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### Related party transactions in commonwealth Asia: Complicating the comparative paradigm

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## Related Party Transactions in Commonwealth Asia: Complicating the Comparative Paradigm

Dan W. Puchniak\* and Umakanth Varottil\*\*†

### ABSTRACT

The World Bank's influential Doing Business Report (DBR) has been a key platform for the American-driven dissemination of global norms of good corporate governance. A prominent part of the DBR is the related party transactions (RPT) index, which ranks 190 jurisdictions from around the world on the quality of their laws regulating RPTs. According to the RPT Index, the regulation of RPTs in Commonwealth Asia's most important economies is stellar. In the 2018 RPT Index, Singapore ranked 1<sup>st</sup>, Hong Kong and Malaysia tied for 3<sup>rd</sup>, and India came in at 20<sup>th</sup>. However, despite the uniformly high RPT Index scores in all of Commonwealth Asia's most important economies,

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empirical, case-study, and anecdotal evidence overwhelmingly suggests that there are in practice significant inter-jurisdictional and intra-jurisdictional differences in the actual function and regulation of RPTs in Commonwealth Asia.

In this article, we assert that the conspicuous gap between what the RPT Index suggests should be occurring and what is actually occurring in Commonwealth Asia exists because the Index fails to capture the complexity of RPTs in three respects, which we term: (1) regulatory complexity; (2) shareholder complexity; and, (3) normative complexity. First, it appears that the RPT Index overly emphasizes the role played by a jurisdiction's formal corporate and securities laws in determining the effectiveness of its RPT regulation, and it fails to pay due regard to its corporate culture and rule of law norms in determining the efficiency of its RPT regulation. Second, the RPT Index erroneously assumes that controlling shareholders are a homogeneous group driven by similar incentives. Third, the general assumption that RPTs *per se* are evidence of defective corporate governance and that stricter regulation of RPTs consequently equates to "good law" is erroneous.

Demonstrating the frailties of the RPT Index is important in practice because jurisdictions – especially developing ones – commonly look to the DBR and its indices when reforming their laws. In addition, the RPT Index is built on some of the most influential research in the field of comparative corporate law, which makes our challenge to the validity of the RPT Index academically significant.

**Keywords:** Comparative corporate law and governance, related party transactions, Commonwealth Asia, World Bank Doing Business Report, legal origins theory

**JEL Classification:** K22, L22

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## INTRODUCTION

Two decades ago, within the blink of an eye, the Asian Financial Crisis pushed many of Asia’s miracle economies to the brink of collapse. In the postmortem, the proclivity of Asia’s controlling shareholders to engage in wealth tunneling through related party transactions (RPTs)<sup>1</sup> was identified as a seminal cause of the Crisis.<sup>2</sup> Although Asia has since recovered and emerged as the engine of global economic growth, the corporate governance norms and mechanisms developed in the years following the Crisis – including,

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1. A related party transaction (RPT) is a term used to refer to a transaction between a corporation and a counterparty who has some relationship with the corporation. Normally, for a counterparty to be considered a “related party,” it must have influence over the corporation’s decision-making process or access to corporate information which is unavailable to an arm’s length counterparty.

2. One study explains that corporate governance played an important role in determining the extent to which countries suffered from the economic downturn. It found that in countries with weak legal institutions and limited minority investor protection, controlling shareholders and managers were able to tunnel wealth out of the companies that led to the expropriation of minority shareholders. See Simon Johnson et al., *Corporate Governance in the Asian Financial Crisis*, 58 J. FIN. ECON. 141, 141-86 (2000).

prominently, the regulation of RPTs – have come to define global corporate governance.<sup>3</sup>

The World Bank's influential Doing Business Report (DBR) has been a key platform for the American-driven dissemination of global norms of good corporate governance.<sup>4</sup> The DBR sets global standards for good corporate governance and motivates jurisdictions to adopt them by publicizing yearly rankings of jurisdictional compliance with these norms. A prominent part of the DBR is the RPT Index, which ranks 190 jurisdictions from around the world on the quality of their laws regulating RPTs.<sup>5</sup> The World Bank views the RPT Index as a critically important corporate governance metric and policy promotion tool as it “focuses on one of the most serious breaches of good corporate governance around the world: the related-party transaction.”<sup>6</sup>

The RPT Index is built on the assumption that “good law” places more onerous disclosure and approval requirements on companies that engage in RPTs (*ex ante* controls) and makes it easier to hold controlling directors liable for self-dealing (*ex post* controls).<sup>7</sup> Put simply, the RPT Index assumes that the stricter

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3. Institutions such as the OECD, the Asian Corporate Governance Association and the CFA Institute called upon various Asian jurisdictions to bolster their corporate governance norms to address the risks to investors from abusive RPTs. OECD, GUIDE ON FIGHTING ABUSIVE RELATED PARTY TRANSACTIONS, OECD (2009), <https://www.oecd.org/daf/ca/corporategovernanceprinciples/43626507.pdf>; ASIAN CORP. GOV. ASS'N, *ACGA White Paper on Corporate Governance in India*, ASIAN CORP. GOV. ASS'N (2010), [https://www.acga-asia.org/upload/files/advocacy/20170402220450\\_115.pdf](https://www.acga-asia.org/upload/files/advocacy/20170402220450_115.pdf); CFA INST. CTR. FOR FIN. MKT. INTEGRITY, *Related Party Transactions: Cautionary Tales for Investors in Asia* (2009), <https://www.cfainstitute.org/-/media/documents/article/position-paper/related-party-transactions-cautionary-tales-for-investors-in-asia.ashx>. See Jeffrey Gordon, *Convergence and Persistence in Corporate Law and Governance*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 45-46 (Jeffrey Gordon & Wolf-Georg Ringe eds., 2018).

4. The 2018 DBR is the 15<sup>th</sup> Edition of the DBR. According to the World Bank “The objectives of [the DBR] are as clear as they are ambitious: to inform the design of reforms and motivate these reforms through country benchmarking”. The academic importance of the DBR has been significant as “over 3,000 peer-reviewed academic papers and another 7,000 working papers have been written using the [DBR data]”: WORLD BANK, *Doing Business 2018: Reforming to Create Jobs*, WORLD BANK GROUP iv (2018), <http://www.doingbusiness.org/~media/WBG/DoingBusiness/Documents/Annual-Reports/English/DB2018-Full-Report.pdf>, [hereinafter “2018 DBR”]. All data used in the 2018 DBR are from June 2017. *Id.* at tbl. 8.1 note. An online version of the 2018 DBR (2018 DBR Online) which includes additional information and data is available at WORLD BANK, DOING BUSINESS 2018: REFORMING TO CREATE JOBS (ONLINE), <http://www.doingbusiness.org/reports/global-reports/doing-business-2018> [hereinafter “DBR Online”].

5. In this article, we refer to the DBR's “Extent of Conflict of Interest Regulation Index” as the “Related Party Transaction Index” (RPT Index). We have done this because it provides a more accurate description of what the index measures and the label is more consistent with the existing literature. For an overview of the RPT Index and its components, see 2018 DBR, *supra* note 4, at 92 tbl. 8.10, 93–94. The precise manner in which the RPT Index is constructed and a record and timeline of the legal reforms made in each jurisdiction since the first DBR related to the RPT Index are available at WORLD BANK, *Protecting Minority Shareholders: Doing Business Reforms*, WORLD BANK GROUP <http://www.doingbusiness.org/data/exploretopics/protecting-minority-investors/reforms> (last visited Feb. 18, 2019).

6. WORLD BANK, *Protecting Minority Shareholders: Frequently Asked Questions*, WORLD BANK GROUP, <http://www.doingbusiness.org/data/exploretopics/protecting-minority-investors/faq> (last visited Jan. 9, 2019).

7. 2018 DBR, *supra* note 4, at 91–94.

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the formal legal controls on RPTs the better.<sup>8</sup> The World Bank suggests that the payoffs for jurisdictions with “good law” that strictly regulate RPTs are substantial.<sup>9</sup> It posits that jurisdictions with “good law” will have more minority shareholders as they will be better protected against controlling shareholders and directors extracting private benefits of control.<sup>10</sup> In turn, companies will have more dispersed shareholder ownership, which will ultimately produce “larger equity markets that increase the ability of companies to raise the capital needed to grow, innovate, diversify and compete”.<sup>11</sup>

Conversely, the World Bank suggests that in jurisdictions with “bad law” that loosely regulate RPTs, “investors may be reluctant to invest, unless they become controlling shareholders”.<sup>12</sup> The World Bank considers this to be problematic as it assumes that controlling shareholders may stifle investment in equity markets by using RPTs to expropriate corporate value from minority shareholders by extracting private benefits of control.<sup>13</sup> Thus, according to the World Bank, strictly regulating RPTs to reduce private benefits of control is critical to the success of a jurisdiction’s equity markets and economic development.<sup>14</sup>

By this measure, Commonwealth Asia appears to be a corporate governance utopia. According to the RPT Index, the regulation of RPTs in Commonwealth

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8. According to the DBR Online, the RPT Index ranges from 0 to 10, with higher values indicating stronger regulation of RPTs: WORLD BANK, *Protecting Minority Shareholders Methodology*, WORLD BANK GROUP, <http://www.doingbusiness.org/Methodology/Protecting-Minority-Investors> (last visited Jan. 9, 2019). A jurisdiction’s score on the RPT Index will increase if it reforms its law to place more onerous disclosure and approval requirements on companies that engage in RPTs (*ex ante* controls) and/or make it easier to hold controlling directors liable for self-dealing (*ex post* controls). Conversely, there are no measures in the RPT Index in which a jurisdiction’s score would decrease if it instituted stricter *ex ante* or *ex post* controls on RPTs. 2018 DBR, *supra* note 4, at 91–94.

9. WORLD BANK, *Protecting Minority Shareholders: Why It Matters*, WORLD BANK GROUP, <http://www.doingbusiness.org/data/exploretopics/protecting-minority-investors/why-matters> (last visited Jan. 9, 2019).

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. *Id.*

Asia's most important economies<sup>15</sup> is stellar.<sup>16</sup> In the 2018 RPT Index, Singapore ranked 1<sup>st</sup>, Hong Kong and Malaysia 3<sup>rd</sup> (tied), and India 20<sup>th</sup> out of 190 jurisdictions.<sup>17</sup> The RPT Index scores for Commonwealth Asia's most important economies (i.e., Singapore: 9.3; Hong Kong: 9.0; Malaysia: 9.0; and, India: 7.3 out of 10)<sup>18</sup> suggest that the regulation of RPTs in Commonwealth Asia is uniformly effective, superior to OECD high-income jurisdictions (which have an average score of 6.4),<sup>19</sup> and markedly better than other Asian jurisdictions (which have an average score of 5.8).<sup>20</sup>

Against this backdrop, our in-depth analysis of the actual function and regulation of RPTs in Commonwealth Asia's most important economies presents an intriguing puzzle. Despite the uniformly high RPT Index scores in all of Commonwealth Asia's most important economies, empirical, case-study, and anecdotal evidence overwhelmingly suggests that there are in practice significant inter-jurisdictional and intra-jurisdictional differences in the actual function and regulation of RPTs in Commonwealth Asia. In short, there is a conspicuous gap between what the RPT Index suggests should be occurring and what is actually occurring in practice.

As we explain in detail below, although the RPT Index ranks India and Malaysia as world-leading for RPT regulation, in actual practice there is overwhelming evidence that both jurisdictions have systematic problems with RPTs being abused by controlling shareholders for the purpose of wealth

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15. The Commonwealth comprises a group of 52 countries that were erstwhile colonies of Britain. *Member Countries*, COMMONWEALTH, <http://thecommonwealth.org/member-countries> (last visited Feb. 18, 2019). In this article, we have chosen to consider four jurisdictions that are the most significant economic powers in Commonwealth Asia. These four jurisdictions – Hong Kong, India, Malaysia, and Singapore – are home to the largest number of listed companies and to the largest stock exchanges by market capitalization among the Commonwealth jurisdictions in Asia. WORLD FED'N EXCHANGES, *WFE Annual Statistics Guide* v3, <https://focus.world-exchanges.org/storage/app/media/statistics/WFE%20Annual%20Statistics%20Guide%202017.xlsx>.

Although Hong Kong formally left the Commonwealth in 1997 when it became a special administrative region of China, following the convention of legal writers in the Commonwealth proper, we include it within the group for our purposes as it continues to share a legal tradition with the rest of the Commonwealth. See e.g. Paul Valley, *The Commonwealth: Who's in the Club?*, INDEPENDENT, March 16, 2006; DAVID C. DONALD, A FINANCIAL CENTRE FOR TWO EMPIRES: HONG KONG'S CORPORATE, SECURITIES AND TAX LAWS IN ITS TRANSITION FROM BRITAIN TO CHINA (2014). For a list of Commonwealth economies ranked in the top 20 on the 2018 RPT Index, see Appendix 1.

16. 2018 DBR, *supra* note 4.

17. The World Bank makes all current and past data for the RPT Index – including but not limited to the 2018 RPT Index – and the component indices available at the World Bank Databank. WORLD BANK, *World Bank Databank*, WORLD BANK GROUP, <https://databank.worldbank.org/data/source/doing-business/> (last visited Feb. 17, 2019). See Appendix 1 below which includes the relevant data for from the 2018 RPT Index used in this article, and which is reflected in highly summarized form in the 2018 DBR Report.

18. See Appendix 1.

19. *Id.*

20. *Id.* The average for Asian jurisdictions was calculated by the authors based on the jurisdiction level data.

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tunneling.<sup>21</sup> There is also evidence that India's and Malaysia's RPT regulatory regimes have encountered problems in practice because of overly strict formal legal controls on RPTs – which directly contradicts the RPT Index's suggestion that stricter formal regulation necessarily equates to “good law”.<sup>22</sup>

At first blush, the exceptionally high rankings of Hong Kong and Singapore on the RPT Index appear to match the reality that their RPT regulatory regimes are generally effective in practice. However, a more granular analysis reveals that the RPT Index misidentifies the actual reasons for Hong Kong's and Singapore's success. When comparing Hong Kong and Singapore with India and Malaysia, it appears that inter-jurisdictional differences in corporate culture and rule of law norms provide a compelling explanation for their different levels of success – factors that are not the focus of the RPT Index. Conversely, an inter-jurisdictional comparison of formal corporate and securities laws, which are the primary focus of the RPT Index, do little to explain the inter-jurisdictional differences in the actual successes and failures of regulating RPTs in Commonwealth Asia. This is unsurprising as the formal corporate and securities laws are generally similar across all the jurisdictions.<sup>23</sup>

Moreover, Singapore stands out for its somewhat surprising success in effectively regulating RPTs among its state-owned enterprises (SOEs). Again, on closer inspection, this appears to have little to do with the formal corporate and securities laws that are at the core of the RPT Index and more to do with Singapore's unique institutional and regulatory architecture for promoting good corporate governance in its SOEs.<sup>24</sup> Yet, despite Hong Kong's and Singapore's general success in RPT regulation, both jurisdictions have been plagued by pervasive wealth tunneling in listed companies with mainland Chinese controlling shareholders.<sup>25</sup> These failures in Hong Kong's and Singapore's otherwise successful RPT regimes suggests that intra-jurisdictional differences may arise in the effectiveness of RPT regulation based on the *type* of controlling

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21. Wai Meng Chan, *Expropriation Through Related Party Transactions: The Position in Malaysia*, 2010 IABR & ITLC Conference Proceedings (2010), [https://umexpert.um.edu.my/file/publication/00005164\\_55151.pdf](https://umexpert.um.edu.my/file/publication/00005164_55151.pdf); Marianne Bertrand et al., *Ferretting Out Tunneling: An Application to Indian Business Groups*, 117 Q.J. ECON. 121 (2002).

22. For a discussion of this issue, see Part 5 *infra*.

23. Janine Pascoe, *Corporate Law Reform and Some 'Rule of Law' Issues in Malaysia*, 38 HONG KONG L.J. 769 (2008); Dan W. Puchniak & Luh Luh Lan, *Independent Directors in Singapore: Puzzling Compliance Requiring Explanation*, 65 AM. J. COMP. L. 265, 327 (2017); Alex Lau et al., *In Search of Good Governance for Asian Family Listed Companies*, 28 CO. LAW. 306 (2007).

24. On the efficiency of Singapore's SOEs, see Tan Cheng Han et al., *State-Owned Enterprises in Singapore: Historical Insights into a Potential Model for Reform*, 28 COLUM. J. ASIAN L. 61 (2015). On the unique regulatory architecture that has resulted in the success of Singapore's SOEs, see Puchniak & Lan, *supra* note 23, at 305–17.

25. Puchniak & Lan, *supra* note 23, at 319–20, 326–29; Yan-Leung Cheung et al., *Tunneling, Propping, and Expropriation: Evidence from Connected Party Transactions in Hong Kong*, 82 J. FIN. ECON. 343, 346 (2006).



shareholder – an important corporate governance feature that the RPT Index entirely overlooks.<sup>26</sup>

We assert that the conspicuous gap between what the RPT Index suggests should be occurring and what is actually occurring in Commonwealth Asia exists because it fails to capture the complexity of RPTs in three respects, which we term: (1) regulatory complexity; (2) shareholder complexity; and, (3) normative complexity. First, it appears that the RPT Index overly emphasizes the role played by a jurisdiction's formal corporate and securities laws in determining the effectiveness of its RPT regulation. Our detailed comparative analysis of RPTs in Commonwealth Asia's leading economies demonstrates that while a jurisdiction's corporate and securities law are no doubt important, its corporate culture and rule of law norms may be as important – if not more important – in determining the efficacy of its RPT regulation.<sup>27</sup> In turn, we suggest that the *regulatory complexity* of RPTs must be properly appreciated to accurately understand the actual function and role of RPTs in Commonwealth Asia (and, we suspect, elsewhere).<sup>28</sup>

Second, the RPT Index erroneously assumes that controlling shareholders are a homogeneous group driven by similar incentives.<sup>29</sup> The RPT Index proposes common solutions for regulating RPTs in jurisdictions with distinct shareholder ownership landscapes and in different companies within a single jurisdiction that have different types of controlling shareholders (i.e., the state, family members, or a controlling shareholder from another jurisdiction). However, our comparative analysis of RPTs in Commonwealth Asia suggests that RPTs function differently depending on a jurisdiction's specific shareholder landscape – particularly on the characteristics of its most significant controlling shareholders. In turn, we suggest that appreciating each jurisdiction's internal *shareholder complexity* is essential for properly understanding RPTs in Commonwealth Asia (and, we suspect, elsewhere).<sup>30</sup>

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26. See discussion in Part 4 *infra*.

27. This general notion is supported by Luca Enriques: “Unless social norms themselves evolve in unison with the new stricter rules and thus make tunneling socially unacceptable, the social perception may soon become one of overzealous bureaucrats harassing successful entrepreneurs/employers for the benefit of anonymous and often foreign investors, at which point it will be easy for the powerful business elite to obtain laxer enforcement and/or a ‘reparation law.’” Luca Enriques, *Related Party Transactions*, in THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE 529 (Jeffrey Gordon & Wolf-Georg Ringe eds. 2018). See also Guido Ferrarini & Paolo Giudici, *Financial Scandals and the Role of Private Enforcement: The Parmalat Case*, in AFTER ENRON: IMPROVING CORPORATE LAW AND MODERNISING SECURITIES REGULATION IN EUROPE AND THE US 159–160 (John Armour & Joseph A. McCahery eds. 2006); Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review*, 169 J. INST. THEO. ECON. 160, 164–165 (2013); Pascoe, *supra* note 23; Puchniak & Lan, *supra* note 23, at 327.

28. See discussion in Part 3 *infra*.

29. The RPT Index is based on a single hypothetical in which the controlling shareholder is an individual who is also a director on the company's board: 2018 DBR, *supra* note 4, at 91–94. See also the discussion in Part 2 *infra*.

30. See discussion in Part 4 *infra*.

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Third, the general assumption that RPTs *per se* are evidence of defective corporate governance and that stricter regulation of RPTs consequently equates to “good law” is erroneous. The simplistic perception that permissive regulations on RPTs are “bad law” glosses over an important body of research which convincingly demonstrates and explains why RPTs may promote good corporate governance and efficient equity markets.<sup>31</sup> In fact, there is an emerging consensus that even when RPTs provide a vehicle for controlling shareholders to extract private benefits of control, they may, in certain circumstances, promote corporate governance efficiency.<sup>32</sup> We argue that a proper understanding of the *normative complexity* of RPTs is necessary to understand the actual function and role of RPTs in Commonwealth Asia (and, we suspect, elsewhere).<sup>33</sup>

Ultimately, it appears that the RPT Index has limited explanatory value for how RPTs actually function in Commonwealth Asia. Rather, the RPT Index seems to measure the extent to which Commonwealth Asia’s most important economies (for better or worse) follow the formal Commonwealth approach for regulating RPTs.<sup>34</sup> Therefore, it is unsurprising that all of Commonwealth Asia’s leading economies rank high on the RPT Index as they all have strong Commonwealth legal heritages that have similarly shaped the evolution of their formal corporate and securities laws.

Demonstrating the frailties of the RPT Index is important in practice because jurisdictions – especially developing ones – commonly look to the DBR and its

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31. See discussion in Part 5 *infra*. Similarly, the OECD’s Guide on Fighting Abusive Related Party Transactions in Asia suggests that a greater prevalence of RPTs is a sign of poor corporate governance and describes related party transactions as “one of the biggest corporate governance challenges facing the Asian business landscape.” OECD, *supra* note 3, at 9–10. A recent in-depth empirical study on related party transactions in Singapore and Hong Kong views the total amount of RPTs as evidence of wealth tunneling. See Christopher C. Chen et al., *Board Independence as Panacea to Tunneling? An Empirical Study of Related Party Transactions in Hong Kong and Singapore*, 15 J. EMP. LEG. STUD. 987 (2018). Although the authors acknowledge that there is some research indicating RPTs may have beneficial effects in some cases, the total amount of RPTs and specific forms of RPTs are used as “proxies for tunneling”, and their empirical analysis does not address or attempt to measure the beneficial effects of RPTs (*Id.* at 1008–1010). See also Gilson & Schwartz, *supra* note 27, at 162. On the other hand, according to Luca Enriques, “no one denies that RPTs exist that create value for all parties involved. That may more easily be the case in closely held companies incurring higher transaction costs when dealing with unconnected market participants, due to higher information costs on both sides. But listed companies may enter into entirely fair RPTs as well.” Enriques, *supra* note 26, at 509–510. See also Julian Franks & Colin Mayer, *Evolution of Ownership and Control Around the World: The Changing Face of Capitalism* 44 (ECGI Working Paper Series in Law, Working Paper 503/207, 2017), [http://ssrn.com/abstract\\_id=2954589](http://ssrn.com/abstract_id=2954589), published in HANDBOOK OF CORPORATE GOVERNANCE (Benjamin Hermalin & Michael Weisbach eds. 2018); JOHN ARMOUR & LUCA ENRIQUES et al., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 146–147 (3d ed. 2017).

32. The notion that allowing a controlling shareholder to extract private benefits of control is efficient if they are less than the benefits that the controlling shareholder provides to the company as a whole is increasingly being recognized in the leading literature. Gilson & Schwartz, *supra* note 27, at 162. See also Jens Dammann, *Corporate Ostracism: Freezing Out Controlling Shareholders*, 33 J. CORP. L. 683, 684 (2008).

33. See discussion in Part 5 *infra*.

34. See discussion in Part 2 *infra*.

indices when reforming their laws.<sup>35</sup> In addition, the intellectual foundation of the RPT Index also makes the findings in this article academically significant. The RPT Index was originally developed based on Djankov, La Porta, Lopez-de-Silanes and Shleifer's seminal article, "The Law and Economics of Self-Dealing" (the "DLLS article").<sup>36</sup> As highlighted in the conclusion, similar to the RPT Index, the DLLS article fails to properly account for the regulatory complexity, shareholder complexity, and normative complexity – flaws that limit its explanatory value and call into question its central findings.

The DLLS article has emerged as the most important evidence supporting La Porta et al.'s watershed "legal origins theory" (i.e., that common law jurisdictions provide stronger investor protection than civil law jurisdictions and therefore have more dispersed shareholder ownership, larger equity markets, and superior economic development).<sup>37</sup> Thus, by calling into question the utility of the DLLS article, we provide evidence of the weakness of the legal origins theory. Admittedly, there is already a considerable body of research which has called into question the *original* foundational research on which the legal origins theory was based.<sup>38</sup> However, the DLLS article is viewed by leaders in the field as providing an effective response to these challenges to the original legal origins research.<sup>39</sup> There is a dearth of comparative scholarship examining whether the findings in the DLLS article match with the reality of how RPTs actually function across multiple jurisdictions. We aim to address this gap and in doing so to call into question the remaining significant pillar of evidence supporting the legal origins theory.

The remainder of this article proceeds as follows. Part 2 will provide an overview of the RPT Index to explain what it does and does not measure and it will suggest why all of Commonwealth Asia's leading economies uniformly rank highly on the RPT Index. Part 3 considers the legal landscape governing RPTs

35. Justin Sandefur & Divyanshi Wadhwa, *Chart of the Week #3: Why the World Bank Should Ditch the "Doing Business" Rankings—in One Embarrassing Chart*, CTR. FOR GLOBAL DEV., <https://www.cgdev.org/blog/chart-week-3-why-world-bank-should-ditch-doing-business-rankings-one-embarrassing-chart>.

36. Simeon Djankov et al., *The Law and Economics of Self-Dealing*, 88 J. FIN. ECON. 430 (2008) [hereinafter "DLLS article"]. According to the 2018 DBR, the initial methodology for the RPT Index was developed in the DLLS article. 2018 DBR, *supra* note 4, at 96.

37. See Gordon, *supra* note 3, at 34. For the literature on the "legal origins" theory, see Rafael La Porta et al., *Legal Determinants of External Finance*, 54 J. FIN. 1131 (1997); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3 (2000).

38. See, e.g., Theodor Baums & Kenneth E. Scott, *Taking Shareholder Protection Seriously? Corporate Governance in the United States and Germany*, 53 AM. J. COMP. L. 31, 69–75 (2005); Alma Pekmezovic, *Determinants of Corporate Ownership: The Question of Legal Origin (Part 2)*, 18 INT'L CO. COMM. L. REV. 147 (2007); Holger Spamann, *The 'Antidirector Rights Index' Revisited*, 23 REV. FIN. STUD. 467 (2010).

39. As asserted by Jeffrey Gordon in a recent publication, the DLLS article remains the most important piece of research supporting the legal origins theory. See Gordon, *supra* note 3, at 34.

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in Commonwealth Asia's leading economies and argues why an understanding of corporate and securities laws alone is inadequate in light of the operation of other extraneous factors such as rule of law and corporate culture. Part 4 examines the shareholder complexity by way of a granular analysis of the incentives that drive RPTs among corporate groups controlled by two different types of shareholders – the business family and the state – and explains how this limits the explanatory value of the RPT Index. Part 5 shines a spotlight on the normative complexity of RPTs and explains why the assumption that stricter regulation is necessarily “good law” is another factor that compromises the utility of the RPT Index. Part 6 concludes by explaining the link between the RPT Index and the DLLS article and illuminates how this analysis sheds further doubt on the utility of the legal origins theory. It also suggests some future research questions that flow from the complex reality of RPTs in Commonwealth Asia.

### I. THE RPT INDEX: WHAT IT MEASURES, WHAT IT MISSES, AND WHY COMMONWEALTH ASIA RANKS HIGH

At first blush, the methodological foundation for the RPT Index appears sound. Each year, the World Bank distributes the same simple hypothetical, which describes an RPT between two companies, to corporate and securities lawyers in the 190 jurisdictions included in the RPT Index.<sup>40</sup> The hypothetical involves a transaction in which Company A purchases goods from Company B at above market value. The transaction is an RPT because the controlling-shareholder-director of Company A and Company B are the same person, who uses his control over the companies' boards to orchestrate the transaction.<sup>41</sup>

The hypothetical involves an obvious example of self-dealing as the controlling-shareholder-director owns 60% of Company A's and 90% of Company B's shares. Therefore, the controlling shareholder-director indirectly benefits from the wealth tunneling which occurs by Company A paying above market price for the goods from Company B. The hypothetical assumes that the companies are listed and that the controlling-shareholder-director controls the boards through his electoral voting rights. It also assumes that all mandatory approvals are obtained and all required disclosures are made to carry out the RPT (i.e., the transaction is not fraudulent).<sup>42</sup> As a result of the wealth tunneling, the minority shareholders of Company A attempt to sue the controlling-shareholder-director and the other parties that approved the RPT.<sup>43</sup>

Corporate and securities lawyers from each jurisdiction in the RPT Index are asked to answer a questionnaire based on this hypothetical.<sup>44</sup> The questionnaire

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40. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 92–93.

41. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 92.

42. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 92.

43. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 93.

44. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 91.

is divided into three equally weighted sub-indices which measure: (1) the transparency of RPTs (*extent of disclosure sub-index*); (2) a minority shareholder's ability to sue and hold the directors or others who approved the RPT liable (*extent of director liability sub-index*); and, (3) access to evidence and the allocation of legal expenses in the shareholder litigation (*ease of shareholder suits sub-index*).<sup>45</sup> Based on the lawyers' answers to the questionnaire, each jurisdiction is given a score out of 10 on each of the three sub-indices, which are then averaged to calculate the RPT Index score for each jurisdiction.<sup>46</sup>

The *extent of disclosure sub-index* gives a higher score to jurisdictions in which the law requires more disclosure and stricter approval for RPTs.<sup>47</sup> For example, if a jurisdiction's law requires no disclosure of the RPT in the company's annual report then 0 points are given; 1 point is given if only disclosure of the terms of the RPT is required; and, 2 points are given if disclosure of the terms of the RPT and disclosure of the controlling-shareholder-director's conflict of interest are required. In addition to this component, the extent of disclosure sub-index allocates points for: whether immediate disclosure of the RPT to the public is required; whether disclosure by the controlling-shareholder-director to the board is required; whether an external body, such as an auditor, is required to review the RPT before it occurs; and, whether approval must be given for the RPT by the CEO alone, the board with the conflicted director voting, the board without the conflicted director voting, or the shareholders without the conflicted shareholder voting.<sup>48</sup>

The *extent of director liability sub-index* gives a higher score to jurisdictions in which the law makes it easier for a minority shareholder to sue and succeed in holding the controlling-shareholder-director and others who approved the RPT liable.<sup>49</sup> For example, if a jurisdiction's law provides a mechanism for a minority shareholder to directly or derivatively sue to recover the damage caused by the RPT then 1 point is given; if not, then 0 points are given.<sup>50</sup> In addition to this component, the extent of director liability sub-index allocates points for: whether the shareholder-plaintiff is able to hold the controlling-shareholder-director liable for damages caused by the RPT; whether the shareholder-plaintiff is able to hold the approving body (the CEO or other members of the board) liable; whether the controlling-shareholder-director will pay damages for the harm caused to the company upon a successful claim by the shareholder-plaintiff; whether the controlling-shareholder-director will be disqualified as a director

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45. WORLD BANK, *supra* note 8, at tbl. 1; 2018 DBR, *supra* note 4, at 92 tbl. 8.10.

46. WORLD BANK, *supra* note 8, at tbl. 1; 2018 DBR, *supra* note 4, at 92 tbl. 8.10.

47. See WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 93.

48. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 93.

49. See WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 93–94.

50. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 93.

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upon a successful claim by the shareholder-plaintiff; and, whether the court can void the RPT upon a successful claim by the shareholder-plaintiff.<sup>51</sup>

The *ease of shareholder suit sub-index* gives a higher score to jurisdictions in which the law makes it easier for a minority shareholder to sue for the recovery of damages suffered by the RPT.<sup>52</sup> For example, if a 10% shareholder has the right to inspect the documents relating to the RPT before filing a suit or can request that a government inspector investigate the RPT without filing a suit, then 1 point is given; if not, 0 points are given.<sup>53</sup> In addition to this component, the ease of shareholder suit sub-index allocates points for: the range of documents that is available to the shareholder-plaintiff from the defendant and witnesses at trial; whether the shareholder-plaintiff can obtain categories of relevant documents from the defendant and witnesses during trial; whether the standard of proof for civil suits is lower than that for a criminal case; and, whether shareholder plaintiffs can recover their legal expenses from the company.<sup>54</sup>

Considered together, at least four aspects of the scope and method of data collection for the three sub-indices significantly limit the explanatory value of the RPT Index in Commonwealth Asia (and, we suspect, elsewhere). First, the questionnaire merely asks lawyers to provide an assessment of what the law is on the books without any indication of how the law actually applies in practice.<sup>55</sup> For example, Singapore ranks 1<sup>st</sup> out of 190 jurisdictions on the 2018 RPT Index – with near perfect scores on all three sub-indices (i.e., extent of disclosure sub-index: 10; extent of director liability sub-index: 9; and, ease of shareholder suit sub-index: 9).<sup>56</sup> However, extraordinarily, we are unaware of even a *single* successful suit – or even a *single* suit ever filed – by a minority shareholder against a director of a *listed* company in the *history of Singapore* in relation to self-dealing or for any other wrongdoing whatsoever.<sup>57</sup> The RPT Index suggests

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51. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 93.

52. See WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 94.

53. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 94.

54. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 94.

55. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 91 (“The data come from a questionnaire administered to corporate and securities lawyers and are based on securities regulations, company laws, civil procedure codes and court rules of evidence.”). No mention is made of the distinction between “law in books” and “law in action”.

56. See WORLD BANK, *supra* note 17 (with Singapore tying with New Zealand for 1<sup>st</sup> on the RPT Index).

57. Meng Seng Wee & Dan W. Puchniak, *Derivative Actions in Singapore: Mundanely Non-Asian, Intriguingly Non-American and at the Forefront of the Commonwealth*, in *THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH* 324 (Dan W. Puchniak et al. eds. 2012); Luh Luh Lan & Umakanth Varottil, *Shareholder Empowerment in Controlled Companies: The Case of Singapore*, in *RESEARCH HANDBOOK ON SHAREHOLDER POWER* 586–588 (Jennifer G. Hill & Randall S. Thomas eds. 2015); Samantha Tang, *Why Do Shareholders Bring Derivative Actions? Clues from a Uniquely Singapore Experiment* (Centre for Asian Legal Studies Working Paper, 2018). It should be noted that there has been one application for leave to bring a derivative action against a director of a company in Singapore which was delisted – but the allegations related to the director’s behavior when the company was still listed. However, this leave application was denied by the High Court (i.e., the plaintiff was not

that private enforcement by minority shareholders in listed companies should play a major role as a compensatory or deterrent mechanism in Singapore. In practice, however, private enforcement plays almost no role at all in listed companies. The situations for Hong Kong, Malaysia, and India mirror (at least broadly) that of Singapore.<sup>58</sup> Respectively, they rank 3<sup>rd</sup> (tied) and 20<sup>th</sup> out of 190 jurisdictions on the 2018 RPT Index;<sup>59</sup> yet in practice private enforcement by minority shareholders plays a limited to non-existent role for regulating RPTs in listed companies.<sup>60</sup>

To be clear, we are not suggesting that the lawyers in Hong Kong, India, Malaysia, or Singapore answered the questionnaire incorrectly; nor are we suggesting that the scoring of the jurisdictions based on the answers the lawyers provided to the simple hypothetical was done improperly. The problem is that the lawyers were asked to explain what the rules *on the books* say about disclosure requirements, extent of director liability, and the ease of pursuing a minority shareholder lawsuit.<sup>61</sup> They were *not asked* to explain how they would advise their client to act in practice, what would actually happen to the self-dealing controlling shareholder-director, or how prevalent self-dealing through RPTs actually is in their jurisdictions to begin with.<sup>62</sup> Black letter RPT law explains only part of the story, if at all, but law in action has altogether eluded the RPT Index.

Of course, we realize that to meaningfully respond to these practical questions the lawyers would have to go beyond the narrow scope of the corporate, securities, and civil procedure laws that are required to answer the questionnaire for the purpose of the hypothetical. Their analysis would be complicated by having to look at other factors such as public enforcement, rule of law norms, and corporate culture, which may be jurisdiction-specific and harder to translate into numeric values. However, as we discuss below, these factors have tremendous explanatory force for understanding the difference in the successes and failures of RPT regimes among Asia's leading Commonwealth economies. The fact that the RPT Index narrowly focuses on corporate, securities, and civil procedure laws to the exclusion of these other factors is the

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permitted to pursue the derivative action on behalf of the delisted company). See *Chua Swee Kheng v E3 Holdings Ltd.* [2015] SGHC 22.

58. See Vikramaditya Khanna & Umakanth Varottil, *The Rarity of Derivative Actions in India: Reasons and Consequences*, in *THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH* 386–97 (Dan W. Puchniak et al. eds. 2012); Vivien Chen, *The Statutory Derivative Action in Malaysia*, 12 *ASIAN J. COMP. L.* 281 (2017); Wai Yee Wan et al., *Public and Private Enforcement of Corporate and Securities Laws: An Empirical Comparison of Hong Kong and Singapore*, [https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=4728&context=sol\\_research](https://ink.library.smu.edu.sg/cgi/viewcontent.cgi?article=4728&context=sol_research) (last accessed Jan. 9, 2019).

59. See *WORLD BANK*, *supra* note 17.

60. See sources *supra* note 58.

61. See *supra* note 55 and accompanying text.

62. See *id.*

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second aspect of the scope and method of data collection that limits the explanatory value of the RPT Index.

Third, the overly simplistic design of the hypothetical further limits the explanatory value of the RPT Index. To begin with, the hypothetical assumes that the controlling shareholder is a person who is also a director on the boards of the companies.<sup>63</sup> However, in all of Commonwealth Asia's leading economies, a significant number of the largest listed companies, which appear to engage in a high volume of RPTs, are SOEs.<sup>64</sup> Hong Kong and India both have special legislation that specifically deal with RPTs in SOEs.<sup>65</sup> Singapore also has a unique institutional architecture design to limit the extraction of private (political) benefits of control in its SOEs.<sup>66</sup> Malaysia has no special legislation that deals with SOEs and does not have an institutional architecture like Singapore, but instead appears to have an informal system which allows SOEs to engage in RPTs without meaningful approval or disclosure – which leading academics have suggested provide a vehicle for RPTs to be used for political benefits and outright corruption.<sup>67</sup> As the hypothetical does not involve an SOE, these issues are entirely overlooked by the RPT Index. In a similar vein, family firms make up a significant portion of listed companies in all of Commonwealth Asia's leading economies, which present potential problems and solutions for regulating RPTs – none of which are accounted for in the RPT Index due to the simplistic design of the hypothetical.<sup>68</sup> Finally, most SOEs and family firms are part of corporate groups, which raises further complications for regulating RPTs – that escape the simplistic hypothetical. As explained in Part 4 below, the different incentives and regulatory regimes governing these different types of shareholders and shareholding structures must be examined to have an accurate understanding of RPTs in Commonwealth Asia.

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63. WORLD BANK, *supra* note 8; 2018 DBR, *supra* note 4, at 92.

64. Richard W. Carney & Travers Barclay Child, *Changes to the Ownership and Control of East Asian Corporations Between 1996 and 2008: The Primacy of Politics*, 107 J. FIN. ECON. 494, 501 (2013) (observing that state-ownership was significant in Hong Kong listed firms and had 'exhibit[ed] dramatic increases'); Christopher C. Chen, *Solving the Puzzle of Corporate Governance of State-Owned Enterprises: The Path of the Temasek Model in Singapore and Lessons for China*, 36 NW. J. INT'L L. BUS. 303, 327–33 (2016) (providing lists of Singapore firms in which Temasek had substantial holdings); see also OECD, REFORM PRIORITIES IN ASIA: TAKING CORPORATE GOVERNANCE TO A HIGHER LEVEL 2011 at 9 (2012), <https://www.oecd.org/corporate/ca/49801431.pdf> (citing Singapore, Malaysia, Hong Kong, and India as examples); *Id.* at 10 ("Related party transactions are a common feature of business in Asia"); NUS BUSINESS SCHOOL & CHARTERED INSTITUTE OF MANAGEMENT ACCOUNTANTS, THE STATE AS SHAREHOLDER: THE CASE OF SINGAPORE 9-40 (2014).

65. See *infra* note 152 (Hong Kong); note 155 (India).

66. See e.g. Puchniak & Lan, *supra* note 23, at 305–17.

67. EDMUND TERENCE GOMEZ & KWAME SUNDARAM JOMO, MALAYSIA'S POLITICAL ECONOMY: POLITICS, PATRONAGE AND PROFITS (1997).

68. CREDIT SUISSE, *The CS Family 1000*, 6–7 (2017), [www.kreditwesens.de/system/files/content/inserts/2017/the-cs-family-1000.pdf](http://www.kreditwesens.de/system/files/content/inserts/2017/the-cs-family-1000.pdf) (last accessed Jan. 9, 2019).



Fourth, the three sub-indices are constructed in a way that suggests the stricter the law regulating RPTs the better. According to the sub-indices, a jurisdiction will score higher on the RPT Index if they have more onerous disclosure requirements for RPTs, impose a greater amount of liability for directors who approve RPTs, and if they make it easier for minority shareholders to sue for damages suffered from RPTs.<sup>69</sup> There is not a single component in any of the three sub-indices that reduces a jurisdiction's score for having rules which too strictly regulate RPTs.<sup>70</sup> However, as explained in Part 5 below, India and Malaysia have encountered problems with overly strict rules regulating RPTs. In addition, Singapore's SOEs appear to engage in a high level of RPTs and yet have exceptionally strong performance with limited evidence of wealth tunneling.<sup>71</sup>

In sum, it appears that the high rankings of Commonwealth Asia's leading economies on the RPT Index have little explanatory force for understanding how RPTs actually work in these jurisdictions. For such an understanding, there must be an examination beyond the narrow scope of the corporate and securities laws that form the core of the RPT Index – examining the regulatory complexity of RPTs is essential. Similarly, an accurate understanding will require an examination of how different types of shareholders, particularly in SOEs and family firms, impact RPTs – making an awareness of the shareholder complexity of RPTs essential. Finally, evidence that the overly strict regulation of RPTs can be detrimental – and that an abundance of RPTs may not be problematic – makes an understanding of the normative complexity of RPTs essential. The balance of this article will go beyond the RPT Index to examine these essential complexities to obtain a more accurate understanding of how RPTs in Commonwealth Asia work in practice.

Before moving on to this examination, however, we would be remiss to not suggest an answer for why we believe that Commonwealth Asia's leading economies uniformly rank so well on the RPT Index. This is somewhat puzzling based on our finding that the RPT Index has limited explanatory force for understanding how RPTs actually work in Commonwealth Asia. The most likely explanation is that all our jurisdictions have similar formal legal rules because of

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69. 2018 DBR, *supra* note 4, at 91–94.

70. *Id.*

71. Puchniak & Lan, *supra* note 23, at 305–17. See also Tan, *et al.*, *supra* note 24; Carlos D. Ramírez & Ling Hui Tan, *Singapore Inc. Versus the Private Sector: Are Government-Linked Companies Different* (International Monetary Fund Working Paper, 2003), <http://www.imf.org/external/pubs/ft/wp/2003/wp03156.pdf>; KPMG & NUS BUSINESS SCHOOL, THE TIES THAT BIND: INTERESTED PERSON TRANSACTIONS: RULES AND PRACTICES IN SINGAPORE 17 (September 2013), [http://governanceforstakeholders.com/wp-content/uploads/2013/12/The-ties-that-bind-Publication\\_FINAL.pdf](http://governanceforstakeholders.com/wp-content/uploads/2013/12/The-ties-that-bind-Publication_FINAL.pdf).

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their shared Commonwealth legal heritage. Singapore,<sup>72</sup> Hong Kong,<sup>73</sup> India<sup>74</sup> and Malaysia<sup>75</sup> traditionally sought guidance on matters of corporate law reform from other Commonwealth jurisdictions, especially the United Kingdom.<sup>76</sup> The few cases decided by the Privy Council<sup>77</sup> on corporate law matters<sup>78</sup> continue to be cited by courts in these jurisdictions even after Privy Council appeals for commercial cases were formally abolished.<sup>79</sup> There is general empirical evidence that courts in Commonwealth Asia stand out among the common law jurisdictions that have ceased appeals to the Privy Council for their propensity to cite UK jurisprudence even after the judicial link was severed.<sup>80</sup> The fact that Commonwealth (and, more generally, common law) jurisdictions dominate the top of the 2018 RPT Index<sup>81</sup> suggests that the index may be more of a measure of their shared legal heritage than anything else.

With this background, we deal with each of the complexities and how they help explain the realities in our Commonwealth Asian jurisdictions in a manner that is not evident from the RPT Index.

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72. Wee & Puchniak, *supra* note 57, at 340 (discussing Singapore's traditional reliance on the UK and Australia).

73. ERMANN PASCUTTO & CALLY JORDAN, REVIEW OF THE HONG KONG COMPANIES ORDINANCE: CONSULTANCY REPORT 8–9 (March 1997) (discussing Hong Kong's historical reliance on the UK).

74. Umakanth Varottil, *The Evolution of Corporate Law in Post-Colonial India: From Transplant to Autochthony*, 31 AM. U. INT'L L. REV. 253 (2016).

75. Vivien Chen, *The Evolution of Malaysian Shareholder Protection: A Legal Origins Analysis*, 2013 SING. J. L. STUD. 100 (2013).

76. Tang, *supra* note 57.

77. The Judicial Committee of the Privy Council continued to serve as the final court of appeal for Singapore and Malaysia for some time after their formal independence, and for Hong Kong until the People's Republic of China resumed sovereignty in 1997. India, however, asserted full judicial sovereignty soon after independence. On India, see Rohit De, "A Peripatetic World Court" *Cosmopolitan Courts, Nationalist Judges and the Indian Appeal to the Privy Council*, 32 L. HIST. REV. 821 (2014). It should be noted that existing studies of Privy Council appeals have not yet specifically addressed the impact of this court's jurisprudence on the corporate law development of former British colonies.

78. See e.g. *Cook v. Deeks* [1916] 1 A.C. 554 (P.C., on appeal from Ontario); *Howard Smith v. Ampol Petroleum Ltd.* [1974] A.C. 821 (P.C., on appeal from New South Wales); *re Kong Thai Sawmill (Miri) Sdn. Bhd.* [1978] 2 M.L.J. 227 (P.C., on appeal from Malaysia); *Meridien Global Funds Management Asia Limited v. Securities Commission* [1995] 2 A.C. 500 (P.C., on appeal from New Zealand). However, none of these cases specifically address the issue of RPTs.

79. Malaysia abolished appeals to the Privy Council in 1985. Constitutional (Amendment) Act 1983 (Act A566/83) (Malaysia). Singapore formally abolished appeals to the Privy Council in 1993. Judicial Committee (Repeal) Act 1994 (Act 2 of 1994) (Singapore), § 2. In Hong Kong, the Privy Council was superseded by the Hong Kong Court of Final Appeal from 1997. Court of Final Appeal Ordinance (Cap. 484) (Hong Kong). See also Alan K. Koh, *(Non)-Enforcement of Directors' Duties in Corporate Groups*, 81 MOD. L. REV. 673, 686–87 (2018).

80. Kwai Hang Ng & Brynna Jacobson, *How Global Is the Common Law? A Comparative Study of Asian Common Law Systems – Hong Kong, Malaysia, and Singapore*, 12 ASIAN J. COMP. L. 209 (2017).

81. See Appendix 1.

## II. RPTs AND REGULATORY COMPLEXITY

RPTs have attracted a string of regulations in several countries, including in Commonwealth Asia. Largely embedded in corporate law and securities regulation, the goal of RPT regulation is to operate as an effective filter that allows RPTs that enhance value to minority shareholders to pass through, and to prevent value-reducing ones that result in wealth tunneling from occurring. RPT regulations adopt a varied set of measures from disclosures to the approval of transactions by an independent board or disinterested shareholders and to external verification through fairness opinions.<sup>82</sup>

But, despite the regulations in Commonwealth Asia's leading economies being somewhat similar in that they employ most of these tools, the results of their operation vary dramatically. This is because the mere application of bespoke tools to address wealth tunneling does not appear to produce the expected results, as the regulatory environment is much more complex. Ultimately, what seems to count are two factors, one intrinsic to the regulation of RPTs and the other being extraneous factors. Intrinsically, it is not sufficient to examine the rules governing RPTs on a stand-alone basis, but to analyze the manner in which they are enforced by regulators and adhered to by market participants. Moreover, apart from conventional RPT regulation, it is necessary to explore matters extraneous to RPT regulation such as the robustness of the enforcement mechanisms, sophistication of the regulators, quality of legal institutions, rule of law, and a general culture and ethos that determine the extent of tolerance towards wealth tunneling.<sup>83</sup>

Conventional wisdom fails to consider the influence of such factors that are both intrinsic and extraneous to RPT regulation. As a result, influential measures such as the RPT Index produce rankings that are often hard to explain. For instance, how can jurisdictions such as Hong Kong, India, Malaysia, and Singapore – all of which have demonstrated stellar performance in the World Bank's rankings on minority shareholder protection generally and RPT regulation more specifically – display acute divergence in the extent to which RPT transactions occur? More importantly, how can they differ in the extent to which those RPT transactions actually involve value-reducing wealth tunneling? This suggests that in the end the structure and content of RPT regulation may matter less in the backdrop of other factors.

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82. ARMOUR & ENRIQUES ET AL., *supra* note 31, at Ch. 6; Enriques, *supra* note 27; Vladimir Atanasov et al., *Law and Tunneling*, 37 J. CORP. L. 1 (2011). The varieties of regulatory instruments have been captured in the RPT Index in the form of the (i) extent of disclosure sub-index; (2) extent of director liability sub-index; and (3) ease of shareholder suits sub-index. *See* discussion at Part 2 *supra*.

83. Enriques, *supra* note 27, at 528–29; Lau et al., *supra* note 23, at 308–09.

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### A. *Motivating Factors for RPT Regulation in Commonwealth Asia*

The regulation on RPTs in Commonwealth Asia is largely a result of the proliferation of rules from other jurisdictions, in particular the UK. This indicates some level of convergence at a formal level, given that all these jurisdictions adopt a broadly common toolkit to regulate RPTs. Such a *de jure* convergence can be attributed to extraneous pressure applied on these jurisdictions to adopt RPT regulation. As discussed earlier,<sup>84</sup> international bodies such as the International Monetary Fund, the OECD, the ACGA, and the CFA Institute carried out studies of various Asian jurisdictions to highlight the problems of abusive RPTs.<sup>85</sup> These bodies called upon jurisdictions to improve their regulation of RPTs so as to enhance the effectiveness of their filter mechanisms.<sup>86</sup> The fact that RPT regulation in Commonwealth Asia has been motivated due to external factors of globalization suggests that while substantive rules on the books appear optimal, the imposition of those rules in economies with different legal, institutional, and cultural settings is likely to create a mismatch in the acceptance and enforcement of those rules. Concomitantly, the World Bank's approach of analyzing the substantive rules without having adequate regard to the other factors gives rise to the peculiar situation wherein the stellar track record displayed by the rules prescribed in the Commonwealth Asian jurisdictions is not accompanied by a similar impetus in the adherence to, and enforcement of, those rules.

More specifically, two broad approaches have emerged in the international arena to regulate RPTs.<sup>87</sup> One is an *ex ante* mechanism that is procedural in nature, which involves disclosure of RPTs and also requires companies to obtain the prior approval of an independent board of directors and disinterested shareholders after providing them with the requisite information regarding the relevant transactions. Such a rules-based governance approach provides greater certainty to market players. This is commonly followed by countries such as the UK and those that have adopted similar rules.<sup>88</sup> On the other hand, the US follows an *ex post* principles-based litigation approach, whereby transactions are reviewed by courts against predefined standards of conduct.<sup>89</sup> This assumes the existence of a sophisticated and efficient judiciary that can implement the regulation. It is hardly surprising that the *ex ante* governance-based mechanisms

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84. See discussion at Part 1 *supra*.

85. See *supra* note 3 and accompanying text.

86. *Id.* See also INT'L MONETARY FUND, GFSR GLOBAL FINANCIAL STABILITY REPORT 2016 82–113 (2016), <https://www.imf.org/external/pubs/ft/gfsr/2016/02/> (last accessed Jan. 9, 2019).

87. See Alessio M. Paccès, *Controlling and Corporate Controller's Misbehavior*, 11 J. CORP. L. STUD. 177 (2011); Djankov et al., *supra* note 36.

88. Paccès, *supra* note 87, at 205–09.

89. *Id.* at 201–05.

form the pivot of RPT regulation in all the leading Commonwealth Asian jurisdictions.<sup>90</sup>

However, such efforts to thrust international norms into an Asian context arguably suffer from serious defects. At a conceptual level, the regulation of RPTs in the UK (and to a large extent the US) was devised to deal with RPTs that typically occur between managers and the company,<sup>91</sup> including executive compensation, which tends to constitute a paradigmatic form of RPT in companies with dispersed shareholding that are common in the UK. However, when those regulations are transposed to countries with concentrated shareholdings, where RPTs commonly occur between the controlling shareholder and the company, they are unlikely to have the similar desired effect.<sup>92</sup> Add to this the differences in the mix of other factors such as the level of enforcement, quality of legal institutions, and differences in legal culture. In that sense, the forces of internationalization and convergence have caused the countries in Commonwealth Asia to adopt externally imposed standards that do not take into account the idiosyncrasies of each individual system.

In this background, we discuss some of the regulatory tools employed by the four leading Commonwealth Asian jurisdictions to regulate RPTs, and why they are either under-inclusive or over-inclusive, thereby missing the target.

#### *B. Key Regulatory Tools for RPTs in Commonwealth Asia*

A toolkit for regulation of RPTs contains various instruments that have generally been deployed around the world.<sup>93</sup> The precise combination of these instruments and the degree to which they operate varies from jurisdiction to jurisdiction due to the importance of local factors and complexities. Nevertheless, some common themes emerge. Here, we consider the *ex ante* governance-based approach that seeks to introduce safeguards for the protection of minority shareholders in the case of RPTs, so as to ensure that abusive RPTs that amount to wealth tunneling are impeded. All our jurisdictions in Commonwealth Asia possess most, if not all, of these tools, thereby introducing a sense of uniformity, at least at a superficial level. That explains the strong showing of all four Commonwealth Asian jurisdictions in the RPT Index.

Drawn from the approach in the UK, all four jurisdictions regulate RPTs through listing rules or regulations that require companies to comply with certain

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90. Accordingly, among the three sub-indices that form part of the RPT Index, the “extent of disclosure” index would carry greater relevance. The *ex ante* mechanisms are more particularly relevant in jurisdictions where substantive constraints such as fiduciary duties of directors that are enforced through shareholder suits do not function effectively. Kon Sik Kim, *Related Party Transactions in East Asia* 6, 9 (ECGI Working Paper Series in Law, Working Paper No. 391/2018), <https://ssrn.com/abstract=3141179>.

91. Djankov et al., *supra* note 36, at 430.

92. For a more detailed discussion, see Part 3.2 *infra*.

93. See Atanasov et al., *supra* note 82; Enriques, *supra* note 27; Paccès, *supra* note 87; ARMOUR & ENRIQUES ET AL., *supra* note 31.

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obligations to ensure continuous listing on the stock exchange. While Hong Kong and Singapore regulate RPTs through their stock exchange listing rules, India and Malaysia follow a more stringent approach, whereby the basic company statute contains certain essential elements of RPT regulation. The latter approach not only elevates RPT regulation in the legislative hierarchy, but it also ensures more stringent sanctions in case of non-compliance. The following table outlines the sources of RPT regulation in the four Commonwealth Asian jurisdictions:

**Table 1: Sources of Regulation**

<b>Jurisdiction</b>	<b>Companies' Legislation Specifically Regulating RPTs</b>	<b>Listing Rules Specifically Regulating RPTs</b>
<b>Hong Kong</b>	-	HKEx Mainboard Listing Rules, Chapter 14A: Connected Transactions
<b>India</b>	Companies Act, 2013, § 188	Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015
<b>Malaysia</b>	Companies Act, 2016, § 228	Bursa Malaysia Main Market Listing Requirements, Chapter 10: Transactions
<b>Singapore</b>	-	SGX Mainboard Rules, Chapter 9: Interested Person Transactions

This brings us to the *ex ante* governance mechanism by way of procedural safeguards that have been introduced in Commonwealth Asia. Here, we not only briefly examine the specific tools deployed, but also critique them as to their ability to operate as an effective filter to fulfil the goals of RPT regulation. We argue that the existence of these tools (measured by the World Bank's RPT Index) is unsatisfactory on its own; instead, what matters is the effectiveness of the tools in their operations (insufficiently recognized by the RPT Index).

### *1. Disclosure*

The element of transparency has been the most basic, but longstanding, tool to tackle RPTs, particularly value-reducing transactions. The disclosure norms require companies to provide details of their RPTs, so that the board and shareholders can consider them before approving or rejecting such transactions.<sup>94</sup>

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94. Enriques, *supra* note 27, at 524–25; Atanasov et al., *supra* note 82, at 11–13.

While it is intended to reduce the information asymmetry between insiders and outside investors, it also has the oblique effect of moderating the extent to which controlling shareholders or managers may indulge in RPTs. In other words, the need to come clean with abusive RPTs may deter insiders from indulging in them in the first place. All four jurisdictions in Commonwealth Asia carry some form of RPT disclosure requirements, although the form and content vary to some extent. In certain circumstances, even *ex post* disclosures in the financial statements<sup>95</sup> and annual reports can act as useful deterrents.<sup>96</sup>

However, the disclosure strategy suffers from several drawbacks. Companies retain sufficient latitude in borderline cases to not only decide whether or not to disclose, but to also determine the nature and extent of the disclosure.<sup>97</sup> Such an approach hardly does much to diminish opacity and information asymmetry, as investors do not obtain any meaningful result.<sup>98</sup> More importantly, disclosure norms are subject to a plethora of carve-outs and exceptions that allow a range of RPTs to stay underneath the radar. For example, the use of exemptions such as *de minimis* transactions, which split large RPTs into various smaller ones to qualify for such exemptions, exist in Hong Kong and Singapore.<sup>99</sup>

## 2. Shareholder Approval

All four leading jurisdictions in Commonwealth Asia require that at least material RPTs be approved by the shareholders of the company, with the controlling shareholder who may be a “related party” to the transaction abstaining from voting.<sup>100</sup> Known popularly as the “majority of the minority” voting requirement, it ensures that the minority has a voice in light of the controlling shareholder’s position on both sides of the transaction.<sup>101</sup> This is also a straightforward method of addressing the agency problem between the controlling shareholder and the minority shareholders that is replete in companies with concentrated shareholding.

While this is one of the most potent tools in the kit to tackle abusive RPTs in Commonwealth Asia, it also suffers from some shortcomings. Often, it is an open

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95. These are often required by applicable accounting standards as well. See e.g. INT’L ACCT. STD. BOARD, *Int’l Acct. Std. No. 24* (EC Staff Consolidated version of 20 July 2010), <https://www.iasplus.com/en/standards/ias/ias24>.

96. Paccès, *supra* note 87, at 193.

97. Enriques, *supra* note 27, at 525.

98. Atanasov et al., *supra* note 82, at 12.

99. Ernest Lim, *Controlling Shareholders and Fiduciary Duties in Asia*, 18 J. CORP. L. STUD. 113, 123 (2018); Adrian C. H. Lei & Frank M. Song, *Connected Transactions and Firm Value: Evidence from China-affiliated Companies*, 19 PAC. BASIN FIN. J. 470, 487 (2011).

100. HONG KONG EXCH. (HKEX) LISTING RULES, r. 14A.36; SGX Mainboard Rules, rr. 918, 919; Companies Act, 2013, § 188(1), second proviso (India); and Companies Act, 2016, § 228 (Malaysia).

101. Enriques, *supra* note 27, at 518.

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question as to who is a “related party” in a given situation.<sup>102</sup> In the context of business groups, particularly families, relatives and friends of controlling shareholders may be able to lend their support to the transaction since they do not technically fall within the scope of a “related party.”<sup>103</sup> Moreover, questions arise on whether minority shareholders possess sufficient material to make an informed decision.<sup>104</sup> Minority shareholders may suffer from collective action problems, and the larger group among them may swing the choice even though it may not be beneficial to the minority shareholders as a group.

### 3. *Approval of Independent Directors or Audit Committee*

Nearly all our jurisdictions require either a committee of independent directors to approve RPTs, or that task is left to the audit committee (which is subject to independence requirements).<sup>105</sup> Adopting a trusteeship strategy,<sup>106</sup> this approach ensures that an impartial monitor reviews RPTs to ensure that the interests of minority shareholders are protected. For instance, in India, independent directors carry a specific role to review RPTs, and they must act in the interests of minority shareholders and consider the impact of transactions on the minority shareholders.<sup>107</sup>

The mere requirement of approval of independent directors fails to constitute a dependable mechanism against controlling shareholder opportunism through RPTs. Ultimately, it boils down to the question of how effective independent directors are in the context of companies with concentrated shareholding that epitomize Commonwealth Asia.<sup>108</sup> A number of problems are evident, and we mention a few solely by way of illustration. At a formal level, there could be problems with defining an independent director and whether she is truly independent—not just from the company and its management, but also its controlling shareholder.<sup>109</sup> This leads to the question of how independent directors are appointed. Currently, they are elected like any other director, and

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102. For example, in India, the Government had to intervene by way of a clarification to state that a controlling shareholder is not barred from voting to approve every RPT, but only those where it is conflicted. See MINISTRY OF CORPORATE AFFAIRS, GOVERNMENT OF INDIA, *Clarifications on Matters Relating to Related Party Transactions* (General Circular No. 30/2014, Jul. 17, 2014), [http://www.mca.gov.in/Ministry/pdf/Circular\\_No\\_30\\_17072014.pdf](http://www.mca.gov.in/Ministry/pdf/Circular_No_30_17072014.pdf).

103. Enriques, *supra* note 27, at 519.

104. *Id.*

105. See e.g. HONG KONG EXCH. (HKEX) LISTING RULES, r. 14A.40; SGX Mainboard Rules, rr. 912, 917(4); Companies Act, 2016, § 228(4) (Malaysia).

106. ARMOUR & ENRIQUES ET AL., *supra* note 31, at 153–156.

107. Companies Act 2013, sch. IV, items II(5) & III(9).

108. For a detailed analysis of this issue in the context of Asia see Dan W. Puchniak & Kon Sik Kim, *Varieties of Independent Directors in Asia: A Taxonomy*, in *INDEPENDENT DIRECTORS IN ASIA: A HISTORICAL, COMPARATIVE AND CONTEXTUAL APPROACH* 299–300 (Dan W. Puchniak et al. eds., Cambridge University Press 2017).

109. For a detailed analysis of this issue, see Puchniak & Kim, *supra* note 104; Puchniak & Lan, *supra* note 23.



hence controlling shareholders tend to exercise considerable influence over the nomination and appointment of independent directors. This is particularly so in Commonwealth Asia.<sup>110</sup> If board independence is to act as an effective tool to filter RPTs, then alternative mechanisms, such as election of independent directors by a “majority of the minority” or cumulative voting, must be employed.<sup>111</sup> Failing these measures, independent directors are likely to be beholden to the controlling shareholders, rather than accountable to the minority shareholders. The question of substantive independence of judgment is another matter altogether; while in Delaware courts judge this through the application of standards that are wide,<sup>112</sup> the governance approach adopted in Commonwealth Asia is far narrower and possibly does not serve the intended purpose.

Oversight by independent directors and audit committees are indeed useful in reviewing RPTs, but it would be imprudent to place undue reliance on them for the reasons discussed above.

#### 4. *Fairness Opinion from an Independent Adviser*

In order to provide adequate advice to independent directors, audit committees and shareholders, some of the leading Commonwealth Asian jurisdictions mandate that an independent adviser supply a fairness opinion regarding the merits of the transaction to the shareholders.<sup>113</sup> This aims to address the information asymmetry, as the advice is used by the decision-makers within the company to arrive at a better outcome. But, there is a great deal of latitude available to the independent advisers, who are motivated to act to protect their reputation.<sup>114</sup> Often there are also questions regarding the independence of such advisers as they act in numerous roles, including investment banking and advisory services.

#### 5. *Reviewing the Toolkit of Ex Ante Measures to Regulate RPTs*

An illustrative analysis of the *ex ante* tools deployed by our Commonwealth Asian jurisdictions to regulate RPTs presents a somewhat mixed picture. The robustness of the substantive rules, as measured for these jurisdictions in the RPT Index, is high. While ascribing scores to these substantive rules in its extent of

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110. See e.g. Puchniak & Lan, *supra* note 23 (for Singapore); Umakanth Varottil, *Evolution and Effectiveness of Independent Directors in Indian Corporate Governance*, 6 HASTINGS BUS. L.J. 281 (2010) (for India); Puchniak & Kim, *supra* note 108 (for Asia).

111. Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271 (2017).

112. See e.g. *In re Oracle Corp. Derivative Litigation*, 824 A.2d 917, 938–39 (Del. Ch. 2003).

113. See e.g. HONG KONG EXCH. (HKEX) LISTING RULES, r. 14A.44; SGX Mainboard Rules, rr. 920(1)(b)(v), 921(4)(a).

114. Enriques, *supra* note 27, at 525–26. Related to this is the question of whether advisers can be made liable for producing biased opinions. See Wai Yee Wan, *Independent Financial Advisers' Opinions for Public Takeovers and Related Party Transactions in Singapore*, 30 CO. & SEC. L.J. 32 (2012).

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disclosure sub-index, the World Bank essentially looks at the letter of the law, for example, whether disclosure of RPTs is required and whether approval of RPTs is to be obtained from an independent board or shareholders (i.e., “majority of the minority” shareholder voting). These measures only offer us part of the story regarding the ability of RPT regulations to permit value-enhancing transactions and prohibit abusive wealth tunneling. As we have sought to demonstrate, there are several other factors running deeper than the substantive rules, which are often hard (or inefficient) to measure given the legal complexities involved. Hence, any analysis of the legal toolkit for RPT regulation must not lose sight of the underlying factors that are incapable of being measured and are, indeed, not measured by the World Bank in its RPT Index. If there are nuances within the regulatory toolkit for RPTs that the RPT Index does not adequately address, the level of regulatory complexity is arguably even more severe when we add to the mix other extraneous factors, which we now discuss.

### *C. Extraneous Determinants of RPT Trends*

As we have seen, the regulation of RPTs in our four jurisdictions through formal corporate and securities laws demonstrates substantial resemblances. All of them use similar tools from internationally accepted combinations, and they all suffer from certain inadequacies to different degrees. More importantly, all of our jurisdictions have performed exceedingly well in establishing and enhancing their regulatory toolkits, and they have earned plaudits at an international level. They all take pride in the fact that their systems have been rising rapidly in the rankings developed by the World Bank on the ease of doing business, by far the most influential ranking index at a global level; this is particularly so on the RPT Index. In fact, on this measure, as previously noted, all of our four jurisdictions rank within the top 20 in the world in the 2018 RPT Index.<sup>115</sup>

This, however, presents an important puzzle: if all our jurisdictions have a common set of tools to address RPTs, and the use of those regulatory tools have been considered to be optimal at a global level, why is there a sizeable difference in the nature and extent of the incidence of RPTs in these jurisdictions? Why do companies in some of our jurisdictions use RPTs in an advantageous manner, thereby benefiting all shareholders, while others engage in abusive RPTs that amount to wealth tunneling to the detriment of minority shareholders? If the tools utilized are the same and their success is reflected in renowned and influential global rankings, what explains the differences in outcomes in four Commonwealth Asian jurisdictions? It is to these questions that we now turn.

It is our assertion that the regulation of RPTs using formal corporate and securities laws provide us with a woefully incomplete picture. In order to solve the puzzle, we need to understand other factors that are at play in the context of

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115. See Appendix 1.

RPT regulation in our jurisdictions. It is well accepted that the enforcement of laws is equally, if not more, important than the substantive content of the regulation. This depends in large part on the quality and sophistication of the regulators who enforce the regulation, including on RPTs. For instance, it would be reasonable to assume that the general strength of a robust public enforcement establishment in Singapore has a bearing on why there is no evidence of systematic wealth tunneling in Singapore, despite a strong incidence of RPTs, especially among SOEs. The quality of enforcement also depends on other factors.

For example, RPT regulation (and the enforcement of corporate governance norms more generally) is hampered in Hong Kong because of the composition of listed companies on the Hong Kong Exchange (HKEx). Nearly 87% of the companies listed on HKEx are incorporated in jurisdictions outside Hong Kong.<sup>116</sup> Hence, those companies are governed by the basic corporate statutes in their own jurisdictions, which may not comport with the governance levels that Hong Kong regulators demand. Moreover, HKEx and other regulators in Hong Kong would be constrained in taking appropriate enforcement actions against companies and their directors and officers who are domiciled in other jurisdictions. Available empirical studies support our conclusion that extraneous elements pertaining to the legal system demonstrate their effect on the incidence and impact of RPTs.<sup>117</sup> One study finds that Hong Kong-listed companies, which have ultimate owners in mainland China, are likely to undertake RPTs that violate the exchange's listing rules and are less likely to disclose the required information, thereby making those transactions opaque.<sup>118</sup> This phenomenon is attributable to the fact that investors in mainland Chinese companies are unlikely to be able to lay their hands on expropriated assets held in China, due to the differences in the two legal systems and the lack of enforceability of Hong Kong court judgments in mainland China.<sup>119</sup> Moreover, in showing some direct evidence of tunneling through RPTs in China-affiliated companies, another study finds that "investors discount companies engaged in potentially expropriating transactions."<sup>120</sup> This study also demonstrates that China-affiliated companies use disclosure exemptions available to smaller RPTs, in order to engage in tunneling that stays beneath the threshold of disclosures and approvals by board or independent shareholders.<sup>121</sup> In that sense, the pattern of RPTs in Hong Kong listed companies appears to follow a dichotomous approach between wholly domestic controlled companies and those that mainland Chinese owners control.

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116. DONALD, *supra* note 15, at 101, 152.

117. Yan-Leung Cheung et al., *Buy High, Sell Low: How Listed Firms Price Asset Transfers in Related Party Transactions*, 33 J. BANKING FIN. 914 (2009).

118. Cheung et al., *supra* note 25, at 346.

119. *Id.*

120. Lei & Song, *supra* note 99, at 487.

121. *Id.*

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In a similar vein, Singapore too has in the past witnessed one particular type of listed company in which blatant wealth tunneling has been highly problematic: Chinese-controlled companies (i.e., companies that are listed on the Singapore Exchange (SGX), but whose operations and controlling shareholders are located in mainland China).<sup>122</sup> In the late 2000s in Singapore, within a few years, Chinese-controlled companies went from being inconsequential to accounting for one-third of the value of IPOs and 20% of total listings on the SGX.<sup>123</sup> Chinese-controlled companies, however, were riddled with corporate governance scandals, which typically involved blatant wealth tunneling by mainland Chinese controlling shareholders. These scandals revealed that Chinese-controlled firms were uniquely at risk for wealth reducing RPTs, because they were largely beyond the reach of Singapore's effective public regulators and lacked the strong good corporate governance culture of Singapore based companies.<sup>124</sup>

The RPT Index, which ranks both Singapore and Hong Kong among the highest in the world for effectiveness of their RPT regulatory regimes, would not capture such factors peculiar to foreign-listed companies that are located in these jurisdictions. Although the substantive rules pertaining to RPT regulation are similar, constraints relating to the enforcement of the rules against these specific types of companies brings about a substantial divergence in practice, a matter that the RPT Index does not account for.

Similarly, regulators in countries such as India and Malaysia have faced challenges in enforcing corporate governance norms in general, let alone rules on RPTs. The enforcement of corporate governance norms has faced significant challenges in India, not least due to inadequate enforcement machinery available to the regulators and also on account of an overburdened court system.<sup>125</sup> In Malaysia too, it has been argued that having robust substantive regulation in the sphere of corporate governance is insufficient. Matters such as an effective “rule of law” and effective enforcement are crucial.<sup>126</sup> Unless these issues are addressed, corporate law reforms are unlikely to be effective on their own.

Certain other differences in enforcement measures matter as well, although they sometimes operate in curious ways. For example, the use of listing rules to regulate RPTs in Hong Kong has been criticized due to questions regarding their status and the extent to which non-compliant companies can be appropriately sanctioned,<sup>127</sup> while these complaints have not been heard as much in Singapore.

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122. Puchniak & Lan, *supra* note 23, at 319–20, 326–29.

123. *Id.*

124. *Id.*

125. Umakanth Varottil, *A Cautionary Tale of the Transplant Effect on Indian Corporate Governance*, 21 NAT'L L. SCH. IND. REV. 1, 30 (2009).

126. Pascoe, *supra* note 23.

127. Rita Cheung, *Corporate Governance in Hong Kong: On Certain Issues of Minority Shareholders' Rights and Protection in Listed Companies*, 19 INT'L CO. COMM. L. REV. 181, 185 (2008).

On the other hand, even though India and Malaysia have captured RPT regulation in their basic company statute,<sup>128</sup> it does not necessarily mean that the enforcement of the regulations and the forcefulness of the sanctions are likely to be more optimal. All of these suggest that the overall strength of the legal system, the legal institutions, and the rule of law in general in these jurisdictions matter to an extent that commentators have so far largely ignored. Solely examining substantive RPT regulation, as influential world rankings such as the RPT Index have done in disregard of these factors, will likely generate peculiar outcomes.

Finally, corporate culture and ethos matter too, in not so trivial ways. Jurisdictions in which corporate actors and regulators display greater tolerance towards wealth extraction and tunneling are likely to witness minimal results, no matter how robust the substantive regulation of RPTs is.<sup>129</sup> This is particularly true in Commonwealth Asia, where corporate groups have been the mainstay of business, and where RPTs are the norm. For example, Puchniak and Lan observe that:

the difference in corporate culture between Singapore based government-linked companies/family firms and PRC controlled firms is another factor which may suggest that a distinct and more robust regulatory regime is warranted for PRC-controlled firms. In Singapore-based family firms, the focus of passing on the wealth of the business to the next generation and maintaining the controlling family's reputation in Singapore's small, tight-knit business community helps mitigate the risk of private benefits of control. In a similar vein, in Singapore-based government-linked companies, the meritocratic, largely corruption-free, and efficient culture of the Singapore civil services, combined with Singapore's distinct regulatory architecture for protecting the boards of government-linked companies from politics, appears to significantly reduce the risk of private benefits of control. In contrast, the culture of good corporate governance tends to be lacking in PRC-controlled firms as they have tended to be second-class Chinese companies that have emerged from an environment where controlling-shareholder abuse is rife.<sup>130</sup>

The ability of various actors to discern between beneficial and abusive RPTs will be diminished in cultures that display tolerance towards transactions within constituents of corporate groups. Such an outlook and ethos may even render an element of legitimacy that may invite scorn in other jurisdictions. The importation of Western-style corporate governance norms and RPT regulation to the Asian context is likely to face resistance, unless the cultural implications are carefully addressed.

As the above discussion suggests, the regulation of RPTs in Commonwealth Asia is riddled with complexity. Factors that are extraneous to substantive regulation of RPTs, embedded in corporate and securities laws, need greater focus. Existing studies of RPTs, including the RPT Index, have failed to consider the impact of those factors, thereby producing somewhat curious results.

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128. See Tbl. 1 above.

129. Enriques, *supra* note 27, at 529.

130. Puchniak & Lan, *supra* note 23, at 327.

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### III. RPTs AND SHAREHOLDER COMPLEXITY

Given the prevalence of concentrated shareholding in Commonwealth Asia, RPTs predominantly involve controlling shareholders as opposed to managers (that are common in countries with dispersed shareholding).<sup>131</sup> Hence, the identity and character of the controlling shareholder assumes considerable importance. However, conventional wisdom largely focuses on the dichotomy between dispersed and concentrated shareholding and, in doing so, is grounded on one significant (but mistaken) assumption: that controlling shareholders are a homogeneous group that are motivated by similar incentives. It ignores the differences in the types of controlling shareholders whose impetus to engage in RPTs may vary considerably. The role of RPTs and their regulation ought to consequently take on different hues depending on the nature of controlling shareholders prevalent in different jurisdictions. Here, we rely upon the four Commonwealth Asian jurisdictions to demonstrate the importance of controlling shareholder identity in the regulation of RPTs.

Delving into the types of controlling shareholders, they can be numerous. In firms that have a single controlling shareholder, the incentives that the single controlling shareholder perceives drive the decisions. However, matters may be rather different when there is a group of controlling shareholders, as the interests of various constituents within the group may diverge at times. Here, decision-making may take on greater complexity, as is commonly the case in family-owned firms.<sup>132</sup> Family-owned firms are of greater interest to us as they are common in Commonwealth Asia. Similarly, SOEs are worthy of focus as they too are widespread in our jurisdictions.<sup>133</sup> It is often attractive, at least superficially, to think of the state as a single, monolithic shareholder with a cohesive set of incentives. But, as is well known in the literature,<sup>134</sup> the state mechanism is rather multifaceted and is represented by often disjointed sets of incentives that are difficult to explain, not least because decision-making within SOEs may be driven by political factors. In seeking to assert our point on shareholder complexity, we explore two types of companies that are predominant in Commonwealth Asia: family-owned firms and SOEs.<sup>135</sup>

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131. Djankov et al., *supra* note 36, at 430.

132. D. A. DeMott, *Guests at the Table?: Independent Directors in Family-Influenced Public Companies*, 33 J. CORP. L. 819 (2008).

133. Rajesh Chakrabarti, William L. Megginson & Pradeep K. Yadav, *Corporate Governance in India*, 20 J. APP. CORP. FIN. 59, 66 (2008) (for India); Tan et. al, *supra* note 24 (for Singapore); EDMUND TERENCE GOMEZ ET AL, MINISTRY OF FINANCE INCORPORATED: OWNERSHIP AND CONTROL OF CORPORATE MALAYSIA (2018) (for Malaysia).

134. Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293, 1318 (2011); Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697 (2013).

135. Although there could be other types of controlling shareholders, e.g., a multinational company (which is itself dispersedly held), we refrain from dealing with them. Not only are those other types of controlling shareholders comparatively less prevalent in Commonwealth Asia, but in the interests of space

### A. Family-Owned Firms

Family-owned firms are common in all four leading jurisdictions of Commonwealth Asia.<sup>136</sup> Family groups tend to be diversified in nature, as they are structured through a number of different companies. Transactions between various group companies are commonplace and form the foundation of the persistence of such groups. Given that business families tend to prop up their control through measures such as pyramid and cross-holding structures,<sup>137</sup> there is always a prospective risk of wealth tunneling that is antagonistic to the interests of outside minority shareholders. Arguably, the evidence of wealth tunneling in family owned firms is also borne out in the empirical evidence.<sup>138</sup>

At the same time, we argue that the presumption of wealth tunneling in diversified family groups is unsupported. Family groups are grounded in reputational incentives, as they have multi-generational concerns and possess long-term goals.<sup>139</sup> These incentives, through RPTs that belie their reputation and hence their ability to access the capital markets as a repeat player, may prevent family controlling shareholders from expropriating wealth from the minority shareholders. As Khanna and Yafeh have demonstrated by providing a detailed overview of the literature, the family group structure often helps to fill a number of institutional voids or weaknesses. Thus, if the court system moves slowly (as it does in countries such as India), then transacting with a family group may provide more assurances than relying on contractual promises.<sup>140</sup> A family group may have years (perhaps generations) of family capital at stake in transactions.<sup>141</sup>

Available evidence supports the benefits of group structures and RPTs among family-owned enterprises where they perform a constructive role. In emerging markets like India, the evolution of corporate groups has been attributed to poorly functioning institutions and the need for establishing mechanisms of risk sharing among various components of the group.<sup>142</sup> The theoretical and empirical literature identifies several functions that diversified corporate groups in India perform. For instance, one study shows that up to a threshold, group diversification reduces the performance of group affiliates, but

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we leave them for another day. For an analysis of various ownership models that are prevalent in the context of India, see CFA INST. CTR. FOR FIN. MKT. INTEGRITY, *supra* note 3, at 7–10.

136. See Lau et al., *supra* note 23, at 306.

137. See, e.g., Bertrand et al., *supra* note 21; OECD EQUITY MARKETS REVIEW: ASIA 2017, <http://www.oecd.org/corporate/OECD-Equity-Markets-Review-Asia-2017.pdf>; Stijn Claessens et al., *The Separation of Ownership and Control in East Asian Corporations*, 58 J. FIN. ECON. 81 (2000).

138. *Id.*

139. See Avner Greif, *Reputation and Coalitions in Medieval Trade: Evidence on the Maghribi Traders*, 49 J. ECON. HIST. 857 (1989).

140. Tarun Khanna & Yishay Yafeh, *Business Groups and Risk Sharing around the World*, 78 J. BUS. 301, 340 (2005). See also Ronald J. Gilson, *Controlling Family Shareholders in Developing Countries: Anchoring Relational Exchange*, 60 STAN. L. REV. 633 (2007).

141. Khanna & Yafeh, *supra* note 140, at 349.

142. *Id.* at 301–302; Tarun Khanna & Krishna Palepu, *Is Group Affiliation Profitable in Emerging Markets? An Analysis of Diversified Indian Business Groups*, 55 J. FIN. 867 (2000).

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thereafter it results in incremental performance improvements.<sup>143</sup> This suggests that the most highly diversified Indian business groups, in fact, add value to their shareholders.<sup>144</sup> Furthermore, intragroup loans figure prominently as a form of RPTs among Indian business groups. Some studies show that intragroup loans are used to smooth liquidity across firms as a means of providing support to member firms,<sup>145</sup> while others document that intragroup loans are used as an important means to support financially weaker firms within the group, especially those that are in financial distress.<sup>146</sup>

Applying RPT regulation as a blunt instrument to target all RPTs among family controlled companies, without regard to the long-term goals and reputational incentives of business families, carries the risk of overregulation that may hamper the success of family-owned firms that are driving economic prosperity in Commonwealth Asia.

### *B. State-Owned Enterprises*

Very different considerations are at play when the state is a controlling shareholder. The incentives of the state differ considerably from other types of controlling shareholders such as business families and, therefore, the reasons why it might enter into RPTs vary. Although the state is often considered as a unitary actor, various governmental bodies, bureaucrats, and legislators may be driven by different incentives that are difficult to reconcile.<sup>147</sup>

In the case of private controllers such as business families, conflicts of interests and benefits of control are generally manifested through financial transactions. However, one cannot expect the state to necessarily be motivated by the enhancement of financial interest or wealth maximization, as it may be motivated to enter into RPTs that may serve the political goals of the controller.<sup>148</sup> Nevertheless, transactions or operations of SOEs could be detrimental to the interests of the firm and its minority shareholders and, as a result, RPTs involving SOEs ought to be appropriately regulated. For example, in the past, Indian SOEs have been subject to criticism for having sold their products at less than market price (effectively operating as a subsidy) to achieve

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143. Khanna & Palepu, *supra* note 142, at 869.

144. *Id.* at 887.

145. Khanna & Yafeh, *supra* note 140.

146. Khanna & Palepu, *supra* note 142.

147. Mariana Pargendler, *State Ownership and Corporate Governance*, 80 FORDHAM L. REV. 2917, 2921 (2012).

148. Curtis J. Milhaupt & Mariana Pargendler, *RPTs in SOEs: Tunneling, Propping and Policy Channeling 5* (Eur. Corp. Governance. Inst. (ECGI) Working Paper Series in Law, Working Paper No. 386/2018) <https://ssrn.com/abstract=3119164> (noting that through “policy channeling” the state may use SOEs to achieve public policy or political objectives). They also argue that this generates “political private benefits of control”, which are non-pecuniary in nature.



political goals of the state, thereby depriving minority shareholders of wealth maximization through their investment.<sup>149</sup>

Moreover, the financial motivation of private controllers to enter into RPTs may make them more tangible and measurable. On the other hand, there is a great level of obscurity when the state enters into RPTs, as it may be driven by non-financial goals and more diffuse interests that are difficult to pin down.<sup>150</sup> Hence, traditional notions of RPT regulation, including the toolkit we have discussed earlier,<sup>151</sup> are arguably of limited use in their applicability to SOEs. There is a need for an altogether different approach while dealing with SOEs.

Current regulations do not seem to cater towards tackling abusive RPTs in SOEs. If anything, the treatment meted out to SOEs in Commonwealth Asia is rather intriguing. This can be demonstrated by the comparatively relaxed approach adopted by Hong Kong, India, and Malaysia towards regulating RPTs in SOEs. For instance, the Hong Kong Exchange (HKEx) states that it will not normally treat a governmental body from the People's Republic of China (PRC) as a "connected person" for the purpose of applying RPT regulations.<sup>152</sup> However, HKEx may request an issuer to explain its relationship with a PRC governmental body and why it should not be treated as a "connected person," and it retains the discretion to apply the regulations to such issuer if it so decides.<sup>153</sup> Curiously enough, this dispensation is available only to SOEs from the PRC, and not to issuers from other jurisdictions that may be listed on HKEx. Similarly, SOEs in India are spared from the full rigor of RPT regulation. For instance, RPTs between two or more SOEs have been exempt from the requirement to obtain the approval of the shareholders (by way of a "majority of the minority" vote).<sup>154</sup> The Securities and Exchange Board of India has also relaxed some of its RPT regulation for listed companies involving transactions between two or more SOEs.<sup>155</sup> Malaysia has no special legislation that deals with RPTs in SOEs. However, there is evidence that suggests that an informal regulatory norm has developed which allows SOEs to engage in RPTs without meaningful approval or disclosure; leading academics have suggested that this

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149. Vikas Bajaj, *The Children's Investment Fund Wages Battle with Coal India*, N.Y. TIMES DEALBOOK (Apr. 19, 2012), <https://dealbook.nytimes.com/2012/04/19/coal-india-struggles-with-demands-of-the-childrens-investment-fund/>.

150. Milhaupt & Pargendler, *supra* note 148, at 2 (finding that the state can effect "policy channeling" through SOEs without there being a "transaction" as such).

151. *See* Part 3 *supra*.

152. HONG KONG EXCH. (HKEx) LISTING RULES, r. 14A.10. The definition of a "PRC Governmental Body" is also contained in the HKEx Listing Rules, r. 19A.04.

153. *Id.*

154. Ministry of Corporate Affairs, Government of India, Notification G.S.R. 463(E) (5 June 2015).

155. Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015, reg. 23(5)(a).

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provides a vehicle for RPTs to be used for political benefits and outright corruption.<sup>156</sup>

Such an approach towards RPTs among SOEs raises important questions. Although the possibility of RPTs among government owned companies cannot be ruled out, what is the rationale for relaxing the rules in their favor? Do they indicate that the lack of private financial incentives on the part of the state will eliminate the possibility of abusive RPTs and wealth tunneling in SOEs? These issues have received limited attention in the literature and need to be considered further. One possibility is that this arises from the political economy implications, where the state is both a player and regulator, that could result in inefficient regulations that potentially stymie the interests of outside minority shareholders.<sup>157</sup> This has become a salient political issue in Malaysia, where allegations of massive wealth tunneling from its SOEs as part of the 1 MDB scandal have received international attention, while other instances of alleged significant wealth tunneling by government officials from SOEs has been an ongoing issue.<sup>158</sup> If these claims of egregious wealth tunneling are true, they make a mockery of Malaysia's ranking of 3<sup>rd</sup> out of 190 jurisdictions on the World Bank's 2018 RPT Index.

At the same time, it is noteworthy that the OECD has called for all transactions between the government and SOEs to be tested for market consistency and probity.<sup>159</sup> Moreover, the OECD has displayed its aversion to differential treatment for SOE governance, and has indeed called for a level playing field by which SOEs are held to the same standards as private firms, even when it comes to matters of corporate governance.<sup>160</sup> Evidently, however, jurisdictions such as Hong Kong, India, and Malaysia continue to have considerably lax requirements for SOE governance in the context of RPTs that fail to account for the rather unique "political private benefits of control" that the state may seek to enjoy at the expense of minority shareholders in SOEs.<sup>161</sup>

Interestingly, the dispensations granted to SOEs in the three Commonwealth Asian jurisdictions do not appear to be available in Singapore, where SOEs are held to the same standards as private listed firms. This is because Singapore is an outlier of sorts in our sample jurisdictions. While there is concentration of

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156. GOMEZ & JOMO, *supra* note 67.

157. For a discussion on this issue, see Pargendler, *supra* note 147.

158. *Malaysia's 1MDB scandal: Nothing to see here*, ECONOMIST (Nov. 17, 2016), <https://www.economist.com/news/asia/21710280-billions-are-stolen-only-whistle-blower-goes-jail-nothing-see-here>; GOMEZ & JOMO, *supra* note 67.

159. OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 54 (2015 ed.), <http://www.oecd.org/publications/oecd-guidelines-on-corporate-governance-of-state-owned-enterprises-2015-9789264244160-en.htm>.

160. *Id.* at 20.

161. Dan W. Puchniak, *Multiple Faces of Shareholder Power in Asia: Complexity Revealed*, in RESEARCH HANDBOOK ON SHAREHOLDER POWER 527–32 (Jennifer G. Hill & Randall S. Thomas eds. 2015).

shareholdings, state-controlled companies (known as government-linked companies or GLCs) play a predominant role in the capital markets in addition to family-owned companies.<sup>162</sup> Studies have shown that the incidence of RPTs among GLCs was as high as 81%,<sup>163</sup> indicating that GLCs were more prone to RPTs than family-owned companies. While the incidence of RPTs among GLCs is high, there is no evidence to suggest that such RPTs are value-reducing in nature for minority shareholders. This is arguably attributable to the overall performance and governance of GLCs in Singapore.<sup>164</sup> For instance, studies have also found that GLCs are more profitable than other public companies.<sup>165</sup> In that sense, GLCs are run in a manner that is similar to privately managed enterprises (i.e., with an eye on commercial success and profit maximization).<sup>166</sup> As Milhaupt and Pargendler observe in the context of Singapore: “although state *ownership* of business enterprises is used as a means of pursuing policy objectives, *management* of the enterprises is not.”<sup>167</sup>

As we have sought to demonstrate in this Part, unless the regulation of RPTs captures the complexity surrounding the identity and character of different types of controlling shareholders, the results are unlikely to be optimal. Thus far, the homogenous treatment meted out to different types of controlled companies is not expected to enable the attainment of the goals of RPT regulation (i.e., to filter beneficial RPTs from the abusive ones). The RPT Index approaches shareholder identity from a simplistic perspective. For instance, the illustration that forms the bedrock of the RPT Index is based on a controller-shareholder-director scenario involving an individual, arguably the simplest of circumstances in the context of RPTs. Unless the nuances of shareholder identity discussed in this Part are taken into account, the results emanating from the RPT Index will not provide a true picture regarding RPT regulation. To the extent that jurisdictions are driven by the World Bank rankings in framing their regulation, the results are likely to be sub-optimal, unless they pay sufficient attention to the differing identities of shareholders.

#### IV. RPTs AND NORMATIVE COMPLEXITY

The rationale underlying the World Bank’s RPT Index is simple: the stricter the legal controls on RPTs the better. Specifically, a jurisdiction’s score on the RPT Index increases as the disclosure and approval requirements for RPTs

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162. Puchniak & Lan, *supra* note 23, at 305–17.

163. KPMG & NUS BUSINESS SCHOOL, *supra* note 71. However, GLCs only formed a small portion of the overall sample size in this study.

164. For a more detailed discussion on this point, including the historical evolution of GLCs in Singapore, see Tan et al., *supra* note 24.

165. Ramírez & Tan, *supra* note 71.

166. Puchniak & Lan, *supra* note 23, at 305–17; Milhaupt & Pargendler, *supra* note 148, at 7.

167. Milhaupt & Pargendler, *supra* note 148, at 7; see generally, Puchniak & Lan, *supra* note 23, at 305–17.

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become stricter (*ex ante* controls) and as the law makes it easier and less costly to hold controlling directors liable for self-dealing (*ex post* controls).<sup>168</sup> Conversely, there are no measures in the RPT Index in which a jurisdiction's score would decrease if it instituted overly strict *ex ante* or *ex post* controls.<sup>169</sup>

The rationale that stricter regulation of RPTs is axiomatically better has its foundation in the notion that RPTs *per se* are wealth reducing. This notion can be seen in the World Bank's view that RPTs are "one of the most serious breaches of good corporate governance around the world."<sup>170</sup> Similarly, otherwise sophisticated scholarship on RPTs makes the simplistic assumption that RPTs *per se* are a valid proxy for wealth tunneling.<sup>171</sup> This view is echoed by influential policymaking bodies, such as the OECD, which in a leading policy paper on RPTs in Asia suggests that an increase in the overall frequency and value of RPTs is *per se* evidence of wealth tunneling and poor corporate governance.<sup>172</sup>

However, such a rigid position does not sit well with the reality surrounding the beneficial effects of RPTs. The firm-level and macro-economic benefits that may be derived from corporate groups, and in turn the efficiencies of RPTs, appear to make Commonwealth Asia part of a larger story about corporate governance and the miraculous economic rise of Asia as a whole. The dominant corporate structures, which are central to the economic miracles that have driven the watershed shift in global economic power towards Asia since World War II, have had related party transactions as an integral part of their business models. *Keiretsu* in Japan; *Chaebol* in South Korea; SOEs in China, Hong Kong, India, Indonesia, Malaysia, Singapore, Thailand and Vietnam; and family businesses throughout most of Asia, have often used related party transactions to their strategic advantage, many times in ways that appear to benefit minority shareholders, equity markets, and the economy as a whole.<sup>173</sup> These family-controlled and state-controlled group companies in Asia have come to play a predominant role in the global equity markets – suggesting that these corporate group structures may be a key to Asia's economic success.<sup>174</sup>

The overly simplistic view that RPTs *per se* are wealth reducing has also made its way into the legislation in at least one jurisdiction that chose to completely ban certain types of RPTs. A stark example of this occurred in an amendment to the *Malaysian Companies Act*, which resulted in the complete ban on a significant portion of RPTs with no consideration for whether the RPTs

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168. WORLD BANK, *supra* note 8.

169. 2018 DBR, *supra* note 4, at 91–94.

170. WORLD BANK, *supra* note 6.

171. Chen et al., *supra* note 31.

172. OECD, *supra* note 31, at Box 1.

173. See generally Puchniak, *supra* note 161.

174. See generally OECD, *supra* note 137. For a general view on the potential for the success of such corporate structures, see Franks & Mayer, *supra* note 31.

were wealth reducing or wealth enhancing.<sup>175</sup> According to Philip TN Koh, this amendment went “too far” as it increased the cost of transactions to the extent that it would “curb entrepreneurial flair and efficiency.”<sup>176</sup> Moreover, by completely banning a large swath of RPTs, the amendment appears to have prevented some efficient deals from going forward and raised the cost of transactions.<sup>177</sup> Eventually, under strong pressure from the business community, the government repealed this ban on a significant portion of RPTs, which has been described as “convoluted, perplexing and confounding.”<sup>178</sup>

Taking another example of excessive stringency in RPT regulation, the company statute in India provided that material RPTs require a “majority of the minority” vote of shareholders through a special resolution, which mandates the support of shareholders holding 75% votes among those present and voting.<sup>179</sup> However, this was found to be cumbersome and often impractical to obtain, which led to the Government of India adopting a proposal to reduce the requirement to a simple majority vote (i.e., with the support of more than 50% votes among shareholders present and voting).<sup>180</sup> Likewise, the Government of India found the requirement of obtaining the approval of the audit committee for individual RPTs burdensome, and introduced the possibility of an audit committee providing an omnibus approval for a transaction or series of transactions.<sup>181</sup> These moves have received acceptance of the business community in India.<sup>182</sup>

The source of the overly simplistic view that RPTs *per se* are wealth reducing is grounded in the broader concept that controlling shareholders – particularly those who control a company through group structures with a minority of cash flow rights – necessarily use their control to extract private benefits at the expense of minority shareholders.<sup>183</sup> Put simply, the assumption that the extraction of private benefits of control is axiomatically bad for minority shareholders supports the view that RPTs *per se* are wealth reducing. This is because RPTs are commonly viewed as the most important way in which controlling shareholders extract private benefits of control – particularly in the

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175. CORP. L. REFORM COMM., RESPONSES AND COMMENTS RECEIVED ON CONSULTATIVE DOCUMENT: CREATING A CONDUCTIVE LEGAL AND REGULATORY FRAMEWORK FOR BUSINESSES 32–33, [http://www.ssm.com.my/Pages/Publication/CLRC/Consultation\\_Documents/cd7r%20\(1\).pdf](http://www.ssm.com.my/Pages/Publication/CLRC/Consultation_Documents/cd7r%20(1).pdf). Philip T.N. Koh, *Principles, Practice and Prospects of Corporate Governance: The Malaysian Legal Framework*, [1994] 3 MALAYAN L.J. xi at ¶¶ 7.4–7.5 (1994).

176. *Id.* at ¶¶ 7.4–7.5.

177. *Id.*

178. *Id.*

179. Companies Act, 2013, § 188(1), second proviso.

180. Companies (Amendment) Act, 2015, § 16.

181. Companies (Amendment) Act, 2015, § 14.

182. See e.g. Amrit Raj, *Maruti Wins Shareholder Nod for Gujarat Plant Pact*, MINT, Dec. 18, 2015.

183. Gilson & Schwartz, *supra* note 27.

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case of controlling shareholders that have control rights in excess of cash flow rights.<sup>184</sup>

Although the highly influential RPT Index is still based on the notion that RPTs *per se* are wealth reducing, this overly simplistic view has been called into question by a consensus that appears to have emerged among leading corporate law and governance scholars. Over a decade ago, Ronald Gilson, in his seminal article “Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy”, convincingly argued that jurisdictions with “good law” may have efficient controlling shareholders.<sup>185</sup> In doing so, he debunked the then conventional wisdom that controlling shareholders were axiomatically “bad” for corporate governance because they necessarily reduced the wealth of the company by extracting private benefits of control.

Today, the idea that controlling shareholders may in some contexts be more efficient than dispersed shareholders is an emerging trend among leading scholars.<sup>186</sup> The extraction of private benefits of control may promote efficiency if the controlling shareholder produces benefits for the company as a whole, in excess of its private benefits of control. Thus, allowing some private benefits to be extracted through RPTs may actually be wealth enhancing for the corporation as a whole.<sup>187</sup>

More importantly, a general consensus in the academic literature has emerged that RPTs are not merely a device for controlling shareholders to extract private benefits of control. Indeed, there is now a body of research which clearly articulates and demonstrates how RPTs may produce many wealth enhancing benefits which may exceed the controlling shareholder’s private benefits of control.<sup>188</sup> This consensus is reflected in the fact that no jurisdiction entirely bans all RPTs. It is also supported by the increasingly dominant role that group companies, in which RPTs are central, are playing in global equity and product markets – especially those from Asia.<sup>189</sup> As explained above, Singapore is perhaps one of the best examples of a jurisdiction with such group companies. However, the fact that RPTs may provide benefits and, in turn, that stricter

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184. WORLD BANK, *supra* note 9.

185. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy*, 119 HARV. L. REV. 1641 (2006).

186. Franks & Mayer, *supra* note 31, at 44.

187. *Id.*; Gilson & Schwartz, *supra* note 27; Dammann, *supra* note 32.

188. Michael Ryngaert & Shawn Thomas, *Not All Related Party Transactions (RPTs) Are the Same: Ex Ante Versus Ex Post RPTs*, 50 J. ACCT. RES. 845 (2012); Raymond M.K. Wong et al., *Are Related-Party Sales Value-Adding or Value-Destroying? Evidence from China*, 26 J. INT’L FIN. MGMT. & ACCT. 1 (2015); David H. Downs et al., *Related Party Transactions and Firm Value: Evidence from Property Markets in Hong Kong, Malaysia and Singapore*, 52 J. REAL ESTATE FIN. ECON. 408 (2016).

189. See *supra* note 64 and accompanying text; 33 Major Family-Owned Conglomerates in Asia, NIKKEI ASIAN REV. (Dec. 1, 2016), <https://asia.nikkei.com/Business/list>; Kenji Kawase, *Asia’s Family-run Conglomerates Drive Regional Growth*, FIN. TIMES (Dec. 5, 2016), <https://www.ft.com/content/e1fbc74e-b7d0-11e6-961e-a1acd97f622d>.

regulation of RPTs does not axiomatically equate to “good law” entirely escapes the RPT Index.

V. CONCLUDING REMARKS: THE ACADEMIC SIGNIFICANCE OF RPTs IN  
COMMONWEALTH ASIA

It is patently obvious that related party transactions in Commonwealth Asia are incredibly complex. It is also clear that this complexity is not captured by the World Bank’s influential RPT Index.

Factors as difficult to define as culture and rule of law may play as great a role as the formal corporate and securities laws in the operation of RPTs. This means that we cannot assume that a comparison of corporate and securities laws across jurisdictions will produce accurate results. In fact, we have seen in Commonwealth Asia that limiting the comparison to corporate and securities laws can be terribly misleading. In our Commonwealth jurisdictions, the comparison of the formal corporate and securities rules, which is the focus of the RPT Index, tells us a story of uniformly stellar regulation of RPTs – when in reality, the formal similarity in the law is merely an articulation of the strength of the Commonwealth legal tradition in Commonwealth Asia. However, the actual function and impact of RPTs across our Commonwealth Asian jurisdictions paint a picture of incredible diversity. Understanding this diverse reality only becomes possible by examining factors beyond the traditional corporate and securities law toolkit for regulating RPTs.

The fact that different types of controlling shareholders are driven by different incentives means that we cannot assume that controlling shareholders will respond similarly to the same RPT regulations. It may be that different regulations are warranted for different types of controlling shareholders. If this is the case, understanding how each major type of controlling shareholder works will be important for each country’s RPT law and a topic for future research.<sup>190</sup> This is another critical point of complexity that is entirely overlooked by the RPT Index.

It is clear that RPTs may be wealth enhancing or wealth reducing depending on the particular context—thus, we cannot assume that stricter regulation of RPTs is necessarily better. In fact, we have seen in Commonwealth Asia that stricter regulation may sometimes be worse for corporate governance, which academic theory now predicts. This confirmation of the current academic theory is important as the RPT Index is built on the erroneous assumption that stricter regulation of RPTs is necessarily better.

Understanding the obvious deficiencies in the RPT Index is important in practice because jurisdictions – especially developing ones – commonly look to

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190. Puchniak, *supra* note 161.

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it when reforming their laws.<sup>191</sup> This article suggests that jurisdictions should not expect to have a world leading RPT regulatory regime merely by adopting the laws which strengthen formal *ex ante* and *ex post* controls that result in a high ranking on the RPT Index. Rather, jurisdictions must understand the complexity of their own system and develop strategies to address those complexities in order to develop a successful RPT regulatory regime.

As noted in the Introduction, the academic significance of this article is heightened by the fact that the RPT Index was developed based on the DLLS article. The methodology used to collect data for the World Bank's RPT Index was modeled on the DLLS article.<sup>192</sup> The criteria measured in the Anti-Self-Dealing Index (ASD Index), which was the core data-set used in the DLLS article, closely mirrors the criteria in the RPT Index.<sup>193</sup> The hypothetical RPT distributed to corporate and securities lawyers each year in the 190 jurisdictions in the RPT Index is virtually identical to the one distributed in 2003 to corporate and securities lawyers from the 72 jurisdictions included in the ASD Index.<sup>194</sup>

Given the similarities in the methodology and design of the two indices, it is unsurprising that the rankings of Commonwealth Asia's leading economies on the ASD Index largely track their rankings on the 2018 RPT Index. In the ASD Index, Singapore ranked 1<sup>st</sup>, Hong Kong 2<sup>nd</sup>, Malaysia 3<sup>rd</sup>, and India 18<sup>th</sup> out of 72 jurisdictions.<sup>195</sup> Singapore was the only jurisdiction in the ASD Index to receive a perfect score.<sup>196</sup> However, as noted earlier, we are unaware of a *single* successful suit – or even a *single* suit ever filed – by a minority shareholder against a director of a *listed* company in the *history of Singapore* in relation to self-dealing or for any other wrongdoing whatsoever.<sup>197</sup> This fact is even more astounding in light of the conclusion reached in the DLLS article that private enforcement is the key to successful RPT regulation – which they suggest ultimately leads to successful financial markets and economic development.<sup>198</sup> In practice, however, in listed companies in Singapore, private enforcement

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191. Sandefur & Wadhwa, *supra* note 35.

192. According to the 2018 DBR, the initial methodology for the RPT Index was developed in the DLLS article: 2018 DBR, *supra* note 4, at 96.

193. As the RPT Index has been slightly amended over its 15-year history there are some minor differences between the factors criteria measured in both indices. However, the methodology and core criteria measured are largely the same.

194. WORLD BANK, DOING BUSINESS IN 2004: UNDERSTANDING REGULATION 2–4 (2004); see 2018 DBR, *supra* note 4.

195. See dataset for Djankov et al., *supra* note 36, posted on Andrei Shleifer's website at [https://scholar.harvard.edu/files/shleifer/files/data\\_for\\_web.xls](https://scholar.harvard.edu/files/shleifer/files/data_for_web.xls) (last visited Feb. 17, 2019) (tab labelled 'Ex-Post Control'). See also Appendix 2.

196. See Appendix 2.

197. See *supra* notes 57 and 60 and accompanying text.

198. Djankov et al., *supra* note 36, at 463.



plays almost no role at all. In this respect, the situations in Hong Kong, Malaysia, and India broadly mirror that of Singapore.<sup>199</sup>

DLLS mention in a *footnote* in their article that a “possible limitation of [the ASD Index] methodology is that the law on the books does not reflect the full legal environment, and that the practice of enforcement matters as much or more.”<sup>200</sup> However, despite this caveat in a *footnote*, there is nothing in their empirical analysis that examines the extent to which any private *ex ante* or *ex post* self-dealing legal controls on the books are actually utilized in practice. Obviously, if the actual use and impact of legal controls was measured, Singapore would not rank 1<sup>st</sup> out of the 72 jurisdictions in terms of private enforcement. To the contrary, it would likely rank extremely low as there does not appear to have been any private enforcement efforts in relation to self-dealing in any listed company in Singapore.

As the ASD Index used the same simplistic hypothetical as the RPT Index, it fails to account for the fact that the regulation of RPTs may need to be calibrated to account for different types of controlling shareholders being driven by different incentives – therefore requiring different types of regulation. DLLS acknowledge that in practice regulations “must take account of the fact that, in many countries, firms are organized in business groups with individual firms controlled by the same family while trading separately on the stock exchange, so that many intra-group transactions are potentially conflicted.”<sup>201</sup> However, nothing in their empirical design, analysis, or core findings takes account of this factor or any other of the complexity that arises as a result of different types of shareholders. Indeed, there is no consideration of SOEs in the DLLS article at all.

DLLS note that no jurisdictions examined for the ASD Index have banned RPTs. They posit that this is “perhaps because in many instances related-party transactions actually make economic sense.”<sup>202</sup> However, like the RPT Index, there is nothing in the ASD Index that accounts for the fact that overly strict regulation of RPTs may be detrimental. To the contrary, the ASD Index is built on the assumption that the stricter the formal legal controls on RPTs the better. In fact, DLLS suggest that it may be beneficial to make RPT regulation so strict as to make corporate group structures, which rely on intra-group transactions as part of their business model, impracticable.<sup>203</sup> This illustrates the failure of the ASD Index to account for the normative complexity of RPTs which, as we have

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199. See *supra* notes 57 and 60 and accompanying text. On the contrary, each of our Commonwealth jurisdictions has relied extensively on *ex ante* measures such as disclosure and board/shareholder approvals. See *supra* Part 3.2.

200. Djankov et al., *supra* note 36, at 432 n.1.

201. *Id.* at 463.

202. *Id.* at 431.

203. *Id.* at 463.

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demonstrated, is critically important for understanding their regulation in Commonwealth Asia.

Also, like the RPT Index, the core focus of the ASD Index is the formal corporate and securities rules that are targeted towards regulating RPTs. Although DLLS use other crude measures as control variables to attempt to examine a few other factors, which may influence RPT regulation, these non-corporate and non-securities law factors are extraneous to their analysis and are not included in the ASD Index. This suggests why the RPT Index, which was derived from the DLLS article, focuses on the corporate and securities laws that regulate RPTs.

The one finding in the DLLS article, which on the surface appears to resonate with our analysis, is that the common law legal heritage of the jurisdictions in Commonwealth Asia tends to account for their high ranking on the ASD Index.<sup>204</sup> As suggested earlier, we agree that the reason Commonwealth Asia's leading economies rank high on the ASD Index is because they have relied heavily on the UK and other Commonwealth jurisdictions in their legal developments and reforms.<sup>205</sup> However, we suggest that this explains only the high ranking on the ASD Index and does not have much explanatory value for the successes or failures of the regulation of RPTs in Commonwealth Asia – which is the opposite of what DLLS' juggernaut legal origins theory suggests.

In the end, the complexity of RPTs in Commonwealth Asia appears to make the RPT Index and the DLLS article of little use for properly understanding our Commonwealth Asian jurisdictions. However, we hope that by identifying each point of complexity we have made understanding RPTs in Commonwealth Asia a little bit simpler and a lot more accurate. Only time will tell whether these points of complexity will also make it simpler to compare RPT regimes in other Asian jurisdictions and globally. We hope this will be the case.

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204. See Appendix 2.

205. See text accompanying *supra* notes 72–81.

## APPENDIX 1: 2018 RPT INDEX (DATA FROM DOING BUSINESS REPORT 2018)

Rank	Jurisdiction *Commonwealth Asia	Commonwealth (Cth)? <sup>206</sup> Common Law (CL)? <sup>207</sup>	Extent of Disclosure Index	Extent of Director Liability Index	Ease of Shareholder Suits Index	RPT Index Score <sup>208</sup>
1	New Zealand	Cth, CL	10.0	9.0	9.0	9.33
1	Singapore*	Cth, CL	10.0	9.0	9.0	9.33
3	Hong Kong SAR, China*	Cth, CL	10.0	8.0	9.0	9.00
3	Malaysia*	Cth, CL	10.0	9.0	8.0	9.00
5	Canada	Cth, CL	8.0	9.0	9.0	8.67
5	Ireland	Cth, CL	9.0	8.0	9.0	8.67
7	Israel	CL	7.0	9.0	9.0	8.33
7	Thailand	Neither	10.0	7.0	8.0	8.33
7	United Kingdom	Cth, CL	10.0	7.0	8.0	8.33
7	United States	CL	7.4	8.6	9.0	8.33
11	Colombia	Neither	9.0	7.0	8.0	8.00
11	Georgia	Neither	9.0	6.0	9.0	8.00
11	Kazakhstan	Neither	9.0	6.0	9.0	8.00
11	Macedonia, FYR	Neither	10.0	9.0	5.0	8.00
11	Mauritius	Cth, CL	7.0	8.0	9.0	8.00
11	South Africa	Cth, CL	8.0	8.0	8.0	8.00
17	Albania	Neither	9.0	7.0	7.0	7.67
17	Azerbaijan	Neither	10.0	5.0	8.0	7.67
17	United Arab Emirates	Neither	10.0	9.0	4.0	7.67
20	India*	Cth, CL	8.0	7.0	7.0	7.33
21–190	Jurisdictions ranked from 21 to 190 are not included in this table					
	OECD High Income average <sup>209</sup>					6.36

206. We define the “Commonwealth” as members of the Commonwealth of Nations, plus former territories of the British Empire that have ceased to be, or for political reasons never joined, as members of the Commonwealth of Nations such as Hong Kong and Ireland; see *supra* note 14. Note that some Commonwealth of Nations member states (such as civil law Mozambique) are *not* “common law” countries within the meaning of the next footnote.

207. We classify as “common law” any country that has, to a substantial extent, received, retained, or adopted English law and legal institutions at some point in time. This includes the United States and Israel – which are not “Commonwealth” countries.

208. The RPT Index is officially called the ‘Extent of Conflict of Interest Regulation Index’ by the World Bank, and in the data used for the DBR. WORLD BANK, PROTECTING MINORITY SHAREHOLDERS, <http://www.doingbusiness.org/data/exploretopics/protecting-minority-investors> (last visited Jan. 9, 2019). However, the scores in this column are not directly sourced from the World Bank’s ‘Extent of Conflict of Interest Regulation Index’ dataset available on the 2018 DBR Online, *supra* note 4; in the interests of greater precision, RPT Index scores are instead calculated based on the source data for the three component indices and following the World Bank’s methodology. For data, access 2018 DBR Online, *supra* note 4. On methodology, see 2018 DBR, *supra* note 4, at 92 tbl. 8.10.

209. The list of jurisdictions included in the OECD High Income category are generated by the Custom Query function on DBR Online (at <http://www.doingbusiness.org/en/custom-query>) and are:

## Related Party Transactions

	Asia (ex. Commonwealth Asia in top 20) average <sup>210</sup>	5.78
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## APPENDIX 2: TOP TWENTY JURISDICTIONS IN THE ASD INDEX<sup>211</sup>

Rank	Jurisdiction *Commonwealth Asia	Anti-Self-Dealing Index Score
1	Singapore*	1.000
2	Hong Kong*	0.963
3	Malaysia*	0.950
3	New Zealand	0.950
3	United Kingdom	0.950
6	South Africa	0.813
6	Thailand	0.813
8	Ireland	0.789
9	China	0.763
10	Australia	0.757
11	Israel	0.725
12	Ghana	0.671
13	United States	0.654
13	Bulgaria	0.654
15	Indonesia	0.653
16	Canada	0.642
17	Chile	0.625
18	India*	0.579
19	Colombia	0.573
20	Taiwan	0.565

Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, South Korea, Latvia, Lithuania, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, United Kingdom, and United States. However, the data is sourced from the World Bank Databank.

210. The jurisdictions included in the Asia category are: Afghanistan, Bangladesh, Bhutan, Brunei, Cambodia, China, Indonesia, Japan, Kazakhstan, Kyrgyzstan, Laos, Maldives, Mongolia, Myanmar, Nepal, Pakistan, Philippines, Sri Lanka, South Korea, Tajikistan, Taiwan, Thailand, Uzbekistan, and Vietnam. We have excluded the following jurisdictions from the Asia category: Singapore, Malaysia, Hong Kong, and India (being the Commonwealth Asia jurisdictions in the top 20). This list of jurisdictions (excluding Commonwealth Asia) is generated by the Custom Query function on DBR Online (at <http://www.doingbusiness.org/en/custom-query>) and are the 'Asian' countries in the 'Europe & Central Asia', 'South Asia' and 'East Asia and Pacific' categories.

211. See dataset for Djankov et al., *supra* note 36, posted on Andrei Shleifer's website at [https://scholar.harvard.edu/files/shleifer/files/data\\_for\\_web.xls](https://scholar.harvard.edu/files/shleifer/files/data_for_web.xls) (last visited Feb. 17, 2019) (tab labelled 'Ex-Post Control').