisor, or employee of an affiliated enterprise of the applicant company. However, it is exceptionally permitted if the independent director of its parent company or subsidiary holds the independent director position of the applicant company concurrently.
2) If a director directly or indirectly holds 1% or more of the outstanding shares of the applicant company, or whose shareholding ranks among the top ten of the natural persons holding shares of the applicant company.
3) If a director is the spouse or has a direct relationship within the second degree of kinship of any of the persons mentioned in the preceding two sub-paragraphs.
4) If a director is in the meantime a director, supervisor, or employee of an institution that directly holds 5% or more of the applicant company's outstanding shares, or of an institution where a director's shareholding ranks in the top five of the institutional shareholders.
5) If a director is in the meantime a director, supervisor, manager, or shareholder holding 5% or more of the outstanding shares of another company or institution that has a financial or business relationship with the applicant company.
6) If a director is in the meantime a professional, or an owner, partner, director, supervisor, or manager of a business entity that provides financial, business, legal, or consulting services to the applicant company or its affiliated enterprise.
7) If a director serves concurrently as the independent director of more than five enterprises.

Moreover, the stock exchange rules further require that in order to qualify as an independent director, one must have had previous business, legal, financial, or relevant experiences that the company needs for at least five years.[168] The board in the aggregate

will not be considered independent if the majority board members are mutually related as the lineal relation of the first degree, or more than two thirds of the board members are mutually related in any of the following relationships: (1) spouse, (2) lineal relations within the second degree of kinship, (3) collateral relations within the third degree of kinship, (4) representatives of the same juristic person, (5) related person.[169]

In September 2003, the Securities and Futures Commission (now the Securities and Futures Bureau of the Financial Supervisory Commission (TFSC)) promulgated an order regarding the standard of independence of directors and reiterated the importance of complying with the standards of independence for independent directors for 100 percent owned subsidiary of a financial holding company, which is similar with the aforementioned standards.[170] By January 2007, the TFSC, with the authorization of Article 14-2 of the TSEA, will reissue another order regarding the standard of independence of independent directors to deal with the issue of how to determine that a director has met the standard of independence and is qualified as an independent director.

Accordingly, in order to implement the corporate governance policy, Taiwan's Financial Supervisory Commission has promulgated three important regulations on March 28, 2006. They are: (1) Regulation Governing the Appointments of Independent Directors and Related Matters by Publicly Held Corporations, (2) Regulation Governing the Exercise of Duties of Audit Committee of Publicly Held Corporations, and (3) Regulation Governing the Meetings of the Board of Directors of Publicly Held Corporations.[171] These regulations will take effect beginning from January 1, 2007. However, regarding the appointment of independent directors and the establishment of an audit committee, it is permitted that companies need not comply with the requirements until the current terms of office of directors and supervisors expires.[172]

The newly adopted "Regulation Governing the Appointments of Independent Directors and Related Matters by Publicly Held Corporations" incorporated the independence standards of its previously announced "Rules Regarding the Independence of the Independent Directors and Independent Supervisors" with some modifications, among them some standards were raised and some were liberalized.[173]

In addition, there are at least three important factors related to the issue of independence of directors. The first factor is the deficiency of candidates for the position of independent directors that meet the requirements of independence and expertise. The second factor is that although a candidate meets the independence requirements, he or she usually has some connection or friendship with the board members or the management. The third factor is that it is unclear whether there will be distinctions regarding the liabilities of independent directors and other directors. It would also affect the willingness of people to serve as an independent director. These three factors obviously affect the effectiveness of the independent director system.

The independence of supervisors or independent directors has always been challenged because of the process and the method of election. Large shareholders are normally influential on the election of both directors and supervisors (or independent directors) and dominate both directors and supervisors. This phenomenon has been criticized as the determinant for the flaw of the internal monitoring mechanism because under such circumstances, supervisors could not effectively supervise or monitor the board and the management. Korea has adopted a method which is trying to improve the situation by restricting the voting power of large shareholders. According to the Article 409 of the Commercial Act, any shareholder who holds more than three percent of the outstanding shares will be prohibited from voting for those shares above three percent when electing the supervisors (auditors) or the outside directors who become the members of the audit committee.[174] This can be a possible solution.

Composition of the Board of Directors and Audit Committee

If the independent director is to play the role of monitoring the management, the question of whether the board of directors should be composed of majority independent directors is debatable. The US Congress enacted Sarbanes-Oxley Act of 2002, in which one of the focuses is to ensure the independence of the audit committees and the board of directors.[175] The US Securities and Exchange Commission accordingly promulgated Rule 10A-3 of the Securities Exchange Act of 1934 in which it imposes requirements on audit committees and prohibits companies from being listed if they do not meet the audit committee requirements.[176] According to the listing standards and corporate governance rules of the New York Stock Exchange and the NASDAQ, the board of directors of listed companies must be composed of a majority of independent directors.[177]

Unlike the US requirements, the 2006 TSEA Amendment requires that the board be composed of at least one fifth (or 20%) of independent directors. Although this is the minimum requirement and companies may choose to have a higher percentage of independent directors, past experience tells us that companies usually would meet just the minimum standards. If the company maintains supervisors for resolutions of important proposals as listed in Article 14-3 of the TSEA instead of setting up an audit committee, these proposals must obtain majority votes or super majority votes from the board of directors. The current regulatory philosophy is to ask the company to record the dissenting votes or any reserved opinions of independent directors in the minutes of the board meeting once the board adopts the resolution. Such information must also be disclosed to the public. Therefore, though independent directors are not the majority of the board, it is hoped that independent directors could have some positive influence on the decision process of the board, particularly on important business decisions.

If the company chooses to set up an audit committee to replace supervisors for important proposals as

listed on Article 14-5 of the TSEA, it must first obtain approval from a majority members of the audit committee membership which is composed of all independent directors. However, even though the audit committee disapproves the proposal, the Board can still adopt the resolution if more than 2/3 of the Board members approve it. Similarly, the company must record the audit committee's disapproval in the minutes of the Board meeting and disclose it to the public. The 2006 Amendment reflects the reluctance of publicly held corporations to the new system during the legislative process and with the result being a compromise that produces minimum influence on the business management of publicly held corporations. Of course, this important compromise is the source of considerable criticism.

Future Trend of Taiwan's Corporate Board Structure

The current corporate structure is divided into three organs: the shareholders' meeting, the board of directors, and the supervisors. In order to enhance the internal corporate supervisory function, the independent director regime has become a focus of corporate governance and securities law reform. Three possible models of corporate board structure might evolve or coexist once these provisions take effect on January 2007:

1) Corporations Maintaining the Current Structure—Two-Tier Board

   Publicly held corporations, if not designated by the TFSC to appoint independent directors and/or establish an audit committee, may maintain the current corporate structure, i.e., a board of directors as the managing organ and supervisors as the supervisory organ.

2) Co-existence of Supervisors and Independent Directors—Two-Tier Board Adding Independent Directors

   If a publicly held corporation is designated to appoint independent directors but not required to establish an audit committee, such company may elect to maintain the corporate supervisors. Under this model, corporate supervisors play the monitoring function, while independent directors are appointed to enhance the Board's role in the quality of business decisions and the monitoring functions over management. The independent directors under this model are treated as directors only and do not have the supervisory powers enjoyed by the supervisors.[178]

3) Employment of Independent Directors and Audit Committees to Replace Supervisors—Transforming into Unitary Board Structure

   If a publicly held corporation is designated by the FSC to establish an audit committee, no supervisors can be appointed. Under this model, the audit committee and its members exercise the supervisory power that was formerly exercised by supervisors.[179]

The Roles of External Auditors and Legal Counsels on Corporate Governance

Relationship between the audit committee and the external auditors Misrepresentation in the financial statements has been the focus of corporate scandals. The regulatory reforms in Taiwan, Hong Kong, Singapore, Korea, and the US have put the emphasis on the audit committee and public accountants to oversee the financial disclosures. The issue then becomes the definition of the relationship between the audit committee and the external auditors. In addition to the appointment, dismissal, reappointment, and the remuneration of external auditors, what else do we expect the audit committee to do regarding the supervision of the financial reporting procedure and internal controls?

Will attorney-client privileges be deprived when representing a corporate client before the regulators?—Conflicts between the protection of confidentiality and investing public Special attention has been brought to the professional responsibility of the accountants and accounting firms. The accountants have been expected by the investing public and required by law to be independent auditors who fulfill the auditing work in a manner complying with the Generally Accepted Auditing Standards (GAAS). It is expected that outside auditors will not only provide a more professional view on the corporation's financial reports, but will also to expose irregular and illegal transactions or activities via the auditing of the corporation's financial reports and by overseeing its internal controls.

Likewise, in order to enhance the function of corporate governance, attention has also focused on the role of the legal profession and its accountability for the reporting functons. It is hoped that lawyers will play an important role in enhancing corporate governance, particularly to require lawyers to report the wrongdoings of their corporate clients. This regulatory approach actually creates conflicts between a lawyer's professional responsibility to protect his client by maintaining confidentiality of information obtained from the conversation between he and his client, and the lawyer's new duties to report the wrongdoings of his corporate clients.

In response to corporate scandals like Enron, Section 307 of the Sarbanes-Oxley Act of 2002 (SOA) authorized the SEC to make rules to impose minimum standards for the legal profession when practicing before the SEC.[180] Particularly, the SEC is authorized to issue rules regarding the following contents: [181]

1) [R]equiring an attorney to report evidence of a material violation of securities law or breach of fiduciary duty or a similar violation by the company or any agent thereof, to the chief legal counsel or the chief executive officer of the company (or the equivalent thereof); and
2) [I]f the counsel or officer does not appropriately respond to the evidence (adopting, as necessary, appropriate remedial measures or sanctions with respect to the violation), requiring the attorney to report the evidence to the audit committee of the board of directors of the issuer or to another com-

mittee of the board of directors comprised solely of directors not employed directly or indirectly by the issuer, or to the board of directors.

Although this is not the first time that lawyers have been considered as a vehicle to implement corporate governance, it is the first time it has been enacted by the US Congress.[182]

The US SEC implemented Section 307 of the SOA by adopting a measure to require the lawyers of publicly held corporations to act in this scenario as the "whistleblowers" or more appropriately "gatekeepers" to disclose corporate misconduct.[183] The American Bar Association (ABA) has also adopted rules with the revision to the Model Rules of Professional Conduct (ABA Model Rules), requiring its members to comply with standards set by the SEC.[184] The ABA Model Rules were significantly revised in August 2003 resulting from the suggestion of the ABA's Commission on the Evaluation of the Rules of Professional Conduct in 2000 and the passage of the SOA in 2002.[185] The law firms and lawyers are required to establish the "reporting up" system to ensure that information regarding possible material violations will flow to the independent directors, and the "reporting out" duties to unveil outside the corporation when their corporate clients are involved in fraudulent financial disclosure or material violations.[186] It raises the issue on the conflicts of the lawyer's role as secret keeper to maintain the confidentiality of the conversation between the attorney and his client, and as a whistleblower to disclose fraudulent misconducts of his corporate client.[187] One possible reason for adopting these rules is grounded on the assumption that the client of the lawyers is the corporate entity, rather than the persons that manage the corporation. Therefore, to report up or report out is for the best interest of the corporate client and its shareholders.[188] Contrarily, some literature takes the view that Section 307 of the SOA inadequately influences the traditional self-regulating mechanism in the legal profession.[189] In comparison, Hong Kong takes a different approach regarding the regulation of the legal profession when representing corporate clients and practicing before the securities regulators. The scope of the duties of the lawyers (solicitors) is clarified by the memorandum of understanding negotiated by the Stock Exchange of Hong Kong and the Hong Kong Law Society.[190]

The issue of attorney-client privilege is not directly relevant to the issue of board independence. However, because law firms are competing with one another in obtaining clients, there are indeed potential conflicts on how to maintain a good relationship with their corporate clients and comply with the securities regulation. In Taiwan, unlike external auditors that must be appointed by the board meeting, there is no procedural requirement for obtaining external legal counsel. Therefore, an external counsel may be appointed without the approval of the board meeting or the audit committee. The following issues may be important for us to evaluate at this point:

1) Whether Taiwan should enact laws or make rules to regulate the legal profession similar to Section 307 of the SOA and Rule Part 205 promulgated by the US SEC, or adopt the Hong Kong model to work out the scope of duties of lawyers by self-regulators.
2) Whether we should impose requirements on the appointment procedure that external counsel shall be appointed by the board of directors or by the audit committee. Article 14-5 of the TSEA requires that the appointments, dismissals, and remunerations of external auditors must obtain a majority vote from the members of the audit committee. However, if the audit committee does not approve the proposal, because independent directors normally constitute only a minority of the board, the board may still approve the proposal by supermajority vote. Is this an acceptable regulatory approach?[191] Should the law just require that the audit committee, composed of purely independent directors, decide certain matters? Because independent directors are a minority of the board, it may be argued that corporate affairs must be determined by a majority vote and therefore, corporate affairs should not be decided only by the audit committee. We must respect the audit committee's decision. However, by allowing the board to overide the audit committee's objections with a supermajoity vote, if the voting is transparent,[192] there is an opportunity for the company to move forward because the audit committee could be wrong or things can be handled differently. Then two more questions arise. One is whether we are increasing the ratio of independent directors on the board and the other is if the audit committee's decision is not conclusive.

What Should Be Regulated and What Should Not?—Autonomy v. Regulation

Issues regarding the independent directors

Please take a second to consider whether the following standards should be compulsory or only a suggested code of conduct for independent directors and members of the supervisory commissions. In other words, what should be required by laws, regulations, and rules; and what should be the autonomy of the company?

- Will there be minimum requirement for how much time to spend on the directorate job?[193]
- What shall be the appropriate relationship between the audit committee and the external auditors?
- *Nominating Process:* What shall be the appropriate procedure for the appointments, compensations, evaluations, dismissals, and replacements of independent directors? How does a person become a candidate as an independent director? Who may recommend the candidate? Shall there be a nominating committee (N/C)? If so, who will be the members of the N/C? Can the N/C recommend members of the N/C to be the candidates? Any conflict of interests?
- *Switching from Supervisors to Independent Directors and audit committee:* Are independent directors really a better alternative for corporate governance? What do we expect from indepen-

dent directors? Will independent directors function better than supervisors? Are we choosing from the models of internal monitoring mechanisms or are we choosing from the title of the person?

How to ensure the independence of the board or supervisory committees? Although there might be disagreements on the scope of duties and how much power an independent committee should have, it is generally accepted that there must be an internal supervisory and monitoring mechanism where its members, equipped with powers and knowledge, are capable of making judgments and decisions independently. The issue of how to ensure the independence of the board and functional committees of the board has been recognized by regulators and scholars all over the world. Please consider the following issues regarding the independence of the board or supervisory committees.

Is a board or supervisory committee considered independent because the majority of its members are independent directors? On the other hand, if independent directors constitute only a minority of the board members, is such a board considerd to be indepenent or not? In other words, is the number of independent directors decisive on whether the board is independent or not? Or, is it possible that a board composed of a minority of independent directors can still be considered independent? Are independent directors complying with all the tests of independence to serve much better than executive directors? Are independent directors, if not working full-time, able to handle complicated corporate affairs? Would it still be possible that an independent director cannot make a truly independent judgement because of his friendship with the executive officers, or because of a lack of adequate knowledge? The law or regulation normally would allow independent directors or members of the supervisory committees to seek professional assistance at the cost of the company. Shall we go on to regulate the process of the appointments of outside counsels? Remember that we are afraid of any inappropriate connection between the management and external auditors so that we and our neighboring jurisdictions delegate such power to the audit committee. So, are we not afraid that there could evolve inappropriate connections between independent directors and the outside counsels? Or, have we deified the independent directors? If independent directors must rely on the professional opinions of outsidecounsel, are independent directors exercising their judgment independently or are they in reality influenced by outside counsels? All of the above questions are picky questions but potential risks might be hidden there?

It is important to note here that in many Asian countries such as those discussed in this article, many listed companies are family owned and are the controlling shareholders. How to effectively monitor the board and the management, and to regulate connected transactions to protect the best interest of all shareholders are both very important issues. What kind of regulatory regime and which corporate structure can effectively enhance corporate governance may not be the same in different jurisdictions. The competent authority, legislators, and the court will need to work together and take into consideration the experiences in other jurisdictions, the local legal system, and the business cultures in order to create a regulatory regime that is most suitable to individual countries.

Conclusion

Good corporate governance attracts good investments. There is no specific system or regulatory regime that is perfect. It is not that difficult to find deficiencies in a piece of legislation or a set of rules. If the problems are not fatal, they can be fixed later with amendments. The most critical issue is whether we are following the right trend and are moving in the right direction. The competent authority of the securities market together with the enterprises and scholars have devoted efforts to pursuing a better regulatory and investment environment to facilitate the efficiency and transparency of the securities market. On the one hand, it provides opportunities for enterprises to raise funds from the securities market. On the other hand, it focuses on corporate governance aimed at maximizing the best interests of shareholders and other stakeholders so that investors will choose to invest in the companies that have good corporate governance.

In Taiwan, securities regulators and scholars are reiterating the importance of corporate governance. After years of experiments (or experiences), both publicly traded corporations, as well as investors, have also realized the importance of good corporate governance. The regulation normally imposes the minimum requirements or standards to require compliance by the regulated parties. The difficulties are how to choose the right regulatory regimes and how to set the minimum requirements or standards that would, in practice, be implemented and enforced so that the legislative intent or purposes can be fulfilled. For example, should we adopt supervisors as the monitoring organ or an independent board or independent committees as the monitoring organ? Should the board be composed of a majority of independent directors? If the board is composed of a majority of independent directors, does it matter that the supervisory committees are composed of all independent directors or a majority of independent directors? If the board is not composed of a majority of independent directors, should the audit committee and other supervisory committees be composed of independent directors only?

The answers to these questions are not universal. Obviously, different regulatory models exist. Each has its own advantages and disadvantages. The regulatory reform of corporate governance is now in a process of regulation, deregulation, and re-regulation; and is trying to reach the status of equilibrium. Of course, there still is room for improvement. More importantly, it would be necessary to establish a platform to periodically review the regulations, practices, and rules by regulators, scholars, and publicly held corporations in order to produce a more balanced and effective regulatory regime.

The Market for Corporate Control in Taiwan

HSIN-TI CHANG

Introduction

The market for corporate control is considered to be an external monitoring mechanism of corporate governance. Scholars have long believed that the market for corporate control provides the assurance of competitive efficiency among corporate managers and thereby affords strong protection to the interests of vast numbers of small, non-controlling shareholders.[194] This paper will introduce and discuss the current status of the market for corporate control and the controversies surrounding the market for corporate control in Taiwan. This discussion will be focused on both the macro viewpoint of the whole legal system and the micro viewpoint of individual mechanisms, and will examine the merger, acquisition, proxy, tender offer, and sale of control.

The Problems with the Whole Legal System

From 2002 to 2005, the number of merger and acquisition (M&A) transactions was 288 and the total amounts involved reached NT$151.8 billion in Taiwan. Among these 288 transactions, 15 were transnational.[195] Another trend worth noting is that the government policy encourages integration—especially in the financial industry in Taiwan.

Although M&A transactions are active in Taiwan, there are some problems with the whole legal system. The most important of these is the coordination or unification among different laws. The Company Act is the basic rule governing change-of-control activities for all companies. To encourage M&A, Taiwan's government promulgated the Financial Institutes Merger Act in Dec. 2000, the Financial Holding Company Act in 2001, and the Enterprise Merger Act in 2002. However, there are some discrepancies among these three laws regarding the scope, the methods of M&A, and the legal consequences. Such discrepancies and overlapping rules increase the complications for M&A activities. Therefore, it is strongly suggested that the authorities should coordinate work among different government agencies or unify the provisions in the various laws.[196]

In addition, these three laws only apply to companies or even only to limited-by-share companies. A more comprehensive proposal would be to design a legal framework to facilitate M&A activities for all legal entities and non-profit corporations.[197]

Merger and Acquisition

The Current Laws

The major laws governing M&A activities are the Company Act and the Enterprise Merger Act. In addition to the traditional merger and consolidation, Article 316-2 of the Company Act promulgated the short-form merger in 2001. Article 18 of the Enterprise Merger Act created the asymmetric merger under which newly issued shares for a merger by the surviving company cannot exceed 20% of the total voting shares of the surviving company and the total cash or asset value given to shareholders of the dissolved company cannot exceed 2% of the net value of the surviving company.[198]

There are some disagreements about whether Article 22 of the Enterprise Merger Act has adopted the triangular merger type.[199] However, the triangular merger is practically feasible under the current laws. Also, share acquisitions and asset acquisitions are common in Taiwan. In particular, under Paragraph 1 of Article 185 of the Company Act, the act of transferring the whole or any essential part of its business or assets, or the act of accepting the transfer of another's whole business or assets, have great bearing on the business operation of the accepting company and are considered to be asset acquisitions.[200]

The Controversies and Proposed Solutions

The Appraisal Right In both M&A, the dissenting shareholders are entitled to appraisal remedies and the company is required to buy back the dissenters' shares at the prevailing fair price.[201] The problem of valuation in the appraisal remedies is the key point to the success of such a mechanism. What is the fair price? According to the current courts' opinions, the fair price for listed or OTC companies is the market price at the date of the shareholders' resolution. For non-listed or OTC companies, the fair price is the net value of assets or the estimated share price.[202] However, it is questionable whether the market price is the only proper standard since the market price at the date of the shareholders' meeting might be manipulated or may not reflect the real price due to the price variation limit in Taiwan stock market.[203] As for non-listed or OTC companies which have no market prices, other factors such as management performance and future development should also be considered in determining the fair price.[204]

In addition, there are some legislative suggestions concerning the procedures for exercising the appraisal rights. For example, to reduce the costs of litigation and the risks of the individual dissenter, the company should apply to a court for ruling on the fair price, not the individual dissenter.[205]

The Protection of Creditors After having resolved to enter into the process of a company merger, a company shall give notice to each creditor and shall fix a time limit of not less than 30 days within which the creditors may raise their objections to such a resolution. A company which fails to give notice, or to settle its liabilities, or to provide an appropriate security

for the claims of the creditors who have made objections, shall not set up the company merger or consolidation resolution as a defense against such creditors.[206] Some scholars have questioned the necessity of such protection for creditors. Since the surviving company will assume the rights and obligations of a company ceasing to exist after the merger, the creditors can claim their rights from the surviving company. However, it is likely that the quantity and quality of credits will be weakened after a merger.[207] Therefore, legislators should create rules to balance the creditors' interests and to ensure the simplicity and efficiency of merger procedures.

The Variety of Considerations In response to the fast-changing M&A market, the consideration for M&A should be flexible. For example, the consideration for M&A can include cash, stock, bonds or other assets; and allows for the bundling of these considerations. In addition, the acquirer may provide various combination options to shareholders. The consideration for option one could be all cash and the consideration for option two could be half-cash and half-share. In the past, it was not clear whether the above variety of considerations and combination options were allowed in Taiwan.[208]

Some of the explanatory letters from the Ministry of Economic Affairs (MOEA) resolved this problem. In 2003, the MOEA held that if the merger agreement has expressly stipulated the exchanged numbers of shares or exchanged amounts of cash or other assets, the consideration for the merger can be with different kinds of assets and in different proportions.[209] Also, in 2005, the MOEA was of the opinion that the surviving company can offer various combination options for a merger if the shareholders' meeting in the surviving company resolved to do so and expressly stipulated the terms of each option in the merger agreement.[210] These two letters will have the effect of strengthening the variety and convenience of M&A and thus will encourage M&A activities.

The Interpretation of Asset Acquisitions As mentioned above, the act of transferring the whole or any essential part of a business or its assets under Article 185 of the Company Act is considered a sale of assets or a sale of business. However, what constitutes "the essential part of a business or assets" is a problem with substantial discrepancies among academics and courts. Scholars have suggested various theories. For example, if the sale of a business results in the failure of the company as an operating business, such a sale falls within the scope of the "essential part of a business or assets." Also, if in terms of quality, the sale of a business makes the maintenance of the business difficult or in terms of quantity, the sale of the business constitutes a substantial part of the total assets; such a sale is qualified as the "essential part of a business or assets."[211] In addition to the said theories, courts have also developed some other standards, such as equalizing the essential assets with the assets listed in the main inventory of the property of a company.[212] To clear this discrepancy in interpretation, the authorities should provide a guideline which can consider both the clarity and the flexibility in each individual case.

The Fiduciary Duty of Directors Directors are the leading actors in M&A transactions. As the responsible persons, Article 23 of the Company Act imposed the duty of care and the duty of loyalty on the directors in 2001.[213] This fiduciary duty is especially important in M&A since M&A have the nature of an "end game" with a potential conflict of interests between directors and other stakeholders. The results of M&A will have a substantial impact on all the stakeholders, particularly the shareholders. However, far different from the abundant cases and theories regarding fiduciary duty in M&A developed in the United States, Taiwanese courts have so far made no decisions regarding the fiduciary duty in M&A transactions, nor are the substantive context and the application of fiduciary duty well-developed.[214]

Proxy

The Current Laws

Article 177 of the Company Act provides the legal base for the proxy practice.[215] In 1983, Taiwan promulgated the Regulations Governing the Use of Proxies for Attendance at Shareholders' Meetings of Public Companies (Proxy Rule), and has amended the Proxy Rule 11 times since then. The most important reform was the prohibition of obtaining proxies in exchange for money or other interests in 1996. The latest amendment was made on December 15, 2005[216] and includes the following provisions. First, the voting shares allocated to independent directors or supervisors shall be more than those allocated to non-independent ones.[217] Second, in June 2005, in order to eliminate the drawbacks of cross-holding, the Company Act removed the voting rights from the subsidiary's shares held by its parent company, as well as those of the parent's shares held by its subsidiary.[218] Accordingly, the Proxy Rule provides that those companies, whose shares enjoy no voting rights in their affiliated companies shall not be the solicitors of proxies.[219] Third, in case there is a director or supervisor election agenda in the shareholders' meeting, the numbers of nominees supported by the solicitor shall not exceed the vacancies.[220] Furthermore, the new Proxy Rule also strengthens the information disclosed to shareholders. For instance, it stipulates that the proxy should add the management vision of the director nominee in the case of an election.[221]

The Controversies and Proposed Solutions

The Qualification of Solicitors To act as a solicitor, the Proxy Rule sets some qualification requirements, such as the shareholding period and the shareholding percentage.[222] The purpose of such requirements is to prevent professional shareholders from acting as solicitors. On the other hand, the requirements will indirectly have a function similar to that of an anti-takeover measure. The Financial Supervisory Committee (FSC) proposed raising the shareholding percentage requirement from 10% to 12% to act as a solicitor.[223] Although the new Proxy Rule did not adopt this proposal in the end, the anti-takeover effect of such a trend is worth noticing.[224]

Moreover, the Proxy Rule also sets some negative qualifications for a solicitor. For example, a solicitor shall not have previously been sentenced to imprisonment for six months or more for fraud, breach of trust, or misappropriation, or for violating the Securities and Exchange Act, Futures Trading Act, Banking Act, Trust Enterprise Act, Financial Holding Company Act, or any other financial administration act.[225] The purpose of such a rule is to prevent the proxy from being abused by inappropriate people. However, such a negative clause of qualification might be challenged under the constitutional law for insufficient or ambiguous legislative authorization.[226]

Corporate Governance Issues In the wake of the prohibition on obtaining proxies in exchange for money or other interests, companies have customarily obtained proxies by giving souvenirs to shareholders to successfully convene a shareholders' meeting. These souvenirs impose substantial costs on companies, but it is very common for shareholders to give blank proxies to solicitors in exchange for the souvenirs.[227] This practice is contradictory to the purpose of a shareholders' meeting and shareholder democracy.

Furthermore, proxies have become a convenient and cheap route to gain control of a target company. In the famous proxy fight case in Taiwan in 2004, the ChinaTrust Holding Company, which held only 6% of the China Development Financial Holding Company (CDFH), used the proxies to gain control of the board of CDFH. This raises corporate governance concerns. It is highly debated in Taiwan whether the shareholding of directors/management will be positively correlated with the performance of their company. The philosophy behind the Taiwan securities laws and authority still believes that the directors/management shall hold a certain percentage of shares in order to link their interests with shareholders.[228] Since the management of CDFH only holds a low percentage of shares, the linkage between performance and return is very weak. Thus, it is questionable whether the management will protect small shareholders' interests.

Tender Offer

The Current Laws

Articles 43-1 to 43-5 of the Securities Exchange Act (SEA) and the Regulations Governing Tender Offers for Purchase of the Securities of a Public Company (Tender Offer Rule) govern tender offer activities. Taiwan promulgated the Tender Offer Rule in 1995. Prior to 2002, only three tender offer cases had occurred.[229] In February 2002, Taiwan amended the Tender Offer Rule completely. Most important of all, it abolished the ex ante approval system and adopted the ex ante reporting system for launching a tender offer in order to increase the efficiency and to protect the confidence of an offer. Before 2002, in order to launch a tender offer, the acquirer had to submit an application to the authority in charge and the authority reviewed its merits and decide whether to approve such an application or not. The 2002 amendment to the SEA and Tender Offer Rule abolished the ex ante approval mechanism and adopted the ex ante reporting mechanism, i.e. the acquirer simply needs to file a report and comply with the relevant disclosure requirements and the authority will not review the substances and merits of the case. After this amendment, more tender offer cases took place.[230] To further facilitate takeovers of enterprises, the Tender Offer Rule was amended again in June 2005. The major amendments include the following. First, in addition to cash and existing listed or OTC shares, the offeror can use newly issued shares, corporate bonds or other assets of both domestic and foreign countries as the consideration for a tender offer.[231] Second, the newly amended rule excludes the auction, tender, sale-of-control, and other situations from triggering the mandatory bid.[232] Third, to avoid the uncertainty, after the conditions of a tender offer have been achieved, an offeree may not revoke its offer to sell after the offeror has made a public announcement that the conditions of the tender offer have been achieved.[233]

In June 2005, the FSC amended the Examination Guidelines Governing the Reinvestment of the Financial Holding Company under the Financial Holding Company Act (Reinvestment Guidelines). Item 8 of the Reinvestment Guideline provides that the initial investment amount of a financial holding company in a target company shall not be less than 5% of the total issued and outstanding shares of the target company. This amendment substantially lowers the threshold of reinvestment for a financial holding company from 25% to 5% of the total shares of a target company. For certain financial holding companies, this reinvestment application will be approved automatically by the FSC.[234] Through applying the newly amended Reinvestment Guidelines, China Development Financial Holding Corp. announced a tender offer to acquire shares of the Taiwan International Securities on February 17, 2006. Another tender offer case has also been launched in the financial industry.[235] The role of the tender offer mechanism, especially in the financial sector, is worthy of observation in Taiwan.

The Controversies and Proposed Solutions

The Mandatory Bid Rule Paragraph 3 of Article 43-1 of the SEA and Article 11 of the Tender Offer Rule provides that any person who individually or jointly with another person(s) intends to acquire within 50 days shares accounting for 20% or more of the total issued shares of a public company shall employ a public tender offer to do so. The legislative purpose of this article took reference from the British mandatory bid. However, unlike the British mandatory bid rule, this article does not require the offeror to make a bid to all the remaining shareholders of the target company when the 20% threshold is reached. Instead, this article makes it compulsory to require the offeror to adopt the tender offer mechanism when the offeror purchases 20% or more of the shares of a target company.

The Taiwanese style mandatory bid rule might not only suffer from the challenges faced by the British mandatory bid, such as the issue of small shareholder protection and efficiency problems,[236] but also reduces the flexibility of a takeover. There are various

mechanisms for gaining control of a target company, but the mandatory bid rule in Taiwan only forces an offeror to adopt the tender offer without the flexibility to choose other proper mechanisms. Moreover, Article 175 of the SEA imposes criminal punishment on those who violate the compulsory mandatory bid rule.[237] Such a mandatory bid rule might become a disincentive for takeovers or reorganizations. Therefore, the policy direction to narrow the application of the mandatory bid rule in the newly amended Tender Offer Rule is correct.

The Anti-Takeover Defenses To defend a hostile takeover, it is common for the target company to adopt some anti-takeover measures, such as a staggered board and the golden parachute, etc. under US practices. Some anti-takeover defenses are not workable under the legal regime in Taiwan, such as the poison pill.[238] To protect the shareholders' interests and avoid the abuse of anti-takeover measures, scholars have suggested the legislation of anti-takeover defenses.[239] Nonetheless, during the discussion of amending the Tender Offer Rule, the government was of the opinion that whether to adopt any anti-takeover defense should be at the discretion of the board or decided at the shareholders' meeting of the target company and that the business environment and practices in Taiwan are not mature enough to make a clear policy in this respect. Because of this, the government decided to hold off the legislation of anti-takeover defenses for the time being.[240]

The Squeeze-Out Clause In the United States, some states allow the squeezing out of the minority shareholders to gain control of the target company completely. Taiwan has not adopted such a clause due to the concern over infringing on property rights.[241] However, an acquirer can reach the same result by using the short-form merger or triangular merger under current laws.

Sale of Control

The Current Laws

In addition to the above mechanisms, another way to gain control of a target company is through a sale-of-control transaction. By purchasing a control share block directly from a controlling shareholder, a buyer saves the trouble of gaining shareholders' approval in merger and acquisition cases, as well as the trouble of dealing with the complicated and time-consuming tender offer procedure. In Taiwan, some corporate control transfers are consummated through sale-of-control transactions,[242] but the current laws governing sale-of-control transactions set strict requirements, making it very difficult for a controlling shareholder to sell his control block directly and privately to a specified buyer.

The most direct and important provision governing a sale-of-control transaction in Taiwan is Article 22-2 of the SEA, which provides that "The transfer of stocks by directors, supervisors, managers, or shareholders holding more than 10% of the total shares of an issuer under the SEA shall be effected in accordance with any of the following methods: (iii) to transfer to designated person(s) satisfying the qualification prescribed by the SFC, within three days following reporting with the SFC." In theory, section (iii) shall be applied to sale-of-control transaction cases in which control blocks are transferred to designated person(s). However, according to the explanation of the Securities and Futures Bureau (SFB), the qualification for "designated person(s)" in section (iii) is extremely strict.[243]

The Controversies and Proposed Solutions

Due to the parochial interpretation of the designated person(s), the ingenuity of market participants has found other routes to circumvent such a government imposed impasse. They basically conduct a sale-of-control through an auction, tender, daily trading allowance ration, off-Taiwan Stock Exchange trading, or block trading. However, when compared to a direct and private sale-of-control, these routes involve more time, parties, or consecutive individual transactions, cause higher transaction costs, and fail to increase the value-increasing transactions.[244] Hence, some scholars have argued for a reexamination or abolishment of Article 22-2 of the SEA in order to facilitate sale-of-control transactions.[245]

Another issue regarding the sale-of-control transaction is whether a seller should share the control premium with other shareholders. Currently in Taiwan, as in the United States, a seller is free to sell their control block at any price that a purchaser is willing to pay and minority shareholders enjoy no rights in the proceeds of the transaction. The government and academia have paid little attention to this issue because, as mentioned above, sale-of-control transactions are camouflaged through different routes. Nonetheless, before the 2005 amendment,[246] a sale-of-control transaction will trigger the Taiwan mandatory bid rule if the sale block exceeds the 20% threshold. Some scholars believe that through such triggering of a mandatory bid rule, the interests of minority shareholders will be protected since they will have the opportunity to tender their shares at the premium price.[247] However, such a mandatory bid rule will further suppress the adoption of sale-of-control transactions. Recognizing this, as mentioned before, the authorities amended the Tender Offer Rule to expressly exclude a sale-of-control transaction from the application of the mandatory bid in 2005.

Conclusion

The market for corporate control is a legal regime with a strong policy nature. The current policies in Taiwan are to encourage M&A activities and to deregulate the relevant regulations. However, while acknowledging that change-of-control transactions could positively increase the competitiveness and efficiency of enterprises, Taiwan's government should address corporate governance issues, such as the protection of the interests of shareholders, creditors, and employees; and the disclosure requirements, so that the economic society as a whole can benefit from those transactions.

Employee Compensation in Taiwan

Appendix C

Background Paper

HSIN-TI CHANG

Introduction

In the highly competitive business world, companies have to offer considerable compensation to attract excellent employees, especially in high-tech industry. In Taiwan, the components of employee compensation include basic salary, the employee profit sharing and stock ownership plan (EPSSOP), and the employee stock option plan (ESOP). The legislative purpose of the EPSSOP and ESOP is to provide incentive to employees and to enhance their loyalty. However, there are some controversies surrounding these two mechanisms. This paper will introduce the current mechanism of the EPSSOP and ESOP in Taiwan, discuss their controversies, and analyze the proposed solutions to the problems.

Employee Profit Sharing and Stock Ownership Plan

The Current Laws

Paragraph 2 of *Article 235 of the Company Act* provides that "the percentage of surplus profit distributable as employees' bonus shall be definitely specified in the articles of incorporation," and paragraph 4 of *Article 240 of the Company Act* provides that "…the bonus distributable to the employees under the articles of incorporation may be paid either in the form of shares newly issued for such purpose or in cash." The EPSSOP consists of two parts. First, the *Company Act* stipulates that with the profit sharing done by a limited-by-share company, it is compulsory that the company reserve a certain percentage of surplus for the employees.[248] Second, the *Company Act* authorizes stock ownership by paying bonuses in the form of shares. In 2001, to encourage overseas development and establishment of specialized subsidiaries in the high-tech industry, the government added Paragraph 4 of Article 235, which states that to be entitled to receive the EPSSOP, the employees of a company's subsidiaries must meet certain specific requirements. Because the distribution of the EPSSOP is based on past performance of the company, there is no transfer limitation and the Ministry of Economic Affairs (MOEA) in Taiwan stated that the EPSSOP shall not be issued in installments.[249]

The Controversies

According to a 2004 study, around 70% of the listed and OTC companies in the electronics sector adopted the EPSSOP,[250] and some scholars contend that such a plan is one of the major factors behind the competitiveness of Taiwan's IC industry.[251] However, since 2002, foreign investment organizations have begun to question not only the EPSSOP practice in Taiwan, but the relevant accounting procedures and treatments as well. The headline story in the *Asian Wall Street Journal* on July 18, 2002, declared that Taiwan had the largest amount of employee stock dividends in the world, while the US was suffering from many accounting scandals. Indeed, there are some major controversies surrounding the EPSSOP, including the dilution effect, accounting treatments, and tax issues.

Dilution Effect According to statistics, the market value of the bonuses distributed to employees by both listed and OTC companies has increased from NT$45.4 billion in 1997 to NT$74.2 billion in 2001. The yearly increase of the percentage of employee stock bonuses has led to a serious dilution effect relative to shareholders' equity.[252] From 1992 to 2001, the accumulated dilution ratio of the top 15 companies that suffered the most serious dilution effect all surpassed 11.0%.[253] The dilution effect will be more serious in the case where shareholders receive cash dividends and employees receive stock bonuses,[254] as well as in the case that employees receive stock bonuses despite a loss.[255] For valuation purposes, only the par value of the stock is considered. As a result, it is common in Taiwan for businesses to issue shares whose value would significantly exceed the amount of the cash compensation.[256] Furthermore, managers or CEOs in Taiwan are treated as employees[257] and are consequently entitled to the EPSSOP. Because most of the managers are also members of their board and because the board has substantial influence on the distribution of the related EPSSOP, such a system suffers the potential conflict of interests. In details, Article 235 of the Company Act requires that the percentage of surplus allocable to employees be set forth in the articles of incorporation. If the percentage is specified by a range (2%-10%) or a bottom limit (no less than 2%), the board will have substantial discretion concerning the actual distribution. Before the 2004 amendment, even in the case where the percentage is specified by a fixed number (2%), [258] the board has discretion concerning the proportion between cash bonuses and stock bonuses. This will give rise to the potential conflict of interests.

The example of United Microelectronics Corp. (UMC) illustrates the problem. UMC adopted the EPSSOP in 1983. In 1985, the CEO of UMC, Robert Tsao, held only 75,000 shares of UMC (around 0.093% of the total issued and outstanding shares). As of January 2, 2006, Robert Tsao holds 100.841 million shares of UMC and it is believed that the EPSSOP accounts for this gigantic increase in shares.[259]

Accounting Treatments The current accounting practices in Taiwan book the EPSSOP as retained earnings distributions rather than as expenses because of Article 235 of the Company Act and Article 64 of Business Accounting Law which stipulates "Distribution of earnings of a business, such as dividends and bonuses, shall not be recorded as expenses or losses." This practice could result in a serious distortion of information in financial statements. According to *Taiwan Economic News* on July 19, 2002, if the employee bonuses had been booked as an expense, listed companies, including TSMC,

VIA Technologies Inc. (VIA), and Honhai Precision Industry Co., would have had their net incomes reduced by 50%.[260]

Such accounting treatment has its historic background. In the 1980s, to beat the global competitors by reducing sale prices, Taiwan DRAM intentionally booked low salaries to decrease costs and expenses. In order to compensate employees, the industry distributed the surplus as bonuses. "Low salaries and high bonuses" became a common practice in the high-tech industry.[261]

Nevertheless, such accounting treatment not only distorts financial statements and is inconsistent with the transparency and full disclosure principles of corporate governance, but it also provides disincentives to institutional investors, an outcome that might have a substantial influence on Taiwan's capital market.

Moreover, current practices governing shareholder stock dividends are such that the EPSSOP is booked according to its par value, rather than to the market price.[262] This is another crucial issue to be discussed.

Tax Issues Should the EPSSOP be taxed according to the par value or the market value? Before 1999, *Article 17 of the Regulation Governing the Promoting of Industry Upgrading* provided that, when a company distributes employee bonuses in shares, the par value shall be deemed to be the transfer price. However, after the government rescinded the said article, the question has triggered many debates and both of the sides propose some plausible arguments.[263] The current practice in Taiwan regarding the EPSSOP is taxation based on the par value. The premium part is tax-free because it is considered to be income from securities transactions and these have been exempted from income taxation since January 1, 1990.[264]

The Proposed Solutions

Though there are some controversies surrounding the EPSSOP, industry, government, and a majority of academicians agree that the mechanism strengthens the competitiveness of the high-tech sector. However, the government should adopt some adjustments or reforms to solve the said problems.

Dilution Effect With respect to the dilution effect, shareholders have voiced two major concerns. How much of the surplus should be allocated to employees as stock bonuses? And, what should be the standard for calculating the value of stock bonuses, the par value or market price? To respond to such concerns, in December 2004, the Financial Supervisory Committee of the Executive Yuan (FSC) amended Item 4, Paragraph 1 of Article 76 of the Regulations Governing the Offering and Issuance of Securities by Securities Issuers (Securities Offering and Issuance Regulation). According to this amendment, if the total amount of a listed or OTC company's employee bonuses paid out in cash and distributed as new shares (valued at market price) exceeds 50 percent of net income for the current period or 50 percent of distributable earnings (less legal reserve, special reserve, and balance of reserves after withdrawals), the FSC may reject or decline to approve a filing for issuance of bonus shares by a public company. In other words, to reduce the dilution effect, the FSC sets the upper limits on earnings to be distributed as stock bonuses and expressly uses the market price as the valuation standard.

In addition, to strengthen the information disclosure and to protect investors' interests, the annual report and prospectus of public companies shall disclose, among other things, the following information: the percentages or ranges with respect to employee bonuses as set forth in the company's articles of incorporation, the value of any employee cash/stock bonuses, the number of shares to be distributed in any employee stock bonus, the size of such distribution as a percentage of capital increase through capitalization of retained earnings, and the effect upon imputed earnings per share of any proposed distribution of employee bonuses.[265] This amendment was justified because information disclosure and transparency helps the investors develop a better understanding of the EPSSOP, and excessive employee stock grants can, therefore, be improved through market discipline.[266]

In addition, scholars proposed some detailed solutions. First, an amendment to *Article 240 of the Company Act* should allow firms to distribute shares to employees only when stockholders receive allocations of shares. Second, the FSC should prohibit unprofitable companies from distributing stock bonuses to employees.[267]

Accounting Treatments In industry, there are some disagreements regarding whether the EPSSOP should be categorized as earnings distribution or expenses.[268] In academia, whether business spending belongs to earnings distribution or expenses, it should be determined according to modern accounting theory and current accounting practices. Furthermore, most accounting scholars recommend that businesses book the EPSSOP as an expense.[269] According to the theory, if the bonuses are distributed to the ultimate risk carriers, the bonuses are regarded as earnings distribution; others are considered a company's expenses. Furthermore, bonuses for employees are clearly deferred payments, which is also a cost and expense of an enterprise.[270] In addition, to mitigate the dilution effect and reflect the real financial situation, businesses should book the EPSSOP according to the market price.[271]

To completely resolve the above accounting dispute, Taiwan should amend *Article 64 of the Business Accounting Law* or clarify the existing article.

Tax Issues From the perspective of fairness and legal justice,[272] the EPSSOP should be taxed according to the market value. Besides, *Paragraph 2 of Article 14 of the Income Tax Law* which stipulates that securities shall be taxed according to the local market price when obtained unless the government regulates otherwise, provides the basis for such tax policy. However, an EPSSOP taxation based on market prices will be obviously less attractive to employees, and its legislative purpose might be sabotaged. Thus, in order to mitigate the possible opposition to such tax reform, it is suggested that a tax deferment or tax deduction be considered if the shares are held more than a certain number of years and such suggestion will have the effect of encouraging long-time shareholdings.[273]

Employee Stock Option Plan

The Current Laws

Although the EPSSOP is successful in attracting excellent employees, it creates problems and disputes. Furthermore, because businesses cannot issue the EPSSOP in installments and because businesses can impose no transfer limitation on employees, the mechanism fails to provide forward-looking incentives to employees. In 2000, Taiwan passed the *Securities Exchange Act (SEA)*, in which *Article 28-2* authorizes listed or OTC companies to repurchase their shares for equity conversion in coordination with the issuance of stock warrants.[274] *Article 28-3* authorizes public companies to issue stock warrants. In 2002, *Article 167-2 of the Company Act* authorized the board to enter into the stock option contract with employees. In addition, for public companies, the Securities Offering and Issuance Regulations governed the detailed procedures and rules regarding the ESOP.[275]

Controversies and Proposed Solutions

The major controversies of the ESOP include:

The Scope of the Employee Different from the EPSSOP, the ESOP does not include subsidiaries of the issuing company. Thus, the MOEA explained that the employees in subsidiaries are not entitled to the ESOP.[276] However, for the public company, the FSC opined that employees in subsidiaries are included in the scope of employees of the issuing company.[277] Such discrepancies need to be resolved.

Some scholars have argued that, to encourage employees in affiliates and to avoid the disputes that arise from the sharing of earnings with affiliates' employees, companies should include subsidiaries' employees in the ESOP.278

Another important issue regarding the scope of employees concerns the status of directors and supervisors who are not employees unless they are managers at the same time. Therefore, under current laws, not all directors and supervisors are entitled to the ESOP. This practice is inconsistent with the purpose of the ESOP, since the design of the ESOP is to link the performance of directors, of high ranking officers, and of employees to their compensation. The evidence also shows that the long-term incentive pay of the ESOP for those persons has an obvious effect.[279] Therefore, the legislative design to exclude directors and supervisors from the ESOP is worth reexamining and a separate option plan for directors is worth considering.

From the incentive perspective, the ESOP functions well for those who can influence the management and performance of companies. Therefore, scholars have argued that companies should grant the ESOP to directors and supervisors and not exclude high-ranking employees from the ESOP concurrently.[280] If companies will grant the ESOP to directors, then another issue arises insofar as the board determines the terms of the ESOP and insofar as the establishment of independent compensation committees is uncommon in Taiwan. The problem of potential conflicts of interests needs to be considered and addressed.[281]

Shareholder Protection The resources of shares that facilitate employees' exercise of the ESOP can come from either the treasury stock or new shares. The favored terms and exercise price of the ESOP will dilute shareholders rights and will change the structure of shareholdings from either resource.[282] In the case that the resource comes from the issuance of new shares, shareholders' rights are further affected, since the ESOP deprives shareholders' right of first refusal when the issuance of new shares is for the conversion of stock options.[283] However, according to Article 167-2 of the Company Act and Article 58 of the Securities Offering and Issuance Regulation, the ESOP shall be decided and approved only by the board. Shareholders have no say in the process.

As is the case with the rules of the New York Stock Exchange and NASDAQ, all equity-based compensation arrangements, including the stock option, shall be subject to shareholders' approval.[284] In 1997, Japanese business law also required that the ESOP be approved by shareholders' meetings.[285] To protect shareholders' interests, scholars in Taiwan have proposed that the ESOP shall be subject to shareholders' approval[286] but there is still a way to go to reach the consensus of legislative reform.[287]

Accounting Treatments In the past, there was no clear and specific guideline for an accounting treatment of the ESOP. Taiwan's scholars have promoted the US standard and have urged Taiwan to adopt it as a reference. From 2003 to 2005, the Accounting Research and Development Foundation in Taiwan (ARDF) has promulgated a series of explanatory letters on the accounting treatment of the ESOP: in summary, companies can choose either the intrinsic value method or the fair market value method to book the ESOP as expenses. However, companies are encouraged to adopt the fair market value method, and if they choose the intrinsic value method, the footnote of the financial statement has to disclose some information if the fair market value method is adopted.[288] This practice is basically the same as US practice.

Tax Issues Before 2004, tax issues surrounding the ESOP remained unsettled. Four proposals had been suggested. First, the vesting of a stock option, the exercise of the option, and the subsequent sale of shares will be deemed as one transaction and be subject to the security transaction income tax. Second, the spread between the market price of the exercise date and the exercise price will be subject to the income tax as salary. The spread of the subsequent sale and the market price of the exercise date will be deemed as security transaction income. Third, regardless of the value of the spread between the market price of the exercise date and the exercise price, the tax is based on the par value, which is NT$10. The spread between the subsequent sale and the market price of the exercise date will be deemed as security transaction income. Fourth, regardless of the value of the spread between the market price of the exercise date and the exercise price, the tax is based on the par value. However, if the market price of the exercise date is lower than the exercise price, the tax is based on the exercise price. The spread between the subsequent sale and the market price of the exercise date will be deemed as security transaction income.[289]

In 2004, the Ministry of Finance promulgated guidelines for tax treatment of the ESOP. The spread between the market price of the exercise date and the exercise price shall be subject to the income tax according to Article 14 of the Income Tax Law. The spread between the subsequent sale and the market price of the exercise date will be deemed as security transaction income, which has been exempted from income tax since January 1, 1990.[290]

Conclusion

Because the EPSSOP is unique and controversial, some analysts have suggested that the government abolish the mechanism, particularly since 2002, when the government promulgated the ESOP under the Company Act. However, many people in industry and government believe that the mechanism does have its value in attracting excellent employees. The majority of academicians also disapprove of such a drastic abolishment. In favoring the parallel system, these voices outline two underlying reasons. First, because the EPSSOP is backward-looking, it encourages employees by accounting for their performance of the preceding year. On the other hand, the ESOP is forward-looking. It encourages employees by accounting for future performance. Second, the parallel system can provide flexibility to companies. When the share price is low, the cash bonuses, rather than the stock bonuses, will be preferred by employees, and the ESOP will have a better encouraging effect in these circumstances. On the other hand, when the share price is high, the attractiveness of the ESOP will fade in the eyes of employees because the spread will be small.[291]

Nevertheless, as discussed above, the controversies surrounding the EPSSOP and the ESOP need to be resolved. These controversies concern shareholder protection, accounting treatments, and tax issues.[292] In particular, the principle of fairness shall govern the accounting treatment and the taxation that characterize these two mechanisms. Under current accounting practices, the EPSSOP is booked as earnings, rather than as expenses, while the ESOP is booked as expenses. In addition, the EPSSOP is taxed according to the par value while the ESOP is taxed according to the market price. This partial and unfair treatment weakens the two mechanisms and will lead companies to favor the EPSSOP, which is more problematic from the international investors' viewpoints. Also, the Taiwan government's efforts to encourage businesses' adoption of the ESOP will be undermined.

As Taiwan continues to link its business activities to those of the international community, corporate governance issues will attract the attention of both domestic investors and global investors. While Taiwan should credit both employees' past contributions and current employee compensation practices, the government should establish a more reasonable, fair, and transparent employee compensation.

HSIN-TI CHANG

TAIPEI WORLD TRADE CENTER
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7 For an overview and analyses on the cause(s) of the Asian financial crisis and suggestions for financial reforms, see Desai, Padma. *Financial Crisis, Contagion, and Containment: from Asia to Argentina* (New Jersey: Princeton University Press, 2003); and from perspective of IMF, see Goldstein, Morris. *The Asian Financial Crisis: Causes, Cures, and Systemic Implications*, Policy Analyses in International Economics No. 55 (Washington: Institute for International Economics, 1998).

8 East Asia has been one of Taiwan's major exporting destinations. During the period of the Asian financial crisis, there was a significant drop in the rate of purchasing power in the relevant countries of this area, which resulted in Taiwan's negative economic growth. Domestically, several large enterprises in Taiwan had maintained a very high equity-debt ratio due to bad corporate governance and consequently became involvent. With the prevailing economic downturn of the time, the banking sector was thereby negatively hit.

9 For statistical figures on the economic indicators (economic growth rate, unemployment rate, inflation rate, export growth rate and trade surplus) of Taiwan prior to the financial crisis, see *http://www.gio.gov.tw/info/taiwan-story/economy/eframe/frame3.htm.*

10 Average ROA of foreign banks was 1.25% or more.

11 Lee, Yung-San. (2002) "The Policy on Financial Reform" *ROC Bankers Association Bi-Monthly Bulletin* 7 (in Chinese).

12 During the Asian financial crisis, the author was the then Deputy Finance Minister and assisted the then Finance Minister in planning and executing various reactionary measures that had relatively spared Taiwan from the negative impact of the crisis. At that time, the author had already recognized the importance to engage in fundamental reforms of the financial market in order to ensure its stability and growth.

13 The author was the then Finance Minister (October 2000 to January 20002). Despite being a firm believer of market mechanism, the author had taken a policy view that, to achieve liberalization of the financial market of Taiwan, some reform at the fundamental level (ie. legal and regulatory etc.) would be required. As to when that reform should be carried out, it would depend on the macroeconomic condition at the time as well as the nature of the intervening measures to be introduced under the liberalization package. For example, at times of political or economic instability, ruling out the possibility for government intervention would be just unthinkable. However, whenever such instability diminishes, it would be the most appropriate time for the government to introduce a systematic and comprehensive reform plan for liberalization. Thus, for the first few months shortly after the author took office, as a result of those destabilizing elements on the financial market such as continued partisan struggles resulting from the first-ever change in government in 2000 and the new government's declaration on 27 October 2000 to terminate the nuclear power plant 4 project, intervening measures had to be carried out. As the financial market of Taiwan gradually became more stable one year thereafter, a series of major reform measures were then introduced.

14 For English translation of legal text, see *http://law.moj.gov.tw/eng/*.

15 Article 17 of the *Financial Institutions Merger Act*.

16 Article 15. *Ibid*.

17 *Ibid*.

18 Article 43.

19 Article 36 provides a financial holding company may engage in the investment and management of the following enterprises: banking, bills finance, credit card, trust, insurance, securities, futures, venture capital, foreign financial institutions as approved by the governing authority, and other financially related businesses as approved by the governing authority.

20 For background information concerning the Statute, see *http://www.cdic.gov.tw/ct.asp?xItem=266&CtNode=248*. An amendment of the Statute was promulgated on 22 June 2005, under which the size of the fund is increased by NT$110 billion. For details, see *http://www.fscey.gov.tw/ct_search.asp?xItem=641429&ctNode=1474&mp=5&keyword=Financial%20Restructuring%20Fund*.

21 In October 2004, President Chen Shui-Bian announced that one of the goals to be achieved at the "second-stage financial reform" was

to reduce the number of financial holding companies by half at the end of 2006. But the Cabinet appears to have put the brakes on. For details see *http://www.chinapost.com.tw/p_detail.asp?id= 80317&GRP=E&onNews=*.

22 For rankings of top 10 world banks by assets in 2004, see "Thinking Big," *The Economist*, 18 May 2006.

23 Claessens, Stijn, Simeon Djankov, and Larry H.P. Lang. "Who Controls East Asian Corporations?" : *http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2000/02/24/000094946_99031911113874/additional/124524322_20041117144054.pdf*

24 For details, see Wang, Heh-Song. (2004) "The Experience and Problems of State-Owned Bank Privatization" *National Policy Quarterly* 3, 4: 107-123 (in Chinese).

25 See *http://www.banking.gov.tw/ct.asp?xItem=87238&ctNode=1845&mp=7*.

26 On the privatization of Taiwan Business Bank, see "Bank staff end strike, return to work" Taipei Times, 14 September 2005: *http://www.taipeitimes.com/News/biz/archives/2005/09/14/2003271622*. See also *http://www.sinorama.com.tw/en/show_issue.php?id=2005109410046e.txt&table=2&h1=Finance%20and%20Economy&h2=Public%20policy*.

27 According to a resolution passed at the plenary session of the Legislative Yuan on 13 January 2004 after reviewing the central government's budget for 2004, the Executive Yuan is required to draft a so-called "Regulation for Management and Disposal of State-Owned Shares" for the approval by the Legislative Yuan before any disposal of state-owned shares can be undertaken.

28 Article 185. For legal text in English, see *http://law.moj.gov.tw/Eng/Fnews/FnewsContent.asp?msgid=2396&msgType=en&keyword=company+act*

29 Article 14-2.

30 Article 14-4.

31 For an overview of corporate governance in Taiwan, see *http://www.tse.com.tw/en/listed/governance/cg_01.php*

32 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified at 15 U.A.X. §§78j-o, Supp. II 2002) [hereinafter SOA]. The complete title of the SOA is "The Public Company Reform and Investor Protection Act of 2002."

33 The proposed amendment bill was initially submitted to the Legislative Yuan on July 14, 2004. Because the proposed bill did not complete the three-reading procedure in 2004, the Executive Yuan would need to resubmit the proposed amendment bill in the Legislative Yuan's next session. The Financial Supervisory Commission and the Executive Yuan made some modifications and resubmit the Proposed amendment bill to the Legislative Yuan on July 13, 2005. The Amendment Bill of the Securities and Exchange Act completed the three-reading procedure on December 20, 2005 and was signed into law on January 11, 2006.

34 Article 183 of the TSEA sets forth that §§ 14-2 ~ 14-5 regarding the appointment of independent directors and the establishment of the audit committees shall become effective on January 1, 2007. However, according to article 181-2, publicly held corporations may comply with the requirements at a later time when the term of the office of current directors or supervisors expires.

35 Karessa Cain, *New Efforts to Strengthen Corporate Governance: Why Use SRO Listing Standards*, 2003 COLUM. BUS. L. REV. 619 (2003).

36 Beginning from February 2002, the listing requirements of both TSE and GreTai Securities Market require that companies applying for listing on the TSE or GTSM must have at least 5 directors and at least 2 of them must be independent directors. Non-listed companies need appoint only three directors as required by the Company Law. Cf. Company Law, §192, para. 1.

37 Currently, publicly held companies must have two or more supervisors as required by the Company Law. Company Law, §216, para. 2.

38 Regulations Governing Establishment of Internal Control Systems by Public Companies, promulgated on Nov. 18, 2002 (as amended). To implement, the Taiwan Stock Exchange issued "Taiwan Stock Exchange Corporation Direction for Auditing Internal Control Systems of Listed Companies" in April, 2003; the GreTai Securities Market also issued similar Direction applicable on OTC companies.

39 It is important to note that the proposed reform mentioned in this article is according to the previous Proposed TSEA Amendment submitted by the FSC, approved by the Executive Yuan on July 14, 2004, and sent to the Legislative Yuan for legislative purpose. This amendment bill is no longer valid due to the close of the 2nd Session of the 5th Legislative Yuan

40 Proposed TSEA Amendment, art. 14-2, para. 1 (July 14, 2004).

41 Proposed TSEA Amendment, art. 14-2, para. 2; art. 26-3 (July 14, 2004).

42 Proposed TSEA Amendment, art. 14-2, para. 3 (July 14, 2004).

43 Proposed TSEA Amendment, art. 14-2, para. 4 (July 14, 2004).

44 Proposed TSEA Amendment, art. 14-3 (July 14, 2004).

45 Proposed TSEA Amendment, art. 14-4, para. 1 (July 14, 2004).

46 Proposed TSEA Amendment, art. 14-5, para. 1 (July 14, 2004).

47 Proposed TSEA Amendment, art. 14-2, para. 1 (July 13, 2005).

48 Proposed TSEA Amendment, art. 14-3 (July 13, 2005).

49 In the 2004 Proposed Reform, major corporate resolutions must obtain majority votes from independent directors or members of the audit committee.

50 Regulations Governing the Appointment and Required Compliance Matters of the Independent Directors of the Publicly Held Corporations, promulgated by the Financial Supervisory Commission of the Executive Yuan (March 28, 2006) [hereinafter the Independent Director Regulation].

51 Order No. Finance-Supervisory-Securities-(1)-0950001616 of the Financial Supervisory Commission, Executive Yuan (Mar. 28, 2006).

52 2006 TSEA, art. 14-2.

53 2006 TSEA, arts. 14-2, 14-4.

54 Hong Kong has considered itself as one of the major fund-raising center for both local and foreign companies. There were 67 companies newly listed on the HKSE in 2005. Total fund raised through issuing equity securities amounts HK$294 billion while more than 50 percent of the fund were raised by Chinese companies or China-linked companies. Chairman Martin Wheatley, Corporate Governance, Address at the Hong Kong Institute of Directors Luncheon (Jan. 16, 2006) (transcript available in http://www.sfc.hk/sfc/doc/EN/general/general/press_release/06/mw_060116_hkiod.pdf).

55 Hong Kong's Securities and Futures Commission, established according the Securities and Futures Commission Ordinance in 1989, is the principal securities regulator in Hong Kong.

56 The Stock Exchange of Hong Kong (HKSE) is a wholly owned subsidiary of the Hong Kong Exchanges and Clearing Limited (HKEx). The HKEx is a stock exchange holding company having five wholly-owned subsidiaries, including the HKSE, the Hong Kong Futures Exchange Limited (HKFE), the Hong Kong Securities Clearing Company Limited (HKSCC), the HKFE Clearing Corporation Limited (HKCC) and The SEHK Options Clearing House Limited (SEOCH). After the integration and consolidation of Hong Kong's capital market, the HKEx went public in June 2000 and is currently a listed company listed on the Main Board of the HKSE.

57 Susan E. Carroll, *Caught Between a Rock and a Soft Place: Regulating Legal Ethics to Police Corporate Governance in the United States and Hong Kong*, 14 *PAC. RIM L. & POL'Y J.* 35, 35-36 (January, 2005).

58 To see the full text of the Code on Corporate Governance Practices [hereinafter HKSE Corporate Governance Code], *see* Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (Main Board) [hereinafter Listing Rules], Appendix 14.

59 The HKSE has promulgated two sets of listing rules. One is the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (Listing Rules). The other is the Rules Governing the Listing of Securities on the Growth Enterprise Market of the Stock Exchange of Hong Kong Limited [hereinafter GEM Listing Rules]. Unless specifically stipulated, the discussion will mainly base on the Main Board Listing Rules.

60 Most content of the HKSE Corporate Governance Code have been incorporated into the Listing Rules of the HKSE. Note to subscribers for the amendments to the rules governing the listing of securities (the "Listing Rules") Update No. 82 (Dec. 8, 2004) (available at *http://www.hkex.com.hk/rule/mbrule/mb_rupdate3_cover.htm*, last visit on March 28, 2006).

61 For GEM listed companies, the Corporate Governance Code is available in Appendix 15 of the GEM Listing Rules, and the Corporate Governance Report can be found in Appendix of the GEM Listing Rules.

62 The HKSE Corporate Governance Code sets forth the principles, code provisions and recommended practices regarding the following topics: (A) Directors, including (A.1) The Board, (A.2) Chairman and Chief Executive Officer, (A.3) Board Composition, (A.4) Appointments, re-election and removal, (A.5) Responsibilities of

Directors, (A.6) Supply of and Access to Information; (B) Remuneration of Directors and Senior Management, including (B.1) The Level and Make-up of Remuneration and Disclosure; (C) Accountability and Audit, including (C.1) Financial Reporting, (C.2) Internal Control, (C.3) Audit Committee; (D) Delegation by the Board, including (D.1) Management Functions, (D.2) Board Committees; and (E) Communication with Shareholders, including (E.1) Effective Communication, and (E.2) Voting by Poll. The above information is retrieved from the headings of the HKSE Corporate Governance Code, available at Appendix 14 of the HKSE Listing Rules.

63 HKSE Corporate Governance Code, §A.2, in Listing Rules, Appendix 14, at A14-3.

64 HKSE Corporate Governance Code, in Listing Rules, Appendix 14, at A14-1.

65 HKSE Main Board Listing Rules, §3.25 (1).

66 For discussion of the deviation from the Corporate Governance Code in the interim report, the issuer may refer to the Corporate Governance Report of the immediately preceding annual report. However, considered reasons and discussion of each deviation must be provided in the interim report. Id. at A14-1.

67 For example, C.P. Pokphand Co. Ltd., a HKSE listed company, disclosed in its interim report that it did not comply with the code provision A.2.1 which stipulates that the chairman and the CEO should be separate and should not be performed by the same person. It explained that the person who performed both the Chairman and the CEO had "substantial experience" in the company's business and being both the Chairman and the CEO could "enhance the company's decision making and operational efficiency." C.P. Pokphand Co. Ltd., 2005 Interim Report 27, available at HKSE website: *http://www.hkex.com.hk/listedco/listconews/sehk/20050930/0043/f112.pdf*. (last visit on July 17, 2006). C.P. Pokphand Co. further stated that the roles of the chairman and CEO have been separated since September 2005. Id. at 28.

68 Id.

69 HKSE Corporate Governance Code, §§A.2.6 & A.2.7, in Listing Rules, Appendix 14, at A14-4.

70 HKSE Corporate Governance Code, §A.3 Principle, in Listing Rules, Appendix 14, at A14-5.

71 HKSE Main Board Listing Rules, §3.10 (1).

72 HKSE Main Board Listing Rules, §3.10 (2).

73 HKSE Main Board Listing Rules, §3.11.

74 According to the Listing Rules, beginning from March 31, 2004, companies applying for listing must have three independent non-executive directors. Companies that had been listed before that date were required to comply with the requirement no later than September 30, 2004. HKSE Main Board Listing Rules, §3.19.

75 HKSE Corporate Governance Code, §A.3.1 Code Provision, in Listing Rules, Appendix 14, at A14-5.

76 Corporate Governance Report, in Listing Rules, Appendix 23, para. 2(c)(i), at A23-2. Other information regarding the board of directors must be disclosed includes the number of meetings held in the year and the attendance of each director at the board meetings. Corporate Governance Report, in Listing Rules, Appendix 23, paras. 2(c)(ii) & (iii), at A23-2.

77 Non-executive directors, or outside directors in other jurisdictions, are directors not engaged in regular business operations. In Hong Kong, there is statute using "independent director." e.g., in §20 (2) of the Mandatory Provident Fund Schemes Ordinance (CAP.485), in order to become the trustee under the Mandatory Provident Fund Schemes, a company must appoint an "independent director" in it board. The qualifications of the independent director is set forth in §9 of the Mandatory Provident Fund Schemes (General) Regulation (CAP.485A, Sub. Leg.).

78 *See* Derek Higgs, *Review of the Role and Effectiveness of Non-Executive Directors*, 1372 PLI/CORP 377, 416, in INTERNATIONAL SECURITIES MARKETS 2003: EMERGING BEST PRACTICES FOR A RAPIDLY EVOLVING REGULATORY SCHEME (May 8-9, 2003).

79 HKSE Main Board Listing Rules, §3.13 (1).

80 HKSE Main Board Listing Rules, §3.13 (1), Note 1.

81 HKSE Main Board Listing Rules, §3.13 (1), Note 1.

82 HKSE Main Board Listing Rules, §3.13 (2).

83 HKSE Main Board Listing Rules, §3.13 (3).

84 HKSE Main Board Listing Rules, §3.13 (4).

85 HKSE Main Board Listing Rules, §3.13 (4).

86 HKSE Main Board Listing Rules, §3.13 (5).

87 HKSE Main Board Listing Rules, §3.13 (6). If the non-executive director is the spouse, child, stepchild, parent, stepparent, brother, sister, stepbrother and stepsister of a director, CEO or substantial shareholder, he will be considered as the connected person. *See* HKSE Main Board Listing Rules, §3.13 (6), note.

88 HKSE Main Board Listing Rules, §3.13 (7).

89 HKSE Main Board Listing Rules, §3.13 (8)

90 HKSE Main Board Listing Rules, §3.13 (8), note.

91 HKSE Main Board Listing Rules, §3.13, last para, at 3-5.

92 HKSE Main Board Listing Rules, §3.13, last para, at 3-5.

93 HKSE Main Board Listing Rules, §3.13, last para, at 3-5.

94 HKSE Main Board Listing Rules, §3.21.

95 HKSE Main Board Listing Rules, §3.21. In order to determine whether the director has sufficient professional quality or expertise in accounting or financial management, the HKSE provides explanation in the Note of §3.10 of the Main Board Listing Rules saying that the HKSE expects the candidate to have the following experiences or similar experiences to prove his expertise, such as experience as a public accountant or auditor, as a CFO, controller, or chief accounting officer of a public company, or experience in internal control, preparing, audit or review the financial statements of a public company. HKSE Main Board Listing Rules, §3.10 (2), Note.

96 HKSE Corporate Governance Code, §C.3.2 Code Provision, in Listing Rules, Appendix 14, at A14-17.

97 HKSE Main Board Listing Rules, §3.21.

98 HKSE Main Board Listing Rules, §3.21, Note 1; §3.19.

99 HKSE Corporate Governance Code, §A.5 Principle, in Listing Rules, Appendix 14, at A14-8.

100 HKSE Corporate Governance Code, §A.5 Principle, Note, in Listing Rules, Appendix 14, at A14-8. The functions of non-executive directors are stated in HKSE Corporate Governance Code, Code Provision §A.5.2, in Listing Rules, Appendix 14, at A14-8~A14-9.

101 HK Companies Ordinance, §40 (1) (prospectus liability against directors and employees named on the prospectus) & §38C (prospectus liability against accountants and other experts).

102 HK Securities and Futures Ordinance, §108.

103 HK Companies Ordinance, §165 (1).

104 HK Companies Ordinance, §165 (2)

105 HK Companies Ordinance, §165 (3)

106 HKSE Main Board Listing Rules, §3.24; HKSE GEM Listing Rules, §5.15.

107 In its initial listing, the listed issuer is required to appoint a compliance adviser, a corporation or an authorized financial institution accepted by the HKSE, for a period between its initial listing and the coming out of the financial result of the first financial year, to ensure that the listed issuer has complied with the respective rules. HKSE Main Board Listing Rules, §§3A.01 & 3A.19; Growth Enterprise Market Listing Rules, §5.19.

108 *See The Stock Exchange's Strategy for Enforcing the Listing Rules*, *EXCHANGE* 4-6 (October 2004). When a breach of the listing rules occurs, the HKSE consider how serious of the breach and whether the nature of the breach is intentionally or recklessly before it take any disciplinary action. *Id.* At 4.

109 Deacons, Hong Kong: Corporate Governance Guide, available at *http://HG.org&HGExperts.com/Hong Kong Corporate Governance Guide00_files/bkg_title3.htm* (Nov. 28, 2004).

110 Non-statutory Guidelines on Directors' Duties, issued by Hong Kong Company Registry on June 26, 2006, available at *http://www.cr.gov.hk/en/standing/docs/director_guide_e.pdf*.

111 In Korea, there is no separate and independent company law statute. Provisions governing corporate affairs are included in Part Three of the Korean Commercial Act.

112 Korean Commercial Act, §415 (1).

113 KSEA, §§191-17, 54-6 (1).

114 KSEA, §§191-17 (2), 54-6 (2); Korean Commercial Act, §415-2 (2). In fact, the composition of the audit committee may vary depending on whether it is a listed company and the size of its assets. It will be explained further in the following discussions.

115 KSEA, §2 (19) (Definition of "outside director"). Article 191-16 (Appointments of Outside Directors) and Article 191-17 (Audit Committee) are arranged under Chapter IX Section 3 "Special Treatment for Listed Corporations. In these two articles, they refer to and apply the requirements set forth in Articles 54-5 and 54-6, which are under Chapter V "Securities Business" Section 2 "Maintenance of Sound Business Order" and govern the appointments of outside directors and audit committee of the securities companies.

116 In fact, the Korean Commercial Act does not define the outside director. However, article 415-2 (2) specifies that no more than one third of the audit committee members shall have active participation in corporate management or have close relationship (affiliated or related persons). Therefore, we can reasonably infer that at least two thirds of the members of the audit committee must be outside directors. The KSEA provides more direct and specific expression regarding that the members of the audit committee must consist of at least two thirds of outside directors. KSEA, §54-6 (2).

117 KSEA, §§54-5 (4), 191-12 (3).

118 KSEA, §54-5 (2).

119 Korean Commercial Act authorizes the board of directors to set up committees and delegates some of the board's power to the committees. Korean Commercial Act, §393-2.

120 Shareholders of listed companies owning more than 0.1% (or 0.5% as prescribed by the Presidential Decree) for more than 6 months have the rights to make proposals and ask directors to include them in the agenda of the General Shareholders' Meeting. KSEA, §191-14 (1).

121 Those companies, required to maintain at least one quarter of outside directors in the board of directors, are required to report to the Financial Supervisory Commission, the Korea Stock Exchange or the Korea Securities Dealers Association. KSEA, §54-5 (5).

122 Korean Commercial Act, Article 415-2 paragraph (1).

123 Korean Commercial Act, Article 415-2 paragraph (2). As stated in this provision, for example, any director, employee, supervisor, of the company, parent or subsidiary company, or any company having material interest in the company, the largest shareholder, and family member of the director are considered as connected persons. If the aforesaid persons are appointed as the members of the audit committee, they cannot take up more than 1/3 of the total committee members.

124 KSEA, §§54-6 (1) (requiring securities companies establish an audit committee), 191-17 (1) (requiring listed companies establish an audit committee).

125 KSEA, §§54-6 (2), 191-17 (2). The detailed rules regarding the composition of the audit committee are set forth in Article 54-6 of the KSEA, which comprises rules regarding the establishment and composition requirements for securities companies. Article 191-17 sets forth general requirement for establishing an audit committee by listed companies other than securities companies. However, regarding the composition of the audit committee of a listed company, it stipulates that the provisions of the Article 54-6 (2) through (6) shall apply *mutates mutandis*.

126 KSEA, §§54-6 (2), 191-17 (2). This requirement applies only to the listed companies. The representative of the audit committee of a non-listed company need not be an outside director.

127 KSEA, §§54-6 (2), 191-17 (2).

128 If the articles of incorporation specify a ratio lower than 3%, the lower ratio applies. Korean Commercial Act, §409 (3); KSEA, §§191-11 (1); 54-6 (6).

129 Korean Commercial Act, §382-4.

130 Korean Commercial Act, §393 (1).

131 Korean Commercial Act, §399 (1).

132 Korean Commercial Act, §399 (2).

133 Korean Commercial Act, §399 (3).

134 Korean Commercial Act, §400.

135 Korean Commercial Act, §401 (1).

136 Korean Commercial Act, §401 (2), §§399 (2) & (3).

137 The Companies Act (Cap. 50) was amended on July 8, 2002.

138 The Code of Corporate Governance was initially issued by the Corporate Governance Committee (Singapore) on Mar. 21, 2001. The Code of Corporate Governance was reviewed by the Council on Corporate Disclosure and Governance ("CCDG"), established by the Ministry of Finance on Aug. 16, 2002. After reviewing the recommendations of the CCDG, the MOF issued the Code of Corporate Governance 2005—Board Matters [hereinafter Singapore Code of Corporate Governance]. Information *available* at *http://www.ccdg.gov.sg/corpgov.htm*, last visited on April 1, 2006.

139 The number of members of the audit committee who are (1) executive directors of the company or of any related corporation, (2) a spouse, parents and family members of an executive director of the company or of any related corporation, or (3) any person having a relationship which would jeopardize the exercise of independent judgment of the audit committee, shall not become the majority of the audit committee members. Singapore Companies Act (Cap. 50), §201B (2).

140 Singapore Code of Corporate Governance, ¶2.

141 Singapore Code of Corporate Governance, ¶2.1.

142 Singapore Code of Corporate Governance, ¶3.1.

143 Generally, an independent director is described as "one who has no relationship with the company, its related companies or its officers ..." A related company includes it subsidiary, fellow subsidiary, or parent company. Singapore Code of Corporate Governance, ¶¶2.1~2.2.

144 Singapore Companies Act (Cap. 50), §201B (1). Section 201B of the Singapore Companies Act applies to only those companies incorporated in Singapore and listed on the stock exchange of Singapore. Singapore Companies Act (Cap. 50), §201B (10).

145 The provision does not directly require that majority members of the audit committee be independent directors but require that executive directors of the company or any related company, family members of an executive director of the company or any related company, and any person having close relationship with the management or the executive directors shall not exceed fifty percent of the total members of the audit committee. Singapore Companies Act (Cap. 50), §201B (2).

146 Singapore Companies Act (Cap. 50), §201B (3).

147 Singapore Code of Corporate Governance, ¶11.1.

148 Singapore Code of Corporate Governance, ¶¶4.1 & 7.1.

149 Singapore Code of Corporate Governance, ¶11.4. The Companies Act also sets forth the functions of the audit committee: (1) to review the audit plan; (2) to evaluate the system of internal accounting control; (3) to review the audit report; (4) to review the assistance given by the company officers to the auditor; (5) to review the scope and results of the internal audit procedures; (6) to review the balance sheet and income statement (or the consolidated financial reports if it is a holding company) of the company; (7) to nominate the candidate as the auditor. Singapore Companies Act (Cap. 50), §201B (5).

150 Company Law, §202.

151 The board of directors may adopt an ordinary resolution (if more than fifty percent of the board members approve) to employ a manager. Company Law, §29.

152 Company Law, §202.

153 "Because of the diffusion of shareholdings, the shareholders as a body are neither motivated nor able to engage in such monitoring." Melvin A. Eisenberg, *Corporate Governance: The Board of Directors and Internal Control*, 19 *Cardozo L. Rev.* 237, 238 (Sept./Nov., 1997).

154 Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals about Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 *Geo. L.J.* 285 (November, 2004).

155 Article 14-1 of the TSEA requires that publicly held corporations, stock exchanges, securities companies, and other securities related institutions establish internal control systems regarding financial matters and operations. TSEA, §14-1, para. 1. The competent authority has promulgated "Regulations Governing Establishment of Internal Control Systems by Public Companies" according to the paragraph 2 of the Article 14-1.

156 *See e.g.*, "Regulations Governing Establishment of Internal Control Systems by Public Companies" (Taiwan FSC Regulation); NYSE Manual, §303A(7)(d).

157 As discussed earlier, the Listing Rules of the Exchange of Hong Kong requires companies listed on the Growth Enterprise Market to designate an executive director as the compliance officer. *See* text companying *supra* note 82.

158 *See* Roberta S. Karmel, *The Securities and Exchange Commission Goes Abroad to Regulate Corporate Governance*, 33 Stetson L. Rev. 849 (Spring, 2004).

159 Securities and Exchange Act of 1934, Rule 10A-3; NYSE Manual, §303A (1); .

160 KSEA, §§54-5, 54-6; Korean Commercial Act, §415-2.

161 TSEA, §14-4, para. 2.

162 KSEA, §191-16, para. 1.

163 KSEA, §§191-17, 54-6, para. 2.

164 Corporate Governance Best-Practice Principles for TSEC/GTSM Listed Companies [hereinafter Corporate Governance Code], promulgated by the Taiwan Stock Exchange Corporation per Public Announcement Ref. No.(91)-Taiwan-Stock-Shang-025298 (October 4, 2002, latest amendment on December 31, 2003).

165 Corporate Governance Code, §28, para. 2.

166 Corporate Governance Code, §33, para. 2.

167 If any of the circumstances occur, the TSE or GTSM could reject the company's application

for listing. *See* Supplementary Provisions to the Taiwan Stock Exchange Corporation Criteria for Review of Securities Listings, art. 17, para. 1, subpara. 1 (latest amendment on Dec. 13, 2004); Directions for Determining Unsuitability for OTC Listing under Article 10, Paragraph 1 of the GreTai Securities Market Regulations Governing Review of Securities Traded on Over-the-Counter Markets, art. 1, para. 8, subpara. 5 (Mar. 2, '06).

168 Supplementary Provisions to the Taiwan Stock Exchange Corporation Regulations for Review of Securities Listings, §17, para. 1, subpara. 2.

169 Supplementary Provisions to the Taiwan Stock Exchange Corporation Regulations for Review of Securities Listings, §17, para. 1, subpara. 4.

170 "Rules Regarding the Independence of the Independent Directors and Independent Supervisors," adopted and promulgated by the Ministry of Finance Securities & Futures Commission on September 23, 2003, per Order No. Tai-Finance-Securities (1) 0920003896 (valid until January 1, 2007); "Rules Regarding the Independence of the Independent Directors of the Financial Holding Company's Hundred-Percent-Owned Subsidiary," adopted and promulgated by the TSFC on June 8, 2004, per Order No. Tai-Finance-Securities (1) 0930115716.

171 The three regulations were promulgated on March 28, 2006 per Order No. Financial-Supervisory-Securities-(1)-0950001615 of the Financial Supervisory Commission, Executive Yuan.

172 TSEA, §181-2.

173 Rules Regarding the Independence of the Independent Directors and Independent Supervisors, *supra* note 145.

174 The articles of incorporation may prescribe a ratio lower than 3%. Korean Commercial Act, §409 (3); KSEA, §§191-11 (1); 54-6 (6).

175 See John M. Holcomb, Corporate Governance: Sarbanes-Oxley Act, Related Legal Issues, and Global Comparisons, 32 DENV. J. INT'L L. & POL'Y 175, 175 (Spring 2004).

176 The US S.E.C. proposed Rule 10A-3 in January 2003. *See* Securities Exchange Act Release No. 47137 (January 8, 2003), 68 FR 2637 (January 17, 2003). SEC adopted Rule 10A-3 in April 2003. 17 C.F.R.§240.10A-3.

177 *See* US S.E.C. Release No. 34-48745, 81 S.E.C. Docket 1586, 2003 WL 22509738 (Nov. 4, 2003).

178 *See* TSEA, §§14-2 & 14-3.

179 *See* TSEA, §§14-4 & 14-5.

180 Section 307 of the Sarbanes-Oxley Act authorizes the SEC to make rules "in the public interest and for the protection of investors, setting forth minimum standards of profession conduct for attorneys appearingand practicing before the Commission in any way in the representation of issuers." 15 U.S.C.A. 7245 (2002).

181 Sarbanes-Oxley Act, § 307, 15 U.S.C. 7245 (2002).

182 Susan E. Carroll, Comment, *Caught between a Rock and a Soft Place: Regulating Legal Ethics to Police Corporate Governance in the United States and Hong Kong*, 14 *PAC. RIM L. & POL'Y J.* 35, 39-40- (January, 2005).

183 The SEC, in implementing Section 307 of the Sarbanes-Oxley Act, proposed a rule entitled "Standards of Professional Conduct for Attorneys Appearing and Practicing Before the Commission in the Representation of an Issuer" on Nov. 21, 2002 (Release Nos. 33-8150, 34-46868) and was codified into the federal regulation on Jan. 29, 2003, 17 C.F.R. §205 (2003).

184 American Bar Association is a national organization. Participation in the ABA is on the voluntary basis. Actually, ABA does not regulate US lawyers directly but influence indirectly by proposing ABA rules that are followed by most state bar associations that regulate lawyers practicing in their state. Susan E. Carroll, *supra* note 157, at 42.

185 American Bar Association, Model Rules of Professional Conduct, Rule 1.13 (Organization as a Client) and Rule 1.6 (Confidentiality) were two key rules revised to cope with Section 307 of the SOA and the SEC regulation. Susan E. Carroll, *supra* note 157, at 42-45; Press Release, ABA, ABA adopts New Lawyer Ethics Rules, Urges Fairness in Military Commission Trials, available at *http://www.abanet.org/media/aug03/081203_1.html* (Aug. 12, 2003), *cited from Developments in the Law—Corporations and Society: Lawyer Conduct and Corporate Misconduct*, 117 *HARV. L. REV.* 2227, 2235 n.53 (2004). The information regarding the ABA's Commission on the Evaluation of the Rules of Professional Conduct in 2000, *available at http://www.abanet.org/cpr/ethics2k.html* (last visited Mar. 28, 2006).

186 Harvey J. Goldschmid, *SEC: Speech by SEC Commissioner: A Lawyers' Role in Corporate Governance: The Myth of Absolute Confidentiality and the Complexity of the Counseling Task*, in CORPORATE GOVERNANCE 2006: BEST PRACTICES FOR GATEKEEPERS, 1530 PLI/CORP 13, 18-22 (NOV. 17, 2003).

187 For more discussion regarding the development of lawyers' responsibilities and standards of conduct when representing corporate clients, particularly practicing before the securities regulators, *see generally*, *Developments in the Law—Corporations and Society: Lawyer Conduct and Corporate Misconduct*, 117 *HARV. L. REV.* 2227 (2004).

188 Susanna M. Kim, *Dual Identities and Dueling Obligations: Preserving Independence in Corporate Representation*, 68 *TENN. L. REV.* 179, 188-193 (Winter, 2001).

189 *See* Stephanie R.E. Patterson, Note, *Section 307 of the Sarbanes-Oxley Act: Eroding the Legal Profession's System of Self-Governance?*, 7 *N.C. BANKING INST.* 155 (2003).

190 Susan E. Carroll, *supra* note 157, at 52-54.

191 Supermajority vote here means that the proposal is approved by more than two thirds of all members of the board of directors. TSEA, §14-5, para. 2

192 The minute of the board meeting must record the resolution adopted by the audit committee. TSEA, §14-5, para. 2.

193 The average US independent directors spent roughly 150 hours annually (or 3 hours per week) on their job. Goldschmid, *supra* note 161, at 16.

194 For example, please see Henry G. Manne, Merger and the Market for Corporate Control, 73 J. Pol. Econ. 110, 113 (1965).

195 New Release of the Department of Commerce, the Ministry of Economic Affairs (MOEA), Mar. 7, 2005.

196 Lawrence Liu, Strengthening the Enterprise Merger Laws, 128 Taiwan L. Rev. 5, 6-7 (Jan. 2006).

197 Id, at 8.

198 For the surviving company and its shareholders, since the un-asymmetrical merger does not constitute a substantial part of its business economically, such a merger shall be approved by the board, rather than by a shareholders' meeting, of the surviving company.

199 It seems that some scholar and the MOEA hold that the triangular merger is mentioned only in the legislative purpose of Article 22 of the Enterprise Merger Act, but some scholar has the opposite interpretation. Please see Explanatory Letter of the MOEA No. 09402030210, Mar. 22, 2005; Lawrence Liu, Strengthening the Enterprise Merger Laws, supra note 3, at 15; Lian-Yu Liu, Different Types of Mergers and Dissenter's Rights, 128 Taiwan L. Rev. 26, 29 (Jan. 2006).

200 Wen-Yeu Wang, Corporation Law 145 (2005).

201 Please see Articles 186 and 317 of the Company Act.

202 Lian-Yu Liu, Different Types of Mergers and Dissenter's Rights, supra note 6, at 32-33.

203 Mei-Li Hsu, A Study on the Problems to the Appraisal Rights, 8 Taiwan Bar Journal 66-68 (Nov. 2002).

204 Please see the decision of Pan-Chiao District Court, No. 124, 1998; Lian-Yu Liu, Different Types of Mergers and Dissenter's Rights, supra note 6, at 33.

205 For other procedural suggestions, please see Qi-Chang Yu, The Leaving and Monitoring Mechanisms of the Appraisal Remedies, 128 Taiwan L. Rev. 53, 64-68 (Jan. 2006).

206 Please see Articles 73 and 74 of the Company Act.

207 For example, if a company with surplus earnings merged with a company with losses, the former company's ability to pay debts might be affected.

208 For example, practitioners have different interpretations regarding whether companies can use cash or other assets as a part of the consideration in share exchange transactions under Article 29 of the Enterprise Merger Act. Please see Lawrence Liu, Strengthening the Enterprise Merger Laws, supra note 3, at 16.

209 The Explanatory Letter of the MOEA No. 09202216710, Oct. 14, 2003.

210 The Explanatory Letter of the MOEA No. 09402031030, Mar. 22, 2005.

211 Please see Chih-Cheng Wang, Fundamental Structure For Sale of Business, 19 Chung Cheng L. Rev. 147, 158-59 (Nov. 2005).

212 Id, at 161-62.

213 According to the legislative reason for the amendment to Article 23 of the Company Act in 2001, directors, as the responsible persons, owe a fiduciary duty to the "corporation". However, the interpretation of "corporation" is unclear under Taiwan's law and practice.

214 For detailed discussions, please see Chieh-Shan Chen, The Directors' Fiduciary Duty—Focus on Merger Law, PhD Dissertation, the Department of Law, National Chung Cheng University (2003).

215 Paragraph 1 of Article 177 of the Company Act stipulates that "A shareholder may appoint a proxy to attend a shareholders' meeting in his/her/its behalf by executing a power of attorney printed by the company stating therein the scope of power authorized to the proxy."

216 The Letter of the Financial Supervisory Committee (FSC) No. 0940005852, Dec. 15, 2005.

217 Paragraph 2 of Article 6 of the Proxy Rule. Prior to 2001, the Company Act compulsorily required companies to adopt the cumulative voting in directors' elections. To provide flexibility and autonomy to companies, the Company Act amended the said compulsory requirement in 2001 by allowing companies to adopt other voting mechanisms provided in the articles of incorporation. Article 198 of the Company Act provides: *"Subject to the provisions otherwise provided for in the articles of incorporation*, in the process of electing directors at a shareholders' meeting, the number of votes exercisable in respect of one share shall be the same as the number of directors to be elected, and the total number of votes per share may be consolidated for election of one candidate or may be split for election of two or more candidates. A candidate to whom the ballots cast represent a prevailing number of votes shall be deemed a director elect." According to Article 6 of the Proxy Rule, a shareholder who meets certain requirement, such as 10% shareholdings, may mandate a trust enterprise or agent for stock affairs to act as the solicitor. In such a case, when allocating the proxy solicited by the solicitor, the number of voting allocated to the candidates of independent directors supported by the shareholder shall be more than the number of voting allocated to the candidates of non-independent directors.

218 Paragraph 2 of Article 179 of the Company Act.

219 Article 6-1 of the Proxy Rule.

220 Paragraph 4 of Article 8 of the Proxy Rule.

221 Please see Articles 7 and 8 of the Proxy Rule.

222 For example, Article 6 of the Proxy Rule provides that "A shareholder who for one year or more has continuously held issued shares of a company in conformance with one of the following conditions may mandate a trust enterprise or agent for stock affairs to act as the solicitor, and the number of shares to be represented by it shall not be subject to the restriction under Article 20: 1. Has held 10 percent or more of the total number of issued shares of the company. 2. Has held 8 percent or more of the total number of issued shares of the company and, when election of directors or supervisors is on the shareholders meeting agenda, one of the candidates it intends to support meets the qualifications for independent director or supervisor…"

223 The Letter of the FSC No. 0940004897, Oct. 20, 2005.

224 Lawrence Liu, Strengthening the Enterprise Merger Laws, supra note 3, at 20.

225 Please see Paragraph 2 of Article 5 of the Proxy Rule.

226 Lain-Yu Liu, An Examination on the Constitutionality of the Negative Qualification of Proxy Solicitors, 328 Tax Monthly 76-79 (Apr. 2002).

227 Please note that the individual investor (natural person) constitutes almost 80% of the total investors in Taiwan's securities market.

228 For example, Article 26 of the SEA requires that the total shares of nominal stocks held by the entire body of either directors or supervisors of an issuer shall not be less than a specified percentage of its total issued shares.

229 The proxy fight between ChinaTrust and CDFH is a little bit complicated. Since the Taiwan government also held around 6-7% shares of the CDFH, which was about the same percentage held by ChinaTrust, in order to win the proxy fight and the board seats, ChinaTrust promised the government that it will increase its shareholding to 15% after gaining control of the CDFH's board in exchange for the government's support. However, ChinaTrust did not increase its shareholdings in CDFH until recently and the performance of CDFH's share price was not good after the change of control.

230 Po-Chen Industrial Corp. acquired shares of his subsidiary, Pei-Li Industrial Corp. in 1996, China Development Industrial Bank acquired the shares of Grand Cathay Securities Corp. in Apr. 2001 and TaiShin Bank acquired the shares of Ta-An Bank in Dec. 2001.

231 In 2003, there are three tender offer cases in Taiwan.

232 Article 8 of the Tender Offer Rule.

233 Paragraph 2 of the Article 11 of the Tender Offer Rule provides that where the following conditions are met, the requirement to employ a public tender offer as set forth in the preceding paragraph shall not apply: (1) Transfer of shares between affiliates mentioned in Article 3. (2) Shares obtained under the Taiwan Stock Exchange Corporation Regulations Governing Auction of Listed Securities by Consignment. (3) Shares obtained under the Taiwan Stock Exchange Corporation Regulations Governing Purchase of Listed Securities by Tender or under the GreTai Securities Market Regulations Governing Purchase of OTC Securities by Tender. (*Note*: this tender is not a tender offer, but a mechanism to bid the securities by brokers.) (4) Shares obtained under Article 22-2, Paragraph 1, Subparagraph 3 of the Act. (*Note*: Article 22-2 of the SEA governs the transfer of shares by large shareholders. i.e. sale of control. Even though this article expressly excludes the sale of control from employing the tender offer mechanism, the sale of control is still subject to the strict restriction imposed by Article 22-2 of the SEA.) (5) Implementing a share exchange under the Company Act, Article 156, paragraph 6, or under the Business Mergers and Acquisitions Act, in which new shares are issued to serve as the consideration for acquiring the shares of another public company. (6) Other conditions in conformity with FSC regulations.

234 Article 19 of the Tender Offer Rule.

235 Please see Items 8, 9 and 11 of the Reinvestment Guidelines, the Letter of FSC No. 0946000399, Jun. 14, 2005.

236 Mega Holdings announced a tender offer to acquire 5% to 26% shares of Taiwan Business Bank on Dec. 19, 2005. Please see China Times, Feb. 18, 2006, at B1 and Economic Daily News, Dec. 21, 2005, at A4.

237 For a detailed discussion of the mandatory bid rule, please see Hsin-Ti Chang, The Study on the Mandatory Bid Mechanism from the Perspective of Economic Analysis, 28 Fu-Jen L. Rev. 47, 63-70, 76-77 (Dec. 2004).

238 In addition, the elements of the mandatory bid rule are somewhat ambiguous. For example, what constitutes "jointly with others intends to acquire"? Does it include the ex post agreement between the offeror and the other person? Moreover, criminal punishment will be inappropriate under such ambiguous circumstances.

239 This is because capital issuance is complicated and time-consuming in Taiwan, so it is difficult to issue new shares to dilute the control of a hostile acquirer in a short period of time. Please see Lawrence Liu, Strengthening the Enterprise Merger Laws, supra note 3, at 18.

240 For example, Lawrence Lee, A Study on the Legal Problems to Hostile Merger among Financial Holding Companies, 128 Taiwan L. Rev. 37, 45 (Jan. 2006).

241 Yu-Geng Kuo, An Introduction of the Tender Offer System and Its Amendments in Taiwan, 23 Securities and Futures Monthly 12, 20 (Jul. 2005).

242 Id, at 20.

243 Such as the change-of-control transaction between the Wen-Chun Food Company and Ding Hsin Group. Please see Hsin-Ti Chang, Regulating Sale of Control Transactions in Taiwan–From the Perspective of Economic Analysis, 31 NTU L. Rev. 43, 111-13 (Jul. 2002).

244 (1) for shares not listed in the stock exchange market and not traded in the OTC market, the designated person(s) is limited to the person(s) who has full understanding and familiarity with the company's business as well as has the substantial financial ability, excluding the person(s) subscribing shares from the public offering; (2) for shares traded in the OTC market, the designated person(s) is limited to securities dealers and all of the issuing company's employees as a group with the same price; (3) for shares listed in the securities exchange market, the designated person(s) is limited to all of the issuing company's employees as a group with the same price. Please see Explanatory Letter of the SFB No. 112118 (Apr. 10, 2000).

245 For detailed discussion, please see Hsin-Ti Chang, Regulating Sale of Control Transactions in Taiwan–From the Perspective of Economic Analysis, supra note 50, at 18-26.

246 Hsin-Ti Chang, A Study on the Transfer Restriction on Insiders, 79 National Chengchi L. Rev. 221 (Jun. 2004)

247 Please see supra note 40.

248 Lian-Yu Liu, Case Study on Securities Exchange Act, 202 (2000).

249 In practice, there are three ways to specify the percentage: a fixed number (such as 2%), a range (such as 2% to 10%), and a bottom limit (such as no less than 2%). Please see the Explanatory Letter of the Ministry of Economic Affairs (MOEA) No. 09102295970, Jan. 21, 2003.

250 Explanatory Letter of the MOEA No. 86219394, Oct. 7, 1997.

251 You-Kun Lee and Jia-Hou Liu, How Many Problems Underlie the Taiwanese-Style EPSSOP? 27 Taiwan Business Bank Monthly 29, 35 (Jul. 2004).

252 An-Ping Chen and Hsin-Wen Wang, The Spring of the Competitiveness of the Information Economy: The Unique Taiwanese-Style Employee Profit Sharing and Stock Ownership, 3 Industry Forum 1, 4, (Jan. 2002).

253 The "dilution" used in this paper mainly refers to the issuance of new shares at below-market value. Before the 2004 amendment to the Securities Offering and Issuance Regulation (please see Section II.C. 1 below), when calculating the surplus distributed to employees in the form of stock, i.e. the EPSSOP, the par value, rather than the market price, is considered. As a result, by using the par value as the divisor, not only the number of shares distributed to employees will increase but the actual value of compensation received by employees swells. For example, if the surplus distributed to employees is 1 million in the form of stock, by using the par value as the divisor, the company will issue and distributed 0.1 million shares to employee. If the market price is more than the par value, the actual compensation received by employees swells.

254 Yu-Feng Ma and Yeong-Jia Goo, A Study of Employee Profit Sharing and Stock Ownership Plans in Taiwan, 22 International J. of Management 127, 129 (Mar. 1, 2005).

255 The shareholders meeting can resolve to distribute cash to shareholders and stock to employees. Please see Explanatory Letter of the MOEA No. 88215293, Jul. 15, 1999.

256 Even if the company reports a loss this year, it can distribute stock bonuses to employees by using the retained earnings accumulated over the past years.

257 Paul M. Dudek, International Reporting and Disclosure Issues in the Division of Corporation Finance, Oct. 1, 2003, 1428 PLI/Corp. 871, 938 (May 2004).

258 Explanatory Letter of the MOEA No. 206278, Apr. 14, 1990.

259 Please see Section II.C.1. below.

260 *Business Weekly*, Jan. 9, 2006, at 60.

261 Yu-Feng Ma and Yeong-Jia Goo, A Study of Employee Profit Sharing and Stock Ownership Plans in Taiwan, supra note 6, at 130.

262 It Is Time to Examine the Huge Bonuses in the Electronics Industry, China Times, Nov. 14, 2004, at A2.

263 Please see Explanatory Letter of the MOEA No. 36589, Nov. 29, 1988.

264 For the detailed arguments of both of the sides, please see Chi-Jian Chen, A Study on the Employee Profit Sharing and Stock Ownership and Stock Option, Master's thesis, Department of Law, Soochou University 19-21 (2001).

265 Article 4-1 of the Income Tax Law.

266 Item 7 of Article 11 of the Regulations Governing Information TO BE PUBLISHED in Public Offering and Issuance Prospectuses, promulgated on Dec. 21, 2004, and Article 11 of the Criteria Governing Information TO BE PUBLISHED in Annual Reports of Public Companies, promulgated on Dec. 21, 2004.

267 Yu-Feng Ma and Yeong-Jia Goo, A Study of Employee Profit Sharing and Stock Ownership Plans in Taiwan, supra note 6, at 133.

268 Id, at 133-34.

269 Morris Chang of TSMC and Robert Tsao of UMC have completely opposite opinions in this regard. Morris Chang believes that the EPSSOP should be booked as expenses, and Robert Tsao, the earnings distribution. Please see China Times, Jul. 10, 2004.

270 Please see Chun-Jing Tung, The Accounting Treatment of Employee Bonuses and Director and Supervisor Compensations, from The Perspective of Corporate Governance, 1842 Tax Affairs 7, 11-12 (Nov. 30, 2002); Show-Ru Ma, Stock Bonuses Are the Shareholders' Costs and Company's Expenses, 214 Accounting Research Monthly 62, 70 (Sep. 2003); Yu-Feng Ma and Yeong-Jia Goo, A Study of Employee Profit Sharing and Stock Ownership Plans in Taiwan, supra note 6, at 134.

271 Yu-Feng Ma and Yeong-Jia Goo, A Study of Employee Profit Sharing and Stock Ownership Plans in Taiwan, id, at 134.

272 Chun-Jing Tung, The Accounting Treatment of the Employee Bonuses and Director and Supervisor Compensations, supra note 22, at 12. What is more, should market value be determined by the intrinsic value method or the fair market value method? Some analysts favor market value because it reflects the true value of dividends and bonuses shared by employees. This preference raises the question of how corporations select between the intrinsic value method and the fair market value method. The US government has not forced companies to adopt the fair recognition value provisions of FASB No. 123, and the fair market value will not become effective until 2007 in the EU. Taiwan can temporarily adopt the intrinsic value method while observing the international trends and adjusting the plan in order to meet international standards. Id, at 135.

273 For example, both Company A and Company B distribute stock bonuses to their employees. The market price of Company A is NT$100, and that of Company B is $5. To tax all stock bonuses according to the par value is unfair to Company B's employees.

274 Chi-Jian Chen, A Study on the Employee Profit Sharing and Stock Ownership and Stock Option, supra note 16, at 31.

275 For the employee compensation regime, the term *stock warrant* under the SEA basically has substantially the same meaning as *stock option*. Therefore, for ease of discussion, this paper uses the term *stock option* to include stock warrants.

276 The laws governing the ESOP are complicated in Taiwan. For the summarized comparison, please see Show-Feng Lee, A Study of Employee Stock Options in Taiwan, Master's thesis of the Department of Law, National Cheng-Chi University 23 (2003).

277 Please see Explanatory Letter of the MOEA No. 09102167580, Aug. 16, 2002.

278 Please see Explanatory Letter of SFC No. 0910005444, Oct. 28, 2002.

279 Da-Ying Liou, Stock Options and Employee Bonuses, 37 Taiwan L. J. 79, 94 (Aug. 2002).

280 Yuan-He Lai, Wen-Yu Wang and etc., Comments on the Newly Amended Company Act, 230(2002).

281 Da-Ying Liou, Stock Options and Employee Bonuses, supra note 31, at 90; Wan-Ru Tseng, The Analysis of the Managing Teams' Compensation in Limited-by-Share Companies, Papers on Corporate Management and Capital Market, 97 (2002)

282 For a detailed analysis, please see Hsin-Ti Chang, A Study on the Pay-Setting Process and Disciplinary Mechanism of Executive Compensation in Public Companies, National Taipei Uni. L. Rev. (forthcoming Jun. 2006)

283 The problem of dilution by the ESOP is not as serious as the EPSSOP because Article 53 of the Securities Offering and Issuance Regulation sets the limit on the number of shares for the individual and total employee stock options respectively. Article 53 provides, "Where an issuer applies for issuance of employee stock options, the number of shares for each issuance of employee stock options shall not be more than 10% of its total issued shares, and when outstanding employee stock options are taken into account, the aggregated volume shall not be more than 15% of total issued shares. Where an issuer issues employee stock options, the volume of stock option granted to each recipient shall not be more than 10% of the total volume of each issue of employee stock options, and the number of shares that may be subscribed to by each person for any given fiscal year shall not be more than one percent of the total number of shares that have been issued by the concluding day of the fiscal year."

284 Paragraph 5 of Article 267 of the Company Act.

285 Lucian A. Bebchuk and Jesse M. Fried, Pay without Performance –The Unfulfilled Promise of Executive Compensation, 196 (2004).

286 Da-Ying Liou, Stock Options and Employee Bonuses, supra note 31, at 88.

287 Id, at 93; Hsin-Ti Chang, A Study on the Pay-Setting Process and Disciplinary Mechanism of Executive Compensation in Public Companies, supra note 34.

288 Some scholars hold that to retain the flexibility of the ESOP, the super-majority vote of the board and reports to shareholders' meetings afterwards are sufficient. Wen-Yu Wang, The Design of the Employee Stock Option and the Relevant Laws, Financial Law 306 (2001).

289 http://www.deloitte.com/dtt/article/0,1002,sid%253D65526%2526cid%253D105053,00.html , visited on Feb. 23, 2006.

290 Wen-Yi Lin, Four Proposals of the ESOP Tax Issue, Commercial Times, Dec. 30, 2002, at A2.

291 Explanatory Letter of the Ministry of Finance No. 0930451436, Apr. 30, 2004.

292 Lian-Yu Liu, Employee Stock Bonuses, Employee Stock Options, and Employees' Right of First Refusal, 44 Taiwan L. J. 137, 140 (Mar.).