The Evolution of Taiwan Company Law: A Focus on the Blockholder-Centric Model

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I. INTRODUCTION

Three years after its establishment as the first constitutional republic in Asia in 1912, Republic of China (ROC) issued the company regulation by executive order. In 1927, this company regulation was replaced with the code of Company Law (Company Law), which was enacted by the Legislative Yuan, the lawmaking branch of the ROC. Because the Sino-Japanese War started in 1937, the Company Law was not given a full opportunity to evolve. When the war appeared to come to an end, the ROC government began to overhaul the Company Law to meet the needs of economy recovery. The amendment was finally passed in 1946. However, the Chinese civil war soon erupted. The ruling party of the ROC, the Nationalist Party, lost China to the Communist Party and retreated to Taiwan in 1949.

Under the rule of the Nationalist Party, the Company Law as well as other codes were imposed on Taiwan. The Company Law was revised first in 1966, and many times since then. In 2000, the presidential elections produced the first ever ruling party change in Taiwan. The Nationalist Party lost in the election, and the Democratic Progressive Party candidate was elected president. An economic downturn emerged shortly after the new president was inaugurated and forced the new cabinet to prioritize the improvement of the legal environment for business.¹ In addition, accounting scandals involving Enron and WorldCom, which were first exposed in 2001, offered an exogenous impetus for Taiwanese regulators and lawmakers to pass new laws and prevent similar corporate frauds from occurring in Taiwan. In the years following the 2001 amendment, the Company Law and Securities Exchange Law (SEL) was further revised to promote the goal of strengthening corporate governance.

According to the Company Law, there are four types of companies, i.e. unlimited company, limited company, unlimited company with limited liability shareholders, company limited by shares (“corporation”). In terms of the number of organizations, the limited company is ranked the top and the corporation is the second. In practice, there are few, if any, unlimited company and unlimited company with limited liability shareholders. Because of the practical familiarity and administrative convenience, small business owners who are willing to take the risk of unlimited liability always prefer to the form of partnership which is subject to the Civil Law.

While the entities of corporation are outnumbered by the entities of limited company, the corporation is the unquestionably most significant business organization

when it comes to the development of economy and capital market. Thus, the evolution of company law can be seen, to a large extent, as the evolution of rules on corporation. In view of comparative corporate governance, it is asserted that how diffusive the corporate ownership structure can be may depend on the investor protection rules in a particular regime.\(^2\) An in-depth review of the Company Law may reveal that the concentrated corporate ownership in Taiwan is resulted from the blockholder-centric model that lawmakers and jurists willfully molded.\(^3\)

The remainder of this paper is organized as follows: Part II describes the two unique rules in the Company Law in terms of comparative corporate governance. Both the juridical person director rule and the mandatory cumulative voting rule are advantageous to blockholders. Part III explains the change to these two rules brought about by the 2001 amendment. While the law on books is modified, the law in action remains the same. Part IV discusses the allocation of power between shareholders and the board as an example of the blockholder-centric model in Taiwan. Part V describes the shareholder right of proposal in 2005 and the revival of mandatory cumulative voting in 2011, and reveals the frictions between cumulative voting and U.S.-style governance mechanisms. Part VI turns to the shadow director rule in 2012 and piercing corporate veil rule in 2013. These rules are put into law in an attempt to hold blockholders accountable. VII concludes that formal convergence toward the U.S. model is evident in East Asia and in Taiwan. However, although most of the legal rules are similar to those in the U.S. regime, the few rules excluded from legal transplantation may be more essential than others borrowed from abroad. This should explain why legal transplantation, even when wholesale, often does not work as expected.

II. TWO UNIQUE CORPORATE GOVERNANCE RULES

A. Juridical Person Director Rule

According to the 1946 Company Law, juridical persons, such as the government and companies, were permitted to be elected as directors and supervisors. Article 21, Section 1 reads: “A company can be a director or supervisor of another company, but it must designate a natural person as its representative.”

Apart from companies, other forms of juridical person are not mentioned in the article. However, as a textual and contextual interpretation of related articles indicated,\(^4\) the government is entitled to be a director or supervisor according to the

\(^2\) (LLSV)
\(^3\) Bebchuk & Roe (2000).
\(^4\) Articles 118 and 185 of the Company Law of 1946.
1946 Company Law. Although juridical persons are not typically eligible as directors in comparative corporate governance,⁵ the uniqueness of the acceptability of juridical persons as directors inheres in Article 185 in the 1946 Company Law, which states:

*If the government or juridical persons are corporate shareholders, the number of directors to be designated by them shall be in proportion to the number of shares they subscribe as prescribed in the charter.*

*The director in the above Section, owing to his/her vocational capacity, may be replaced anytime.*

The law empowers juridical persons that are shareholders to provide representatives that serve as directors (and supervisors⁶) without being elected in shareholder meetings. The number of directors from the board that the shareholder can single-handedly appoint is in accordance with the proportion of its shareholding in the total outstanding shares of the corporation. The designated director is removed when he or she is deprived of his or her representative capacity by the shareholding juridical person. The shareholding juridical person can then install a new face in the board simply by assigning such capacity to someone else.

In the 1966 amendment, Article 185 was revised and renumbered Article 27, and several changes were made pertaining to the directorship of juridical persons. First, the power of juridical person shareholders to install directors was abolished; it was mandated that directors be selected by corporate election. Second, governments and other juridical persons were allowed to be elected as directors. They could instead choose to send natural person representatives to participate in elections. By this means, such representatives were to be elected as directors in their own names rather than in the names of juridical person shareholders. Directors could no longer be unilaterally installed, but juridical person shareholders retained the right, as was allowed by the 1946 Company Law, to replace their original representatives with new representatives.

**B. The Rise of Mandatory Cumulative Voting Rule**

In the corporate election for directors, two election methods –cumulative voting and straight voting –are often used. In straight voting, each directorship is a separate matter on which a shareholder votes. For example, in an election for nine directors, a shareholder who has one share is entitled to nine votes and must distribute the nine votes equally between the nine candidates. Thus, the election works as though there

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⁵ (DGCL §141(b): The board of directors of a corporation shall consist of 1 or more members, each of whom shall be a natural person.)

⁶ (applied to supervisor, too—Article 203)(regarding supervisor, infra note ----)
are nine separate contests for nine seats. Consequently, majority shareholders, as a group, can always seize all of the seats on the board. Unlike straight voting, which is majority-take-all, the original idea behind cumulative voting is that majority and minority electors should be represented in proportion to their numbers.\(^7\) To achieve the ideal combination, cumulative voting differs from straight voting by grouping the nine contests and distribution of votes that a shareholder can cast. In cumulative voting, the shareholder in the aforementioned example is allowed to allocate nine votes to one or several candidates. Minority shareholders are empowered to allocate votes strategically and are thus in a more formidable position in cumulative voting than in straight voting.

In the 1946 Company Law, election methods for directors were not explicitly specified. Corporations were left to autonomously decide which election method to use. The 1966 amendment constituted the first incorporation of cumulative voting and made it mandatory for all corporations. Article 198, Section 1 of the 1966 Company Law reads as follows:

\[\text{When an election for directors is held at the shareholder meeting, each share is entitled to the number of votes equal to the number of directors to be elected, and the votes can be assembled to support one person or allocated to support several persons. Persons who get more votes as represented by the ballots are elected as directors.}\]

In comparison to the United States regime of corporate law that Taiwan lawmakers often emulate, the mandatory cumulative voting specified in the 1966 amendment seems like an anachronism. Cumulative voting acquired considerable traction in the late 1940s in the United States, when 22 states made cumulative voting mandatory and another 15 states adopted permissive cumulative voting rules. Subsequently, the popularity of cumulative voting declined. By the time Taiwan adopted cumulative voting in 1966, mandatory cumulative voting in the United States had mostly been abolished. This anachronistic adaptation is likely the result of the time lag in legal transplantation. Regulators began preparing the draft for the 1966 amendment in 1959 and produced it in 1960. This draft was later sent from the executive branch to the Legislative Yuan and was deliberated among lawmakers in 1961.\(^8\) Thus, Taiwanese techno bureaucrats might just have caught the tail end of the cumulative voting trend in the United States when they began brainstorming for the


\(^8\) (Legislative Yuan Communiqué volume 50 issue 27, at 27 )(esp. Lai (1988)—at 19)
reform of the Company Law.

The introduction of cumulative voting seemed to be a radical change. Minority shareholders who had no chance of winning board seats in straight voting could send their representatives to the boardroom. Majority shareholders who could completely control the board beforehand had to communicate or even share power with dissidents who were elected to the board due to cumulative voting. However, the change represented by Article 198 is less dramatic when the juridical person director rule is taken into account. The rise of the mandatory cumulative voting makes the abolition of the power to install directors, as provided in Article 185 of the 1946 Company Law, more a change in form than a change in substance. This is because the function of cumulative voting is to allocate board membership approximately in proportion to shareholding. Allocation strategies and calculation mistakes\(^9\) set aside, juridical person shareholders can support approximately the same number of directors to win in the election under cumulative voting and Article 27 as they could install under the pre-Article 27 regime. In other words, lawmakers have compensated for the abolition of the power of juridical person shareholders to designate directors by mandating cumulative voting.

When it comes to evaluating how cumulative voting affects attempts to empower minority shareholders in the corporate governance regime, the two-tier board and the role of the supervisor cannot be ignored. In contrast to the one-tier corporate governance system employed in the United States, the two-tier system\(^10\) created under the Company Law in Taiwan necessitates that a corporation have directors and at least one supervisor,\(^11\) both of which are elected by shareholders through cumulative voting as mandated by the 1966 amendment. Supervisors are tasked with monitoring the corporate board and management. Supervisors are empowered by the law to instigate investigations whenever they deem necessary. In addition, they have the right to inspect the books of the corporation and request that the board or management to produce such books or other reports.\(^12\)

The roles of the director and supervisor are both valuable from the corporate governance perspective and share much in common. Supervisors are not members of

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\(^9\) See Amihai Glazer, Debra G. Glazer & Bernard Grofman, Cumulative Voting in Corporate Elections: Introducing Strategies into the Equation, 35 S. C. L. Rev. 295, 297 (1984)(Taking for example the 1883 election of the Sharpsville Railroad Company Board of Directors to show that “the majority’s miscalculation in cumulating its votes can prove costly”).


\(^11\) Company Law, art. 216. If the corporation is a public one, the minimum number of supervisors is increased to two.

\(^12\) Company Law, arts. 218.
the board; however, the 2001 revision to the Company Law empowered supervisors to
attend board meetings. Supervisors can participate in discussions and offer input at
the board meetings. They are distinguished from directors in that they are not entitled
to vote at board meetings. Regarding power and responsibilities, the black letters of
the Company Law do not explicitly offer any individual director the power, clearly
granted to the supervisor, to demand that the corporation produce books or reports for
inspection. However, a legal explanation issued by the Ministry of Economic Affairs
(MOEA) indicated that individual directors have “internal monitoring power” and can
request books. Directors and supervisors are thus not extremely dissimilar.

To be sure, supervisors enjoy two critical powers that directors do not. The first
is the power to call special shareholder meetings. Generally, a shareholder meeting
can be convened only by resolution of the board of directors. The Company Law
empowers any supervisor to call a special shareholder meeting if the supervisor deems
it necessary. The second is power pertains to the self-transactions of directors. The
Company Law requires that “the corporation is represented by the supervisor”
whenever directors, on behalf of themselves or others, conducts any business with the
corporation. Recent Supreme Court verdicts have elucidated that such
self-transactions need not be approved by the board, but must be endorsed by all of
the supervisors. The supervisor is equipped with these two powers, if not controlled
by majority shareholders, and is expected to engage in preventing corporate
mismanagement and tunneling.

Because the number of supervisors is often limited, in cumulative voting,
supervisors are required to garner a greater number of votes than directors in order to
be elected. Thus, minority blockholders may have little chance of becoming elected as
supervisors. When the number of supervisors to be elected is exceedingly low,
whether cumulative voting or straight voting is adopted yields no difference. Majority
shareholders can easily dominate the election under either method. In 1980,

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13 Company Law, arts. 218-2. Even before the 2001 amendment, supervisors were often invited to
attend the board meetings. Such meeting is often called a “joint meeting of directors and supervisors”
in practice.
14 (MOEA June 13, 2013 No.10200063220)
15 Company Law, art. 171.
16 Company Law, art. 220.
17 Company Law, art. 223.
18 See ZUIGAO FAYUAN [Supreme Court], Civil Division, 100 Tai-Shang No. 964 (2011); ZUIGAO
FAYUAN [Supreme Court], Civil Division, 100 Tai-Shang No. 1026 (2011) (Taiwan).
19 Cf. Kraakman et al., The Anatomy of Corporate Law, at 56 footnote 5 (In the two-tier system in the
East Asian jurisdictions, the “powers of the [supervisors] are generally limited, however.”)
20 As a rule of thumb revealed by simple mathematics, the more the number to be elected under
cumulative voting, the better the chance for the minorities to seize the spots in the election. See Robert
Charles Clark, Corporate Law 364 (1986) (“Cumulative voting assures a board seat … only to those
(if any) who have more than a certain percentage of shares. What the critical percentage is depends on,
lawmakers amended Article 198 to increase the chances of minority shareholders in acquiring supervisorships. The 1980 amendment requires that a joint election be held whenever both directors and supervisors are to be elected in a shareholder meeting. In such an election, the number of votes entitled to one share is equal to the sum of the number of directors and supervisors to be elected. Strategically, minority shareholders can distribute all of their votes to their candidates for supervisorship. By contrast, majority shareholders whose first priority is to control the board completely may be unable to fend off minority shareholders in the contest for supervisorship. However, this well-intended revision was short-lived. A 1983 amendment abolished the joint election rule. In legislative documents, this amendment appears to have been passed based on the reasoning that corporate management disruptions caused by minority-elected supervisors wielding investigatory powers must be avoided.\(^\text{21}\) Because management disruption is often the flip side of monitoring in action, the step taken by regulators and lawmakers for easing management disruptions shows that mandatory cumulative voting coupled with the joint election rule in Taiwan did render minority shareholders potent. Absent the joint election rule, supervisors in Taiwan are always criticized for being perfunctory and serve to please majority shareholders.\(^\text{22}\)

III. 2001 Amendment and Aftermath

A. Juridical Person Director Rule Refined

It goes without saying that legal person director regime is of great convenience for blockholders. Unlike any individual shareholder who can only be elected to occupy one board seat, one juridical person shareholder can have more than one representatives be elected as board members as well as supervisors. Representative directors run the risk of losing their positions if they disobey orders of the legal person shareholder since the legal person shareholder has the power to replace the representative directors at his will. The juridical person director regime has long been severely attacked by scholars but always survived. Minor changes are made to this regime in the 2001 amendment, and its essence remains untouched. Progress was made in the 2006 amendment to the SEL. It is stipulated that representatives of any juridical person shareholder can only


\(^\text{22}\) (LY relevant documents 1076-1089, at 10)
be elected either as directors or as supervisors; the juridical person shareholder of a public corporation can no longer send some of its representatives to be directors and others to be supervisors. In 2012, Article 27 of the Company Law was revised in the same way and thus expanded the application of the no-simultaneous rule to all corporations.

B. The Fall of Mandatory Cumulative Voting Rule

Cumulative voting provides blockholders the opportunity for representation on the board and possible access to corporate control. To obtain directorships, corporate raiders expend resources in purchasing stocks to create a toehold in target corporations. To ease opposition and avoid scorched-earth battles inside the boardroom, majority shareholders and management may choose to play favorites with raider-blockholders and listen to them regarding corporate affairs. Sitting on the board provides such raiders greater access to corporate information and allows them additional leverage to collaborate with others in the fight for corporate control. Thus, hostile takeovers may occur more frequently when cumulative voting is used.

In the 1990s, the aforementioned scenario was particularly true in Taiwan. One of the most infamous cases involved the Kaohsiung Business Bank. As a local bank based in Southern Taiwan, it was long controlled by major shareholders from three families. In the 1995 annual shareholder meeting, insurgent shareholders, who had acquired only 0.03% of outstanding shares, purchased sufficient proxies and seized 5 out of the 15 director seats in the election. They further formed a coalition with three other directors. The coalition therefore constituted most of the board and replaced the management. Subsequently, loans of vast sums from the bank were offered to politicians and businessmen close to the coalition, and substantial losses were incurred. Majority shareholders, who owned 35% of the outstanding shares, could not prevent the bank from deteriorating. In 1996, the majority shareholders called a special shareholder meeting and regained control of the bank. However, the bank was unable to recover from debts incurred under the previous management and

23 See SEL, art. 26-3 sec. 2.
26 See Gordon (1994), at 155 (“Cumulative voting was also perceived as increasing the risk of a hostile takeover bid.”). But see Easterbrook & Fischel (1992), at 73 (“Cumulative voting …… has the additional property of impeding changes of control and thus supporting the position of mangers vis-à-vis residual claimants.”).
27 Proxy purchase is now not allowed in Taiwan. See Lawrence S. Liu, The Politics of Corporate Governance in Taiwan, in Transforming Corporate Governance in East Asia, Hideki Kanda, Kon-Sik Kim and Curtis J. Milhaupt eds., 267 (2008).
finally went bankrupt. In 2002, the bank was taken over by Taiwan’s Central Deposit Insurance Corporation in 2002.

The Kaohsiung Business Bank case and similar cases show how insurgent shareholders can derail corporate management by means of cumulative voting. The question of whether cumulative voting should be mandatory was in the spotlight.\(^{28}\) The rigidity of the Company Law was strongly criticized; furthermore, the Company Law exacerbated the bursting of the Internet bubble and economic downturn in Taiwan at the beginning of the twenty-first century.\(^{29}\) Management teams in distressed firms were believed to be shackled with numerous restrictions imposed by the Company Law such that they could not effectively respond to the crisis. Against this background, the enabling model rather than a prohibitive model or self-enforcing model of corporate law was heralded as the goal of the 2001 amendment. Nearly half of the articles in the Company Law were affected in this overhaul of the corporate law system.\(^{30}\) Revised Article 198 reads as follows:

*When an election for directors is held at the shareholder meeting, unless otherwise stipulated in the corporate charter, each share is entitled to the number of votes equal to the number of directors to be elected, and the votes can be assembled to support one person or allocated to support several persons. Persons who get more votes as represented by the ballots are elected as directors.*

The revised Article 198 includes the text, “unless otherwise stipulated in the corporate charter,” which renders this article no longer a mandatory provision, but an opt-out rule with cumulative voting as the default. This election rule change could be expected to cause severe tension to block shareholders’ relationship established under mandatory cumulative voting. To pass the charter amendment at a shareholder meeting may not be a difficult task for majority shareholders. According to the Company Law, for nonpublic corporations, at least a two-thirds majority of shares must be represented in the shareholder meeting, which constitutes the quorum. More than half of the shares entitled to vote in this meeting must be in favor of this amendment. For public corporations, if the two-thirds majority quorum is not met, a simple majority suffices. Under such circumstances, the number of votes required is


increased to a two-thirds majority of shares entitled to vote.\textsuperscript{31} In other words, majority shareholders who have two-thirds of outstanding shares siding with them have absolute power to obviate cumulative voting. If this occurs, incumbent directors who were elected with the support of minority shareholders lose their positions in the next election.

Considering the concerns of minority shareholders, placing additional requirements into the law for the charter amendment of abolishing cumulative voting to take effect would be expected. In this regard, the state of Ohio’s transition from mandatory to permissive cumulative voting in 1986 is an example. The law categorizes Ohio corporations into two groups and establishes different conditions for charter amendments regarding cumulative voting.\textsuperscript{32} Most essential, in the case of nonpublic corporations, the amendment for eliminating cumulative voting cannot be effective if the votes of a sufficient number of shares are cast against an amendment that, if cumulatively voted upon at an election of all the directors or all the directors of a particular class, would at the time the amendment is acted upon by the shareholders be sufficient to elect at least one director.\textsuperscript{33}

As minority shareholders of nonpublic corporations cannot easily follow the Wall Street Rule and sell their stocks, special protection for minority shareholders offered by the law is justified. By contrast, the 2001 amendment to the Company Law does not incorporate any such requirements. Regarding whether to adopt cumulative voting, minority shareholders are at the mercy of majority shareholders in Taiwan. Predicting that, not long after the 2001 amendment, a certain number of corporations will change their charters and opt out of cumulative voting is logical.

What occurred thereafter in Taiwan is in contrast to this pessimistic prediction regarding the future of cumulative voting following the passage of the 2001 amendment. Most corporations did not opt out of cumulative voting after the 2001 amendment. A study conducted in 2007 indicated that only 7 out of the top 1,000 Taiwanese corporations amended their charters to eliminate cumulative voting and adopt the straight voting rule.\textsuperscript{34}

The reasons for this business inertia are multifold. Because the operation of cumulative voting often results in allocating board membership in proportion to shareholding, well-funded investors have additional incentives to acquire a block of

\textsuperscript{31} Company Law, art. 277.
\textsuperscript{34} (author’s publication)
shares in the invested corporation. Therefore, the ownership structure facilitated by cumulative voting is often composed of several blockholders. If none of the blockholders owns a majority of outstanding shares, retaining cumulative voting may be the most favorable decision for each of them. Even if there is a group of majority shareholders that has sufficient votes for amending the charter in a corporation, initiating such a charter amendment and eliminating cumulative voting would be expectedly difficult. Fierce opposition from other blockholders is unavoidable as they encounter the do-or-die situation of being involved in corporate management. Therefore, retaining cumulative voting may also be deemed a form of shareholder favoritism from the standpoint of majority shareholders. Network externalities developed based on the prevailing rule causes uncertainty in operating the cumulative voting rule.35 This makes potential movers uneasy in opting for the relatively unfamiliar straight voting rule. In addition, regulators always encourage corporations to keep cumulative voting in the charter. In the Corporate Governance Best Practice Principles approved by the securities regulators, cumulative voting was identified as the preferred election method.36 All of these, to a large extent, explain why cumulative voting rule remains a sticky default in Taiwan.

IV. The Blockholder-Centric Model in Action: Allocation of Power Between Shareholders and the Board

Regarding the allocation of power between shareholders and the board, board hegemony has long been characteristic of U.S. corporate law. Delaware General Corporation Law vests the board with the power to manage the business and affairs of the corporation, “except as may be otherwise provided in this chapter or in its certificate of incorporation.”37 However, in accordance with Section 242(b)(1), the resolution to change the certificate of incorporation can be proposed only by the board. Thus, the power of the board clearly cannot be constrained without its own approval.

In Taiwan, the idea of board hegemony has been tested in two major amendments to the Company Law since 1946. In the Company Law of 1946, Article 196 is interpreted to lean toward shareholder primacy by stating that “business execution by directors shall be in accordance with laws, charter and resolutions of the shareholder meeting.”

In the 1966 amendment to the Company Law, the aforementioned Article 196 was reassigned as Article 193, Section 2 and remains the same. In addition, Article

36 Corporate Governance Best-Practice Principles for TWSE/GTSM Listed Companies, art. 21.
37 (DGCL 141(a))
202 is presented below:

*Execution of corporate business is decided by the board of directors. Except for the matters reserved for resolutions of the shareholder meeting as required by Company Law or the corporate charter, all can be done pursuant to resolutions of the board of directors.*

To be sure, the wording of Article 202 is not without controversy. Whether this article reiterates the essence of shareholder primacy or deviates toward director hegemony is subject to interpretation. Shareholder primacy became the mainstream view only after Article 193 was considered.

In the 2001 amendment to the Company Law, the topic of the allocation of power was clearly emphasized. Article 202 is among those revised and currently reads, “execution of corporate business, except for the matters reserved for resolutions of the shareholders meeting as required by Company Law or the corporate charter, shall be done pursuant to resolutions of the board of directors.”

As mentioned, mandatory cumulative voting was also revised in 2001. Both the permissive cumulative voting and board hegemony are products of legal transplantation from the U.S. corporate regime. The legislative intent was clearly to distribute power between the shareholder meeting and board. The word *shall* in place of *can* is at the core of the textual change. Because the corporate business *shall* be executed by the board, the shareholder meeting has lost most of its power to control. Article 193 was not changed in the 2001 amendment. Hence, regarding textual interpretation, Article 202 and Article 193 seem to conflict with each other. Article 202 favors board hegemony, and Article 193 still preserves shareholder primacy. Most people believe this technical complexity arises out of legislative negligence in not revising Article 193 concurrently. Expressing the latest legislative mandate, Article 202 should be offered deference.38

The legal pendulum swung considerably toward a board hegemony regime in Taiwan until 2005 when another legal import of shareholder proposal right attempted to strike a new balance. Because Article 202 clearly states that the decisions of the board cannot violate the corporate charter, shareholders may still restrict the power of the board. Shareholders may find this path to regaining control illusive. Although the Company Law does not specifically require that any amendment to the charter be

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38 But see Christopher John Gulinello, The Revision of Taiwan’s Company Law: The Struggle toward a Shareholder-oriented Model in One Corner of East Asia, 28 Delaware J. Corp. L. 75, 112 (2003)(“The revised [Taiwan] Company Law also reinforces the notion that the board serve the interests of shareholders by expressly providing that directors cannot violate shareholder resolutions.”)
proposed only by the board, it prescribes that for a charter amendment to be valid when passed at a shareholder meeting, the motion of charter amending must be disclosed in the notice of meeting.\textsuperscript{39} What should be written in the shareholder meeting notice was completely controlled by the board until the 2005 amendment placed the shareholder proposal right into the Company Law. Granted this right, shareholders finally had the power of initiation for charter amendment. However, because of the high threshold for the shareholder proposal right, this right is often not exercised.\textsuperscript{40} Thus, Taiwan’s corporate governance regime appears to be more of a board hegemony than of a shareholder primacy.

Taiwan’s preference for the board hegemony regime may seem at odds with its longstanding cumulative voting rule. Based on the traditional principal-agent model, shareholders, rather than agent-directors, should have ultimate power in the corporate hierarchy. Though counterintuitive, the board hegemony regime is often justified by theories that marginalize the role of shareholders. Nexus-of-contracts theory claims that a corporation is “a set of contracts.”\textsuperscript{41} Shareholders of a corporation, like its directors, employees or creditors, are part of contracting parties.\textsuperscript{42} Thus, shareholders cannot be regarded as owners of the corporation. Maximizing the wealth of shareholders may remain the foremost goal of the board of directors, not because they are the principals that directors work for, but because this rule is favorable for every type of constituent of the corporation.\textsuperscript{43} Comparably, the team production theory proposed by Margaret Blair and Lynn Stout refers to the corporation as a team production activity.\textsuperscript{44} Each constituent of the corporation (team member) makes a different contribution, and the outcome of their efforts is inseparable.\textsuperscript{45} Based on this theory, the board is granted the absolute power to manage the corporation simply because this arrangement is in the interest of all of the team members.\textsuperscript{46} The team members require a third party to solve team production problems. In their own words, the corporation works as a “mediating hierarchy.”\textsuperscript{47} The board is the trustee of all of the team members rather than the agent of the shareholders.\textsuperscript{48} Thus, corporate social responsibility activities, which are often unwarranted under shareholder primacy

\textsuperscript{39} Company Law, art. 172 sec. 4.
\textsuperscript{40} See infra note ---.
\textsuperscript{44} See Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 Va. L. Rev. 247 (1999).
\textsuperscript{45} Blair & Stout (1999), at 265-266.
\textsuperscript{46} Blair & Stout (1999), at 274.
\textsuperscript{47} Blair & Stout (1999), at 276-287.
\textsuperscript{48} Blair & Stout (1999), at 290-292.
norms, are justified by this theory.\textsuperscript{49} Nonetheless, a challenge remains for these theories. Both of the theories must explain why the members of the board are elected by shareholders, not by all of the contracting parties or team members. It might be argued that shareholder’s voting right is practically meaningless in a public corporation with widely dispersed share ownership\textsuperscript{50} and deserves little attention. Another line of argument is that voting rights should be detached from the corporate decision-making structure. In reality, voting rights are not the power to review the decisions of directors, but an “accountability device of last resort to be used sparingly, at best.”\textsuperscript{51}

These theories obviously cannot be effectively applied to the corporate governance regime in Taiwan. The ownership structure is more concentrated, and public corporations usually comprise one or a group of controlling shareholders.\textsuperscript{52} The role of controlling shareholders is too dominant, and they cannot be treated equally with other constituents. More crucially, in cumulative voting, blockholders’ voting power is anything but meaningless. This election method also induces the directors-elected to regard themselves more as the agents of blockholders who vote for them and less as trustees of all shareholders as a group or the corporation. The unintended side effect of cumulative voting is exceedingly severe such that the OECD must emphasize the fiduciary role of directors when they promote cumulative voting.\textsuperscript{53} Against the backdrop of mandatory cumulative voting, the board hegemony rule in Taiwan counterintuitively ranks agents above principals.

An in-depth review suggested that blockholders may be in favor of the board hegemony rule. Cumulative voting makes the composition of a board similar to that of the proportional shareholding among blockholders. The board is often controlled by those who also own the majority of outstanding shares. Thus, the change from a shareholder-centric regime to a director-centric regime might not be opposed by blockholders because the decisions that the board makes should not differ from those

\textsuperscript{49} Blair & Stout (1999), at 299-305.
\textsuperscript{50} Blair & Stout (1999), at 310-311.
\textsuperscript{52} See supra note ---.
\textsuperscript{53} OECD (2012), at 38: While cumulative voting holds out the promise of greater diversity of opinion and outlook at the board level, with this promise comes greater risk of board deadlock or antagonistic relations between the board and management. Consequently, in identifying the potential benefits of cumulative voting, Roundtable participants have stressed that cumulative voting not be confused with “parliamentary politics” insofar as a representative elected by a particular constituency feels an obligation primarily to represent the interests of that constituency. Rather, Roundtable participants have reiterated that a company director, irrespective of what party or parties nominated or elected him, has a responsibility to serve the interests of the company as a whole and the interests of the shareholders as a class.
that would be reached in the shareholder meeting. Moreover, the boardroom differs from the shareholder meeting in which other shareholders are present and may intervene or participate in discussions. The board is a platform on which only directors (blockholders themselves or their representatives) can exchange opinions and bargain with each other. Vesting the power of control in the board can further marginalize the voices of individual shareholders and prove favorable to blockholders.

What if the decisions of the board deviate from the will of shareholders as a group? The unlikely occurrence is limited to when the shareholding ownership structure changes. Because of share transfers or other reasons, the majority of the board may not constantly own a proportional number of shares in the corporation. Conflicts between the board and shareholders can therefore be expected. The blockholder-centric model predicts that the process of reelection is facilitated and the balance between shareholding and directorship is restored in this situation.

The Taiwan Supreme Court’s verdict in the Fuhwa Financial Holding Company (Fuhwa) case may be reflective of the belief in the blockholder-centric model in spite of Article 202. Fuhwa, a securities firm turned into a financial holding company, was controlled by the Central Investment Holding Company (Central Investment). The second largest shareholder of Fuhwa is the Taiwanese government. Yuanta Core Pacific Securities Company (Yuanta), a prosperous securities firm eager to transform itself into a financial holding company, was highly interested in acquiring Fuhwa and established its blockholding gradually. By 2005, the shareholding of the “big three” in Fuhwa was 25% owned by Yuanta, 20% owned by Central Investment, and 14% owned by the Government. To facilitate a friendly merger, Yuanta attained a consensus with the other two companies regarding power sharing on the board. Among the nine directorships on the board, Yuanta occupied four, Central Investment occupied three, and the government occupied two. However, the following negotiations toward a friendly merger did not proceed as well as Yuanta had hoped. Gaining control of the board emerged as the only tactic for Yuanta to alter the situation. At the 2006 Fuhwa shareholder meeting, one shareholder, who was believed to be an ally of Yuanta, proposed on site to have the board convene for another shareholder meeting within the following 90 days and to hold an advance election of directors.

Because of the passage of this proposal at the shareholder meeting, Central Investment filed a lawsuit and requested the court to declare the resolution invalid.

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54 See ZUIGAO FAYUAN [Supreme Court], Civil Division, 96 Tai-Shang No. 2000 (2007).
Central Investment argued that the Fuhwa shareholder meeting intruded into the power of the board. Article 171 of the Company Law requires that, unless otherwise stipulated in this law, the shareholder meeting shall be convened by the board. In addition, based on Article 202, resolutions passed at shareholder meetings in this fashion are technically invalid. However, this viewpoint was not accepted by the court. The reasoning offered by the Supreme Court was that Article 202 applies only to corporate business. Convening a shareholder meeting, in the view of the Supreme Court, is not corporate business but noncorporate business. Although the board has the power of control over “corporate business,” the shareholder meeting is the institution which has the final say regarding noncorporate business. Following this line of reasoning, the existence of Article 171 does not deprive shareholder meetings of the power to demand that the board call another shareholder meeting.

The term noncorporate business is never used by lawmakers and was coined by the Supreme Court. To create the noncorporate business category and empower the shareholder meeting on such matters appears to conflict with the board hegemony regime established in the 2001 amendment. Whether corporate business and noncorporate business can be clearly defined is a question that may prove to be problematic for jurists in the future. The Supreme Court’s standpoint can be justified only by considering the blockholder-centric model. The model centered on blockholders indicates that the board hegemony regime is favored by blockholders and lawmakers unless the shareholding structure among blockholders changes. The composition of the board should be changed to be reflective of the blockholder structure. A reelection should be facilitated, not hindered. Thus, the Supreme Court’s holding should not be mistaken as the revival of the shareholder primacy regime, but should be considered an integral part of the blockholder-centric model.

V. BLOCKHOLDER EMPOWERMENT CONTINUED

A. The Shareholder Right of Proposal

Shareholders in a Taiwanese corporation did not have the right of proposal until Article 172-1 in the 2005 amendment was enacted. The current Article 172-1, Section 1 of the Company Law provides that

Shareholder(s) holding one percent (1%) or more of the total number of outstanding shares of a company may propose in writing to the company a proposal for discussion at a regular shareholders’ meeting, provided that only one proposal shall be allowed, and in case more than one proposal are made, all the proposals shall not be included.
The threshold of 1% shareholding is an insurmountable challenge for nonblockholders in a public corporation. Although the rule issued by the MOEA has it that the 1% shareholding can be met by assembling the shareholding ownership of multiple shareholders, a collective action problem and rational apathy may prevent individual shareholders from coordinating such action. Consequently, only blockholders would consider it practical to initiate shareholder proposals.

Shareholder proposal right functions differently in Taiwan from its counterpart in the U.S. First, because blockholders can often be elected as directors and voice their concerns in the board, attempting to persuade their fellow board members may be the most effective strategy to obtain what they seek. This right has seldom been exercised since its inception. By the end of 2013, the number of corporations whose shares are listed on the Taiwan Stock Exchange (TSE) or traded over-the-counter was 1,420. In 2013, the number of shareholder proposals proposed in these corporations was only a little more than 20.

Second, controlling shareholders occasionally use shareholders’ right of proposal. This is certainly not what lawmakers anticipated when they borrowed this rule from the United States. Shareholders’ right of proposal was created to provide shareholders with access to proxy material and the opportunity to put their proposals to a vote in shareholder meetings. Controlling shareholders, as their name suggests, should not require this right. However, the board is often divided under cumulative voting. Although controlling shareholders can dominate the majority of the board, the discussion of the board is not immune to opposition and obstruction. Alternatively, controlling shareholders can have the controversial proposals formed into a shareholder proposal. Legally, the board would have no choice but to accept the shareholder proposal. Because the board has no discretion, controlling shareholders would easily suppress the opposition in the board meeting and place the proposal in the shareholder meeting notice.

For example, in 2010, the Miramar Group (Miramar) and Nice Group (Nice) were two major shareholder groups in the Waterland Financial Holding Company (Waterland). In the 11-member board, Miramar held six seats and Nice held four. The remaining seat was seized by the Taiwanese government, which is also a shareholder of Waterland. The two groups disagreed with each other on nearly every major business decision. Before the shareholder meeting in 2010, a shareholder who was believed to have strong ties with Miramar submitted a proposal to remove three out of the four directors supported by Nice. According to the Company Law, the removal of

55 (http://hanreporter.blogspot.tw/2013/12/20133.html)
56 (AT 29)
directors can be executed in the shareholder meeting only if this motion is clearly stated in the shareholder meeting notice. To meet the requirement, Miramar either had to make this suggestion when the content of the notice was under the discussion of the board or submit this proposal to the board by exercising the shareholders’ right of proposal. By selecting the latter approach, Miramar avoided a board conflict, and a minority of the board members could do nothing regarding the removal motion proposed by the shareholders.

The removal proposal did not come to a vote in the end. Miramar had the shareholder withdraw the proposal soon after the Financial Supervisory Commission (FSC), the financial regulator in Taiwan, warned Miramar against such a proposal. One of the justifications that the FSC cited to intervene in this corporate control fight was that Miramar misused the shareholders’ right of proposal, which is intended to protect small shareholders.

B. The Revival of Mandatory Cumulative Voting Rule

The rare incidence of opting out of cumulative voting in the wake of the 2001 amendment suggests that majority shareholders or blockholders consider it not cost-effective to initiate such an amendment. This also suggests that majority shareholders will not hesitate to contend if conflicts among blockholders increase to such an intolerable level that the hope of maintaining an amicable relationship vanishes.

The Ta-I Inc. case is a case in point. During the 2007 director election season, Yageo Inc., the insurgent shareholder, secured more than 40% of Ta-I Inc.’s outstanding shares and expected to occupy nearly half of the seats on the board under the cumulative voting rule, whereas the Ta-I Inc. management group was expected to maintain a weak board majority. In the shareholder meeting notice sent to all of the shareholders, “charter amending” was listed on the agenda to be discussed in this meeting. However, no specific proposals on which of the articles of its charter would be revised were identified. When this motion of “charter amending” was in process, a shareholder abruptly proposed to amend the provision on the director election method in the charter. This extemporaneous proposal was for eliminating the cumulative voting rule and adopting the straight voting rule. Yageo Inc. was caught off guard. Despite strong opposition from Yageo Inc., the amendment was passed. In the immediate ensuing election in which the straight voting rule was adopted, the Ta-I Inc. management group thus acquired all of the board seats, and Yageo Inc. left the meeting with none.

Be it fair or unfair for minority shareholders, judged from the perspective of legal technicalities, the manner in which the shareholder meeting of Ta-I Inc. was
conducted complies with judicial and regulatory interpretations. According to the Taiwan Supreme Court, presenting extempore proposals on any provisions of the charter at a shareholder meeting is legal as long as the motion to amend the charter is included on the meeting notice.\(^{57}\) An interpretation issued by the MOEA indicated that charter amendment takes effect immediately after the amendment proposal is approved in the shareholder meeting. However, Yageo Inc. demanded a fair election. The complaint was well-received among scholars and regulators. To defend Yageo Inc., the quasigovernmental institution, the Securities and Futures Investors Protection Center,\(^{58}\) filed a suit against Ta-I Inc. in an attempt to void its shareholder meeting resolutions and the election result. In the end, the Supreme Court did not overturn its prior decision and awarded a victory to Ta-I Inc.\(^{59}\)

Whereas procedures of the shareholder meeting were the core topic of the court case, the disproportionate allocation of board seats seemed to be the major reason that people were more sympathetic toward Yageo Inc. Regulators and lawmakers believed that only the revival of mandatory cumulative voting could prevent an inequitable outcome. Because cumulative voting remained the prevailing norm, the change from a permissive rule to a mandatory rule would influence only few corporations. Opposition to this revision proposal was rarely heard in the business community. By the end of 2011, the Legislative Yuan passed the revision of Article 198 and mandatory cumulative voting was reinstated in the Company Law.

VI. CORRESPONDING DUTIES AND LIABILITIES OF BLOCKHOLDERS

A. Shadow Director Rule

Because of the persistence of both the mandatory cumulative voting rule and juridical person director rule, blockholders are a centerpiece of the Taiwanese corporate governance model. In cumulative voting, board seats can be proportionately allocated among blockholders. In addition, the Company Law requires automatic removal of directorship when the number of shares that an incumbent director holds is less than half of that held when elected at the shareholder meeting.\(^{60}\) These rules provide strong incentives for blockholders to maintain their shareholding above a certain level. This can also explain, to some extent, why the ownership structure of corporations in Taiwan is not as highly diffused as that of corporations in the United

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\(^{57}\) See ZUIGAO FAYUAN [Supreme Court], Civil Division, 72 Tai-Shang No. 113 (1983) (Taiwan).


\(^{59}\) See ZUIGAO FAYUAN [Supreme Court], Civil Division, 98 Tai-Shang No. 923 (2009) (Taiwan).

\(^{60}\) Company Law, art. 197.
The presence of blockholders makes the balance between powers and duties a topic too visible to be disregarded. Directors and management are responsible for managing a corporation and owe fiduciary duties to that corporation. By contrast, shareholders or even blockholders owe no duties, other than that of contributing the capital, to the corporation. The case of juridical person shareholders exposes the shortcoming of the director-centric regime, namely, that it is under-inclusive. Under such circumstances, juridical person shareholders owe no duty to a corporation, but their representatives who are elected as directors are fiduciaries of the corporation. In addition, the representative-directors owe to the juridical person shareholders numerous duties arising out of their representative capacity and contractual relationship. This obliges representative-directors to report all they know of from serving as directors to the juridical person shareholders. In other words, juridical person shareholders may benefit from information advantages derived from directorship, but bear no corresponding duties.

To fill the legal vacuum on this topic, regulators have adopted an extensive approach in defining directors’ duty. For example, the Company Law imposes a duty of noncompetition on directors. The legal interpretation of this clause from the regulator has made it clear that the juridical person shareholders whose representative serves as directorship are subject to the same duty. In addition, the Company Law requires that a director recuses himself from board discussions and decisions when the director has a conflict of interest pertaining to the topic discussed. The rule states that the director is prohibited from participating in the board meeting if the juridical person shareholders of whom the director serves as representative has a conflict of interest.

All the interpretative expansions made by the regulator fall short of imposing a general fiduciary duty on blockholders. According to Taiwanese Civil Law, the contractual relationship between a director and the corporation imposes a fiduciary-like duty on the director. The 2001 amendment inserts the fiduciary duty rule into the Company Law. The current Article 23, Section 1 now reads: “The

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61 See Christopher John Gulinello, The Revision of Taiwan’s Company Law: The Struggle toward a Shareholder-oriented Model in One Corner of East Asia, 28 Delaware J. Corp. L. 75, 95 (2003)(“Ownership of public companies in Taiwan is dominated by family groups.”). Yeh-Lee-Woidtke (family control and corporate governance-evidence from Taiwan)-- Ownership structure – Lin (2011), at 376 (LLSV-protection of minority – ownership structure)
62 Company Law, art. 209.
63 (MOEA interpretation)
64 Company Law, art. 206.
65 (MOEA interpretation)
responsible person of a company shall loyally execute the business and shall exercise the due care of a good administrator.” It is well indicated that legislators intend to borrow the concepts of duty of care and duty of loyalty from the United States.

Before the Company Law was revised in 2012, the term responsible person of a company defined in Article 8 encompassed directors, supervisors, and managers, but did not include blockholders. The definition was not broadened to include juridical person shareholders. The new institution of shadow director, which was placed into law by the 2012 amendment, is reflective of lawmakers shifting their focus on blockholders. Below is the text from Article 8, Section 3:

For a public company, a non-director who de facto conducts business of a director or in effect controls the personnel, financial or business operation of the company and in effect instructs a director to conduct business shall be liable for the civil, criminal and administrative liabilities as a director in this Law, provided, however, that such liabilities shall not apply to an instruction of the government to the director appointed by the government for the purposes of economic development, promotion of social stability, or other circumstances which can promote public interests.

Because juridical person shareholders can replace representative-directors at will, their representatives are expected to follow the orders of juridical person shareholders. In this sense, juridical person shareholders come close to the concept of a shadow director. With regard to interpreting the new rule, the remaining question is whether exercising substantial control over the board is a requirement for the shadow director. Based on the textual requirement of “in effect controls the personnel, financial or business operation,” the answer seems to be positive. Comparatively, the laws of the United Kingdom, where the concept of the shadow director originates, do not define the shadow director in such narrow terms. According to the 1994 case of Re Hydrodam (Corby) Ltd., to establish that a defendant is a shadow director, one must demonstrate “a pattern of behavior in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the directions of” the defendant. However, the strict requirement of control is not accepted in the Secretary of State for Trade and Industry v. Deverell. The Deverell court believed that a person can be a shadow director if he or she has “real influence in the corporate affairs of the company, although it was not necessary that such influence was

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exercised over the whole of its corporate activities."\(^\text{69}\) Thus, proving that the elected directors “cast themselves in a subservient role or surrendered their respective discretions”\(^\text{70}\) is not necessary for shadow directors. Against the backdrop of legal transplantation and the laws of the United Kingdom, the lesser legal requirement for a shadow director may prove to be acceptable in Taiwan. In this light, this Article 8, Section 3 can be remarkably useful in the blockholder-centric model of Taiwan.

B. Piercing Corporate Veil Rule

The most recent amendment to the Company Law is the piercing corporate veil rule. Effective in January 2013, this rule is incorporated into Article 154, Section 2 and reads as follows:

> If a shareholder abuses the company’s status as a legal entity and thus causes the company to bear specific debts and to be apparently difficult for the company to pay such debts, and if such abuse is of a severe nature, the shareholder shall, if necessary, be liable for the debts.

VII. CONCLUSION

In terms of corporate governance rules, formal convergence toward the U.S. model is evident in East Asia and in Taiwan. However, although most of the legal rules are similar to those in the U.S. regime, the few rules excluded from legal transplantation may be more essential than others borrowed from abroad. This should explain why legal transplantation, even when wholesale, often does not work as expected.

Both the juridical person director rule and mandatory cumulative voting rule in Taiwan are extremely unusual and persistent. By focusing on these rules, it is shown that blockholders are favored in this regime and encouraged to maintain the block shareholding. The board hegemony rule and shareholder right of proposal, both of which are transplanted from the U.S., are adjusted to fitting the blockholder-centric model. To balance the powers and duties of blockholders, this article suggests that the newly enacted shadow director rule and piercing corporate veil rule should be interpreted in a way that can keep blockholders accountable.

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\(^{69}\) [2001] Ch. 340, 341.

\(^{70}\) Id.