The Failure of Corporate Internal Information Sharing and Internal Controls: From Japan to Taiwan

Chang-hsien Tsai∗

Abstract

Studying failure of corporate internal controls across Japanese and Taiwanese cases, this paper seeks to resolve Taiwan’s above all. Although Japan and Taiwan have similarly been adopting U.S. independent directors and audit committees during recent years, we find that common issues among these East Asian cases are failure of internal controls in general and dysfunctional internal information sharing mechanisms in particular.

To accommodate Taiwan’s reform trend towards further adoption of independent directors and audit committees, this paper would suggest a complementary regulatory framework as prerequisites to make monitors of management have incentives and means to exercise their oversight: First, the board’s duty to monitor should be articulated while being transplanted into corporate governance rules. Second, independent information channels should be established for internal governance information to flow to corporate monitors, thus facilitating their decision making in oversight. Third, external market forces should meanwhile be channeled to safeguard internal corporate governance.

∗ Associate Professor, Institute of Law for Science and Technology, National Tsing Hua University, Taiwan. LL.B., LL.M., National Taiwan University; LL.M. in Corporate Law, New York University; J.S.D., University of Illinois at Urbana-Champaign. Member, Taiwan & New York Bars.
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Introduction

Effective corporate internal controls and internal audits have long been the key elements of corporate governance. International fraudulent cases, from Enron and WorldCom in the United States to Toyota and Olympus in Japan, and even to the outbreak of the global financial crisis (“GFC”), have been repeatedly illustrating severe consequences of failed internal controls.

The earlier cases (Enron and WorldCom) in the United States pushed the U.S. Congress to enact the Sarbanes-Oxley Act (“SOX”) while being attributed to two main kinds of failure: First, all corporate organs relevant to internal controls (including external auditors, the management, boards or directors, and audit committees) did not work as designed; second, their internal control mechanisms, especially standard operating procedures to record, collect and gather internal information, did not function.¹ The GFC further aroused our concerns on whether enterprise risk management (“ERM”) played its role effectively as the board of directors should have been able to prevent excessively risky investments before corporate managers made them. Generally speaking, theorists in the United States believed the financial industry should reform its risk management mechanisms for future investments.² Similar corporate fraud also appeared in Japan, as two representative cases shown in Part I.A below, corporate organs with the responsibility to monitor the management (i.e. corporate monitors including independent/outside directors or traditional supervisors) were unable to complete their tasks without sufficient information. In Taiwan, dysfunctional internal control systems and lack of information also played an important role in recent corporate governance scandals, which might severely decrease investors’ confidence in the capital market.

Why this paper begins with case studies in Japan is that with similar civil law origin, Japan and Taiwan both traditionally adopted the binary or dual board mode (as known as the “two-tier system”) where directors and supervisors (or company/statutory auditors) are both elected by shareholders. But in the first decade of twenty-first century, both Japan and Taiwan began to transplant a unitary

Anglo-American style of board of directors and independent directors (as known as
the “one-tier system”), with audit committees replacing supervisors. Therefore it
would be meaningful to compare Japanese and Taiwanese cases since both of them
experienced similar transformation of corporate governance structures while these
cases illustrate similar internal control failure.

<table>
<thead>
<tr>
<th>Type of system/structure/model</th>
<th>One-tier system (Anglo-American style)</th>
<th>Two-tier system (Japanese/Taiwanese traditional style)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Task of the board of directors</td>
<td>Monitoring managerial performance</td>
<td>Performing management function</td>
</tr>
<tr>
<td>Internal oversight</td>
<td>Independent directors/audit committees</td>
<td>Statutory Supervisors (Kansayaku in Japanese)</td>
</tr>
</tbody>
</table>

Table 1. Simplified Classification of Corporate Governance Structure

As discussed above, in order to prevent internal illegal activities or managerial
misconduct, independent directors are generally viewed as a magic bullet in corporate
governance for Taiwan’s government. As a recent example, the Financial Supervisory
Commission (“FSC”)\(^4\) has announced that all listed companies are required to have
independent directors by 2017. As for requirements to establish audit committees in
lieu of supervisors, the first deadline for specific financial institutions and listed
companies with a contributed capital larger than 10 billion NTD is 2017 while the
second deadline for listed companies with a contributed capital larger than 2 billion


\(^4\) The FSC is the competent authority generally in charge of all financial markets in Taiwan, including the securities market. Its position in Taiwan is similar to that of SEC in the United States. See FSC’s web site, http://www.fsc.gov.tw/en/home.jsp?id=9&parentpath=0,1 (last visited February 24, 2014) (Taiwan).
NTD but less than 10 billion NTD is 2019. This illustrates a typical regulatory strategy from the general belief that independent directors ensures good corporate governance.

<table>
<thead>
<tr>
<th>Contributed Capital (NTD)</th>
<th>&lt;2 billion</th>
<th>2~10 billion</th>
<th>≥10 billion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Directors</td>
<td>All Listed Companies: By 2017</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Audit Committee</td>
<td>Not Required</td>
<td>2017~2019</td>
<td>By 2017</td>
</tr>
</tbody>
</table>

Table 2. New Requirements Imposed by the FSC on Establishment of Independent Directors and Audit Committees

To accommodate Taiwan’s reform trend towards further adoption of independent directors and audit committees, this paper would suggest a complementary regulatory framework. Specifically, in order to make the above reforms indeed function, several supporting tools appear to be prerequisites: First, the board’s duty to monitor should be articulated while being transplanted into corporate governance rules. Second, independent information channels should be established for internal governance information to flow to corporate monitors such as traditional supervisors or independent directors, thus facilitating their decision making in oversight. Third,

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5 According to the FSC, listed companies in all industries are required to have at least two independent directors; if they currently do not have enough independent directors, independent directors should be elected in the next election for new directors. See Order of the Financial Supervisory Commission, Executive Yuan, Jin-Guan-Zheng-Fa-Zi No. 1020049956 行政院金管證發字第1020049956號令 (passed Nov. 28, 2013). There are staged requirements on establishing audit committees: Specific financial institutions as well as listed companies with contributed capital over 10 billion NTD will have to immediately establish audit committees in lieu of supervisors; the deadline for this establishment is 2017. Listed companies with contributed capital between 2 billion and 10 billion NTD will have to establish audit committees in lieu of supervisors from January 1st, 2017; the deadline for this establishment is 2019. Other companies with contributed capital less than 2 billion NTD will not be affected by the above requirements. See Order of the Financial Supervisory Commission, Executive Yuan, Jin-Guan-Zheng-Fa-Zi No. 10200499561 行政院金管證發字第10200499561號令 (passed Nov. 28, 2013).
external market forces should meanwhile be channeled to safeguard internal corporate governance.

This paper is organized into three parts. Part I instances two Japanese cases and five Taiwanese corporate governance failures across industries, pointing out that common issues among these East Asian cases are the dysfunctional internal information sharing mechanism in particular and failure of internal controls in general. Part II delves into the above failures of internal controls not only to demonstrate the link between the malfunction of internal controls and the role of internal information flow, but also to highlight that cosmetic independence of the board of directors would not solve failure in board oversight. Furthermore, Part II proposes possible solutions to the corporate governance failures especially in Taiwan. Part III concludes by arguing that the transplant effect should be considered when Taiwan continues importing from the United States the one-tier system in lieu of the traditional two-tier system.

I. Failures of Internal Information Sharing and Internal Controls in Japan and Taiwan

In this section, two Japanese cases and five Taiwanese cases will be explored, and the lessons from these cases will be drawn for failure in internal self-regulating mechanisms. The comparison among these cases would further highlight common issues in internal control, which would need to be fixed through legal and market approaches as exhibited in Part II.C.

A. Japanese Cases

1. Toyota’s Corporate Governance Model

Japanese corporate legislation adopts a mixture of two corporate governance models: The first one is the traditional management model, or the two-tier system, where directors and supervisors (kansayaku) are both elected by shareholders. In this model,
the board of directors proactively manages corporate operations while supervisors (also as known as company/statutory auditors) monitor its management. The second one is the new monitoring model, or the one-tier system. This unitary Anglo-American style of the board of directors is designed to supervise operations by itself, mainly through independent directors.6

Toyota Motor Corporation (“Toyota”) has adopted the traditional two-tier system, in which Japanese laws do not require shareholders to elect outside directors. In this kind of company, supervisors are in charge of monitoring managers’ job performance and corporate operations. However, since supervisors do not have the power to dismiss directors or managers, it is a very difficult task for them to discharge their duty of oversight.7

The Toyota recall crisis involved design failures in their products, which resulted in serious safety issues and even casualties.8 In the beginning of 2010, Toyota has recalled six million cars within the United States and totally eight million cars worldwide.9 What followed were a series of problems: Continued recalls, a stagnant growth of production, lowered corporate credit ratings, and an extremely heavy fine imposed by the U.S. National Highway Traffic Safety Administration.10 Faced with this crisis, Akio Toyoda, CEO of Toyota, suggested several measures to improve Toyota’s public image, including tightening quality control of internal and external operation as well as products, proactively heeding customer complaints, establishing effective internal information sharing mechanism, and improving communication with the authorities concerned.11 However, a commentator pointed out that more important issues of their corporate governance were missed, especially regarding the


9 Aronson, “Toyota” (n 7 above), p 67.


11 Aronson, “Toyota” (n 7 above), p 69.
role of their board; in other words, if Toyota were a U.S. corporation, the focus of concern would obviously have been on their corporate governance. For example, has the board of director performed their monitoring function? Did their information flow and internal alert system along with decision making process fail? Could replacing senior managers to improve corporate governance prevent the same crisis in the future?12

The Toyota scandal revealed that, within companies adopting the Japanese traditional management model, a serious issue of internal information sharing may exist, demonstrating one dimension of internal control failure. According to Japanese corporate law, in corporations with supervisors, the board of directors also has the responsibility to establish an internal control system to ensure that directors and managers will obey laws and articles of incorporation in performing their duties.13 Nonetheless, the Toyota case showed that their internal auditing department, the main organ for internal control, just needed to directly report to the board of directors; it is possibly the reason why important information was unable to be efficiently conveyed to their supervisors.14 Another incident in 2009 exemplifies internal control failure inside Toyota: they found serious technical problems in their products within European Union (“EU”), but internal sharing of this information had been delayed for four months before the problems were finally reported to the U.S. authority, indicating

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12 Ibid. p 70.
13 Aronson, “Olympus” (n 6 above), p 219. In corporations with audit committees, however, members of the audit committee take the responsibility to monitor internal controls, since committee members, usually as outsiders, rely on internal control systems to fulfill their duty. See Liu Len-Yu et al., Xuan Ren Du Li Dong Shi Yu Gong Si Zhi Li [The Election of Independent Directors and Corporate Governance] (Taipei: Angle Press, 2013) p. 63 (Taiwan). As for the genesis of the board’s duty to establish and maintain internal control system under Japanese corporate law, it can be traced back to the Daiwa Bank Case in 1995. In this case, the court held company directors had to bear the responsibility of establishing an integral policy for internal control and legal compliance, and of maintaining the effectiveness of the policy. This opinion has expanded directors’ duty to monitor in Japanese law. This ruling was later incorporated into the new Japanese Company Law coming into force in 2006, which requires directors in large public corporations to bear the responsibility to monitor internal controls. See Bruce E. Aronson, “Reconsidering The Importance Of Law In Japanese Corporate Governance: Evidence From The Daiwa Bank Shareholder Derivative Case,” (2003) 36 Cornell International Law Journal 11, 26, 51; Curtis J. Milhaupt, “In the Shadow of Delaware? The Rise of Hostile Takeovers in Japan,” (2005 )105 Columbia Law Review 2171, 2188; Aronson, “Toyota” (n 7 above), pp 71-73; Tsai Chang-hsien, “Cong Nei Kong Zhi Du Ji Feng Xian Guan Li Zhi Guo Ji Gui Fan Qu Shi Lun Wo Guo De Gong Si Zhi Li Fa Zhi: Jian Lun Dong Shi Jian Du Yi Wu Zhi Fa Lu Yi Zhi [On Taiwan's Corporate Governance Rules from a Perspective of the International Regulatory Trend of Internal Controls and Risk Management (with Notes on the Legal Transplant of Directors' Duty to Monitor)],” (2012) 41 Tai Da Fa Xue Lin Cong [National Taiwan University Law Journal] 1819, 1859-1860 (Taiwan); Tsai Ying-hsin, “Lun Gong Si She Hui Ren Zhi Gui Fan Mo Shi: Yi Ri Ben Fa Zhi Jing Yan Wei Li [The Regulation of Corporate Social Responsibility: The Experience of Japan],” (2008) 37 Tai Da Fa Xue Lin Cong [National Taiwan University Law Journal] 189, 221-222 (Taiwan).
14 Aronson, “Totoya” (n 7 above), p 77.
a noticeable communication gap within this transnational company.\textsuperscript{15} All of the problems mentioned above have displayed that a traditional assumption, that a company dominated by insiders who are professionals and familiar with corporate operations enjoys an advantage in internal communication, is not necessarily as true as believed.\textsuperscript{16} That internal information flow was obstructed or retarded may cause Toyota’s disasters.

The following Olympus case is another example, showing that even in corporations with outside directors, which are a minority in Japan, obstruction of the information flow could also contribute to corporate governance failure.

2. Olympus’s Corporate Governance Model

As previously mentioned, there are two main corporate governance models followed by Japanese companies: corporations with supervisors (the two-tier system), and corporations with outside directors and other necessary independent committees (the one-tier system). Most of the Japanese companies are still keeping the traditional model where the monitoring task is done by supervisors,\textsuperscript{17} even though Japan has undergone a reform trend toward gradually adopting independent directors, instead of directly transplanting the one-tier American style of corporate governance structure. Nevertheless, the following Olympus case exhibited that even if an audit committee was formed\textsuperscript{18}, without being given the committee an actual power to monitor their senior managers, a failure of corporate governance could still arise. In fact, before the scandal was unveiled, the Olympus Corporation (“Olympus”) had already successfully transformed from a dying camera maker to a competitive manufacturer in the medical instrument industry; they even possessed 3 outside directors in total 15 directors, contrasting sharply with other Japanese companies, of which only a half had any outside director.\textsuperscript{19} The core corporate governance issue in the Olympus scandal was that their board, even if with outside directors, had long been unaware of illegal activities organized by their senior managers and thereafter were unable to react in time.\textsuperscript{20}

\begin{flushleft}
\textsuperscript{15} \textit{Ibid.} p 83-84.
\textsuperscript{16} \textit{Ibid.} p 84.
\textsuperscript{17} Aronson, “Olympus” (n 6 above), p 96.
\textsuperscript{18} Jonathan Soble, \textit{Olympus Sues 19 Executives for Damages}, Fin. Times (Jan. 10, 2012, 6:57 PM), http://www.ft.com/intl/cms/s/0/203c4e64-3b2f-11e1-b7ba-00144feabde0.html#axzz2kEFFrthFG.
\textsuperscript{20} Aronson, “Olympus” (n 6 above), p 107. Meanwhile Olympus’s external accounting auditors should have uncovered or stopped this scandal as a gatekeeper in the whole story, but the concept of
\end{flushleft}
The Olympus scandal in 2011 might be the most serious corporate governance failure in Japan. In short, three previous Olympus presidents concealed 1.5 billion USD financial losses for 20 years, which had never been disclosed to their board of directors.\(^1\) Even after Japan's Whistleblower Protection Act was passed in 2004, the senior managers by all means prevented information of dubious activities from being flowing to the board; thus, the board could not have effectively exercised their oversight.\(^2\) Besides the managers circumvented the application of new accounting principles through complicated financial tactics; it is known that misleading financial statements had long been made for five years, while basic information of these statements was not disclosed to the board of directors.\(^3\) This case is a vivid example that if outside directors could not gather correct information to fulfill their obligation to monitor, the board is actually of no use in terms of corporate governance.\(^4\)

3. Lessons from the Japanese Cases

According to the recent Japanese cases, including those of Toyota, Olympus and even the governance issues within the Tokyo Electric Power Company, Inc. which worsened the Fukushima power plant crisis, we can find that a common phenomenon across those cases is the dysfunctional internal information sharing mechanism, no matter which of the two corporate governance models a company adopted.\(^5\) Especially in corporations with outside directors, a core message conveyed from the practice is that outsiders lack essential information to complete their task.\(^6\) During the decision making process of a typical Japanese board meeting, motions would first be discussed and determined by senior managers before being sent to the board of directors, so that at the time when outside directors have the first chance to take part in the discussion, internal information has already been filtered; information gathered

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\(^1\) Aronson, “Olympus” (n 6 above), p 106.
\(^2\) Ibid. p 110.
\(^3\) Ibid. pp 106, 112, 132.
\(^4\) Ibid. pp 130-131.
\(^5\) Ibid. pp 131-132. Although not the focus of this article, the issues within Tokyo Electric Power Company (“Tokyo Electricity”) also resulted from hindrance to internal information flow. On March 11\(^b\), 2011, a strong earthquake occurred off the east coast of Japan, which triggered tsunami and produced following nuclear disasters in Fukushima, Japan. Bruce Aronson pointed out that what worsened the Fukushima nuclear power plant crisis was problematic information sharing inside Tokyo Electricity, as well as information communication between Tokyo Electricity and Japanese government. See Bruce E. Aronson, “Basic Issues and Current Topics in Corporate Governance in Asia: An American Perspective,” (2013) Address at Corporate Law Seminar, National Tsing Hua University, HsinChu, Taiwan 12-14 (on file with author).
\(^6\) Aronson, “Olympus” (n 6 above), p 131.
in this way is insufficient for outside directors to fulfill their obligation of oversight.\textsuperscript{27} This is because those outside directors, unlike supervisors, are not vested with a legal right to ask for information proactively.\textsuperscript{28} Neither could Japanese outside directors rely on court precedents as in the United States, where the court already clarified that board decisions made without sufficient information is a breach of fiduciary duty.\textsuperscript{29} Therefore, internal information flow or internal information sharing has been a key element in determining if an outside director is able to complete its job to monitor managerial performance.

In fact, in corporations with supervisors, those supervisors are unable to urge their corporations to establish an internal control system solely with their oversight authority either. Likewise an audit committee might be struggling with no practical authority to establish and maintain the internal control structure. Apparently neither of the two corporate monitors could be real players in overseeing managers’ performance.\textsuperscript{30} Blocking corporate monitors from receiving essential information on business operations might have caused serious corporate governance failures like Toyota’s or Olympus’s scandals.

In the following Part I.B., examples of corporate governance failures from Taiwan will be elaborated, and we would observe that common features across those cases appear to similar to those in Japan.

\textbf{B. Taiwanese Cases}

As further discussed in Part I.C., internal self-regulating mechanisms consist of internal controls, legal compliance programs and ERM frameworks. In addition to internal controls, the importance of legal compliance programs to corporate

\textsuperscript{27} \textit{Ibid.}
\textsuperscript{28} \textit{Ibid.} However, even supervisors in Japanese companies continuing the traditional model also encounter great difficulties in obtaining sufficient information necessary for them to monitor the performance of top managers. See Aronson, “Japan and East Asia” (n 20 above), pp 32-33.
\textsuperscript{29} Aronson, “Olympus” (n 6 above), p 131. The precedent referred to here is \textit{Smith v Van Gorkom}, 488 A.2d 858 (Del. 1985). In this case, the court held that the board in question had made a decision without sufficient information, and that if a board made an uninformed or unadvised decision, the decision made would not be protected by the business judgment rule. “Gross negligence” is the standard used to determine if a decision was made with sufficient information. See Smith v. Van Gorkom, 488 A.2d 858, 872-873 (Del. 1985); Citron v. Fairchild Camera & Instrument Corp., 569 A.2d 53, 66 (Del. 1989). See also Christine Hurt, “The Duty to Manage Risk,” (2013) p 23, \textit{Illinois Program in Law, Behav and Soc. Sci. Paper No. LBSS14-09}, available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2308007 (“Courts will look not to the substance of decisions, but to whether boards were rational in their decision-making process. In other words, had the board spent time and resources acquiring quality information, then the board would not have been liable for the same decision.”).
\textsuperscript{30} Aronson, “Toyota” (n 7 above), pp 76-78.
governance will be illustrated in this section, and the three are closely connected. With Taiwan’s critical position in the global supply chain, the range of legal compliance for Taiwanese corporations has already been extended to foreign laws. Hence, if a legal compliance program embedded in an internal control system can direct Taiwanese corporations to comply with local and foreign laws, a certain number of unwanted illegal scandals can be prevented in advance. Although Taiwanese corporations have been recently valuing internal controls more and more under pressures from inside and outside, corporate governance scandals still occur. In this section, several recent cases of internal control failures will be introduced, in order to find out what common governance issues Taiwanese companies face in their day-to-day operations.

When it comes to corporate governance structure, Taiwanese companies usually adopt the traditional two-tier system— that is, monitoring tasks are done by supervisors, and companies are managed by the board of directors, which is similar to the two-tier system (traditional management model) in Japan. Nonetheless, Taiwan’s current reform trend mentioned in the introduction favors the one-tier system imported from the United States. Therefore more and more Taiwanese companies will be required to adopt the one-tier system and establish an audit committee to replace supervisors. Although there is a mixture of different corporate governance models in Taiwan, common failure in internal controls appears in the following cases.

1. The Exchange Loss of GIO Optoelectronics

In the year 2011, GIO Optoelectronics Corp. (“GIO”), a Light-Emitting Diode (“LED”) electronics maker in which was reinvested by CHIMEI Corporation (“CHIMEI”), a Liquid-Crystal Display (“LCD”) panel maker used to be the second biggest in Taiwan, suffered a 1.5 billion NTD exchange loss from a series of improper foreign exchange transactions made by the then general manager Hung. GIO’s chairman of the board later apologized to investors for the exchange loss while attributing this loss to sudden fluctuation of exchange rate as well as unexperienced decision of the management, which was followed by general manager Hung’s

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31 Under Taiwan’s current regulations, there are three sorts of corporate governance structures among public companies. Under the first structure a company would have an audit committee consisting all of independent directors without supervisors. Under the second “hybrid” structure a company would have independent directors and supervisors at the same time without audit committees. Under the third traditional structure a company only have supervisors. As mentioned in the Introduction, all listed companies are currently required to have independent directors by 2017. As for requirements to establish audit committees in lieu of supervisors, the first deadline for specific financial institutions and listed companies with a contributed capital larger than 10 billion NTD is 2017 while the second deadline for listed companies with a contributed capital larger than 2 billion NTD but less than 10 billion NTD is 2019.
resignation.\textsuperscript{32} The board then appointed a new general manager and added new internal control rules.\textsuperscript{33}

However, the true issue in this case has been pointed out that GIO’s chairman of the board had delegated full authority for conducting foreign exchange transactions to the former general manager, such that the board had little knowledge of the transactional details; it is an outcome arguably from a problematic internal control system inside GIO.\textsuperscript{34}

2. Taiwanese LCD Panel Makers Involved in Overseas Anti-trust Lawsuits

In the end of 2006, several Taiwanese LCD panel makers were involved in anti-trust lawsuits in the United States, EU and South Korea, where they were accused of price fixing cartels. Specifically, eight panel makers and twenty one managers in total globally were prosecuted in the United States, including four Taiwanese companies. AU Optronics Corporation (“AUO”), the biggest Taiwanese LCD panel maker, was one of them; three AUO senior managers were finally given heavy penalties.\textsuperscript{35} In addition to penalties imposed by the U.S. government, the European Commission later in 2010, fined five major Taiwanese LCD panel makers approximately three billion Euro under EU competition law.\textsuperscript{36} The South Korea Fair Trade Commission also fined four of the Taiwanese firms.\textsuperscript{37} Among those fined companies, former vice-chairman of CHIMEI, Ho Chao-Yang, who had completed his jail term in the United States reassured in public the importance of complying with foreign anti-trust law based on his own experience.\textsuperscript{38} These lawsuits to an extent illustrated failure in


\textsuperscript{33} Ibid.


legal compliance programs in Taiwan.

3. Formosa Plastics Corporation’s Industrial Safety Issues

Formosa Plastics Corporation (“Formosa”) built its sixth cracking plant in Mailiao, Yunlin County in Taiwan, but there has been eight industrial accidents for more than one year since its operation until July 2011. In order to solve this problem, the Industrial Development Bureau of Taiwan’s Ministry of Economic Affairs even established a task force to monitor safety improvement carried out by Formosa, and the former chairman and general manager of Formosa both resigned to take responsibility for the accidents.39

Actually, the accidents breaking out in Formosa’s plants might reveal their failure in corporate governance. In concrete terms, focusing on industrial safety issues, news reports indicated that no person in Formosa was punished under their internal control rules, only because no one was prosecuted by government attorneys. In other words, according to the internal control rules no one had to take the responsibility for the loss as a result of the industrial safety issues. Furthermore, even a suggestion made by a top manager to establish an industrial safety team inside Formosa was rejected by the board of directors.40

4. Taiwan Sports Lottery Scandal

Taiwan Sports Lottery Corporation (“TSLC”), a subsidiary company of Fubon Financial Holding Co., Ltd. (“Fubon”), was established in August 2007, running the sports lottery business commissioned by Taiwan’s Sports Affairs Council.41 In 2011, a fraud was uncovered inside TSLC: Manager Lin has abused his authority to abnormally win lottery prizes.42 This event revealed that TSLC’s internal control system was not successfully established and maintained.43

43 See Wu Jingjun, “Yun Cai An Fu Bang Jin Zao Fa Si Bai Wan [Fubon Was Fined Four Million NTD Due to the Sports Lottery Investigation]”, Zhong Yang Tong Xin She [Central News Agency News], 08
After the incident, Fubon held an extraordinary stockholder meeting to re-elect two independent directors and a board meeting to re-examine the internal control systems across ten major subsidiaries within the financial conglomerate, hoping to strengthen internal controls.\textsuperscript{44} This scandal was actually a serious crisis to Fubon as a renowned financial conglomerate because to them, “credit” is an essential asset, and cannot be retained without well-functioning internal controls.\textsuperscript{45} Therefore, Fubon’s corporate governance appears to have room to improve.

5. Insider Trading in Genome International Biomedical Co. Ltd.

A more recent case in Taiwan happened in August 2013, when Top Pot Bakery (“TPB”)\textsuperscript{46} was accused of deceptively advertising their bakery as “complete natural products”, and a wave of criticism arose.\textsuperscript{47} However, this incident afterwards unveiled another scandal in Genome International Biomedical Co. Ltd. (“Genome”), TPB’s controlling parent company: The chairman of the board, a supervisor and several major shareholders of Genome were suspected to have committed insider-trading.

Genome was initially a publicly listed integrated circuit design (or IC design) company named as Yachiuan Technology Co. Ltd., which was delisted from the stock exchange in 2009 because it was unable to follow the financial statement reporting schedule set by laws. Thereafter, it was first renamed as Ta-Yu and then relisted again in 2010 after being renamed as Genome, with its public offering price skyrocketing. In April 2012, Genome became TPB’s controlling company by buying out its stock, then renaming TPB’s registered name as Sheng Ji Da Ren Co. Ltd.. Genome


After the news of TPB’s deceptive advertisement was widely known, Genome’s chairman of the board, the supervisor who was also the chairman’s wife, and several major shareholders were accused of engaging in insider-trading: that is to say, they sold their shares prior to the disclosure of TPB’s making deceptive advertisement.\(^{49}\)

In addition, two of Genome’s independent directors both resigned immediately after the scandal was revealed\(^{50}\), and a TPB’s supervisor resigned as well in September 2013.\(^{51}\) Resignation of corporate monitors (including supervisors and independent directors) was a warning signal to the capital market.

### 6. Lessons from the Taiwanese Cases

Reviewing the above five Taiwanese cases, we could find that a common issue besides dysfunctional internal control systems was corporate non-compliance with local and foreign laws. For example, the LCD anti-trust lawsuits exemplify the operational risk of violating foreign anti-trust laws. The lesson drawn from them is that companies should have had the ability to avoid this kind of legal risk by way of its internal controls with legal compliance programs incorporated.

In addition to cases of high-tech firms illustrating problems of legal compliance, financial firms like Fubon are another high-risk group now under serious scrutiny by

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the FSC; meanwhile they are required by the FSC to appoint a chief legal compliance officer in each company with a duty to ensure the effectiveness of ERM frameworks in particular, through which the FSC aims to advance the integrity of financial market in general.\(^5\) In sum, the cases presented above to an extent substantiate that internal control systems within those companies did not properly work.

C. Internal Self-Regulating Mechanisms and Corporate Governance

The aforementioned cases clearly showed that if internal self-regulating mechanisms do not work effectively, serious scandals would follow probably, hence hurting investors’ confidence in companies. These cases also illustrated the significance of internal self-regulating mechanisms, which embrace internal control systems, legal compliance programs, and ERM frameworks. Firstly the GIO case exhibited that their internal controls did not prevent their general manager from making excessively risky investments. Secondly there might be something wrong with legal compliance programs such that LCD panel makers suffered from strict punishment due to their violation of foreign anti-trust laws. Thirdly failure in internal controls and legal compliance programs could lead to Formosa Plastics’s safety issues. Fourthly the internal control system did not prelude TSLC’s scandal. Fifthly, in the Genome case, the internal controls seemed functionless in detecting insider-trading.\(^5\) Moreover, to explore the link between information flow and internal controls that prevent insider trading, one way to preclude insider-trading is controlling information flow inside corporations. Therefore corporations need to establish a precautionary system to control the use of internal information.\(^4\) In other words, information control (preventing improper use of information) is essential to regulating insider-trading. On the other hand, the premise of effective internal controls is to ensure that internal


information will be properly shared with corporate monitors such as supervisors and outside directors. Furthermore, internal self-regulating mechanisms have to cooperate with these monitors, since only with well-functioning internal controls can governance information flow to these monitors and they can thus fulfill their obligation of oversight.  

A survey done by the COSO committee after financial crisis also showed that in a majority of U.S. corporations, their risk management measures were still under-developed and mostly equipped with unsatisfactory monitoring procedures. Some of those problems were due to incomplete internal information sharing, which impeded risk management. Another study indicates that two main factors hinder the board from fulfilling its obligation to monitor: first, board members were unable to control information supply, so that it is impossible for them to gather necessary information of risks created by managerial activities; second, board members lacked the ability to process risk-related information, thus lacking incentives or authority to affect managers’ decision making. Therefore, after the GFC, key to enhancing the efficacy of ERM frameworks are solidifying risk management process, strengthening the board’s oversight in risk management, and completely incorporating risk management procedures into every aspect of business operations.

As this author used to argue, the concept of ERM frameworks has already encompassed internal controls; these two mechanisms are no longer interchangeable, but complement each other. Additionally as early as the Institute of Chartered

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57 Ibid. p III.
58 Even if senior managers do report high risk exposure to the board, the reporting process itself is less well-structured while potential risks or key risk indicators are reported with less caution. Ibid. p 4.
60 See Michael Crouhy et al., Feng Xian Guan Li [Risk Management] 539 (Taiwan Academy of Banking and Finances trans., Taipei: Taiwan Academy of Banking and Finances Press, 2004).
61 Note 55 above, p 138.
62 The COSO committee started to develop a corporate risk management structure since 2001, but it was not to replace the former internal control structure, but to expand the scope of internal control to include risk management. Wang Chihcheng, " Fa Ling Zun Xun Zhu Guan Zhi Du Zhi Fu Zhan Ji Tiao Zhan [The Development of and the Challenge to the Compliance Officer]." (2010) 23 Cun Kuan Bao Xian Zi Xun Ji Kan [CDIC Quarterly Bulletin] 92, 97.
Accountants in England and Wales (“ICAEW”) released “Turnbull Report” in 1999, the intrinsic connection between risk management and internal controls directing legal compliance programs as well as information flow has been emphasized. In short, the integrated structure of internal control systems could be presented as in Figure 1 below. Inside the internal self-regulating mechanisms, legal compliance programs are the core; internal control systems are expanding the scope to become ERM frameworks.

Figure 1. Internal Self-Regulating Mechanism as an Integral Internal Control System

In the next section, we will discuss why cosmetic independence of the board cannot serve as a magic bullet to fix internal control failure especially in Taiwanese cases. Further we will propose solutions for the failure, suggesting a complementary regulatory framework to accommodate Taiwan’s reform trend towards a US style of one-tier system. In other words, after dissecting problems revealed by Taiwanese corporate governance failures in the next section, we’ll discuss how to make corporate monitors (including supervisors and independent directors of audit committees) have incentives and means to establish and maintain this integral internal control system, as shown in Figure 1.

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65 Furthermore, there is a tendency that internal control would be mainly based on risk management. See Wu Cong-Fan, *Shen Ji Xue: Shi Wu Ying Yong Yu Fa Lü Guan Dian* [Auditing: Practical Application and a Viewpoint of Law] 146 (Taipei: Wu Cong-Fan Self-Publishing, 4th edn, 2009).
66 As Bruce Aronson argues, the most useful characteristics of the U.S. corporate governance system are not always independent directors only, but rather a better operating environment where the U.S. system furnishes those monitoring the management with incentives and means to perform their function. Aronson, “Olympus” (n 6 above), pp 104-105. In Part II.C below, this paper would hence argue: to resolve corporate governance failures in Taiwan, practical measures are not limited to independent directors (and related structural and compositional board reforms). More important, we need to enhance the effectiveness of any monitor of management by giving them incentives (by imposing duty of oversight) and means (by strengthening the ability to gather information or building
II. Problems Revealed by Corporate Governance Failures and the Proposed Solutions in Taiwan

Reviewing examples from Taiwan and Japan, we could find that in order to maintain the function of internal controls, “information flow” is a key element in addition to cosmetic independence, or independence of the board merely in form. This section would then provide the reasons of these governance failures and solutions to the issues particularly in Taiwan.

A. Internal Control Systems and Legal Compliance Programs Do Not Fully Work

1. Common Issues among the Cases: Why Internal Controls Fail

Taking the GIO case as the first example, we can dissect this case from three aspects. First, did the general manager follow the standard operating procedures under their internal control rules in carrying on foreign exchange transactions of such a high amount? Second, did GIO establish and maintain an effective internal control and audit system to record, collect and gather internal information? Third, should GIO’s directors take the responsibility for not well exercising their oversight?67

Also in the LCD anti-trust lawsuits, we could find that if internal control systems in the fined companies had sounded an alert and their directors had tried to maintain the systems with legal compliance programs embedded, would the LCD makers still have violated the foreign laws in such a large scale?

As for Formosa’s serial accidents, it appeared that their internal control system did not prevent themselves from violating industrial safety regulations; as previously mentioned, one of their executive officers once suggested establishing an industrial safety oversight task force, but this proposal was rejected by the board. This implied

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67 Note 34 above, p 53.
that the board might actually play the key role inside a firm to assure legal compliance.

In the TSLC case, although the company appeared to have a standard operating procedure of internal controls to prevent internal fraudulent activities, the necessary internal audit reports were not properly reviewed by internal audit divisions which should have been supervised by the board and executive officers, but just directly archived long before the fraud was uncovered.  

The Genome case is another example where the company’s internal control system was not able to prevent illegal insider-trading; effectively utilizing financial statements as an internal control tool is one of the key measures which should be taken to prevent insider trading.

2. An Essential Prerequisite for Internal Controls to Work: Internal Information Flow

Based on the aforementioned examples, a lesson we learn is that the board of directors has to shoulder the legal obligation to monitor, that is, to establish and maintain an internal control system. Initially, the U.S. Delaware Supreme Court decided in the 1963 Graham Case that the board did not have such a duty to actively establish an internal detective system to monitor any suspicious activities within a company. However, Delaware Court of Chancery restated in the 1996 Caremark case not only that the duty to monitor did exist, but also that the board also bore this legal duty. The Caremark decision also held that only if the board actively established an information system providing directors with accurate information in time, could the directors fulfill their fiduciary duty of oversight; therefore this duty was called “Caremark Duty”. This decision confirmed that the board’s duty to monitor would include establishing and maintaining an internal information sharing mechanism.

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Therefore, according to the Caremark case, it is clear that the focus should be placed on internal information sharing and information flow. In fact, no matter when it comes to ensuring legal compliance, to maintaining internal controls or even to precluding insider trading, the prerequisite for the board of directors to fulfill its duty to monitor depends on independent information channels, which could supply necessary governance information without obstruction from insiders and the management. In another word, independent information channels are essential to those who bear the duty to monitor within a corporation (including supervisors in the two-tier system or audit committees in the one-tier system). With efficient flow of internal information to these corporate monitors, internal self-regulating mechanisms can play a real role in corporate governance.

B. Cosmetic Independence of the Board of Directors Would Not Solve Failure in Board Oversight

1. The Traditional View Over-emphasizing Cosmetic Independence of the Board

According to the agency theory, the main function of the board is to exercise its oversight, and to reduce agency costs incurred when managers are authorized to operate a firm; it is one of the ways to alleviate the agency problem. Nevertheless, the recent trend of board reforms internationally is primarily focused on enhancing board independence by altering board composition and structure. For instance, a Taiwanese commentator emphasize how board independence can improve corporate internal control: when we cannot rely on managers to operate internal controls, then the law should enhance board independence, and an independent board should be allowed to lead internal auditors to implement internal control systems. From the comparative law perspective, U.S. legislators have long been focusing corporate governance reforms on this compositional and structural change in the board. The
SOX set requirements of board independence with an assumption that board independence would reduce illegal activities inside a corporation; the Dodd-Frank Act echoed with the concept that enhancing board independence would increase board efficacy.\(^{76}\) As discussed in the Introduction, Taiwan’s FSC is requiring all listed companies in Taiwan to have independent directors by 2017. As to mandatory audit committees, listed companies with a contributed capital larger than 10 billion NTD will be required to establish an audit committee in lieu of traditional supervisors by 2017 while those with a contributed capital between 2 to 10 billion NTD to do so by 2019.

Overall, it is theoretically expected that by enhancing board independence—for example, through establishing board committees full with independent directors, down-sizing the board, giving directors stocks to unify their interests with shareholders’—the board will not be controlled by senior managers and directors can thus exercise their oversight properly.\(^{77}\)

2. Views Other than Those Merely Stressing the Board’s Cosmetic Independence

Nevertheless, solely substituting independent directors for inside directors would not enhance board independence, because the question would just turn to whether independent directors could monitor operations effectively.\(^{78}\) There are three elements constraining independent directors’ ability to monitor: Time, information and knowledge.\(^{79}\) In this regard, Professor Bruce Aronson has specifically pointed out that the true strength of the U.S. one-tier system is to provide “tools” to the board of directors, and “good access” to information is definitely one of the important tools.\(^{80}\) It infers that merely stressing board compositional and structural reforms will not automatically enhance the board’s monitoring function. Until today, we can observe that Taiwanese legislators have been concentrating on strengthening independence of board members and requiring institution of board committees as a regulatory strategy;

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\(^{77}\) Ibid. p 1444.


\(^{79}\) Note 76 above, p 1450. These intrinsic defects have already been viewed as an important issue which will decrease effectiveness of the board’s risk management and monitoring function. However, the defects have not yet been addressed well by the U.S. financial regulatory reforms as in the Dodd-Frank Act of 2010. From a viewpoint of behavioral economics, regulations ignoring structural bias provide insufficient incentives for the board and especially independent directors to fulfill their legal duties of oversight. See Kristin N. Johnson, “Addressing Gaps in the Dodd-Frank Act: Directors’ Risk Management Oversight Obligations,” (2011) 45 University of Michigan Journal Law Reform 55, 98-100.

\(^{80}\) See note 20 above, p 15, 32.
this reform tendency can be exemplified by requirements on independent directors\textsuperscript{81}, audit committees\textsuperscript{82} and compensation committees\textsuperscript{83}.

We can substantiate the ineffectiveness of enhancing cosmetic independence through board composition and structural reforms via one of the Taiwanese cases—Taiwan Sports Lottery Scandal discussed in Part I.B.4. In this example, Fubon has early established an audit committee, a corporate governance committee and a compensation committee; it can thus be deemed as a role model of good corporate governance in Taiwan and even across Asian industries.\textsuperscript{84} Their audit committee consists entirely of independent directors; their audit committee’s meeting frequency is much higher than the FSC requires.\textsuperscript{85} According to their internal rule, the audit committee’s meeting planning and procedure are as complete as those for a board meeting.\textsuperscript{86} Even with such seemingly perfect internal control and legal compliance mechanisms, the fraud in their subsidiary company TSLC still occurred. We should therefore think of different tools which could further ensure that the board is able and incentivized to accomplish its obligation to monitor internal self-regulating mechanisms.

C. The Proposed Solutions to Corporate Governance Failures in Taiwan

1. Transplanting the Board’s Duty to Monitor

Following the Graham case and the Caremark case in Part II.A.2, Delaware Supreme Court in the 2006 Stone case clearly explained the elements constituting the board’s oversight liability.\textsuperscript{87} In concrete terms, they required the plaintiff to prove one of the two situations: First, the board do not establish any reporting, information and control system at all; or second, although the board establishes such a system, they intend not to maintain and monitor the system, so that they have no knowledge of risks or issues that they should have known.\textsuperscript{88}

\textsuperscript{82} Ibid. Art. 14-4 and Art. 14-5.
\textsuperscript{83} Ibid. Art. 14-6.
\textsuperscript{85} Ibid. p 24-25.
\textsuperscript{86} Ibid. p 28.
\textsuperscript{87} Stone v Ritter, 911 A.2d 262 (Del. 2006).
\textsuperscript{88} Ibid. p 367.
Subsequent to GFC, Delaware Court of Chancery in the 2009 Citigroup case stated that even if the board made inaccurate predictions of business risks, they would not breach the duty to monitor, and that even if the board made a decision that was considered unwise *ex post*, the board would not be legally liable for the decision. The reason is that if the board’s duty to monitor would be expanded, that means that the court second-guesses the board’s business judgments, thus contradicting the business judgment rule. Even though the above U.S. court decisions did not completely agree on the scope of duty to monitor (whether the board should monitor only legal compliance programs and internal controls, or even ERM frameworks), one thing is for sure that the board has the legal duty of oversight.

Given the Shining Building Business Co. Case (the “Shining” case), we could, to some extent, demonstrate the necessity of transplanting the board’s duty of oversight as well as that of articulating this duty in more details under Taiwan’s Company Act. In this case, the plaintiff, who was a former general manager of Shining, claimed that Shining had not made two of his bonus payments before he left his job. The main issue in question was whether the plaintiff can be recognized as a manager in a legal sense. As a matter of fact, neither the appointment of the plaintiff nor the internal rule on bonus payments were approved by the board, but both should have been approved in accordance with Art. 29 of Taiwan’s Company Act. The court of appeals, Taiwan High Court Taichung Branch Court, made two decisions respectively, but did so based on the same facts with these two judgments in conflict with each other. Nevertheless, Taiwan’s Supreme Court made a final decision in 2013, where the Supreme Court stated: When the company made its financial statements, although the board might not be directly involved in the administrative process, they had to review those financial statements with a due care of a good administrator; if the board had

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90 Note 2 above, p 120.
92 For example, Under *Caremark*, the court held that only if there is a sustained and systematic failure of the board in performing its duty of oversight, then the board’s liability would result; for example, there is a complete failure in attempting to ensure the existence of a proper information and reporting system. Under the Caremark Duty, directors’ duty of oversight therefore embraced an aggressive duty to establish information systems with a view to overseeing business performance, even though the test for liability would be strict. The Caremark Duty would drive the board to set up internal control systems and increase expectations concerning directors’ role in monitoring corporate compliance with laws. See note 71 above, p 6.
94 99 Zhong Shang Zi No. 174 (High Ct. Taichung Branch February 15, 2011) (Taiwan); 99 Zhong Shang Zi No. 164 (High Ct. Taichung Branch) (Taiwan).
95 Tsai, “Nei Kong Zhi Du” (n 13 above), p 1851.
96 102 Tai Shang Zi No. 360 (Supreme Ct.) (Taiwan).
reviewed all reports, it would have needed to take the responsibility for the truthfulness of the statements. The Supreme Court added that based on the fact that the plaintiff’s name as a general manager and the relevant bonus payments were exhibited in the financial statements, it would be sufficient to prove that Shining and the plaintiff entered into a mutual agreement on the bonus payments. This case not merely demonstrated that the credibility of Shining’s financial statements should be questioned, but also implied that the board probably did not fulfill its duty to monitor, hence resulting in internal control failures, including the dubious reliability of their financial statements, the appointment of managers, and related compensation arrangements.97

As shown in Figure 1, according to the above U.S. and Taiwanese court decisions, we may note how important the board’s duty to monitor, including that to establish and maintain a company’s internal self-regulating systems, would be. Nonetheless, as stated below, even though recent reforms were concentrated more on the cosmetic independence of the board in order for outsider directors to monitor managers, we should also realize that sharing of sufficient internal information with corporate monitors would enhance their ability to exercise oversight in terms of corporate governance, as well as how to further fortify independent information channels.

2. Building Independent Information Channels

After Enron’s scandal, the NYSE has offered instruction on corporate governance of listed companies. NYSE Listed Company Manual Art. 303A requires every listed company to establish corporate governance guidelines; the guidelines should contain access to the management and access to independent advisors when proper and necessary.98 In addition, a Taiwanese commentator indicated that if Taiwan’s Company Act and Securities and Exchange Act require a listed company to have independent directors and audit committees consisting fully of independent directors, not merely should supervisors be legally abolished, but also the position of the board should be changed to be viewed as a purely monitoring organ, instead of a management one.99 Accordingly independent directors’ liabilities would depend on

97 Tsai, “Nei Kong Zhi Du” (n 13 above), p 1858.
99 Huang Ming-jye, “Gong Si Zhi Li Yu Dong Jian Min Shi Ze Ren - Yi Du Li Dong Shi Zhi Shuang Zhong Ze Ren Wei Zhong Xin [Corporate Governance and the Civil Liabilities of Directors and
whether the board has fulfilled its duty to found the company’s sound corporate governance system, as well as whether the board has proactively and with good faith established and maintained an objective and well-functioning internal-control and legal-compliance mechanism. Therefore, in order for corporate monitors (including supervisors, independent directors and audit committees) to monitor effectively, the law should ensure that they have sufficient information. A supplementary legal toolkit may embrace: (1) Allowing the above corporate monitors to directly control internal and external auditors; (2) strengthening the whistleblowing system; (3) providing the corporate monitors with access to internal information through assistance from external legal or other professional consultants.

The first legal tool is to allow corporate monitors to directly control internal and external auditors; most Taiwanese companies adopt the traditional two-tier corporate governance structure where both the board of directors and supervisors co-exist. However, information would sometimes be blocked by top managers not simply in Japan but in Taiwan as well. Hence, supervisors should be furnished with transparent and formal communication channels to directly reach internal audit divisions and external accounting auditors. In order to make internal and external auditors of real help to supervisors, the corporate law should allow supervisors to meet with internal auditors and external accountants alone, without participation by managers or inside directors, with an aim to prevent insiders from impeding flow of internal information. In addition, the authority to appoint and dismiss internal and external auditors as well as that to assess their performance and related compensation

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100 See also Chen Yin-chi, Ru He Qiang Hua Gi Sao Jian Cha Ren Jian Du Zhi Zhi Ze Qi Nei Bu Kong Zhi Zuo Ye Cheng Xu [How to Strengthen Supervisors’ Responsibility of Oversight and Corporate Internal Control Process] (Taipei: The Securities & Futures Institute, 2002), p. 67 (Taiwan).
101 Aronson, “Japan and East Asia” (n 20 above), pp 33.
102 Theoretically, supervisors have strong statutory power to investigate and request disclosure of information. Specifically, Art. 15 and Art. 16(1) of Regulations Governing Establishment of Internal Control Systems by Public Companies (“Internal Control Regulations”) stipulate that internal audit divisions shall report to supervisors respectively in a regular and ad hoc manner. Also, Art. 218, Art. 218-1, Art. 218-2, Art. 219 and Art. 228 of Taiwan’s Company Act provide that supervisors may hire external lawyers and accountants to assist its oversight, which seems to show that supervisors have independent information channels. However, those hired professionals are still outsiders and not as informed as internal auditors directly under the management and CEO; in practice supervisors are still lacking in independent channels to gather internal information.
103 Certified public accountants should play the role as an independent gate-keeper in corporate governance, with the responsibility to examine whether corporate internal control systems properly function. See Huang Ming-jye, “Guan Kui Li Ba Feng Bao Zhong Suo Bao Lou Zhi Gong Si Zhi Li Yu Jin Rong Jian Li Wen Ti [A Reflection on Issues in the Rebar Case from the Perspectives of Corporate Governance and Financial Supervision]”, (2007) 8 Yue Dan Cai Jing Fa Za Zhi [Financial and Economic Law Review] 1, 11 (Taiwan).
104 Note 101 above, pp 69-70.
should vest in supervisors so as to maintain these auditors’ independence from the management.\textsuperscript{106}

Likewise, when it comes to companies with audit committees in a one-tier corporate governance structure, to preclude inside directors and managers from retarding information flow, the corporate law could grant members of audit committees a power to directly communicate with internal auditors and external accountants.\textsuperscript{107} Meanwhile, compensation arrangements, assessment of job performance, appointment, and dismissal of internal and external auditors should not be determined by inside directors, including the CEO.\textsuperscript{108} Since decisions of Taiwan’s audit committees in listed companies may be replaced by a super-majority vote of the board\textsuperscript{109}, there should be relevant law amendments to allow audit committees (albeit structured under the board) to have a final say over the aforementioned evaluation items of internal and external auditors as a usual board do, and audit committees only need to notify the board after their decisions have been made.\textsuperscript{110} As a consequence, audit committees would possess more direct control over internal and external auditors, so as to prevent them from being controlled by corporate insiders, while independent channels of gathering reliable governance information would therefore be assured.

The second legal tool is to strengthen the whistleblowing system. Art. 301 of SOX required a whistle-blowing channel within companies to be set up by audit committees, and its function is to process inside secret reports on accounting, internal control and auditing; the goal of this institution is to protect employees blowing their whistles and to advance independence of internal auditing jobs.\textsuperscript{111} Art. 806 of SOX contains a whistle-blower provision, explicitly protecting employees providing evidence of illegal inside corporate conducts from negative treatments by their

\textsuperscript{106} \textit{Ibid.} pp 52-53.

\textsuperscript{107} See note 76 above, p 1444; note 98 above, p 139.

\textsuperscript{108} See note 104 above, p 12.

\textsuperscript{109} Note 81 above, Art. 14-5(2).


corporations, such as lay-off, demotion, suspension, threat, attack or discrimination.\textsuperscript{112} The Dodd-Frank Act \textsuperscript{113} further strengthened related protections for whistle-blowers.\textsuperscript{114} In addition to the U.S. legislation, Japan legislated a whistle-blowing system for employees as well— the Whistleblower Protection Act of 2004, which came into force in 2006.\textsuperscript{115} In Taiwanese legal system, the direction of law reform should pay equal attention to building whistle-blowing channels, which would encourage employees to resist joining illegal internal activities and expose illegalities earlier.\textsuperscript{116} To sum up, on condition that substantive independence of Taiwan’s audit committees and supervisors can be better assured, then these corporate monitors could serve as information reporting centers within companies, while they can thus be guaranteed to gather necessary and reliable internal governance information in a more effective way.\textsuperscript{117}

As for the third legal tool, from the perspective of comparative law, U.S. and Singaporean laws grant authority to audit committees to gain access to internal information by means of assistance from external legal or other professional consultants; expenses of the assistance would be covered by their companies.\textsuperscript{118} A Taiwanese commentator submits that the right of access to information is an inevitable and essential prerequisite for the board to perform their fiduciary duties.\textsuperscript{119} The Company Act should thus be modified to provide the right of access to information to both independent and inside directors equally, with a suitable restriction on the range of information.\textsuperscript{120} As a reform direction, companies should provide directors with necessary information and assistance in a reasonable time prior

\begin{thebibliography}{99}
\bibitem{113} Pub. L. No. 111-203 (July 21, 2010).
\bibitem{115} \textit{See} note 104 above, p 21; Tsai, “Lun Gong Si She Hui Ze Ren” (n 13 above”), pp199-200.
\bibitem{116} Note 104 above, p 19. Over recent years, Taiwan’s legislature has been considering transplanting whistleblower protections in specific fields. \textit{See e.g.}, “Chui Shao Zhe Bao Hu Tiao Kuan Ni Ding, Li Wei: Bao Zhang Shen Su Lao Gong Bu Yin Zi Xun Xie Lou Zhi Quan Li Shou Sun Hai [Legislators Consider Enacting Whistleblower Protection Law to Protect Reporting Employees]”, \textit{LawBank}, 28 January 2013, available at: http://www.lawbank.com.tw/news/NewsContent_print.aspx?NID=108363.00 (Taiwan).
\bibitem{117} \textit{See} note 104 above, p 23; note 101 above, p 68.
\bibitem{119} Art. 8(1) and Art. 23(1) of Taiwan’s Company Act impose fiduciary duties and liabilities on directors and other corporate responsible persons, while Art. 210 and Art. 218 may be interpreted to be the legal basis of a right of access to information since sufficient information is the premise for directors to fulfill their fiduciary duties. \textit{See} Wang Wenyu, “Dong Shi Zhi Zi Xun Qing Quan [Directors’ Right of Access to Information]”, (2009) 86 \textit{Sue Dan Fa Xueiao Shi} /Taiwan Jurist/ 18, 18 (Taiwan).
\bibitem{120} \textit{Ibid.} p 19.
\end{thebibliography}
to board meetings; the board of directors should also be able to engage external professionals, such as lawyers, accountants, and financial experts to process information.\footnote{121} Traditional supervisors have already had a similar right of access to information according to Art. 218(2) and Art. 219(2) of Taiwan’s Company Act. For audit committees, before relevant hard laws are amended, the authorities concerned should clarify this right through soft laws such as the Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies (“Corporate Governance Principles”), which is jointly written by two major stock exchanges in Taiwan: the Taiwan Stock Exchange Corporation ("TWSE") and the GreTai Securities Market ("GTSM"). The above guidelines are nonetheless unbinding, so that it may eventually be necessary in Taiwan’s Company Act to vest directors with a general right of access to information, together with punishments placed on corporate insiders who try to block information flow.\footnote{122} Meanwhile, Art. 14-4(4) of the Securities and Exchange Act should also be amended for the above penalty provisions to be applied \textit{mutatis mutandis} to companies with audit committees in lieu of supervisors.

3. External Discipline Imposed by the Capital Market

This author believes that besides the legal reforms discussed above, we can invoke market forces to supervise corporate governance as well.\footnote{123} For example, if Taiwanese LCD panel makers made a horizontal agreement to fix the price, and if any director of these companies opposed this agreement, dissenting directors might request the company appointing them to record their dissent on board meeting minutes.\footnote{124} Especially when opposition was made by an independent director, this opposition is required to be made public and the disclosure would produce a signaling effect across the capital market.\footnote{125} In addition, as discussed in Part I.B.5, after the

\footnote{121 Note 110 above, p 248.} \footnote{122 The penalty provisions can be patterned after Art. 218(3) of Taiwan’s Company Act.} \footnote{123 Under the concept of regulatory humility, this author argues that we should count on not just mandatory legal rules, but also capital market discipline to safeguard corporate internal governance. This concept should also remain as guidance for future amendments to Taiwan’s corporate law. Specifically, humble regulation embraces lessening unnecessary regulations, lowering transactional costs, and shifting the regulatory focus from \textit{ex ante} restrictions to \textit{ex post} remedies. See Larry E. Ribstein, “Sarbox: The Road to Nirvana”, (2004) 2004 \textit{Mich. St. L. Rev.} 279, 296-97; Tsai Chang-hsien, “Cong Fa Yu Jing Zheng Quan Dian Lun Zui Di Zi Ben Zhi Zhi Bian Qian: Jian Lun Wo Guo Zhi Zhi Ke Neng Gai Ge [A Jurisdictional Competition Perspective on Changes of Minimum Capital Requirements: With a Look at Taiwan's Probable Reforms on Par Value Rules]”, 42 (2013) \textit{Tai Da Fa Xue Lun Cong [National Taiwan University Law Journal]} 553, 610 (Taiwan).} \footnote{124 Note 93 above, Art. 193(2).} \footnote{125 Yu-Hsin Lin, “Overseeing Controlling Shareholders: Do Independent Directors Constrain Tunneling in Taiwan?”, (2011)\textit{12 San Diego International Law Journal} 363, 401 (“In practice, dissenting opinions from independent directors are rare. Nevertheless, once the companies make such opinions public, the market and government will watch carefully. Such opinions usually bear signaling effects.”).}
outbreak of the Genome scandal, two independent directors of Genome, the parent company, resigned, followed by the resignation of a supervisor of TPB, the subsidiary company, in September 2013. The resignation of these independent directors and supervisor served as a public signal to the capital market, which not merely alerted individual investors, but also brought in capital market discipline.126

Furthermore, market discipline underlying the “comply or explain” rule127 (including mandatory disclosure and professional evaluation of disclosure quality) can be utilized to drive corporate monitors (i.e., supervisors and independent directors of audit committees) to exercise their oversight diligently.128 For example, Art. 10 of Regulations Governing Information to Be Published in Annual Reports of Public Companies (“Annual Report Regulations”) requires public companies to disclose how they implement corporate governance, any departure of such implementation from the Corporate Governance Principles, and the reason for any such departure. This author recommends that TWSE and GTSM incorporate guidelines on best practice of corporate monitors into the Corporate Governance Principles, such as the minimum number of times for which each corporate monitor attends board meetings, that public companies shall be required to disclose how corporate monitors interact with internal and external auditors, as well as disclosure of whether public companies prepare written internal rules governing the exercise of powers by supervisors or audit committees. What follows is that a neutral third-party professional organization or institutional investors should be encouraged to evaluate the state of each public company's implementation of corporate governance, and then to make the evaluation reports public.129 Then external market forces would be channeled to safeguard internal corporate governance in this respect.

126 Ibid. p 408. As to an economic analysis of the theory of signaling, see Eric A. Posner, Law and Social Norms (Cambridge, Mass.: Harvard University Press, 2000), pp 19-27. Important events such as resignation of independent directors or supervisors in Taiwanese listed companies shall be publicly announced; it is required in several provisions of listing rules, exemplified as in Art. 2 of the GreTai Securities Market Procedures for Verification and Disclosure of Material Information of Companies with GTSM Listed Securities.

127 The “comply or explain” technique originating in the United Kingdom spread not just to Taiwan, but also to the Japanese system. Aronson, “Olympus” (n 6 above), pp 105. For instance, in its preliminary report issued in December, 2011, the Corporate Law Subcommittee of the Legislative Council within the Ministry of Justice in Japan, whose task is to propose amending the Companies Act, used to adopt a “comply or explain” provision. This provision would require a reporting company that do not have any outside director to elaborate why it lacks outside directors. Ibid. p 119.

128 Note 101 above, p 43, 45, 47, 56-58, 73-74, 77.

129 Ibid. p 73-74.
III. Implications and Conclusion

With Taiwanese technology firms prospering, their operations have expanded worldwide. Therefore, by exploring such a case as the LCD anti-trust cases, it is obvious that foreign laws have already entered the scope of legal compliance. What’s more, according to the cases of GIO, Formosa Plastics, TSLC and Genome, the importance of compliance both with local and foreign laws is no longer ignorable. These scandals in Taiwan further remind us of the connection between internal control failure and internal self-regulating mechanisms including legal compliance programs, internal control systems and ERM frameworks.

This failure, however, cannot be fixed solely by enhancing cosmetic independence of the monitors of management. As explicated in this paper, a common issue among the cases is the lack of internal information flow. Specifically, corporate monitors cannot work without governance information, as in the TSLC case where Fubon obeyed all corporate governance standards required by laws and even surpassed its peers in this regard, but a serious corporate scandal still broke out; it might be because necessary information was not flowed to persons in charge of monitoring business performance.

Also, Taiwan’s regulatory trend towards further adoption of the U.S style of one-tier system may be deemed as an example of the transplant effect: merely transplanting foreign “advanced” corporate law provisions into local regulatory infrastructure may not a success-guaranteed solution to existing corporate governance problems.\(^{130}\) Hence, when the FSC, the authority concerned for corporate governance of public companies in Taiwan, is eager to transplant independent directors and audit committees in a full-scale manner, one question should be asked first: Does Taiwan’s corporate law currently provide supplementary legal toolkits such as a well-interpreted duty to monitor, facilitating corporate monitors’ fulfilling their fiduciary duties? Only with sufficient preparations before legal transplantation and a delicate adjustment during the transplant process given the local culture and course of

regulation can the new corporate governance rules function as well as desired.

Moreover, based on the reflection on previous corporate governance failures in Taiwan, we need to ensure that corporate monitors can effectively exercise their oversight. In other words, it is necessary to make sure that monitors of the management have the incentive and ability to monitor the effectiveness of internal self-regulating mechanisms encompassing legal compliance programs, internal control systems and ERM frameworks. This paper would thus suggest a complementary regulatory framework as prerequisites to make corporate monitors have incentives and means to exercise their oversight: not only should the duty to monitor and accompanying liabilities be formally transplanted and articulated to produce oversight incentives for corporate monitors, but independent information channels should be built up for internal governance information to flow to corporate monitors, thus vesting them with the ability to monitor. Together with external discipline imposed by the capital market, failures in corporate governance in Taiwan might be alleviated.