Governance Challenges of Listed State-Owned Enterprises around the World: National Experiences and a Framework for Reform

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Abstract

Despite predictions of their demise in the aftermath of the collapse of socialist economies in Eastern Europe, state-owned enterprises (SOEs) are very much alive in the global economy. The relevance of listed SOEs—firms still subject to government ownership, a portion of whose shares are traded on public stock markets—has persisted and even increased around the world, as policymakers have encouraged the partial floating of SOE shares either as a first step toward, or as an alternative to, privatization. In this article, we evaluate the governance challenges associated with mixed ownership of enterprise, and examine a variety of national approaches to the governance of listed SOEs, with a view to framing a robust policy discussion in the many countries where SOE reform is a topic of major significance. We describe the evolution and current status of the institutional framework applicable to listed SOEs in eight different jurisdictions, reflecting a variety of economic, legal, and political environments: France, the United States, Norway, Colombia, Brazil, Japan, Singapore, and China. We leverage the lessons from this comparative analysis to critique the policy prescriptions of international agencies such as the OECD, and to frame policy suggestions of our own.

Keywords: State-owned enterprises (SOEs), corporate governance, mixed ownership

JEL Classifications: G38, K22, L33, P50

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Abstract

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Introduction

The state is still in business. Despite predictions of their demise in the aftermath of the collapse of socialist economies in Eastern Europe, state-owned enterprises (SOEs) are very much alive in the global economy. As of 2010, state-owned firms accounted for about one-fifth of world market capitalization.[1] Since then, listed SOEs have generally suffered from the recent decline in commodity prices, but otherwise continue to play a major role in their respective economies and capital markets. The relevance of listed SOEs—firms still subject to government ownership, a portion of whose shares are traded on public stock markets—has persisted or even increased around the world, as policymakers have encouraged the partial floating of SOE shares either as a first step toward, or an alternative to, privatization.

The "mixed ownership" model presented by listed SOEs is spreading. For example, Saudi Arabia, which previously relied on a system of whole ownership by the state, has recently announced its plan to float shares of its oil giant Aramco.[2] In China, the Xi Jinping administration has championed mixed ownership as a means of reforming the massive state sector of the economy.[3] Motivating this approach is the notion that injecting private capital into SOEs will improve their management and expose the enterprises to badly needed market discipline.

Yet mixed ownership structures add a distinctive layer of governance challenges atop the standard corporate governance problems faced by any listed firm, because "the state" is a distinctive type of owner. State ownership creates its own agency problems caused by the separation of the politicians and bureaucrats who oversee SOEs from "the citizens" on whose behalf the firms are ostensibly owned. From time to time, problems caused by these distinctive governance challenges explode into scandal, as has recently happened in Brazil. Brazil's oil giant Petrobras, a state-controlled firm whose shares are listed both domestically and on the New York Stock Exchange, was previously held up as an international model of solid corporate governance and performance.[4] But today it is embroiled in crisis on two fronts.

First, the government used Petrobras as a tool of macroeconomic policy in the last decade, keeping oil prices significantly below the international market price as a means of fighting inflation. This resulted in major losses to the company and a reduction in its investment

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[1] *Why China is Different*, THE ECONOMIST, Nov. 11, 2010.
[2] *Saudi Arabia Considers Aramco Share Sale*, FINANCIAL TIMES, Jan. 7, 2016.
[3] *See* Section II(H) *infra*.
[4] *See*, *e.g.*, THE WORLD BANK, CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES: A TOOLKIT 44-5 (2014) (citing Petrobras among "several successful listed SOEs [that] are recognized as world leaders"); Francisco Flores-Macias & Aldo Musacchio, *The Return of State-Owned Enterprises: Should We Be Afraid?*, HARV. INT'L REV., Apr. 4, 2009.

capacity.[5] Second, Petrobras is at the center of the *Lava Jato* ("Carwash") investigation, which uncovered the largest corruption scandal in Brazil's history. The ruling Workers Party (PT) and its coalition partners appointed many of Petrobras's most important executives. A massive bid rigging scheme orchestrated by some of these appointees generated a campaign slush fund for PT politicians while providing lavish payouts to the corrupt insiders.[6] Petrobras has so far written off more than US$2 billion in direct corrupt payments associated with Lava Jato,[7] but analysts estimate that the total losses will be far greater.

In this article, we evaluate the governance challenges associated with mixed ownership of enterprise, and examine a variety of different international approaches to the governance of listed SOEs, with a view to framing a robust policy discussion in the many countries where SOE reform is a topic of major significance. Brazil is one such country, where the crisis just described has motivated both private sector and government initiatives to restore investor and popular confidence in these firms.[8] In September 2015, BM&FBovespa, the Brazilian stock exchange, launched an innovative SOE Governance Program (*Programa de Governança de Estatais*), which offers special certification to listed SOEs that agree to comply with various sets of corporate governance best practices. In June 2016, Brazil enacted a new statute on SOEs, which includes a number of special governance rules for these firms.

Although the governance challenges associated with listed SOEs are common to all mixed ownership firms, countries have responded to these challenges in myriad ways. In this article, we describe the evolution and current status of the institutional framework applicable to listed SOEs in eight different jurisdictions, reflecting a variety of economic, legal, and political environments: France, the United States, Norway, Colombia, Brazil, Japan, Singapore, and China. We leverage the lessons from this comparative analysis to critique the policy prescriptions of international agencies and to frame policy suggestions of our own.

The selection of countries for our study was based on several factors. They represent a diverse sample of countries across a range of dimensions: geography, stage of economic development, governmental structure and philosophy, and the relevance of SOEs to the domestic political economy. We included two countries that receive high marks for SOE governance: Singapore and Norway. We selected China because it is a large, developing country in which SOEs play a particularly important economic role and in which a mixed ownership strategy has long been its preferred path toward enterprise reform. China's experience is also interesting because at times it has looked to Singapore as a model in its approach to mixed enterprises. In Norway, Brazil and Colombia, SOEs operating in the oil industry are particularly important to

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[5] Edmar Luis Fagundes de Almeida et al., *Impactos da contenção dos preços de combustíveis no Brasil e opções de mecanismos de precificação*, 35 REV. ECON. POL. 531 (2015).

[6] *See What Is the Petrobras Scandal that Is Engulfing Brazil?*, FIN. TIMES, Mar. 31, 2016, https://www.ft.com/content/6e8b0e28-f728-11e5-803c-d27c7117d132

[7] Petrobras, Annual Report on Form 20-F (2015) at 30.

[8] *See* Section II(E) *infra*.

the national economy, despite vast differences among these countries along a host of other dimensions. France was chosen as an example of an advanced democracy in which SOEs play an important role in the political economy. The United States and Japan were included in part due to the size and importance of their economies. In addition, the U.S. is often viewed (justifiably or not) as a leader in corporate governance reform, while Japan has adopted a distinctively gradual plan of partial privatization for important firms in its economy, a process that is ongoing to this day.

The national experiences we discuss are rich and diverse. We use them to provide a perspective from which to critically evaluate the guidelines on SOE governance prepared by the Organization for Economic Co-operation and Development (OECD) and the World Bank. They also help frame a list of subjects ranging from ownership structures and board composition to executive compensation and the noncommercial, "public policy" role of mixed-ownership enterprises that policy makers may find useful as they seek to address the governance challenges of listed SOEs.

The article is organized as follows: Part I outlines the rationale for mixed ownership of enterprise and the distinctive governance challenges associated with this organizational form. Part II provides analytical narratives on the evolution and key attributes of governance arrangements for listed SOEs in eight countries in different parts of the world and at different stages of development. Part III analyzes the governance patterns (or lack thereof) that emerge from the various national experiences we examine. Part IV critiques the prescriptions of best practice guidelines of international organizations. Part V offers a conceptual framework for improving the governance of listed SOEs.

I. Governance Challenges

Why are mixed-ownership enterprises so prevalent around the world, and how do their governance challenges differ from those of private firms?[9] The prevalence of listed SOEs—in which the government retains a controlling or blocking stake in a firm with private investors—may at first blush appear to present a puzzle: If a government wants to be directly engaged in commercial activity, why cede partial ownership of the firm to private investors? The answer is that listing of SOE shares on stock exchanges has a number of potential advantages over whole ownership by the state. SOE performance may benefit from both the monitoring efforts of outside investors and the tighter governance and regulatory constraints applicable to publicly traded firms. Moreover, capital obtained through partial listings of shares may permit states to reallocate funds to other uses, such as paying off public debt or performing critical government

[9] For a detailed discussion of the tradeoffs associated with mixed ownership, *see* Mariana Pargendler, Aldo Musacchio & Sérgio G. Lazzarini, *In Strange Company: The Puzzle of Private Investment in State-Controlled Firms*, 46 CORNELL INT'L L. J. 569, 574 (2013).

functions, while not relinquishing control over corporate operations or the other perceived benefits of government ownership of enterprise.[10]

Nevertheless, as the recent Brazilian experience makes clear, the listing of SOE shares does not eliminate—and often exacerbates—corporate governance challenges. Listed SOEs generally take the form of a joint-stock business corporation. The corporate form, in turn, gives rise to two primary agency problems: (i) the agency problem between managers and shareholders (which is more severe if corporate ownership is dispersed) and (ii) the agency problem between controlling shareholders and non-controlling shareholders (which is more severe if corporate ownership is concentrated). These problems do not disappear, and in fact intensify, when the state is a large shareholder, though the relative strength and contours of these problems will depend on how the state acts as an owner.

The state is a distinctive type of owner. It is an economic and political organization in its own right, giving rise to another layer of agency costs—which might be called the "agency costs of state capitalism."[11] The main agency cost within the state is that between government officials (elected or not) and citizens, who should in theory be the ultimate beneficiaries of state action. As is well known, the agency costs within the state are particularly severe, for various reasons. First, the exit options enjoyed by citizens are far weaker than those available to shareholders (and, in non-democratic societies, the voice option is also virtually non-existent). Second, the collective action problem faced by citizens in monitoring politicians is more intense than the one facing shareholders in private firms. Third, the lack of a clear consensus on which objectives the government should pursue—as well as on the means to accomplish such objectives—hinders the development of effective mechanisms of accountability. Consequently, there is great risk that the actions by government officials will serve their own interests in enhanced power and wealth, rather than the interests of citizens.

Listed SOEs may face different problems depending on how the state behaves as a shareholder. If it acts as a passive or absentee owner, managerial agency problems will prevail, so SOEs may suffer from (i) managerial slack and (ii) managerial tunneling (i.e., theft of corporate assets). Although these problems are common to private firms as well, they tend to be more severe in SOEs, given the absence of a market check on managerial agency costs. The presence of the state as a large shareholder prevents the operation of a market for corporate control through hostile takeovers. In addition, the existence of implicit state guarantees undermines the threat of bankruptcy as a source of managerial discipline.

[10] Governments have a wide range of motivations for retaining control over commercial enterprises, ranging from opportunities for employment or theft by political insiders to national security concerns.

[11] Ronald Gilson and Jeffrey Gordon have coined the expression "the agency costs of agency capitalism" to describe the second layer of agency costs created by the rise of institutional ownership of corporate shares. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism Activist Investors and the Revaluation of Governance Rights,* 113 COLUM. L. REV. 863 (2013).

If the state is actively engaged as a shareholder, this can, in theory, reduce managerial agency problems but at the cost of increasing the potential for abuse by the controlling shareholder. As in private firms, there is a risk that the state will appropriate to itself a disproportionate share of SOE returns—what the corporate governance literature calls pecuniary private benefits of control—to the detriment of minority shareholders. State ownership exacerbates other risks, however, such as the possibility that government officials will appropriate financial value to themselves to the detriment of both citizens and minority shareholders—in other words, the risk of corruption. Moreover, compared to private controlling shareholders, the state has stronger incentives to pursue non-pecuniary private benefits of control. These can be benign, as in the pursuit of corporate policies that enhance social welfare, even if they fail to maximize shareholder value. However, they can also be malign, as when SOEs favor political allies in awarding contracts to the detriment of both citizens and minority shareholders. Consequently, while the strong role of the state as a shareholder may mitigate managerial agency problems, it opens the door to private benefits of control, political favoritism, and corruption.

The combination of these two layers of agency costs creates areas of both alignment and misalignment between the interests of citizens and outside shareholders in listed SOEs. Both shareholders and citizens have a shared interest in (i) increasing managerial effort, (ii) reducing managerial tunneling, and (iii) curbing rent-seeking behavior by politicians (from favoritism to outright corruption). Mixed ownership, however, also creates conflicts of interest between shareholders and citizens with respect to other dimensions, such as (iv) the pursuit of social welfare objectives by SOEs,[12] which favors citizens but not shareholders; (v) the appropriation of disproportionate financial benefits by the state (which favors citizens, at least in the short term, but not shareholders); and (vi) the award of subsidies to SOEs, which favors shareholders, but not necessarily citizens (who pay for these subsidies, which may disrupt the level playing field between SOEs and private firms and hamper competition).

The main mechanisms to address these two layers of agency costs are general corporate laws, on the one hand, and general political and legal institutions, on the other. Strong corporate laws, backed up by effective enforcement mechanisms, tend to benefit minority shareholders of SOEs as well. Moreover, the governance of SOEs (including listed SOEs) is also inherently dependent on how the existing legal and political institutions reduce or magnify the agency

[12] In a separate paper, we develop the concept of "policy channeling" to describe the state's control of an SOE (as opposed to resort to regulatory processes or other mechanisms of government) to achieve a policy objective. Although policy channeling may not be in the financial interests of the private investors in the SOE, state actors may engage in this conduct because it generates a distinctive type of private benefits of control – what we call political private benefits of control. *See* Curtis J. Milhaupt & Mariana Pargendler, *RPTs in SOEs: Tunneling, Propping and Channeling*, Working Paper (2017). In theory, it is clear that SOEs should be permitted to pursue welfare-enhancing public policies, such as price moderation in non-competitive industries or the pursuit of countercyclical strategies. After all, this is one of the most common theoretical justifications for state ownership of enterprise. In practice, however, there is often disagreement about whether any given strategy constitutes a welfare-enhancing public policy or rent-seeking by politicians and interest groups.

problems between politicians and citizens. For instance, the challenges associated with Brazil's political system and mechanisms of campaign finance likely played a significant role in the recent SOE corruption scandals. There is little question that SOEs will tend to work much better both when corporate laws mitigate private benefits of control and when political institutions effectively constrain corruption and mismanagement by government officials.

Nevertheless, despite their obvious importance, neither general corporate laws nor general political institutions are the primary object of our attention here. Instead, our focus is narrower, centering on institutions and strategies that target more directly the peculiar challenges facing listed SOEs. In contrast to other areas of corporate law and governance, the scholarly literature on the institutional and governance frameworks applicable to listed SOEs is relatively scarce. We seek to redress the imbalance, if only marginally, in the sections that follow.

II. National Experiences

National experiences with the governance challenges of mixed-ownership enterprises have rarely been subjected to side-by-side comparison. Even beyond the purely informational benefits of the exercise, understanding how different countries have approached mixed-ownership enterprises promises a policy payoff, due to the common nature of the governance challenges faced by all countries with this form of economic organization. A side-by-side analysis also provides a useful perspective from which to evaluate the best practice guidelines for SOEs adopted by international organizations such as the OECD, a subject we address later in the article.

A. France

Famous for its state-centered society and *dirigiste* economic policy, France has a long history of government involvement in business, dating back to the trading companies from the era of Louis XIV. Yet corporatized SOEs were virtually non-existent in France until the twentieth century. In the few instances in which the state engaged in economic activity in the nineteenth century, it did so directly—as in the case of its tobacco monopoly (1810) and the postal service (1851)—without resorting to a separate business entity.[13] Mixed enterprises first appeared in France in the interwar period as a transplant and heritage from German experience, with the return of Alsace-Lorraine to France.[14] The French state initially participated as a minority shareholder in the first mixed enterprises of the 1920s. However, following the Great Depression and World War II, majority ownership and control became increasingly prevalent, as

[13] ANDRE DELION, DROIT DES ENTREPRISES ET PARTICIPATIONS PUBLIQUES 13 (2003).
[14] JEAN-DENIS BREDIN, L'ENTREPRISE SEMI-PUBLIQUE ET PUBLIQUE ET LE DROIT PRIVE 19 (1957); GEORGES RIPERT, ASPECTS JURIDIQUE DU CAPITALISME MODERNE 315 (1946)

the government sought to rebuild the economy and bridge France's historical gap in certain economic sectors.[15]

Under the socialist government of François Mitterrand in the early 1980s, France witnessed its most recent wave of nationalizations, when the state came to own 13 of the country's 20 largest corporations and almost the entire credit sector.[16] France then underwent two waves of privatizations in 1986 and 1993 and, since then, has alternated between further privatizations, new equity investments by the state in private firms, and periods of the so-called "ni-ni" policy of "*ni privatisation, ni nationalisation*" (neither privatization nor nationalization). The weight of the state's participation in French listed companies has oscillated between 13% in the early 1980s to 3% in 1996 and 10-12% following the financial crisis.[17] Minority holdings by the French state are increasingly prevalent. As of 2014, France ranked sixth among OECD countries in terms of the value of enterprises under majority state control, but first in view of the market value of firms subject to minority ownership by the state,[18] amounting to government shareholdings of over €83 billion in listed firms alone.[19] Recent laws have encouraged the state to sell partial stakes in SOEs to raise revenue without necessarily relinquishing control and the pursuit of public policy objectives.[20]

Given the traditional centrality of state ownership to France's style of capitalism, dedicated systems of SOE governance have emerged and evolved over time. We will address them in two parts, first focusing on the special governance arrangements applicable to SOEs, and then turning to the recent experience with the centralization of the state's shareholding function in a specialized government agency since 2004.

Special Legal Regime: As in other countries, mixed enterprises in France have traditionally been subject to a hybrid legal regime. As a rule, these companies take the form of a business corporation (*société anonyme*) and are subject to the same legal regime governing private firms. However, numerous exceptions apply. First, industry regulations and statutory charters can create firm-specific carve-outs from general corporate laws, which led French jurist

[15] LA COMMISSION DES PARTICIPATIONS ET DES TRANSFERTS ET LES PRIVATISATIONS EN FRANCE 31-2 (2016), http://www.economie.gouv.fr/files/cptexpo2016.pdf.

[16] Pepper D. Culpepper, *Capitalism, Coordination, and Economic Change: The French Political Economy since 1985 3-9, in* CHANGING FRANCE (Pepper D.Culpepper et al., 2008).

[17] Final Report Submitted to the European Commission and Financial Services User Group, *Who Owns the European Economy? Evolution of the Ownership of EU Listed Compani*es, between 1970 and 2012 (Aug. 2013), http://ec.europa.eu/finance/finservices-retail/docs/fsug/papers/1308-report-who-owns-european-economy_en.pdf.

[18] ByJon Sindreu, *GE and Alstom: In a World of State Ownership, France Prefers Minority Stakes*, WALL ST. J., June 20, 2014.

[19] Agence des participations de l'État, L'État actionnaire (2014-2015) [hereinafter "APE Report of 2014-2015"] at 8, http://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Rapport_APE.pdf.

[20] Ordonnance n° 2014-948 du 20 août 2014, article 4; Loi n° 2015-990 du 6 août 2015 pour la croissance, l'activité et l'égalité des chances économiques (« Loi Macron »). For a discussion of these recent developments, *see* Grégory Kalfleche, *Les sociétés à participation publique et l'Etat actionnaire après la loi Macron*, REVUE DE JURISPRUDENCE COMMERCIALE 6 (2015).

George Ripert to decry the system of "*une loi par société*" as early as 1946.[21] For instance, the Civil Aviation Code allows the minister in charge of civil aviation to appoint a government commissioner to attend board meetings of listed firm Aéroports de Paris in an advisory capacity.[22] Second, as will be further explained below, there are a number of general laws subjecting SOEs to distinct rules that set them apart from privately owned enterprises (POEs).[23] While we focus here on the rules of corporate law and governance, it is important to recognize that, unlike POEs, SOEs (notably those under majority state control) are also subject to various public law constraints, including the broad supervisory authority of the Court of Auditors (*Court des comptes*),[24] the exercise of economic and financial control by the state,[25] and requirements of prior state approval of certain decisions.[26]

Since the mid-twentieth century, the state has enjoyed the right to appoint board representatives in proportion to its equity ownership whenever it held more than 10% of the shares, subject to a minimum of two members and a maximum of two-thirds of the board seats.[27] In 1983, however, the prominent "law for the democratization of the public sector" (known as "*loi* DSP") established a number of special rules for majority-owned SOEs, including listed firms.[28] In companies where the state held a majority but less than 90% of the shares, workers had the right to appoint one-third of the board members (or three out of 18 board members in companies employing up to 1,000 employees). The remaining two-thirds of members were appointed by the shareholders meeting subject to the state representatives. However, the number of state representatives was not specified by the *loi* DSP and, in practice, it so happened that the state was under-represented in SOE boards.[29]

The state representatives to the board of directors (*conseil d'administration*) were appointed by Presidential decree, as was the officer combining the roles of chairman of the board and president (*président-directeur general* – PDG)—a position that has traditionally concentrated significant power under the French system of corporate governance.[30] This, in turn,

[21] RIPERT, *supra* note 14, at 317.
[22] Moreover, specific decrees also provide for the appointment of government commissioners and other officials to attend in advisory capacity the board meetings of major SOEs (such as energy firms EDF and AREVA), for purposes of conveying the government's policies.
[23] In France, this special legal regime is typically triggered when the state acquires 10% of the shares and is strengthened when it holds a majority of the capital.
[24] Code des juridictions financières Article L133-1.
[25] Décret n° 55-733 du 26 mai 1955 relatif au contrôle économique et financier de l'Etat.
[26] Décret n° 53-707 du 9 août 1953 relatif au contrôle de l'Etat sur les entreprises publiques nationales et certains organismes ayant un objet d'ordre économique ou social (for companies taking the form of a business corporation, budgets, income statements, balance sheets, the allocation of profits, and the remuneration of managers require the prior approval of the Minister of the Economy).
[27] Décret-loi du 30 octobre 1935 organisant le contrôle de l'Etat sur les sociétés, syndicats et associations ou entreprises de toute nature ayant fait appel au concours financier de l'Etat, Article 2, as amended by Loi 49-985 1949-07-25 Art. 12 and Loi 2001-420 2001-05-15 Art. 139.
[28] Loi n° 83-675 du 26 juillet 1983 relative à la démocratisation du secteur public (hereinafter "Law DSP").
[29] For instance, Gaz de France and Snecma followed this pattern after their privatization.
[30] *See, e.g.*, Benjamin Mojuyé, *French Corporate Governance in the New Millenium: Who Watches the Board in*

has enabled politically motivated changes in management following electoral cycles.[31] The *loi* DSP formally imposed a five-year term for board members (which is lower than the six years permitted under the commercial code but higher than the four years recommended by the France's Corporate Governance Code Afep-Medef), though in practice there has been a high turnover of state appointees.[32]

This system has undergone a significant transformation in 2014 with the enactment of new laws ostensibly aimed at simplifying SOE governance and approximating it to the regime applicable to POEs.[33] The new rules withdraw all entities taking the form of business corporations (including majority-owned SOEs) from the scope of the *loi* DSP. They eliminate prior requirements in terms of board size and director terms, and permit the state to appoint certain board members who are not public servants. Yet the key goal of this reform was to *strengthen* the government's influence as a shareholder. First, pursuant to the new regime, the state may appoint directly by ministerial order one state representative (who must be a public servant) in all majority-owned SOEs. The state may also *directly* appoint one representative in all firms in which it directly holds more than 10% of the shares.[34] This is in contrast to the former rules, according to which the shareholders meeting appointed the state representatives upon the proposal of the state.[35] Second, in firms in which the state holds a direct participation between 10% and 50% of the shares, the government also has the right to propose at the shareholders meeting a number of board members in direct proportion to its equity interest in the firm.[36] These rules help put "an end to the paradox that led the state to have less influence as a shareholder in state-owned enterprises than a private shareholder."[37] Nevertheless, convergence to the private legal regime remains elusive, in view of the generous appointment rights enjoyed by the state as well as by employees, which retain one-third of board seats in majority-owned SOEs.

Corporate France?, 6 COLUM. J. EUR. L. 73, 75 (2000).

[31] Christophe Boillon, *La gouvernance des entreprises à participations publiques : L'État comme actionnaire privé* 17 (2013-2014) at 18-9, http://memoire.jm.u-psud.fr/docannexe/file/4401/La-gouvernance-des-entreprises-à-participations-publiques---Christophe-Boillon---VF.pdf.

[32] *Id.* at 18-9.

[33] Loi n° 2014-1 du 2 janvier 2014 habilitant le Gouvernement à simplifier et sécuriser la vie des entreprises; Ordonnance n° 2014-948 du 20 août 2014 relative à la gouvernance et aux opérations sur le capital des sociétés à participation publique.

[34] Ordonnance n° 2014-948 du 20 août 2014, article 4; Décret n°2014-949 du 20 août 2014 portant application de l'ordonnance n° 2014-948, article 2.

[35] *See* former Article 2 du décret-loi du 30 octobre 1935 modifié organisant le contrôle de l'Etat sur les sociétés, syndicats et associations ou entreprises de toute nature ayant fait appel au concours financier de l'Etat et article 139 de la loi n° 2001-420 du 15 mai 2001 modifiée, relative aux nouvelles régulations économiques, both abrogated by the Ordonnance n° 2014-948 du 20 août 2014.

[36] *Id.*, art. 6. If the meeting does not approve the state's nominees, the state can then make such temporary appointments unilaterally, subject to confirmation at the subsequent shareholder meeting. If the number of board seats is greater than 10, the state is entitled to appoint at least two board members.

[37] Compte rendu du Conseil des ministres du 20 août 2014, *Gouvernance et opérations sur le capital des sociétés à participation publique*.

Another area of both traditional and recent concern under French law is that of executive compensation in SOEs. Under the *loi* DSP, state-appointees to SOE boards did not receive any remuneration for their services (though expenses were reimbursed). Since 2001, companies must pay for the services of state representatives on the board, but the amounts revert to the government budget. Moreover, since 2012 the remuneration of managers in majority-owned SOEs is subject to a cap, currently set at €450,000.[38] The new state appointees who are not public servants, as permitted by the 2014 reform, may receive compensation up to a certain cap to be determined by the Minister of the Economy, with the excess amounts also reverting to the government.

Beyond the special legal regime governing SOEs, the state's interests as a shareholder have also shaped France's general corporate laws, a pattern that is particularly clear in the area of shareholder voting rights.[39] While French law prohibits the issuance of multi-voting stock, it has long permitted companies to grant double voting rights to investors holding shares for at least two years.[40] More recently, the openly protectionist *loi Florange* of 2014 has provided for the automatic application of double voting rights to shares held for at least two years (unless shareholders opt out by securing a two-third majority vote)—a reform that was explicitly driven by the state's interests as a shareholder.[41] The broader attribution of double voting rights would permit the French state to divest some of its stockholdings to reduce the national debt while at the same time preserving or magnifying its influence as a shareholder in companies of strategic importance. In a controversial and widely followed episode, the French state acquired additional shares in Renault and Air France-KLM in order to secure the automatic application of the double voting rights under *loi Florange*.[42]

Government Shareholding Agency: The second pillar of the SOE infrastructure relates not to the rights granted to the state as shareholder under corporate laws and industry regulations, but to the institutional framework for the exercise of the ownership function by the state. In 2003, the influential Report by René Barbier de La Serre and others identified a number of shortcomings of the existing system of SOE governance, including considerable confusion in the various roles played by the state with respect to its enterprises, the poor functioning of the board of directors, and the excessive presence of the state in day-to-day management.[43] As a result of the Report's recommendation, France established its Government Shareholding Agency (*Agence de*

[38] Décret n° 2012-915 du 26 juillet 2012 relatif au contrôle de l'Etat sur les rémunérations des dirigeants d'entreprises publiques.
[39] For an early analysis of this pattern, *see* Mariana Pargendler, *State Ownership and Corporate Governance*, 80 FORDHAM L. REV. 2917, 2953-54 (2012) (hereinafter "State Ownership and Corporate Governance").
[40] *Id.*
[41] Loi n° 2014-384 du 29 mars 2014 visant à reconquérir l'économie réelle No. 2014-384 of 29 March 2014 ("Loi Florange").
[42] *See* APE Report of 2014-2015, *supra* note 19, at 19.
[43] M. René Barbier de La Serre et al., *L'État actionnaire et le gouvernement des entreprises publiques* (Rapport à M. Francis Mer, Ministre de l'économie, des finances et de l'industrie) (2003), http://www.ladocumentationfrancaise.fr/var/storage/rapports-publics/034000095.pdf.

participation de l'État – APE) with the goal of dissociating the state's shareholder function from its role as a regulator.[44]

Linked to the Ministry of the Economy, the APE centralizes the shareholding responsibilities with respect to numerous companies subject to whole or partial ownership by the state. Not all government equity stakes are held through APE, however. For example, while the French state accounts, directly or indirectly, for over 85% of the capital of AREVA, the APE holds only 28,83% of its shares; the main shareholder is the CEA, France's Alternative Energies and Atomic Energy Commission.[45]

The APE should consider the financial interests of the state in exercising its role as a shareholder, but it exercises this mission in conjunction with the other ministries in charge of the other (regulatory) responsibilities of the state. The APE may be consulted for the appointment and removal of board members nominated by decree or ministerial orders. The APE also represents the state in shareholder meetings and ensures, together with the government commissioner (if there is one), the coherence of the positions of government representatives. Moreover, the APE participates, as and when required, in the drafting of the relevant contracts between its portfolio companies and the government.

In contrast to Singapore's holding company Temasek (discussed below), the APE's role is not limited to managing its portfolio companies under strictly commercial terms. Instead, its focus, especially in recent years, is also on "managing its investments from an industrial perspective, and on establishing a clear, long-term industrial and economic development strategy for the companies concerned." Such a strategy must "simultaneously optimize the value of its assets and the specific business and social aims of each of the companies concerned," especially in strategic sectors such as national defense, energy, and the car industry.[46] The most recent APE reports specifically mention the 2014 legal reforms permitting the state to embrace a stronger and more active role as a shareholder in view of the "general interest."[47] The Agency also takes pride in its responsible and stable dividends policy, calibrated in view of the risks involved and of the practices of comparable companies in regulated sectors.[48] Nevertheless, its above-market rate of dividend payments has attracted criticism by the *Court des comptes*, which has raised concerns over a short-term orientation by the state as a shareholder to the detriment of long-term investments.[49]

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[44] Décret n° 2004-963 du 9 septembre 2004 portant création du service à compétence nationale Agence des participations de l'Etat.

[45] http://www.areva.com/EN/finance-1166/shareholding-structure-of-the-world-leader-in-the-nuclear-industry-and-major-player-in-bioenergies.html

[46] *The French State as Shareholder*, 2012 Report at 7, http://www.economie.gouv.fr/files/files/directions_services/agence-participations-etat/Documents/Rapports-de-l-Etat-actionnaire/2012/Overview_2012.pdf.

[47] APE Report of 2014-2015, *supra* note 19, at 11-12.

[48] *Id.* at 33.

[49] *Les dividendes de l'Etat inquiètent la Cour des compt*es, REUTERS, May 27, 2005.

Finally, in 2014 France disclosed its new policy for intervening as a shareholder, which is comprised of four key objectives reflecting a mixture of industrial policy, sovereignty, and macroeconomic considerations: (i) ensuring that the government has sufficient control over companies of strategic public interest operating in areas key to France's sovereignty; (ii) guaranteeing the existence of resilient companies able to fulfill the country's basic requirements; (iii) supporting corporate growth and consolidation, particularly in sectors and industries that are key to French and European economic concerns; and (iv) subject to EU regulations, helping corporate bail-outs on an ad hoc basis in systemic risk cases.[50]

B. United States

The United States boasts the world's largest capital market and is the principal originator of "best practices" in corporate governance. The United States is also exceptional in its traditional hostility to government ownership of enterprise.[51] At present, there is not a single domestic SOE among the thousands of companies listed on U.S. exchanges—although, as discussed throughout this study, numerous foreign SOEs cross-list their shares in the United States and are subject to U.S. regulatory authority.

This does not mean, however, that the United States is devoid of experience and lessons with mixed enterprises and other forms of state involvement in corporations. In fact, government stockholdings in private firms were particularly common in earlier periods of U.S. history, even if intentionally eliminated thereafter. The twentieth century saw the emergence of important government-sponsored enterprises (GSEs)—which, like SOEs, also entail the coexistence of public support, influence and mission, on the one hand, and outside shareholders, on the other. More recently, the U.S. government temporarily acquired equity stakes in various private firms in the bailouts following the financial crisis of 2008.

While mixed enterprises have been rare to non-existent in recent times, U.S. states were frequently shareholders in local banks, railroads, and canals in the late eighteenth and early nineteenth centuries.[52] Whatever the merits of such state support in the early days of American capitalism,[53] these investments posed a clear conflict of interest from the perspective of the state's role as regulator. Various studies document the reluctance of different states to charter new corporations when they had stockholdings in the same industry, due to fear that increased competition could jeopardize the government's financial return from existing investments.[54]

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[50] APE Report of 2014-2015, *supra* note 19, at 9.

[51] From the early days of the country's founding, corporations were viewed with suspicion as dangerous concentrations of power and their governance was closely bound up in debates about federalism (the proper allocation of power between the national government and the states). One important result of this historical legacy is that corporate law in the United States is principally the province of the states, not the U.S. Congress.

[52] *See, e.g.*, Lloyd D. Musolf, *American Mixed Enterprise and Government Responsibility*, 24 WESTERN POL. QUART. 789 (1971).

[53] For a review of works supporting this role, *see* Robert A. Lively, *The American System: A Review Article*, 29 BUS. HIST. REV. 81 (1955).

[54] *See, e.g.*, John Joseph Wallis, Richard E. Sylla & John B. Legler, *The Interaction of Taxation and Regulation in*

Although systematic studies on the governance practices of these early mixed enterprises are lacking, existing evidence suggests that government interference in corporate decision-making was fairly limited from the outset. States routinely appointed directors to corporate boards,[55] but generally refrained from exercising their voting rights to interfere with the administration by private managers.[56] Even so, these public stakes in business firms eventually became controversial as the depression of 1837 left states with bad investments. The distinctive U.S. solution then was to eliminate these hybrid entities. As part of a broader set of reforms seeking to encourage fiscal responsibility, most state constitutions in the mid-nineteenth century came to prohibit state shareholdings in private companies.[57]

Early instances of stock ownership by the federal government were fewer, but involved companies that played a major role in the U.S. economy. Take, for instance, the U.S. government's participation in the First Bank of the United States of 1791. Conceived by then Treasury Secretary Alexander Hamilton, the Bank displayed the combination of a public mission with essentially private management—a recipe that would become the hallmark of the U.S. model of hybrid enterprises. Hamilton envisioned that the Bank would not be "a mere matter of private property, but a political machine of the greatest importance to the State."[58] At the same time, he vigorously argued that the Bank should be "under a private not a public direction—under the guidance of individual interest, not of public policy," given the well-recognized risks of governmental abuse.[59]

This suspicion of government involvement, in turn, also translated into a more limited degree of state ownership. Hamilton advocated against both government involvement in management and whole or majority stock ownership by the state.[60] The main right of the government was to inspect the Bank's operations.[61] While the federal government held 20% of the Bank's stock at its founding, it soon sold its shares in order to repay its debt to the Bank.[62]

The federal government was also a 20% shareholder at the founding of the Second Bank of the United States in 1816. Unlike its predecessor, this new Bank's charter followed then-prevailing practice in the states and provided for the government to appoint five (out of 25) directors. Although commensurate with the state's initial financial investment in the Bank, the

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Nineteenth-Century U.S. Banking, *in* THE REGULATED ECONOMY 121, 142 (Claudia Goldin & Gary D. Libecap eds., 1994). For a more general review of these conflicts, *see* Pargendler, *State Ownership and Corporate Governance*, *supra* note 39, at 2928-2931.

[55] *See, e.g.*, Lively, *supra* note 53.

[56] JAMES W. ELY, JR., RAILROADS AND AMERICAN LAW 17 (2001).

[57] LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 121 (3rd ed., 2005); John Joseph Wallis, *Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842 to 1852*, 65 J. ECON. HIST. 211, 232, 251 (2005).

[58] Final Version of the Second Report on the Further Provision Necessary for Establishing Public Credit: Report on a National Bank (Dec. 13, 1790).

[59] *Id.*

[60] *Id.*

[61] *Id.*

[62] Musolf, *supra* note 52, at 796.

presence of government appointees proved controversial and of doubtful practical importance; the Bank reportedly concealed information from public directors fearing a conflict of interest.[63]

The last grand experiment with federal support of corporations in the nineteenth century was the Union Pacific Railroad chartered by Congress in 1862. This time, however, government ownership of stock was eschewed entirely in favor of a model based on generous public subsidies through land grants and loans, coupled with the appointment of a minority of government directors (initially two and later five out of 20 board members). Yet also here government appointees to the board reported that they were kept out of meetings and generally antagonized by the other directors.[64]

Limitations to State Ownership of Enterprise: Fast forwarding to the twentieth century, the U.S. largely resisted the growing international trend toward state ownership of industry. In response to the proliferation of government corporations following the Great Depression, Congress enacted the Government Corporation Control Act (GCCA) of 1945, which sought to restrain the formation of government corporations and enhance their accountability, by, among other things, requiring Congressional authorization for the establishment of new government corporations.[65] Despite these constraints, new hybrid entities, which came to be known as government-sponsored enterprises (GSEs), gradually emerged. GSEs stayed true to the earlier model of state support without ownership: they were chartered by the federal government, imbued with a public mission, but owned and controlled by private shareholders. The government's role in their governance was formally limited to the appointment of a minority of directors by the President of the United States.[66]

The most prominent GSEs are Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac), which became publicly traded on the New York Stock Exchange in 1968 and 1989, respectively. Their mission was to promote access to housing by supporting the secondary market for residential mortgages generally, and, since the 1990s, also by facilitating financing to low- and middle- income borrowers.[67] Fannie Mae and Freddie Mac were chartered by the federal government and enjoyed different legal privileges, such as exemptions from state and local income taxation as well as from federal securities laws.[68] However, the main form of public support to these entities came in the form of an implicit government guarantee. Even though their federal charters explicitly disclaimed any liability or guarantee from the U.S. government for their debts, market participants widely recognized that

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[63] *Id.* at 797.
[64] Herman Schwartz, *Governmentally Appointed Directors in a Private Corporation: The Communications Satellite Act of 1962*, 79 HARV. L. REV. 350, 359 (1965).
[65] For a detailed discussion of the Act, *see* C. Herman Pritchett, *The Government Corporation Control Act of 1945*, 40 AM. POL. SCI. REV. 495, 508 (1946).
[66] Until a 2008 charter amendment, the President had the right to appoint five out of 18 directors at Fannie Mae and Freddie Mac.
[67] Housing and Community Development Act of 1992.
[68] THOMAS H. STANTON, GOVERNMENT-SPONSORED ENTERPRISES: MERCANTILIST COMPANIES IN THE MODERN WORLD 23 (2002).

the state would stand behind their obligations in the event of default—a perception that the financial crisis of 2008 proved to be accurate. As a result, these entities were able to borrow at significantly lower cost than comparable private firms, which contributed to their expansion.

Even prior to the financial crisis, Fannie Mae and Freddie Mac were politically controversial on both sides of the ideological spectrum. Fannie Mae, in particular, was also embroiled in accusations of accounting fraud in the early 2000s. Partly in response to this scandal, there was even greater governance *forbearance* on the part of the federal government. In 2004, President George W. Bush, Jr. decided to stop using its prerogative to appoint government directors to Fannie Mae and Freddie Mac, a policy that continued under President Obama, to the effect that private shareholders could then elect all directors.

Post-Financial Crisis Experience: It was not until the financial crisis of 2008 that the U.S. government would make unprecedented acquisitions of shares in private corporations, even if with significant hesitation. The very idea of having the federal government acquire equity stakes in distressed financial institutions emerged as a policy transplant from England, a country with far greater experience with mixed enterprises.[69] Nevertheless, the U.S. government consistently described itself as a "reluctant shareholder" whose role was meant to be temporary.[70] This reluctance manifested itself in the structure of the government's investments, which reflected lower equity stakes and control rights than standard commercial practice would have warranted.[71]

The government bailouts during the financial crisis did not follow a single model. On the contrary, deal structures were crafted *ad hoc*, leading to significant heterogeneity in governance arrangements.[72] In General Motors, the federal government acquired a controlling stake by exchanging its existing loan for an equity interest in the firm during its bankruptcy proceeding. It held its stock in the company directly and appointed ten out of 12 board members, but generally refrained from intervening in the daily management of the firm. By mid-2009, all directors appointed by the government were required to be independent, and would take responsibility for further director nominations, but the government retained the right to vote against or remove them.[73]

In the case of AIG, the government acquired a large equity stake of nearly 80% of voting stock, but surrendered direct control by transferring its shares to a trust—a move largely motivated by doubts about the federal government's legal authority to hold shares in

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[69] Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 526-7 (2009); Paul Krugman, *Gordon Does Good*, N.Y. TIMES, Oct. 12, 2008.
[70] *See*, for a discussion, Barbara Black, *The U.S. as Reluctant Shareholder: Government, Business and the Law*, 5 ENTREPRENEURIAL BUS. L. J. 56, 563 (2010).
[71] Steven M. Davidoff, *Uncomfortable Embrace: Federal Corporate Ownership in the Midst of the Financial Crisis*, 95 MINN. L. REV. 1733, 1735 (2011).
[72] *Id.*
[73] *Id.*

corporations without prior Congressional authorization.[74] The Trust Agreement also specifically mentioned the Federal Reserve Bank of New York's intention of not exercising its voting rights for AIG stock in order to "avoid any possible conflict with its supervisory and monetary policy function."[75] Although the trustees retained sole discretion with respect to the management of the trust, the Trust Agreement explicitly mentioned the government's expectations that the trustees would not intervene in the daily management of the company.[76] The Agreement also referred to the government's non-binding view that maximizing AIG's ability to repay its debt to the government and not disrupting financial markets are consistent with maximizing the value of the trust stock.[77]

In Citigroup, by contrast, the federal government came to hold its large equity interest of approximately 33% of the shares directly. The government still limited its control power by agreeing to vote in the same proportion as the other shareholders in routine matters, but preserved its voting rights with respect to the election of directors and major corporate transactions.[78]

Finally, the GSEs Fannie Mae and Freddie Mac were subject to the greatest degree of government intervention. The federal government took them into conservatorship in 2008, thus acquiring control and suspending the voting rights of shareholders. A few years later, in 2012 the Treasury entered into a controversial "net worth sweep" with the companies, which essentially transferred their future profits to the government at the expense of private shareholders. This development attracted significant criticism as an unlawful expropriation of private investors,[79] but it has thus far withstood judicial scrutiny.[80]

With the exception of Fannie Mae and Freddie Mac, the government has since sold the stockholdings acquired during the financial crisis, and the relevant firms have returned to wholly private ownership. In fact, the very decision to divest as promptly as possible was in an important sense a governance decision aimed at curbing the risks of damaging political interference. From the perspective of maximizing the government's financial return on its investment, the timing of its exit might have been premature.[81] In any case, the short duration of this experiment, combined with the great variety of institutional arrangements employed, makes it difficult to draw definitive conclusions about the effectiveness of different governance

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[74] For a discussion, *see Starr International Company v. United States*, No. 11-779C (United States Court of Federal Claims, June 15, 2015).
[75] AIG Credit Facility Trust Agreement, dated as of January 16, 2009 ("AIG Trust Agreement"), at https://www.newyorkfed.org/medialibrary/media/newsevents/AIGCFTAgreement.pdf, Recitals.
[76] *Id.*
[77] *Id.* at Section 2.04(d).
[78] Exchange Agreement dated June 9, 2009 between Citigroup Inc. and United States Department of the Treasury, at http://www.sec.gov/Archives/edgar/data/831001/000119312509128765/dex103.htm, Section 4.18.
[79] *See, e.g.*, Jonathan Macey & Logan Beirne, *Stealing Fannie and Freddie*, Working Paper (2014), http://ssrn.com/abstract=2429974; Richard Epstein, *The Government Takeover of Fannie Mae and Freddie Mac: Upending Capital Markets with Lax Business and Constitutional Standards*, 10 NYU J.L. & Bus. 379 (2014).
[80] *Starr International Company v. United States*, *supra* note 74.
[81] Davidoff, *supra* note 71, at 1757-8.

arrangements.

However, it is still possible to discern certain lessons. First, the U.S. has adopted a distinctive approach to mixed enterprises: it sought to avoid its predictable challenges by shunning government ownership through clear constraints in state constitutions and federal legislation. To be sure, recent works have argued that state collaboration with, and support of, businesses in the United States is far greater than usually acknowledged.[82] Nevertheless, such support generally takes the form of state loans and grants, rather than equity investments.[83]

Second, even if helpful, the various mechanisms to curb government influence—such as the transfer of ownership interests to a trust, and strong reliance on independent directors—were insufficient to eliminate the specter of political intervention in the companies' governance and management.[84] Admittedly, there is no consensus on the optimal degree of political influence over business corporations owned by the state, and certain commentators have criticized the bailout deal structures for bestowing too little control on the government.[85] Nevertheless, to the extent that the objective was to avoid any form of politically-motivated intervention, the governance mechanisms employed do not appear to be bullet proof.

Third, the existing legal infrastructure has largely failed to constrain the government's role in the bailouts.[86] Scholars have noted that U.S. corporate law is ill equipped to address the particular political risks created by government ownership—a problem that is only aggravated by the relatively broad scope of the doctrine of sovereign immunity in the United States.[87] Moreover, the conflict of interests between the government's role as regulator and shareholder remained apparent. The recent transaction permitting the government to appropriate all the profits of Fannie Mae and Freddie Mac is illustrative in this regard. Allegedly authorized by recent federal legislation, this move clearly belies the widespread notion that the government would not attempt to enrich itself at the expense of private investors.[88]

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[82] *See* MARIANA MAZZUCATO, THE ENTREPRENEURIAL STATE: DEBUNKING PUBLIC VS. PRIVATE SECTOR MYTHS (2011).

[83] *Id. See also* Alberto Mingardi, *A Critique of Mazzucato's Entrepreneurial State*, 35 CATO J. 603, 613 (2015) (arguing that the SBIR program "adds up to little more than forcing some public bodies to sign checks").

[84] *Starr International Company v. United States*, *supra* note 74, at 472 ("The manner in which FRBNY controlled AIG with its handpicked CEO, carefully selected board members, and its hundreds of on-premises advisers belies any conclusion that the operations of the trust were independent").

[85] *See, e.g.*, Black, *supra* note 70; Davidoff, *supra* note 71.

[86] *See* Pargendler, *supra* note 39, at 2965-66 (discussing how the acquisition of Bear Stearns by J.P. Morgan, which was engineered by the government, likely ran afoul of corporate law rules).

[87] *See* Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293 (2011).

[88] *Id.* at 1318.

C. Norway

The level of state ownership in Norway is higher than in any other OECD country and comparable to that of large emerging economies.[89] The motivation for state involvement in business has varied over time.[90] Significant government ownership of enterprise in Norway dates back to the post-World War II period, when the weakness of local capital markets prevented private firms from financing industrial development. Following the discovery of vast oilfields off its shore, Norway established state-owned enterprise Statoil in 1972 as part of its institutional infrastructure to retain control over natural resources while shielding its economy from the black gold curse. Government ownership in the banking industry increased dramatically in response to a financial crisis in the late 1980s. In the last decade, state shareholdings have represented roughly between 35-40% of the Oslo Stock Exchange (OSE) market capitalization, up from approximately 15% in the 1990s.[91] The increase is largely due to IPOs of major SOEs—including Statoil and telecom company Telenor—during the early 2000s.[92]

The Norwegian Model: In addition to the sheer significance of state ownership in its advanced economy, Norway also stands out in view of its acclaimed institutional arrangements. The "Norwegian model" for the oil sector—premised on the separation of policy, regulatory, and commercial functions—has become a blueprint for resource-rich countries (though questions persist about its adequacy to different contexts).[93] Here we will focus on two dimensions of the institutional framework: (i) the exercise of the shareholder function by the state and (ii) the corporate law and governance framework applicable to listed SOEs.

Shareholder Function: Under Norway's constitution, state-owned enterprises fall under the administration of government ministries, but the Norwegian Parliament (*Storting*) has express authority to instruct the government with respect to SOEs. This framework requires the prior consent of the *Storting* for changes in the state's shareholdings (acquisitions and divestitures), as well as for capital increases entailing disbursements by the state. However, SOEs are generally able to buy and sell shares in other companies without *Storting* approval when this is part of their regular business activities. The Office of the Auditor General of Norway oversees the administration of SOEs by the relevant ministry and provides annual reports to the *Storting*.[94]

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[89] Thomas Dowling et al., *Norway: Selected Issues*, IMF Country Report No. 14/260 (2014), https://www.imf.org/external/pubs/ft/scr/2014/cr14260.pdf.

[90] OECD, REGULATORY REFORM IN NORWAY 7 (2013), https://www.oecd.org/regreform/sectors/15360734.pdf.

[91] Norwegian Ministry of Trade, Industry and Fisheries, *Diverse and value creating ownership*, Meld. St. 27 (2013–2014) *Report to the Storting* (white paper) (hereinafter "2013-2014 White Paper") at 89, https://www.regjeringen.no/contentassets/899ac257df2648d788942b78c6d59787/en-gb/pdfs/stm201320140027000engpdfs.pdf.

[92] OECD, *supra* note 90, at 7.

[93] *See, e.g.*, Mark C. Thurber, David R. Hults & Patrick R. P. Heller, *Exporting the ''Norwegian Model'': The effect of administrative design on oil sector performance*, 39 ENERGY POL'Y 5366 (2011).

[94] For a general description of this constitutional framework, *see* 2013-2014 White Paper, *supra* note 91, at 60-61.

The pursuit of formal differentiation between the state's role as shareholder and regulator is a hallmark of the Norwegian model. Norway has followed the trend toward centralization of shareholdings by allocating interests in most commercial SOEs to the "ownership department" of the Ministry of Trade, Industry and Fisheries, especially since 2001.[95] For instance, the ownership department exercises the shareholding function of Telenor, while the Ministry of Transportation and Communication serves as the company's regulator. Nevertheless, important exceptions to centralization persist, as in Statoil, whose shareholdings are administered by the Ministry of Petroleum and Energy.[96] Still, even here there is a formal separation of functions: Statoil, like private oil firms, is subject to regulatory oversight by the Norwegian Petroleum Directorate, a technical advisory agency.[97]

In the mid-2000s, Norway carefully considered but ultimately rejected the possibility of instituting a holding company model. A 2004 report by the preparatory committee in charge of reviewing the organization and administration of state ownership offered only timid support for the institution of a holding company to manage state shareholdings with purely value-maximization objectives, and pointed to the need for further assessments. The same committee counseled against the use of a holding company structure for SOEs serving the goal of keeping head office functions in Norway, in view of the perceived need for continued political governance and supervision. The government eventually discarded the need for a holding company, which it regarded as leading to unnecessary duplication of functions and confusion in terms of responsibility. It argued that "ownership matters are of such a character that they need to be handled through a political body," and that "[t]he current ministerial affiliations ensure transparency concerning ownership and ensure considerations of democratic control."[98]

Governance Regime: Norway's listed SOEs are subject to the same corporate and securities laws governing private firms, including the Public Limited Liability Companies Act and stock exchange regulations. Norway's corporate law provides for a strong principle of equal treatment.[99] Majority shareholders have significant decision-making powers under Norwegian law, but may not act in abuse of power to the detriment of the company and other shareholders.[100] There is special concern that the state as a shareholder does not receive

[95] OECD, *supra* note 90. Overall centralization of SOE shareholdings (including non-commercial SOEs) has been less extensive, however, with 65% of SOEs remaining under the supervision of sectoral ministries as of 2005. Stine Ludvigsen, *State Ownership and Corporate Governance: Empirical Evidence from Norway and Sweden* (2010) (A dissertation submitted to BI Norwegian School of Management for the degree of PhD), http://web.bi.no/forskning%5Cpapers.nsf/wSeriesDissertation/4F488755C624C943C125771F0030605F.
[96] 2013-2014 White Paper, *supra* note 91, at 29.
[97] Thurber et al., *supra* note 93, at 2.
[98] Norwegian Ministry of Trade and Industry, *An Active and Long-Term State Ownership*, Report to the Storting (White Paper) No. 13 (2006–2007) (hereinafter "2006-2007 White Paper"), at 70, https://www.regjeringen.no/contentassets/01527a83111e45639d5dbb0d84882a44/en-gb/pdfs/stm200620070013000en_pdfs.pdf.
[99] 2013-2014 White Paper, *supra* note 91, at 65-7.
[100] Beate Sjåfjell, *Sustainable Companies: Possibilities and Barriers in Norwegian Company Law*, University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2013-20, https://ssrn.com/abstract=2311433.

preferential access to information not available to private shareholders.[101] The Oslo Stock Exchange has also contributed to enforcement of the equal treatment norm by issuing letters questioning whether statements by Statoil management reflected private information not available to public investors or resulted from non-financial considerations.[102] The Oslo Stock Exchange and the Norwegian Annual Accounts Act also require all listed companies to report on their adoption of the Code of Practice for Corporate Governance on a "comply or explain" basis.

The state's involvement as a shareholder must take place through the shareholder meeting, in accordance with the Norwegian Public Limited Liability Companies Act, though the Ministry of Oil and Energy has admitted to exercising influence through informal meetings as well.[103] At the shareholder meeting, shareholders of large companies elect two-thirds of the members of the corporate assembly, with workers electing the remaining one-third. The corporate assembly elects two-thirds of shareholder representatives and one-third of worker representatives to the board. Companies may, however, opt out of the requirement of a corporate assembly by obtaining workers' consent, in which case shareholders and workers directly elect approximately two-thirds and one-third of board members, respectively.[104]

The board of directors appoints the CEO, who may not be a board member, and sets his or her salary. There are no state representatives on the board of listed SOEs, but ministry representatives engage, directly or indirectly, with the nomination committee.[105] The nomination committee, which is composed of shareholders or shareholder representatives, submits recommendations to the shareholder meeting and the corporate assembly (if there is one) for the appointment of the respective shareholder-elected members and the setting of their compensation. In practice, there seems to be moderation in the state's involvement: even though the state holds 67% of the capital in Statoil, it has recently appointed only one member (from the Ministry of Petroleum and Energy) out of four members of the nomination committee.[106]

A distinctive trait of the Norwegian system compared to other countries is that currently serving politicians and public servants from the central government may not serve on SOE boards. This prohibition traces back to a 1962 fatal accident involving a state-owned mining

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[101] Statoil, 2014 Board Statement on Corporate Governance, http://www.statoil.com/no/InvestorCentre/AnnualReport/AnnualReport2014/Documents/DownloadCentreFiles/01_KeyDownloads/Board_statement_on_Corporate_Governance.pdf (hereinafter "2014 Board Statement"); Mark C. Thurber & Benedicte Tangen Istad, *Norway's Evolving Champion: Statoil and the Politics of State Enterprise* 32 (Program on Energy & Sustainable Dev., Working Paper No. 92, 2010), http://iis-db.stanford.edu/pubs/22919/WP_92%2C_Thurber_and_Istad%2C_Statoil%2C_21May2010.pdf.
[102] OECD, *supra* note 90, at 23.
[103] Beate Sjåfjell, *supra* note 100, at 6.
[104] While some listed SOEs such as Statoil and Telenor have a corporate assembly, there are others which have opted out of this requirement.
[105] Although listed companies are not technically required to have a nomination committee, all listed SOEs in Norway have adopted a nomination committee, as recommended by the corporate governance code.
[106] 2014 Board Statement, *supra* note 101, at 4-6.

company, which had the Minister of Industry serving on its board.[107] The incident, which came to be known as the "King's Bay affair," resulted in allegations of negligence, and ultimately brought down the ruling labor government. The original rationale for the ban was not primarily to prevent political interference in management, but rather to mitigate conflicts of interest in the government's oversight of SOEs[108] and to discourage Parliament from holding the government accountable for the business decisions of state-owned companies.[109] The existing restriction on board membership, however, does not encompass former politicians, whose participation in SOE boards remains relatively common.[110]

Norway has continuously strived to strengthen the corporate governance of SOEs, which is touted as "of vital importance for the market's confidence in the companies and hence also for the companies' capital costs."[111] Moreover, the state has repeatedly acknowledged that, given its large participation in listed companies, "[t]he manner in which the State acts as an owner therefore has great influence on public and investor confidence in the Norwegian capital market."[112] The state has chosen to follow the principle of proportionality between capital invested and voting rights in SOEs, avoiding the introduction of special rights to the state as shareholder.[113] In the International Monetary Fund's assessment of SOEs in Norway, "[m]ost large enterprises operate on a commercial basis and are profitable."[114]

In 2002, the Norwegian government formulated ten principles of corporate governance for SOEs, with the goal of increasing predictability in the exercise of ownership by the state. These principles were subject to modest amendments in 2014 to further underscore the role of the board of directors in SOE governance and administration and the commitment to corporate social responsibility. As emphasized by the Norwegian government, its principles essentially correspond to the OECD Guidelines on the Corporate Governance of State-Owned Enterprises.[115]

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[107] Thurber & Istad, *supra* note 101.
[108] OECD, *supra* note 90, at 14.
[109] Ludvigsen, *supra* note 95, at 39.
[110] *Id.* at 122 (finding that 23% of the chairmen of Norwegian SOEs fall in the category of political representatives); Jenni Maria Nossum, *Corporate Governance in Oil-Lubricated Norway: Regulation, Practice, Ethics and Incoherence* at 11, University of Oslo Faculty of Law Research Paper No. 2015-16, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2622072.
[111] 2006-2007 White Paper, *supra* note 98, at 22.
[112] *Id.*
[113] 2006-2007 White Paper, *supra* note 98, at 21.
[114] Dowling et al., *supra* note 89, at 35.
[115] 2013-2014 White Paper, *supra* note 91, at 65. The Norwegian state's principles of corporate governance (2014) are as follows: "1. All shareholders shall be treated equally; 2. There shall be transparency in the State's ownership of companies;3. Ownership decisions and resolutions shall be made at the general meeting; 4. The board is responsible for elaborating explicit objectives and strategies for the company within the constraints of its articles of association; the state sets performance targets for each company; 5. The capital structure of the company shall be appropriate given the objective and situation of the company; 6. The composition of the board shall be characterized by competence, capacity and diversity and shall reflect the distinctive characteristics of each company; 7. The board assumes executive responsibility for administration of the company, including performing an independent

Since 2006, the government has also issued guidelines on the remuneration of senior executives of SOEs, partly out of concern over a widening gap between the remuneration of senior employees and that of the rest of the workforce.[116] According to the 2015 version of the guidelines, which are applied on a "comply or explain" basis, executive salaries should be competitive (but not wage leading), the main element of compensation should be the fixed salary, and the use of stock options and similar arrangements is prohibited.[117] Norway's Code of Practice for Corporate Governance encourages stock ownership by board members, and the state takes a positive view of this strategy.[118]

Also starting in 2006, Norway implemented prior recommendations by the preparatory committee on state ownership to clarify the fundamental objectives served by state ownership in each case, with the objective of reducing uncertainty in capital markets and thus lowering financing costs. The committee proposed the classification of SOEs into four categories: (1) companies with commercial value maximization objectives; (2) companies with commercial value maximization objectives, and ensuring head-office functions in Norway; (3) companies with commercial value maximization objectives and other specific defined objectives; and (4) companies with sectoral policies objectives.[119] From the eight listed SOEs in Norway, six fall within category 2 (including Statoil, Telenor, and financial firm DNB), and two fall within category 1.[120] Categories 3 and 4 are composed exclusively of non-listed SOEs.

The 2010-2011 Report to the *Storting* highlighted the contribution of extensive state ownership to the success of the Norwegian economy, and the plan to strengthen the state's ownership administration.[121] More recently, however, the current Conservative administration has vowed to reduce the level of state ownership in the economy, despite the fact that "[i]n the government's assessment, the governance of direct state ownership is handled in a professional and responsible way."[122] The objective is to partially or fully divest companies in category 1, while maintaining at least 34% of stockholdings (enabling "negative control" through veto

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supervisory function vis-à-vis the company's management on behalf of the owners; 8. The board should adopt a plan for its own work, and work actively to develop its own competencies and evaluate its own activities; 9. Compensation and incentive schemes shall promote value creation within the companies and be generally regarded as reasonable; 10. The company shall work systematically to safeguard its corporate social responsibility."

[116] 2006-2007 White Paper, *supra* note 98, at 71.

[117] *Guidelines for remuneration of senior executives in companies with state ownership* (Adopted by the Ministry of Trade, Industry and Fisheries with effect from 13 February 2005, replacing the previous guidelines of 31 March 2001), https://www.regjeringen.no/contentassets/4391143c1f0a472faa0b3975e00e3c78/guidelines-for-remuneration.pdf.

[118] 2013-2014 White Paper, *supra* note 91, at 74.

[119] 2006-2007 White Paper, *supra* note 98, at 30.

[120] 2013-2014 White Paper, *supra* note 91, at 5.

[121] Norwegian Ministry of Trade and Industry, *Active Ownership: Norwegian State Ownership in a Global Economy*, Meld. St. 13 (2010–2011) Report to the Storting (white paper) Summary, https://www.regjeringen.no/globalassets/upload/nhd/statenseierberetning/pdf/engelsk/active_ownership_norwegian_state_ownership_in_a_global_economy.pdf.

[122] 2013-2014 White Paper, *supra* note 91, at 10.

rights) in companies within category 2.[123]

The government argues that three particular challenges associated with state ownership persist: (i) conflicts between ownership of companies and the state's other roles; (ii) the risk of a concentration of powers which weakens the private sector; and (iii) limitations in industry expertise. Specifically, the government has suggested that, notwithstanding effective governance arrangements, "[a]s long as the state has ownership interests, it is however effectively impossible for the state to be organised and to act in such a way as to prevent or discourage doubt being raised about its neutrality in exercising authority."[124] This initiative has already resulted in the IPO of Entra, a state-owned commercial real estate company, in 2013.

D. Colombia

State-owned firms are pervasive in Latin America, but the significance of listed SOEs to the respective local economies varies widely. Mexico, the only OECD country in the region and home to the national oil giant Pemex, has no listed SOEs.[125] Chile and Peru, regarded by the World Bank as the "regional frontrunners" in SOE governance reform,[126] boast a few listed SOEs, but they represent a comparatively small share of the trading and capitalization of their respective markets.[127] We will thus focus on Colombia and Brazil in the next two sections, jurisdictions in which state-controlled firms play an important role in the stock market and in the economy more generally, and that have made significant strides in reforming their system of SOE governance.

Until recently, Colombia had four listed SOEs (Ecopetrol, ETB, ISA and ISAGEN), which together accounted for over 15% of market capitalization and 50% of the total value of SOEs.[128] These firms went public in the 2000s but the government kept a stake of nearly 80% on average.[129] ISAGEN was since fully privatized in January 2016.[130]

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[123] *Id.* at 11.
[124] *Id.* at 41.
[125] OECD, *The Governance of Mixed-Ownership Enterprises in Latin America: Discussion Paper* (2012) (hereinafter "OECD Discussion Paper"), at 4, https://www.oecd.org/daf/ca/SecondMeetingLatinAmericanSOENetworkMixedOwnership.pdf.
[126] World Bank, *Corporate Governance of State-Owned Enterprises in Latin America: Current Trends and Country Cases* (2014) at 3, http://documents.worldbank.org/curated/en/2014/07/20183864/corporate-governance-state-owned-enterprises-latin-america-current-trends-country-cases. While the federal government is or was the controlling shareholder of Ecopetrol, ISA and ISAGEN, ETB is owned and controlled by the capital district of Bogotá).
[127] OECD Discussion Paper, *supra* note 125, at 4. Although Peru formally has 9 listed SOEs, almost all of them are either wholly owned by the state or lack meaningful trading activity.
[128] World Bank, *supra* note 126, at 96.
[129] OECD, *OECD Review of the Corporate Governance of State-Owned Enterprises: Colombia* (2015) at 23 (hereinafter "OECD Review"), http://www.oecd.org/daf/ca/OECD-Review-Corporate-Governance-SOE-Colombia.pdf.
[130] Ryan Dube & Daniela Ramirez, *Colombia Sells Stake in Power Generator Isagen to Canadian Investment Fund*, WALL ST. J., Jan. 13, 2016.

The main player in this context is national oil company Ecopetrol, which has been the largest listed company in Colombia, with a budget representing almost 7% of GDP and 20% of the government budget as of 2014.[131] A few years ago, the company made headlines when it overtook much bigger Petrobras as Latin America's largest oil company by market capitalization—a scenario at least partially motivated by perceptions about the quality of the institutional environment.[132] Recently, however, Ecopetrol's economic performance has faltered due to falling international oil prices. It has also been the subject of a corruption probe relating to the payment of bribes by a foreign company to secure a lucrative contract.[133]

Under Colombia's constitutional framework, the creation of SOEs, including mixed enterprises, must be authorized by statute. The constitution also provides that divestitures of state shareholdings should seek to democratize ownership, especially among workers.[134] Moreover, the Comptroller General's Office (CGR) exercises fiscal control over SOEs under the Constitution and Law 42 of 1993. Nevertheless, the OECD identified overly zealous oversight by the CGR as a potential problem, which has arguably deterred professional and independent board decision-making in the assumption of risks.[135]

Mixed enterprises in which the state holds less than 90% of the shares are generally subject to a private law regime.[136] While they may adopt any of the business types available under the Commercial Code, the corporation is usually the organization of choice. Listed SOEs are also subject to Colombia's Securities Market Law (Law 964 of 2005) and to its corporate governance code (Código País) on a "comply or explain" basis. Listed SOEs rank among the top companies in terms of implementation of Código País.[137]

Special Protections: Moreover, the Colombian state as a controlling shareholder has opted to grant additional protections to minority investors. In a practice that started with the IPO of energy company ISA in 2000, the government has signed Declarations as controlling shareholder committing to the adoption of certain governance safeguards that go beyond those required by law. For instance, under Ecopetrol's declaration, these protections include the right of minority shareholders to elect one independent director (out of 9 board members), as well as to seek a valuation by an investment bank appointed by the Bogotá Chamber of Commerce to determine the value of the shares in appraisal proceedings.[138] While the declaration is valid for

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[131] World Bank, *supra* note 126, at 96. Near the peak of its valuation, Ecopetrol alone accounted for over 46% of the local market capitalization in 2012. *See* OECD Review, *supra* note 129, at 23.
[132] Ed Crooks & Pan Kwan Yuk, *Ecopetrol overtakes Petrobras by market cap*, FINANCIAL TIMES, Jan. 27, 2013.
[133] U.S. Department of State, Colombia Investment Climate Statement (May 2015) at 18, http://www.state.gov/documents/organization/241730.pdf.
[134] Constitucion, Art. 60; Ley 226 de 1995, Art. 3.
[135] OECD Review, *supra* note 129, at 32.
[136] Código de Comercio de Colombia (Decreto 410 de 1971), Arts. 461 and 464.
[137] *See* OECD Review, *supra* note 129, at 36.
[138] Declaracion de la Nación en su Calidad de Accionista Mayoritario de Ecopetrol S.A. (Jul. 26, 2007), http://www.ecopetrol.com.co/documentos/40316_Declaracion_del_Accionista_Mayoritario_26-07-07.pdf.

an initial term of 10 years expiring in 2017, prior practice in other SOEs was to make these protections permanent by incorporating their content into the company's charter.[139]

Colombia's listed SOEs grant one vote per share. The board of directors appoints and removes the CEO in accordance with general corporate law. The boards of SOEs are comprised of a majority of independent directors,[140] a practice that exceeds the 25% threshold imposed by securities laws. Ecopetrol has traded its ADRs on the New York Stock Exchange since 2008, and is therefore also subject to regulatory oversight by the U.S. Securities and Exchange Commission. It used to trade ADRs on the Toronto Stock Exchange as well, but it voluntarily delisted from that exchange in 2016.[141]

The state has long employed Ecopetrol to subsidize the sale of fuel to consumers. In anticipation of the company's partial privatization in 2007, the government assumed responsibility for the price subsidies.[142] Under the current regulatory framework, Ecopetrol sells gasoline and diesel at a regulated price, but the government then reimburses the company for the subsidy.[143] Although there were initial delays in the early reimbursements,[144] this mechanism has apparently worked smoothly since, as Ecopetrol stopped mentioning the risk of such delays in its securities filings.

Until its financial condition deteriorated in recent times, Ecopetrol has practiced generous dividend payments. As a majority shareholder holding 88.49% of the shares, the state stood to gain from high dividends as a source of revenue, giving rise to suspicions of a short-term orientation on the part of the government. In fact, Ecopetrol's securities filings warned that the state as a controlling shareholder "may approve dividends at the ordinary general shareholders' meeting, notwithstanding the interest of minority shareholders, in an amount that results in us having to reduce our capital expenditures, thereby negatively affecting our prospects, results of operations and financial condition."[145]

International Recognition: The general assessment of the firm-level practices of Colombia's listed SOEs has been very positive. Observers have hailed Ecopetrol, together with

[139] *See* OECD Review, *supra* note 129, at 53.
[140] Consejo Nacional de Política Económica y Social, *Política general de propriedad de empresas estatales del orden nacional*, Documento CONPES 3851, Nov. 23, 2015, at 13.
[141] *See* http://www.ecopetrol.com.co/wps/portal/es/ecopetrol-web/nuestra-empresa/sala-de-prensa/boletines-de-prensa/Boletines/Boletines/Ecopetrol-deslistar-voluntariamente-Bolsa-Valores-Toronto.
[142] Helena Garcia Romero & Laura Calderon Etter, *The Political Economy of Fuel Subsidies in Colombia*, OECD Environmental Working Paper n. 61 (2013) 7.
[143] The subsidy is calculated as the "difference between the producer's regulated revenues and the parity price; the latter is equivalent to the opportunity cost of the local product or to the import cost of gas or ACPM at the U.S. Gulf Coast reference price." *See* Ecopetrol Form 20-F for the fiscal year ended December 31, 2014, at F-18 (hereinafter "Ecopetrol 2014 20-F").
[144] *See* Ecopetrol Form 20-F for the fiscal year ended December 31, 2008, at 9.
[145] Ecopetrol 2014 20-F, *supra* note 143, at 120.

the other listed SOEs in Colombia, as models of strong corporate governance.[146] The recent OECD review of governance practices of SOEs in Colombia underscores the prevailing opinion by Colombian experts that the three listed firms (including ISAGEN, not yet privatized in 2015) "are good examples of professional management and excellent corporate governance," a view that "is also borne out by the different awards they have received for good corporate governance" and "shared by public opinion in general."[147] Beyond the particular institutions, however, the OECD review also noted the perception that individual leadership played an important role in such success, singling out the contribution of Javier Gutiérrez as longtime CEO of ISA and later of Ecopetrol.[148]

While the OECD concluded that Colombian practices are "good examples" and "internationally recognized" when it comes to the equal treatment of shareholders or stakeholders' engagement, it identified a number of weaknesses in the exercise of the ownership function by the state.[149] By law, the exercise of the ownership function lies with the minister or head of department to which the company is linked.[150] Colombia has traditionally followed a decentralized model of SOE administration, with companies falling under the supervision of different ministries according to industry and regulatory affinity.[151] It is however common for certain SOEs to be owned by a certain ministry but regulated by another, which creates the potential for administrative conflicts.[152] Representation of ministers and government officials on SOE boards, including those of ISA and Ecopetrol, is also common.[153] According to the World Bank's report, some director and managerial appointments are made on the basis of political allegiance rather than technical competence.[154]

In anticipation of joining the OECD in 2017, Colombia has recently announced a plan to overhaul its system of SOE governance.[155] The goal is to strengthen the role of the state as shareholder by centralizing the ownership function, initially under the Finance Ministry as a pilot project, and starting in 2019 under a new dedicated national entity that will act as the shareholder of all SOEs. Colombia has also committed to developing a general policy that clarifies the

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[146] *See*, *e.g.*, Georgina Núñez & Andrés Oneto, *Corporate Governance in Brazil, Chile, Colombia, Mexico an Peru: The Determinants of Risk in Corporate Debt Issuance*, Economic Commission for Latin America and the Caribbean (ECLAC) Project Documents Collection (2015), http://www19.iadb.org/intal/intalcdi/PE/2015/15271.pdf ("Ecopetrol offers a unique example of a company that has succeeded in combining majority State ownership with solid corporate governance, instilling confidence in the market with respect to its corporate management"); Andrés Bernal et al., *Corporate Governance in Latin America: Importance for State-Owned Enterprises – SOEs*, Public Policy and Productive Transformation Series n. 6 (2002) at 28 (listing Ecopetrol and ISAGEN, together with Brazilian firms Petrobras and SABESP, as "successful listed SOEs" and "worldwide leaders").
[147] OECD Review, *supra* note 129, at 32.
[148] *Id.* at 32.-3.
[149] *Id.* at 81.
[150] Ley 489 de 1998, Art. 99.
[151] World Bank, *supra* note 126, at 30; OECD Review, *supra* note 129, at 24. *Id.* at 25.
[152] OECD Review, *supra* note 129, at 25.
[153] *Id.* at 25.
[154] World Bank, *supra* note 126, at 102.
[155] For a detailed description of the plan, *see* CONPES, *supra* note 140.

objectives of state ownership, communicating a clear mandate to firms, and to institutionalizing the mechanisms for selection and evaluation of board members.

In view of the goal of separating the roles of state as shareholder and regulator, Colombia will phase out the participation of ministers and other government officials on SOEs boards, starting with ISA and other non-listed SOEs. In light of Ecopetrol's importance to the Colombian economy, changes to its board practices will come last, in order to take advantage of the lessons learned with other SOEs. Finally, the government intends to publish a corporate governance code for SOEs.

E. Brazil

While Brazil had early experiments with state-owned corporations in the nineteenth century, it was in the second half of the twentieth century that SOEs witnessed a significant expansion. Since then, listed SOEs have played a key role in the Brazilian economy and capital markets. Mixed enterprises in which the state held a majority of the voting rights accounted for a staggering 70% of stock market capitalization in the 1970s, the decade in which most of the current legal framework went into effect.[156] Even after the wave of privatizations in the 1990s and the IPO boom for private firms of the 2000s, SOEs still accounted for roughly one-third of Brazil's stock market value in 2008.[157] As of 2015, this proportion was down to approximately 14%.[158] Yet the reduction was not due to a major retreat of state ownership during this period, but rather to the decline in the stock prices of SOEs in recent years—in no small measure due to governance problems, as described below.

Legal Framework. Like other jurisdictions, mixed enterprises in Brazil are subject to a combination of both public and private law constraints. Brazil's Constitution of 1988 conditions the direct undertaking of economic activity (other than general public services) by the state through SOEs on the existence of "national security imperatives" or "relevant national interest."[159] Mixed enterprises must be created by statute,[160] and are subject to oversight by *Tribunais de Contas*, an external body that has a constitutional mandate to control the government's activities and expenditures.[161] Brazil's Constitution requires mixed enterprises engaging in economic activity to be governed by the legal regime applicable to private firms, including as to civil, commercial, labor, and tax matters.[162] However, statutory law has from time to time exempted SOEs from bankruptcy laws, though the constitutionality of this special regime

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[156] *See* Mariana Pargendler, *The Unintended Consequences of State Ownership: The Brazilian Experience*, 13 THEORETICAL INQ. L. 503, 511 (2012) (hereinafter "The Unintended Consequences").
[157] Pargendler, *State Ownership*, *supra* note 39, at 2919.
[158] BM&FBOVESPA, SOE GOVERNANCE PROGRAM 3 (2015), http://www.bmfbovespa.com.br/lumis/portal/file/fileDownload.jsp?fileId=8A828D295048C0EF0150CE2C3F077741.
[159] Constitution of the Federative Republic of Brazil, Art. 173.
[160] *Id.*, Art. 37, XIX.
[161] *Id.*, Art. 71, III.
[162] *Id.*, Art. 173, II.

remains the object of debate.[163] There are also constitutional exceptions to the application of the general corporate regime, such as the requirement that the annual federal budget law include the investment budget of SOEs controlled by the federal government.[164]

Mixed enterprises in Brazil (*sociedades de economia mista*) must be organized as a *sociedade anônima* (business corporation) and have been largely governed by general corporate and securities laws, except to the extent to which their statutory corporate charters abrogate the standard private law regime. [165] Until the recent enactment of a special SOE statute in 2016 (as discussed below), Brazil's Corporations Law contained only a handful of specific provisions tailored to SOEs.[166] Brazilian law had long afforded minority board representation in SOEs—a mechanism that is currently prescribed by Brazil's constitution.[167] Shareholders in private firms are entitled to appraisal rights in case of a subsequent government taking of control.[168] Yet the most prominent and distinctive feature of the legal regime applicable to mixed enterprises in Brazil—which is unique among the jurisdictions examined in this Article—is the rule contained in Art. 238 of the Corporations Law (now reproduced in modified form in the new SOE statute[169]), which specifically provides that the legal entity controlling a mixed enterprise has the same rights and duties imposed on a controlling shareholder of a privately owned corporation, but "may steer company's activity in order to satisfy the public interest that justified its creation."

Beyond these special rules applicable to SOEs under majority state ownership, the interests of the state as a shareholder in mixed enterprises have also shaped the content of the general corporate law regime in Brazil. The strong stakeholder orientation of fiduciary duties under Brazilian law—which is especially accommodating to the interests of the state as a controlling shareholder—was conceived against the background of equity markets populated by SOEs.[170] However, the most conspicuous example of the influence of the state as shareholder in

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[163] *See*, for the most recent rule in this respect, Law 11,101 of 2005, Art. 2º, I.
[164] Art. 165, §5º, II.
[165] SOE charters have historically included various provisions that abrogate the standard legal regime. Some of these special provisions exacerbated the influence of the state, such by granting the President of Brazil the right to directly appoint the firm's chief executive. Other exceptions were protective of minority shareholders, for example, by granting them special board appointment rights. Petrobras, for instance, had such a system in place until the late 1990s.
[166] Lei No. 6.404, de 15 de Dezembro de 1976, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (hereinafter "LSA"), Art. 235 and § 1º. Subsidiaries of SOEs, however, were subject exclusively to general corporate laws. LSA, Art. 235, § 2º.
[167] Constitution of the Federative of Republic of Brazil, Art. 173, IV.
[168] LSA, Art. 236, sole paragraph.
[169] Lei No. 13.303, de 30 de junho de 2016, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 1º.7.2016 (hereinafter "SOE Statute"), Art. 4º, § 1º (providing that the legal entity that controls a mixed enterprise has the same duties and responsibilities of a controlling shareholder under the LSA, and "must exercise the power of control in the interest of the company, subject to the public interest that justified its creation").
[170] See, *e.g.*, LSA, Art. 117, § 1º, a (Braz.) (qualifying as abuse of control power the action of a controlling shareholder that "guides the company towards an objective that is foreign to its corporate purpose or damaging to national interest, or that leads it to favor another company, domestic or foreign, to the detriment of minority shareholder's participation in the profits or assets of the company, or the national economy") (emphasis added).

general corporate laws took place during the wave of privatizations in the 1990s, when a legal reform to the Corporations Law eliminated various minority shareholder rights in control transfers and spin-offs in order to facilitate privatizations and permit the appropriation of the entire control premium by the government as selling shareholder.[171] Although listed SOEs have populated Brazilian markets since the mid-twentieth century,[172] the federal and state governments have made various new issuances of SOEs' stock to the public in the late 1990s and 2000s. These included for the first time the issuance of ADRs traded on the New York Stock Exchange, hence subjecting these firms to U.S. securities laws and enforcement mechanisms.

Recent Governance Challenges. While Brazil's listed SOEs—and especially Petrobras—were hailed as models of good corporate governance and performance not long ago,[173] they have since entered a period of crisis, experiencing the full array of governance challenges plaguing mixed enterprises. First, listed SOEs have been at center stage of the main public corruption scandals of the last decade, such as the Congressional vote-buying scandal orchestrated by government officials ("mensalão"), which implicated Banco do Brasil, and the more recent and large-scale corruption charges involving Petrobras.[174]

Second, these firms have experienced a clear conflict between the social and political objectives of the government as a controlling shareholder, on the one hand, and the interests of outside investors in the firm, on the other. In the last few years, Brazilian SOEs have engaged in actions that were widely perceived as detrimental to the interests of the company and its private shareholders. The use of price controls by oil giant Petrobras and the renegotiation of concession contracts by power company Eletrobras illustrate the tendency to pursue objectives that are not in the financial interest of the firm.

Third, Brazilian SOEs also face problems that are not unique to state control, but common in private firms as well (and especially in companies with a controlling shareholder), such as engaging in related-party transactions that may harm minority investors.

Finally, the very definition (and legal treatment) of government *control* raises difficult questions in the Brazilian context. Like France, Brazil has increasingly relied on minority, rather than majority, stockholdings by the state. The prevalence of state-controlled institutional investors (such as pension funds of SOEs and BNDESPAR, the equity arm of Brazil's development bank) in the Brazilian stock market, as well as the widespread use of shareholder agreements by state actors, raise the specter of government intervention even in firms where the

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[171] For a discussion of the interests of the state in molding corporate laws in Brazil and beyond, *see* Pargendler, *State Ownership and Corporate Governance*, *supra* note 39; Pargendler, *The Unintended Consequences*, *supra* note 156.
[172] The international literature, however, has inaccurately depicted the rise of listed SOEs in Brazil as a strategy first initiated in the last two decades. *See*, *e.g.*, WORLD BANK, *supra* note 4, at 44; Flores-Macias & Musacchio, *supra* note 4.
[173] *See* note 4 *supra* and accompanying text.
[174] *See* notes 6-7 *supra* and accompanying text.

government does not directly hold a majority of the voting capital.[175] However, the special legal regime applicable to SOEs under the Brazilian constitution, the Corporations Law and the new SOE statute apply exclusively to mixed enterprises in which the state holds a majority of the voting stock. Despite the significant governance clout of the state as a minority shareholder, these firms continue to be governed by the private legal regime alone, without commensurate mechanisms of public oversight.[176]

Reform Initiatives. Recently, both private sector and legislative initiatives have emerged in an attempt to restore the confidence of investors and society in listed SOEs. In 2015, BM&FBovespa launched its SOE Governance Program, which appears to be the first initiative in which a stock exchange provides a governance platform specifically tailored to listed SOEs. The Program follows the exchange's successful experience with the Novo Mercado, a premium corporate governance listing segment, in fostering governance reform and attracting investor confidence without legislative or regulatory change.[177]

Like the Novo Mercado and the other premium corporate governance segments, participation in the SOE Governance Program, requiring adherence to stricter corporate governance rules, is voluntary. The program, which contains 25 corporate governance requirements, reflects four lines of action: (i) disclosure and transparency, (ii) internal control structures and practices, (iii) composition of boards and management, and (iv) commitment of the government shareholder to include in the state's code of conduct rules concerning the protection of inside information and the disclosure of nonpublic information. Under the Program, BM&FBovespa will grant certification in Category 1 to SOEs complying with all of the 25 corporate governance requirements of the Program. Category 2 is reserved to companies that comply with six mandatory requirements while earning a total of at least 27 points (out of 37) by adopting some of the remaining corporate governance rules, weighted based on their importance.[178] However, in contrast to the Novo Mercado and the other premium listing segments, the SOE Governance Program is not a listing regime, and therefore does not impose

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[175] Mariana Pargendler, *Governing State Capitalism: The Case of Brazil*, *in* REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM (Benjamin H. Liebman & Curtis J. Milhaupt eds. 2015) (hereinafter "Governing State Capitalism").

[176] *Id.*

[177] For a discussion of the Novo Mercado experiment, see Ronald J. Gilson, Henry Hansmann & Mariana Pargendler, *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States and the European Union*, 63 STAN. L. REV. 475 (2011)

[178] The six core requirements which form the core of the program are: (i) enhanced disclosure in securities filings, especially with respect to the SOEs' actions in enforcing public policies and their impact on the company's financial performance; (ii) establishment of a Compliance & Risk Department; (iii) existence of an Internal Auditing Department and a Statutory Audit Committee, under independent leadership and comprised of a majority of independent members; (iv) enactment of a policy on related-party transactions, which shall provide, among other things, for the analysis by an independent corporate body); (v) determination of minimum criteria for the composition of the board of directors (*conselho de administração*), the board of officers (*diretoria*) and the board of supervisors (*conselho fiscal*), including limitations on the appointment of political appointees and a ban on the appointment of representatives of the SOE's regulator, directors of political parties and holders of elective office; and (vi) compliance with the requirements for the appointment of managers.

any sanctions for noncompliance beyond the loss of certification. Since SOEs may withdraw from the Program at any time, the only potential sanctions for noncompliance or withdrawal are reputational in nature, which significantly weakens the promise of the program as a credible commitment device. To date, the Program has yet to attract its first member, though certain SOEs are said to be considering adoption.

More broadly, in 2016 Brazil enacted a statute providing for a special legal regime for public and mixed enterprises,[179] as required by a 1998 constitutional amendment.[180] The statute imposes a number of new governance rules on SOEs, some of which partially overlap with the SOE Governance Program. First, the statute enhances disclosure requirements for SOEs, including the obligation to spell out the SOE's public policy objectives and to quantify the financial consequences of pursuing such objectives in an annual letter. SOEs must also produce and disclose a related-party transactions policy, as well as formulate a dividends policy in view of the public interest that justified its creation. Second, the statute mandates the adoption of internal control systems that include an internal audit and a permanent audit committee, the establishment of a risk and compliance unit, as well as practices that preserve the independence of the board of directors in the exercise of its functions. Third, the statute contains numerous rules on board composition. It sets forth minimum qualifications for and restrictions on the appointment of directors and officers.[181] A minimum of 25% of the board must be comprised of independent directors (including minority shareholder representatives), or at least one independent director if shareholders opt for cumulative voting. It also limits the remunerated participation of government officials to a maximum of two board memberships in SOEs. Finally, the statute attempts to define the social function of SOEs.[182]

[179] Lei No. 13.303, de 30 de junho de 2016.

[180] Brazilian Constitution, Art. 173, § 1º.

[181] In addition to mandating several years of experience in government or the private sector in the same or related area in which the SOE operates, the statute includes a long list of individuals who may not serve as directors or officers, including ministers and secretaries of state, regulators, legislators, leaders of political parties, union leaders, and contractual counterparties of the SOE. The experience requirements, however, may be overly rigid, and may detract from the objective of promoting strong, independent and diverse boards.

[182] *Id.*, Art. 27 . Art. 27 provides as follows: The public enterprise and the mixed enterprise will have the social function of fulfilling the collective objective or serving the national security imperative defined in the legal instrument of its creation. § 1º. The fulfillment of the collective interest addressed by this article must be geared towards the achievement of economic welfare and the socially efficient allocation of resources administered by the public enterprise and the mixed enterprise, as well as toward the following: I – the economically sustainable expansion of consumer access to the products and services of the public enterprise and mixed enterprise; II – the development or utilization of Brazilian technology for the production and supply of products and services by the public enterprise and the mixed enterprise, always in an economically justifiable manner. § 2º The public enterprise and the mixed enterprise must, as dictated by statute, adopt practices of environmental sustainability and corporate social responsibility that are compatible with the market in which they operate. § 3º. The public enterprise and mixed enterprise may enter into a sponsoring agreement or contract with a natural or legal person for the promotion of cultural, social, sports, educational, and technological innovation activities, provided that they are proved to be linked to the strengthening of its brand, in compliance, as applicable, with the rules on procurement and contracts of this Law.

Exercise of the Ownership Function. Beyond the reforms of the governance framework applicable at the firm level, Brazil has always witnessed recent changes to the government bodies in charge of overseeing SOEs and exercising shareholder rights. While SOEs in Brazil are formally linked to the ministry with jurisdiction over their market activity, they are also subject to different forms of centralized oversight and control. In 1979, the government created the Secretariat of Control of State-Owned Enterprises (*Secretaria de Controle de Empresas Estatais*—SEST), under the Ministry of Planning, with the aim of gathering information on SOEs and enabling the government to exercise greater control over their budget and management in a time of international crisis. In 1999, in the aftermath of the wave of privatizations, SEST lost its status as Secretariat and became the Department of Coordination and Control of State-Owned Enterprises (*Departamento de Coordenação e Controle das Empresas Estatais*—DEST).

More recently, there have been two changes to this structure. In 2007, the federal government instituted the Interministerial Commission of Corporate Governance and Administration of the Federal Government's Shareholdings (*Comissão Comissão Interministerial de Governança Corporativa e de Administração de Participações Societárias da União*—CGPAR), with the goal of tackling strategic and corporate governance issues relating to federal SOEs. In July 2016, the government transformed DEST into the Secretariat of Coordination and Governance of State-Owned Enterprises (*Secretaria de Coordenação e Governança das Empresas Estatais*—SEST), with a view toward strengthening their governance and monitoring, and possibly paving the way for future privatizations. While it is too early to assess the end results of these changes, Brazil continues to lack full centralization of the state's shareholding function in the form observed in some other countries, with the relevant line ministries continuing to play an important role in the SOEs' governance and management.

F. Japan

In Japan, "special public corporations" (*tokushu hojin*) are used to deliver government services or operate a monopoly. These enterprises, whose shares are wholly owned by the Ministry of Finance, are not subject to the corporate laws that govern private corporations; rather, their establishment, governance structure and operations are regulated by special laws subjecting them to oversight by specified government ministries.[183] "Privatization" in the Japanese context first entails converting special public corporations into regular joint stock corporations governed by the Companies Act so that their shares can be offered to the public.[184] Mixed ownership enterprises in Japan are the result of the distinctively gradual process of privatization in that country.

[183] KOICHIRO FUKUI, JAPANESE NATIONAL RAILWAYS PRIVATIZATION STUDY 6 (1992).
[184] If the government continues to hold a portion of the shares even after shares are offered to the public, in addition to the Companies Act, the corporation will still be subject to the special law that specified its permitted activities and governance features prior to the privatization effort. (In 2005, Japan removed the company law provisions from the Commercial Code and created a stand-alone Companies Act. Privatizations taking place before 2005 thus involved subjecting the newly created corporations to the Commercial Code. For simplicity, in this narrative we refer only to the Companies Act).

Privatization of special public corporations in Japan has come in two waves. The first, influenced by the Thatcher Revolution in Britain, was launched by Prime Minister Yasuhiro Nakasone in the 1980s in response to a national debt crisis. Large-scale privatizations of three special public corporations were initiated in this era: Nippon Telegraph and Telephone Public Corporation (NTT), Japan Tobacco & Salt Public Corporation, and Japan National Railways (JNR). The second major privatization push, for financial institutions affiliated with Japan Post, was undertaken by reformist Prime Minister Junichiro Koizumi in 2005, but for political reasons shares were only offered to the public for the first time in 2015. An exploration of these privatizations provides a window onto some distinctive features of Japan's approach to privatization and post-privatization governance of enterprises still partially owned by the government.

JNR: The railway industry in Japan was nationalized in 1906. In 1949, Japan National Railway (JNR) was created under the U.S. occupation as a special public corporation to manage all railway operations in the country.[185] Under the Japan National Railway Law, JNR received appropriations from the Diet (legislature). Discretion in the use of funds was left to JNR's managers, but the governance structure mandated by the law provided an avenue for government control over managerial decisions.[186] In response to a massive build-up of debt in JNR and a government-wide debt crisis, in 1981 a Provisional Committee on Administrative Reform appointed by the Prime Minister recommended the privatization of JNR, together with that of NTT and Japan Tobacco. With respect to JNR, the committee recommended not only privatization but also division of the company into several smaller, regional (JR) companies that would be more manageable and tailored to local conditions, as well as one freight railway company operating throughout the country. After five years of preparation and planning, the JNR Restructuring Act was enacted on the premise that the JR companies would be completely privatized. The law changed the mission of the companies from "improving the welfare of the general public" to "responding to market needs and effective management."[187]

In the first step of the corporatization process, the JR companies were formed as wholly owned subsidiaries of a newly established and government-owned JNR Settlement Corporation (JNRSC), which took on the debt of JNR. JNRSC began to sell shares in the JR companies in the early 1990s. In 1998, the JNRSC was dissolved and the Japan Railway Construction Public Corporation was formed to settle the remaining obligations of the JNRSC.[188] Sale of shares in three JR regional companies was completed in the early 2000s. Shares in four JR companies with less attractive assets and railway routes remain wholly owned by the government, although

[185] YOSHIYUKI KASAI, JAPANESE NATIONAL RAILWAYS: ITS BREAK-UP AND PRIVATIZATION 3 (Nozomu Nakaoka & Christopher P. Hood trans., 2003).
[186] The Cabinet appointed a governor to chair the board of directors; the governor in turn appointed the remainder of the board with the approval of the Minister of Transportation. The Minister of Transportation appointed the members of the board of audit. FUKUI, *supra* note 183, at 6-7.
[187] TATSUJIRO ISHIKAWA & MITSUHIDE IMASHIRO, THE PRIVATISATION OF JAPANESE NATIONAL RAILWAYS 2 (1998).
[188] *East Japan Railway Company History*, FUNDING UNIVERSE, http://www.fundinguniverse.com/company-histories/east-japan-railway-company-history/ (last visited June 19, 2016).

privatization of one of these companies is planned for the near future. When the JR companies were initially corporatized, important matters required approval from the Minister of Land, Infrastructure, Transport and Tourism, including the selection of the CEO and corporate auditors, issuance of stock and bonds, long-term borrowing, business plans, sales of important assets, and revision of articles of incorporation.[189] The four companies that are still government owned retain these restrictions, but they no longer apply to the JR companies that have been fully privatized. The privatized JR companies have a standard Japanese corporate governance structure provided for by the Companies Act, consisting of a board of directors (with a number of independent directors[190] that exceeds Japanese legal requirements), and a separate board of corporate auditors (*kansayaku*) comprised of a majority of independent auditors, also in excess of the legal requirement.[191]

There is widespread agreement that the privatization of JNR and regional division of the resulting firms has been highly successful.[192] Dividing JNR into regional companies promoted business policies tailored to specific local markets. A new corporate culture promoted profitability, while deregulation allowed for more cost-effective policies. Moreover, perhaps most significantly, the new companies were relieved of the massive debt burden that had weighed down JNR.

NTT and Japan Tobacco: In contrast to the strategy of complete (if very gradual) privatization of the railway system, the privatization of the other two special public corporations launched in the 1980s, NTT and Japan Tobacco, was by design only partial. Until 1986, the Japanese government owned 100% of the shares of NTT. Through a series of share offerings taking place over a long period of time, the government's ownership of shares gradually fell to its current level of about 35%. Under the NTT Act of 1984, enacted as part of the privatization process, the government is required to retain at least one-third of the shares of NTT Corporation, the holding company for several regional NTTs.[193] In 1997, the government stated before the Diet that it did not intend to actively use its position as a shareholder to direct the management of

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[189] FUKUI, *supra* note 183, at 65.

[190] Technically, the requirements of Japan's Companies Act are framed in terms of "outside" rather than "independent" directors and auditors, with the former classification being defined in somewhat less demanding fashion than the latter. Some Japanese firms thus describe a specific member of the board as an "independent outside director." This distinction is not significant for the purposes of our analysis, so we simply use the term "independent."

[191] JR East has a board of 17 directors, 3 of which are independent, and a five-member board of corporate audit, 4 of which are independent. East Japan Railway Co., Annual Report 57 (2015). JR Central has 16 directors (3 independent) and 5 corporate auditors (3 independent). Central Japan Railway Co., Annual Report 30 (2015). JR West has 14 directors (5 independent) and 4 auditors (3 independent). West Japan Railway Co., Annual Report 42 (2015).

[192] *See, e.g.*, FUKUI, *supra* note 183, at 91; KASAI, *supra* note 185, at 160.

[193] Law Concerning Nippon Telegraph and Telephone Corporation, Etc., Law No. 85 of December 25, 1984, as last amended by Law. No. 87 of July 26, 2005, http://www.soumu.go.jp/main_sosiki/joho_tsushin/eng/Resources/laws/NTTLaw.htm.

NTT, and in fact, the government has not historically used its power to do so.[194] Nonetheless, the government retains significant control rights in the firm wholly apart from its status as a shareholder, as the NTT Act requires approval of the Minister of Posts and Telecommunications (subsequently restructured and renamed the Ministry of Internal Affairs and Communications) with respect to the appointment or dismissal of directors or corporate auditors, and submission of the business plans of the regional subsidiaries of NTT to the Minister.[195]

The privatization plan for Japan Tobacco was similarly designed to be only partial. The Japan Tobacco Act established a new corporation, JT, as a joint stock corporation subject to the Companies Act.[196] The JT Act provides that the Japanese government must continue to hold one-third of JT's issued shares, except for shares that have no voting rights.[197] The Act also provides that issuance of new shares and a variety of other important matters, including the appointment or dismissal of directors and corporate auditors, requires the approval of the Minister of Finance.[198] The current chairman of the board of JT is a former senior official of the Ministry of Finance, and there is a long history of personnel connections between the ministry and JT.[199]

As noted, by law the Japanese government retains significant share ownership and governance rights in both NTT and JT. It is not entirely clear why retention of some level of government ownership of telecommunications and tobacco was legally mandated while railways were slated for complete privatization.[200] Regardless of the reason, while the government's retention of the *potential* to control post-privatization NTT and JT is of course not without significance, there is no evidence that either of these companies has pursued non-commercial objectives at the behest of political actors or subjected public shareholders to transactions that extract corporate value to the benefit of the government or other government-favored interests. However, at least with respect to tobacco, it has been argued that the reverse phenomenon has occurred: namely, that the significant level of ongoing government ownership in the tobacco industry has reduced the government's incentives to regulate smoking more aggressively in the interests of public health.[201]

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[194] NTT Form 20-F (2009), at 15, https://www.sec.gov/Archives/edgar/data/769594/000119312509141360/d20f.htm.

[195] YOSHIRO TAKANO, NIPPON TELEGRAPH AND TELEPHONE PRIVATIZATION STUDY 18 (1992).

[196] Japan Tobacco Inc. Annual Report FY 2014, The Japan Tobacco Inc. Act at 142, https://www.jt.com/investors/results/annual_report/pdf/annual.fy2014_E_all.pdf.

[197] *Id.* at 51.

[198] *Id.*

[199] Mark A. Levin, *Smoke around the Rising Sun: An American Look at Tobacco Regulation in Japan*, 8 STAN. L & POL. REV. 99 (1997).

[200] Maintaining some level of government ownership was probably a means of dealing with political opposition to privatization of these industries, and a reflection of the perceived public interest of these industries. While the same may have been true of the railway business, JNR was in sufficiently dire economic straits that complete privatization and re-organization along regional lines may have seemed like the only alternative. See Hiromi Tamamura, *The Actual State and Effect of Privatization in Japan*, undated working paper at 4-5, http://www.jftc.go.jp/eacpf/03/privatization.pdf.

[201] *See* Levin, *supra* note 167.

Japan Post: The second privatization wave, initiated in the mid-2000s, centered on financial services provided by Japan's extensive network of post offices. The government established postal operations and a postal savings system in the 1870s and a postal life insurance system in 1916.[202] A Ministry of Communications, formed in 1885 to run these enterprises, was superseded in 1949 by the Ministry of Posts and Telecommunications.[203] Through the postal savings system, the Japanese government is one of the largest holders of private assets in the world. In 2000, shortly before plans for privatization were first developed, the postal savings system held 260 trillion yen, about 40% of all Japanese household savings.[204] Profits from the postal savings and insurance system accrue to the Fiscal Investment and Loan Program (FILP), which is managed by the Financial Bureau within the Ministry of Finance. FILP (often referred to as the "second budget") provides funding for public works projects and local governments.[205] This renders postal finance privatization a highly fraught political topic in Japan. As with the privatizations of JNR, NTT and JT, the process began with the formation by the Prime Minister of a council to evaluate the benefits of privatization and the plan for carrying it out. Koizumi's effort to privatize the postal savings and insurance system was motivated by criticism of FILP as a font of mismanagement and pork barrel politics.[206] Privatization proponents also argued that moving the enormous assets of the postal finance system from the government's balance sheet into the private sector would boost Japan's struggling financial industry.

In 2003, the government established the Japan Post Corporation to manage the three services of postal operations, banking, and insurance. In 2005, the Diet passed the Postal Service Privatization Act, which abolished the Japan Post Corporation and established Japan Post Holdings (JPH), a holding company owned by the government, with four subsidiaries: Japan Post Bank, Japan Post Insurance, Japan Post Service, and Japan Post Network. Assets and operations of Japan Post Corporation were divided among the four subsidiaries. The original law required the government to reduce its ownership interest in JPH to one-third "as soon as possible." It also required JPH to sell its entire interest in Japan Post Bank and Japan Post Insurance by 2017. The two subsidiaries that operate the post offices and postal delivery service were to remain wholly owned by JPH.[207]

Due to a change of government in Japan, Koizumi's privatization plan stalled after he left office. However, following the earthquake and nuclear disaster affecting the Fukushima area in 2011, plans for privatization of Japan Post were resuscitated to raise funds for the rebuilding effort, and in fact $4 billion of proceeds from the offering has been earmarked for reconstruction.

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[202] Thus, in addition to offering standard postal services, post offices in Japan provide customers the opportunity to deposit savings and to purchase various types of insurance policies and annuities.
[203] Japan Post Holdings Co., Ltd., Offering of 495,000,000 Shares of Common Stock 93 (Oct. 26, 2015).
[204] NOBUYUKI KINOSHITA, THE ECONOMICS OF JAPAN'S POSTAL SERVICES PRIVATIZATION 6 (2008).
[205] *Id*. at 4.
[206] Patricia L. Maclachlan, *Two Steps Forward, One Step Back: Japanese Postal Privatization as a Window on Political and Policymaking Change*, *in* POLITICAL CHANGE IN JAPAN 157, 165 (Steven R. Reed, Kenneth Mori McElwain & Kay Shimizu eds., 2009).
[207] KINOSHITA, *supra* note 204, at 17.

The new framework called for disposing of all shares in Japan Post Bank and Japan Post Insurance "as soon as possible" rather than the original deadline of 2017.[208] The two postal service subsidiaries were combined into a single entity, Japan Post Co., which will remain wholly owned by JPH.[209] In an initial public offering in the fall of 2015, the government sold 11% of its shares in JPH, and 11% of JPH's shares in both Japan Post Bank and Japan Post Insurance. All three offerings were popular with Japanese retail investors.[210] Under the privatization law, the government will gradually sell shares in JPH until its ownership interest falls to one-third, and to gradually dispose of all of its shares in JPB and JPI, although the legislation does not set out a timeframe for these sales.

In contrast to the traditional Japanese corporate governance structure adopted by NTT, JT and the JR companies, the Japan Post privatization has utilized a board structure option that was not available at the time of the earlier privatizations. Under the Companies Act, firms selecting this new board option eliminate the board of corporate audit and establish three mandatory committees of the board of directors (Audit, Compensation, and Nomination), each comprised of a majority of independent directors.[211] JPH has a board of 15 directors, 10 of which are independent—well above the two independent directors recommended by the Japanese Corporate Governance Code. In addition to the statutorily required committees, JPH established an Executive Committee responsible for overseeing management decisions and advising the President and CEO.[212] Japan Post Bank and Japan Post Insurance have the same corporate governance structure.[213]

Although as noted, the initial public offering was considered highly successful, the privatization of Japan Post has drawn some criticism for the vagueness of its timetable, and the success of the resulting companies is not without some doubt.[214] There are statutory constraints on the businesses of the financial subsidiaries to limit their ability to compete with other financial institutions, a legacy of their government ownership. For example, Japan Post Bank is not allowed to offer many standard types of loans such as home mortgages, while Japan Post, which will remain a wholly owned subsidiary of the holding company, is required to maintain post offices in every locality in Japan without regard to profitability.[215] Another potential problem is a divergence of interests between the public shareholders and the government, and

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[208] Passage of the Amendment to Postal Privatization Law, House of Councilors (Upper House) of the National Diet of Japan, at 6, http://www.sangiin.go.jp/japanese/annai/chousa/rippou_chousa/backnumber/2012pdf/20120904003.pdf.
[209] Japan Post Holdings Co., Ltd., *supra* note 203, at 94.
[210] Atsuko Fukase, *Japan Post and Financial Units Soar in Trading Debuts*, WALL ST. J., Nov. 4, 2015, http://www.wsj.com/articles/japan-post-and-financial-units-soar-in-trading-debut-1446600123.
[211] On the committee structure, see Ronald J. Gilson & Curtis J. Milhaupt, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, 53 AM. J. COMP. L. 343 (2005).
[212] Japan Post Holdings Co., Ltd., *supra* note 203, at 314.
[213] Japan Post Bank Co., Ltd., Annual Report 18 (2015); Japan Post Ins., Co. Ltd., Annual Report 32 (2015).
[214] Editorial, *Japan Post's Murky Privatization*, THE JAPAN TIMES, Oct. 30, 2015, http://www.japantimes.co.jp/opinion/2015/10/30/editorials/japan-posts-murky-privatization/#.V5Mfvflf_fBI.
[215] Fukase, *supra* note 210.

between shareholders of the holding company and those of its subsidiaries.[216] Due to the recent and small-scale nature of the initial public offering, it may be many years before the success of the Japan Post privatization plan can be fully assessed.

As these episodes reveal, privatization in Japan is characterized by a highly deliberate, gradual process. In each case, a committee outside the formal government bureaucracy was established to formulate a privatization plan. This had the benefit of insulating the process from the vicissitudes of politics to the extent possible, so that the results were effective and the burdens of privatization were fairly distributed.[217]Although privatization of special public corporations in Japan has been partial rather than complete, post-privatization governance has not been plagued by political interference or extraction of wealth from public shareholders. It should be noted, however, that this benign outcome appears to be the result of healthy forbearance on the part of the Japanese government rather than an inevitable consequence of robust institutional design: the continued application of special laws governing mixed ownership corporations provides an avenue for government interference, if it chose to do so. At least under conditions of relatively clean and responsible government, privatization in Japan appears to demonstrate the viability of prolonged, partial government ownership as an alternative to the polar extremes of state and private ownership. As practiced in Japan, while not completely problem-free, this approach appears to be effective in improving management and profitability while retaining some level of potential government control over the provision of services deemed important to public welfare.

G. Singapore

Since its independence from Malaysia and the withdrawal of the British military, Singapore’s economic development strategy has relied heavily on what are known in that country as government-linked companies (GLCs). The GLC-centered strategy, developed in the 1960s, grew out of “the ruling PAP [People’s Action Party] government’s perceived need to support the transformation of the Singapore economy,” based on the conclusion that “control over key domestic markets and institutions [was] the most effective way to … meet the main planning objectives of absorbing surplus labour and promoting economic growth.”[218] As has been the case in China for the past several decades, political legitimacy of the ruling PAP in Singapore is strongly tied to successful economic development.

Shares of Singapore’s GLCs are held by Temasek Holdings Pte Ltd (Temasek), which was formed in 1974 as a wholly owned subsidiary of the Ministry of Finance (MOF). Temasek

[216] Japan Post Holdings Co., Ltd., *supra* note 203, at 68.
[217] FUKUI, *supra* note 183, at 128.
[218] Cheng Han Tan, Daniel Puchniak & Umakanth Varottil, *State-Owned Enterprises in Singapore: Historical Insights into a Potential Model for Reform*, NUS Working Paper 2015/003.

is an exempt private[219] investment holding company governed by the provisions of the Singapore Company Act. The government interposed a holding company between itself and the GLCs in the hopes of insulating the latter from political influence and to reinforce their commercial orientation.[220] Upon its establishment, Temasek took control of a number of companies that had been held by other government bodies. These companies had already been formed into groups by the government in order to foster national champions, an approach that China would later replicate with its national SOEs. Thus, each of the companies in Temasek's portfolio is the head of its own corporate group with numerous affiliated companies.[221] Today, Temasek is the controlling shareholder of 23 of Singapore's largest companies, which collectively account for almost 40% of Singapore's total market capitalization.[222]

Temasek has two closely related defining features that distinguish it from China's State-owned Assets Supervision and Administration Commission, which will be discussed in the following section: (1) an unambiguously commercial orientation articulated in public documents and verified by its performance; and (2) a high degree of independence from direct political influence over the companies in its portfolio.

Commercial orientation: Temasek refers to itself as an active investor and steward of state assets. This claim is backed up by its performance: It has achieved a total shareholder return of 16% compounded annually since its inception in 1974. Temasek uses various devices to increase its financial discipline, such as issuing bonds (rated AAA by Standard & Poor's) and using market benchmarks to structure incentive compensation for its managers. These performance incentives are deferred over a number of years and subject to clawbacks.

Independence: Temasek's board of directors is highly professional and non-political in its orientation. The thirteen-member board (expanded from ten in January 2015) is presently comprised of a majority of independent, private-sector directors, three of whom are non-Singapore nationals, including Robert Zoellick, former president of the World Bank, and Peter Voser, former CEO of Royal Dutch Shell. There is no ministerial representative on the board. It is also interesting to note that approximately 40% of the staff of Temasek is comprised of non-Singapore nationals, whose political allegiances likely have little bearing on their motivations and performance.

To mitigate the risk that the GLCs will be politically rather than commercially driven, the Singapore government has "constructed a highly visible and well-tailored regulatory regime,

[219] This is a company with no more than 20 shareholders and no corporate shareholders. It is exempt from filing audited financial statements with the public registry. As discussed below, however, since 2004 Temasek has made public its Group Financial Summary and portfolio performance.
[220] FAQs: Why was Temasek Established? Temasek, http://ww.temasek.com/sg/abouttemasek/faqs#.
[221] Grant Kirkpatrick, Managing State Assets to Achieve Developmental Goals: The Case of Singapore and Other Countries in the Regions, OECD Workshop on State-Owned Enterprises in the Development Process (2014).
[222] Tan et al., *supra* note 218.

which aims to prevent the government from abusing its position as the ultimate controlling shareholder of" the GLCs.[223] This regulatory regime has multiple, complementary components.

First, a variety of legal constraints are imposed on MOF's rights as a shareholder. For example, the Singapore Constitution provides that MOF's appointment, reappointment or removal of Temasek directors must be approved by the President of Singapore.[224] (The President is the head of state, who cannot be a member of a political party at the time of his or her election and may not have served in the government for at least 3 years prior to his/her election). Moreover, Temasek's Articles of Incorporation provide that its board of directors (not MOF as the controlling shareholder) has authority to determine the amount of dividends to be paid to the government.

Second, restrictions are placed on Temasek's board to minimize the potential for politically motivated intervention. As a so-called Fifth Schedule entity—a constitutional designation signifying that it is a key government company—the board is accountable to the President of Singapore to demonstrate that the disposition of an investment is done at fair market value, and the President must approve of a drawdown of accumulated reserves.[225] In addition, Temasek's own public corporate governance policy statement, called the Temasek Charter, places voluntary restrictions on its involvement in portfolio companies. It is worth quoting the investment section of the Charter in full[226]:

- Temasek is an investment company. We own and manage our assets based on commercial principles.

- As an active investor, we shape our portfolio by increasing, holding or decreasing our investment holdings. These actions are driven by a set of commercial principles to create and maximize risk-adjusted returns over the long term.

- As an engaged shareholder, we promote sound corporate governance in our portfolio companies. This includes the formation of high caliber, experienced and diverse boards.

- Our portfolio companies are guided and managed by their respective boards and management; we do not direct their business decisions or operations.

- Similarly, our investment, divestment and other business decisions are directed by our Board and management. Neither the President of Singapore nor our shareholder, the Singapore Government, is involved in our business decisions.

Temasek's public statements also emphasize the consultative nature of its interactions with its portfolio firms: "We identify value creation opportunities within our investee companies

[223] Dan W. Puchniak & Luh Luh Lan, *Independent Directors in Singapore: Puzzling Compliance Requiring Explanation*, NUS Working Paper 015/006, at 37 (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2604067.
[224] Constitution of the Republic of Singapore, Arts. 22A, 22C.
[225] *Id.*, Art. 22B.
[226] Temasek Review (2015), http://www.temasekreview.com.sg/overview/the-temasek-charter.html.

and engage with the boards and management to share our perspective, as appropriate, for their consideration."[227] In view of its investment orientation and approach to its portfolio firms, commentators have suggested that Temasek is akin to an engaged pension fund – promoting good corporate governance and actively voting its shares, but not becoming directly involved in management.[228]

Finally, although Temasek is legally exempt from public reporting requirements, it has chosen to publish detailed disclosures of its portfolio and performance, and subjects its financial statements to annual audits by an international audit firm. As a result, Temasek is often viewed as setting the "gold standard" for transparency by a government-owned investment fund, receiving the highest possible rating in the Linaburg-Maduell Transparency Index.[229]

An additional form of protection for the commercial orientation and political independence of Singapore's GLC infrastructure is extensive reliance upon independent directors. The listed GLCs in Temasek's portfolio are subject to Singapore's Code of Corporate Governance, which sets out best practices for public companies on a "comply or explain" basis. The Code provides that at least one third of the board of a listed company should be independent, increasing to one half in companies where the chairman is not independent of management. As previously noted, a majority of Temasek's board is comprised of independent directors. In addition, Temasek splits the positions of CEO and Chairman, with the Chairman being a non-executive director independent of Temasek's management. Temasek also promotes the independence of the boards of its GLC portfolio firms. Recent research indicates that 65% of the directors at the GLCs in Temasek's portfolio are identified as "independent."[230] The authors of this study, who examined the publicly available biographical information of every director identified as independent, concluded that they are "generally highly skilled, prominent figures in the Singapore business community who appear to be independent from the management of their respective Government-Linked Companies."[231]

Notwithstanding all of these safeguards, it may be inaccurate to conclude that Temasek and the GLCs are entirely free from political influence. Temasek's current CEO is the daughter-in-law of modern Singapore's founding father Lee Kwan Yew. Members of the boards of both Temasek and its portfolio companies have historically been drawn from Singaporean civil service and the military. Even today, the managers of Temasek's portfolio firms are chosen from the "ruling strata of Singapore. As a result, there [is] widespread agreement about the developmental objectives of the government, which has remained in the hands of the People's

[227] Temasek Review (2015), http://www.temasekreview.com.sg/investor/as-an-active-investor.html.
[228] Puchniak & Lan, *supra* note 223, at 38-39.
[229] http://www.swfinstitute.org/statistics-research/linaburg-maduell-transparency-index/. Norway's sovereign wealth fund GPFG and the Alaska fund also achieved the highest rating.
[230] Puchniak & Lan, *supra* note 223, at 41.
[231] *Id*.

Action Party since independence."[232] Consistent with this view, 50% of the 148 directors in the portfolio GLCs identified as independent currently hold or previously held positions in the Singapore government and/or government bodies.[233] Given the shared backgrounds, world view and objectives of the controlling shareholder on the one hand, and directors and managers of the GLCs on the other, direct intervention by the government would not be necessary to ensure that Temasek's GLC investment strategy fulfills the government's policy goals and strategic objectives. Yet at the same time, the unalloyed *commercial* objective of the government in holding shares of the GLCs provides great clarity to managers operating within the system, and stands in considerable contrast to the mixed commercial and social motives of many governments in holding shares in business enterprises.[234]

It should also be noted that Temasek's excellent long-term investment returns have not completely insulated the Singapore government's GLC strategy from criticism. Some view an economic development strategy centered on GLCs as misguided, since these firms compete with the private sector and potentially crowd out private businesses in new markets, products and technologies. Temasek has also been embroiled in controversy over an investment in a politically connected Thai conglomerate.[235]

These side notes and criticisms, however, should not detract meaningfully from the remarkable overall success of the Singapore approach on almost any measure—financial performance, transparency, lack of corruption, and protection of minority shareholder interests. Singapore appears to have achieved the "best of both worlds" with its GLC strategy: the government, acting through Temasek, achieves the monitoring benefits of a controlling shareholder regime in its portfolio companies; yet due to a host of institutional constraints and what might be called an "ethos of cleanliness" pervading the state sector, it has avoided the problems with minority shareholder exploitation that most controlling shareholder regimes present.

Although their impact may be impossible to quantify, Singapore's unique qualities—in particular, its small size and extensively globalized domestic economy, and the shared work ethic among its managerial elites—may have contributed to the success of the government's GLC strategy. If so, it will be difficult to replicate the Singapore model elsewhere. Issues of replicability loom largest for China, which has consciously modeled reforms to its SOE holding

[232] Kirkpatrick, *supra* note 221, at 10.
[233] Puchniak & Lan, *supra* note 223, at 42. Although most of these positions are or were with government bodies not connected to MOF, and are thus "far removed from anything to do with the regulation or governance of Temasek and/or its portfolio." Id.
[234] This is not to say that the Singapore government completely breaks the link between its involvement in commercial enterprise and its broader social policy goals. Rather, its strategy is to run the GLCs on an entirely commercial basis, seeking the highest returns possible, and using those returns to finance its social policies. In this way, Singapore-style state capitalism has a strongly redistributive strand, consistent with the PAP's roots as a social democratic party. *See* Chua Beng Huat, *State Owned Enterprises, State Capitalism and Social Distribution in Singapore*, Working Paper (2015).
[235] Kirkpatrick, *supra* note 189, at 6-7.

structures on Temasek. But the question whether Temasek can be scaled up and translated into a very different institutional and cultural environment is relevant for any country that is seeking to emulate Singapore's approach.

H. China

Structure of State Ownership: Although, as discussed below, a mixed-ownership strategy is currently the focus of China's approach to SOE reform, this is not a new approach. Since the inception of economic reforms in the late 1970s, the boundary between state-owned and private firms in China has often been blurred. One of the main drivers of China's economic miracle during the 1980s and the early 1990s was the emergence of so-called "non-state" firms, whose share of national industrial output increased from 22% in 1978 to 42% in 1993.[236] One major category of non-state firms was "collectively owned" firms, ostensibly owned by "all residents" in a community. Many of these collectively owned firms were in fact privately owned and operated and were registered as collectively owned only because, at the time, there was no legal framework for the registration of private firms.[237]

With the adoption of the Company Law in 1994, the government started converting SOEs to corporate forms. This corporatization campaign created not only SOEs whose corporate shares were wholly owned by the state, but also mixed-ownership firms where the ownership and management of the firms were shared among state and private shareholders. In 1997, China announced a massive program to privatize all but the largest SOEs under the slogan "grasping the large, letting go of the small." In practice, however, the newly "privatized" SOEs under this program did not become private firms as that term is commonly understood; instead, they became firms with mixed-ownership. It was estimated that as of 2003, mixed-ownership firms accounted for 40% of China's GDP.[238] Some of the best-known Chinese firms, such as Haier, TCL, and Lenovo, are of the mixed-ownership type. Mixed ownership is currently an important ownership form among China's SOE groups at the subsidiary level. For example, almost all of the thirty-four subsidiaries of China National Offshore Oil Corporation (CNOOC) are mixed-ownership firms, with an average state-share percentage ranging from 40-65%.[239]

Chinese SOEs at the national level are organized into business groups comprised of numerous separate corporations arranged in hierarchical order. The business group concept has been enshrined in regulations that permit registration as a business group if it has certain required components and layers of entities. Registration as a business group affords eligibility to establish

[236] Jiahua Che & Yingyi Qian, *Insecure Property Rights and Government Ownership of Firms*, 113 Q. J. ECON. 467, 467 (1998).
[237] *See* Yasheng Huang, *How Did China Take Off?*, 26 J. ECON. PERSP. 147, 154 (2012).
[238] *See* Mixed-Ownership Sector Accounts for 40% of Economy; To Hit 80% in 5-10 Years), Xinhua Net (Nov. 25, 2003, 14:15:17), http://www.southcn.com/news/china/zgkx/200311250786.htm.
[239] *See* Wang Runqiu: Seventy-Percent of Central SOEs Undergoing Structural Reforms; Promoting the Development of Mixed-Ownership Economy, People's Daily Online, Nov. 26, 2012, http://dangjian.people.com.cn/n/2012/1126/c117092-19693335.html.

a finance company to handle lending, underwriting, cash management and other financial functions that are otherwise prohibited on an inter-company level.[240]

The parent (holding) company of a Chinese SOE business group is legally organized as a "wholly state-owned limited liability company" (WSOLLC) under the Chinese Company Law.[241] A WSOLLC is not required to have an annual shareholders meeting and has only one shareholder—the State-Owned Assets Supervision and Administration Commission (SASAC). SASAC was established directly under the Chinese State Council (cabinet) in 2003 in an attempt to consolidate control over all central SOEs.[242] SASAC's formal role, set out in legislation,[243] is to serve as the investor on behalf of the State Council in the approximately 110 large corporate groups under its supervision.[244] SASAC has a broad mandate: its formal functions include preserving and enhancing the value of state-owned assets, appointing, removing and setting remuneration of top SOE executives, dispatching supervisory panels to SOEs, and drafting regulations on the management of state-owned assets. SASAC shares decision rights on senior management appointments with the Chinese Communist Party (CCP) in a highly institutionalized arrangement whereby the top positions in the most important SOEs are evaluated by the Organization Department of the CCP—the party's premier personnel department. Deputy positions at these firms and positions in the remaining SOEs are handled by other party committees within SASAC. Given its broad remit, SASAC is part investor, part regulator and compliance department, and part conduit for CCP influence and industrial policy dissemination.

Arguably the closest model for Chinese SOE ownership structure can be found in Singapore, discussed in the preceding section of this report. The basic structural similarities between Temasek and SASAC reflect similarities in the two government's motivations for adopting a state capitalist approach. As previously noted, Singapore's GLC-centered strategy, grew out of "the ruling PAP government's perceived need to support the transformation of the Singapore economy," based on the conclusion that "control over key domestic markets and institutions [was] the most effective way" to promote economic growth.[245] Moreover, in both countries, there is a strong link between economic success and political legitimacy. Particularly

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[240] Li-Wen Lin & Curtis J. Milhaupt, *We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697 (2013).

[241] Chinese Company Law recognizes two basic types of companies: a "company limited by shares" and a limited liability company, although the Chinese limited liability company bears little resemblance to an LLC in the United States. Rather, it is modeled after the German corporate entity known as the GmbH. The WSOLLC is a subspecies of limited liability company, regulated by Chapter 2, Section 4 of the Company Law.

[242] Prior to the creation of SASAC, SOEs were typically controlled by the specific line ministries from which they had been separated in the transition out of a centrally planned economy.

[243] SASAC is governed by the Law of the People's Republic of China on State-Owned Assets of Enterprise, promulgated by the Standing Com. Nat'l People's Cong., Oct. 28, 2008, effective May 1, 2009.

[244] The number of SOEs under SASAC supervision has been gradually declining as part of government policy to streamline and enhance the profitability of the state sector. The official goal is to reduce the number below 100.

[245] Cheng-Han Tan, Daniel Puchniak & Umakanth Varottil, *State-Owned Enterprises in Singapore: Historical Insights into a Chosen Model for Reform*, Unpublished Working Paper, at 9 (2014).

given the strength of these parallels and the success of Singapore's approach, it is not surprising that the CCP, along with many other analysts concerned with Chinese SOE reform, have continued to look toward Temasek as a model for SOE share ownership and supervision.[246]

But China has *selectively* adopted the Singapore holding company structure: SASAC is far from a copy of Temasek, which as discussed previously, has two closely related defining features that signal its role as a true holding company: (i) an unambiguously commercial orientation articulated in public documents and verified by its performance; and (ii) a high degree of independence from direct political influence vis-à-vis the companies in its portfolio. Chinese SOEs under SASAC supervision are in the main commercially oriented, but some distinctive features of the Chinese system raise questions about the purely commercial orientation of the state sector. For example, SASAC, in consultation with CCP organs, rotates senior corporate leaders among SOE business groups. On occasion, it has simultaneously rotated the CEOs of several SOEs in a given industry in musical chairs fashion. In addition, the SOEs are sometimes called upon to perform social functions on behalf of the state, such as maintaining employment.[247] These practices suggest that at least for some purposes, the interests of the national SOE business groups are viewed collectively—that is, the important consideration for SASAC and the CCP is to maximize the interests of the state sector *as a whole*, rather than at the individual firm or group level. Perhaps an even more stark contrast with the Singaporean approach relates to the lack of a clear separation of politics from business in the Chinese SOE sector. Within every firm throughout a Chinese SOE business group is a CPC committee responsible for managerial appointments, promotions and party discipline. Senior executives of Chinese SOEs are uniformly members of the CCP, and simultaneously hold positions of equivalent rank within the corporation and the party. "Party centrality" is thus a defining characteristic of the Chinese state sector.[248]

Mixed Ownership Structure: Shareholding in Chinese SOE business groups is hierarchical: firms higher in the structure, beginning with the WSOLLC parent company in which strategic and managerial decision-making are concentrated, own downstream subsidiaries, but there is very little upstream or cross ownership within the group. Typically, one or more of the subsidiaries below the parent company are publicly listed on a Chinese stock exchange, and often cross-listed on the Hong Kong Stock Exchange and/or a major foreign exchange as well. The percentage of shares retained directly or indirectly by the parent company varies, but it is always sufficient to retain ultimate control over the listed firm(s) in the group, particularly given

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[246] *See, e.g.*, World Bank, China 2030 (2012); Boston Consulting Group & China Development Research Foundation Developing Mixed Ownership Structures and Modern Enterprise Systems (2014), http://www.bcg.com.cn/en/files/publications/reports_pdf/BCG_Developing_Mixed_Ownership_Structures_and_Modern_Enterprise_Systems_Mar2014_ENG.pdf.
[247] In a recent example, the Chinese government instructed the SOEs under SASAC supervision to hire soldiers who would be laid off in the restructuring of the military.
[248] See Curtis J. Milhaupt, *Chinese Corporate Capitalism in Comparative Context*, *in* THE BEIJING CONSENSUS? HOW HAS CHINA CHANGED THE WESTERN IDEAS OF LAW AND ECONOMIC DEVELOPMENT (Weitseng Chen ed., forthcoming 2017).

the dispersed nature of the private shareholdings. These public listings are intended to provide not only capital, which often is available at low cost from state-owned banks, but also managerial discipline and global visibility.[249]

As urgency to overhaul China's economy has built up due to problems of overcapacity, high levels of corporate indebtedness, and sluggish domestic demand, SOE reforms have become a priority of China's political leadership. A central component of the current SOE reform efforts, announced with considerable fanfare at the Third Plenum in 2013, is to convert more SOEs to so-called "mixed-ownership" firms—that is, firms in which the state and private shareholders hold joint equity stakes. In September 2015, the State Council promulgated detailed "Opinions on the Development of Mixed Ownership Economy by State-owned Enterprises." The "starting point" of the Opinions is that "cross-shareholding and mutual integration of State-owned capital, collectively-owned capital, [and] private capital is an important manifestation of China's basic economic regime." They seek to "treat enterprises as market players," and combine efforts to attract capital with efforts to diversify property ownership and improve corporate governance structures. In order to implement these goals, the Opinions call for a host of initiatives, including (i) encouraging private capital and foreign investors to participate in the mixed-ownership reforms, while encouraging state-owned capital to invest in non-SOEs; (ii) promoting the public-private partnership (PPP) model; (iii) exploring use of preferred shares and golden shares, which to date have not been used in China; (iv) exploring employee stock ownership plans; and (v) improving corporate governance in mixed-ownership enterprises and promoting professional management thereof. The National Development and Reform Commission, China's economic planning agency, is reportedly developing a plan to "more or less complete" mixed-ownership reforms for all SOEs by the year 2020.

The reform agenda of the Third Plenum aims to expand mixed ownership to all levels of the SOE structures, including the central SOE groups themselves. While the goal is bold and the political rhetoric surrounding the plan is emphatic, it is important to recognize that mixed ownership is the path that China has been pursuing over the past two decades. Thus, it is fair to question whether the current ownership-based reform strategy holds new potential for improving governance and performance in China's state sector.

In fact, there would appear to be serious limitations to this strategy.[250] Injecting more private capital into SOEs may do relatively little to improve the performance of individual SOEs or to increase the competitiveness of the Chinese economy. The profitability gap between the state sector and the private sector is widening. A mixed ownership strategy, bringing more

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[249] Chinese SOEs are usually known publicly by the listed firm. The public filings of the listed firms typically make rather cryptic disclosures relating to the state ownership structures in which they are nested, and almost no disclosure of the role of the CPC in China's state sector, beyond a simple mention of the title of the party position held by a given executive in his or her bio.

[250] For a more detailed critique, *see* Curtis J. Milhaupt & Wentong Zheng, *Why Mixed Ownership Cannot Fix China's State Sector*, Paulson Institute Policy Memorandum (2016), http://www.paulsoninstitute.org/think-tank/2016/01/14/why-mixed-ownership-reforms-cannot-fix-chinas-state-sector/ .

private capital into the state sector, will not transform the role of the state from major participant in the market to impartial arbiter of market competition. On the contrary, the reforms to date seem intended primarily to create larger SOEs on the theory that global competition requires scale.[251] While the number of SOEs under SASAC supervision is declining, total assets under its control have increased.[252] Equally important, the current reforms will do little to eliminate political intervention in the state sector. A Temasek-style structure creating a firewall between the state in its role as investor and the management of its portfolio companies would require the CCP to withdraw from its role in personnel appointments and elimination of the firm-level party committees in favor of depoliticized internal control and reporting structures used in major western firms. Thus far, there is no sign that the party is withdrawing from state-invested firms; to the contrary, the grip of the party seems to be tightening.[253]

III. Patterns of SOE Regulation?

Having surveyed national experiences with SOE governance, we pause to consider whether any patterns can be discerned in the way that the countries in our study have regulated mixed enterprises. To facilitate this effort, we have created Chart 1, which indicates whether a given country's regulatory regime for listed SOEs has the characteristics indicated in the top row.

[Insert Chart 1 here]

Several commonalities in regulatory approach are apparent. As Chart 1 shows, consistent with the recommendations of the international guidelines (but also subject to our critique), every country generally subjects SOEs to the same corporate law and securities law regime that governs private corporations. While various jurisdictions subject listed SOEs to the oversight of different state actors (such as Parliament or a Court of Auditors), judicial enforcement of corporate and securities laws does not appear to play a central role in SOE governance.

Subject to various exceptions, centralization of state ownership of SOE shares, another key recommendation of the international guidelines is also found in all of the countries in our study other than the United States and Brazil. It is noteworthy, however, that only two countries (Singapore and China) have centralized SOE share ownership in the form of a holding company, arguably the most robust formal means of separating the state's distinct roles of regulator and shareholder. Chart 1 also indicates that cross-listing of SOEs on foreign stock exchanges is prevalent. Cross-listing is perceived as a means by which managers bond themselves to higher

[251] See Gabriel Wildau, *China's State-Owned Zombie Economy*, FINANCIAL TIMES, Feb. 29, 2016.
[252] Since the Third Plenum, the Chinese government has pushed through a merger between the largest two state-owned railroad rolling stock manufacturers and a merger between two giant state-owned electricity generating firms. The government is reportedly planning to merge the largest SOEs in even more sectors, including the ship building sector and the petroleum sector.
[253] Lucy Hornby, *China Rows Back State-Sector Reforms*, FIN. TIMES, June 14, 2016, https://next.ft.com/content/92e52600-31f7-11e6-ad39-3fee5ffe5b5b.

standards of corporate disclosure and governance than those required in the company's home country, and credibly signal conformance to high governance standards to foreign investors.[254] Yet we know from global experience that cross-listing turns out to be far from a failsafe method of securing good corporate governance. It is not unusual for SOEs cross-listed on foreign exchanges to be the subject of serious corporate governance scandals.[255]

Chart 1 also reveals an interesting negative commonality: other than Brazil, where it is a very recent and still untested development, none of the countries in our study uses stock exchange rules to create a special governance regime for mixed enterprises. This observation highlights a potential policy area for further inquiry and discussion, considered in the next section.

We can see from Chart 1 that few states possess formal control rights in excess of their equity interest in the firm. In its short-term experiment with state ownership following the financial crisis, the U.S. government intentionally chose to exert *less* influence than a similarly situated private investor would legally possess. Among the jurisdictions examined, France and Brazil are outliers in this regard. France not only provides special governance rights for the state as shareholder but also applies to SOEs the disparate voting rights available to long-term shareholders, which effectively amplifies the power of the state as shareholder. The Brazilian state, in turn, exercises voting control over SOEs that well exceed its cash-flow rights by relying extensively on non-voting shares and pyramidal structures. China also permits disproportionate state influence, due to the formal powers provided to SASAC and to the role of the Chinese Communist Party in SOE governance.

Perhaps the principal takeaway from the effort to discern patterns in SOE governance in the countries we have surveyed is the *lack* of pattern. Diversity appears to be the hallmark of governance of listed SOEs around the world. This finding is probably not surprising, given that SOEs are products of states and often enjoy privileged access to lawmakers and regulators by virtue of their provenance. As such, it is natural for SOE governance to reflect the characteristics of *national* governance—that is, the characteristics and quality of a national regulatory regime for SOEs is deeply influenced by prevailing national philosophy about the proper scope of state ownership of enterprise, separation of powers, the level of corruption in society, and related factors. There is little reason to believe that resorting to mixed ownership—by offering a portion of an SOE's shares to private investors—is sufficient to transform a product of the state into a pure product of private market transactions.

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[254] *See, e.g.*, John C. Coffee, Jr., *Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance*, 102 COLUM. L. REV. 1757 (2002).

[255] For a Chinese example, *see* CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 124-28 (2008) (discussing governance failures in China Aviation Oil, an SOE listed on the Singapore Stock Exchange).

This point leads to a normative conclusion that may disappoint policy makers: there appears to be no single formula for achieving a high quality regulatory structure for SOE governance. Compare Norway and Singapore, for example, the two countries in our study that are frequently cited as setting the global standard for SOE governance. As Chart 1 indicates, although they share some regulatory traits, these countries have not followed a single template for SOE governance. Most prominently, while Singapore's approach revolves around Temasek, the state holding company, Norway has eschewed a holding company approach, and has not even completely centralized the ownership of SOE shares. What these countries have in common, however, is a reputation for clean government and the rule of law.

Another comparison is revealing from a different angle: Singapore and China, countries at some distance from one another in terms of the quality of SOE governance. Yet as Chart 1 shows, they have many regulatory traits in common. This is not accidental: Chinese economic reformers have looked to Singapore as a model in the governance of its SOEs. But the two countries have vast differences in "Governance with a Capital G," including among other things the levels of corruption and political intervention in the economy and the quality of legal institutions. These differences probably influence the quality of SOE governance far more heavily than the specific factors identified in Chart 1.

Yet from a policy perspective, there is a bright side to the lack of a fixed template for SOE governance: the diversity of successful approaches highlighted by our study suggests that each country is free to develop governance structures most suitable to local conditions. Path dependence does not doom any country's system of SOE governance to failure; rather, policy makers have room for experimentation and creativity in addressing the distinctive governance challenges posed by state ownership of enterprise.

IV. Critique of Best Practice Guidelines

International organizations such as the OECD and the World Bank have produced a plethora of policy prescriptions for best practices in SOE corporate governance. Typical examples are the OECD Guidelines for State-Owned Enterprises, originally adopted in 2005 and revised in 2015, and the World Bank Toolkit for State Owned Enterprises, published in 2014. Although the policy recommendations of the various organizations are numerous, they exhibit a high degree of uniformity around the following basic principles:

- The state should act as an informed and active owner;
- The state should not intervene in management and should respect the independence of SOE boards of directors;
- The legal and regulatory framework for SOEs should ensure a "level playing field" for SOEs and private enterprises;

- Non-state shareholders should be treated equitably and should be granted full rights as investors; and
- SOEs should observe high standards of transparency and should adhere to the same disclosure, accounting and compliance standards as private listed companies.

These principles reflect laudable aspirations at the high level of generality at which they are framed. The basic impulse behind the recommendations is to ensure that SOEs are operated "as if" they were private enterprises. Beyond improving operational performance and the protection of minority investors, a primary concern of these initiatives is to level the playing field vis-à-vis private competitors. Perhaps the most important addition to the OECD Guidelines in the 2015 version is the principle, set out at the very beginning of the Guidelines, that the state "should carefully evaluate *and disclose* the objectives that justify state ownership and subject these [objectives] to a recurrent review." Although there may be no direct legal consequences to a state for failing to live up to its disclosed objectives justifying state ownership, disclosure requires the formulation and articulation of concrete justifications for state ownership, and may help "tie the hands" of state actors with respect to the operation of SOEs. Disclosure promotes public scrutiny and may thereby act as an informal constraint on the use of SOEs to fulfill ill-defined or politically motivated objectives.[256]

While we applaud the goal of promoting good corporate governance of SOEs, closer inspection of the principles espoused by international organizations reveals a number of potential problems with this type of initiative, particularly in view of the possibility of government failure. First, whereas the guidelines of the international organizations enunciate numerous objectives, they contain comparatively little guidance on the institutional practices that are necessary to achieve them. In other words, although the destination is clearly marked, there is no road map provided to assist in reaching the destination.

Second, as noted above, the guidelines reflect a strong view that SOEs should be subject to the same legal regime as private firms, a policy linked to the goal of leveling the playing field for private competitors. Yet the state is a very distinctive kind of controlling shareholder as compared to an individual or a POE. The guidelines attempt to deal with this reality by encouraging the state to behave like a "standard" controlling shareholder. This is to be accomplished by (i) centralizing the exercise of ownership rights in a single state shareholding entity or holding company, and (ii) subjecting SOEs to the same corporate law regime as POEs. This policy approach, however, has potentially serious weaknesses. It is not obvious why *centralization* is an effective antidote to the unique problems posed by a state controlling shareholder, such as political interference in management and the pursuit of noncommercial objectives. Centralized ownership has been very effective in Singapore, but it has arguably not

[256] We note, however, that the most recent annual report filed by Petrobras with the U.S. SEC (Annual Report on Form 20-F 2015) states that the government may use the company to pursue its macroeconomic objectives. Broad disclosures of this sort probably do not act as much of a constraint on the government.

been relevant to good governance in the other "gold standard" country, Norway. The second approach, a unitary legal regime for SOEs and POEs, may have serious political economy consequences if the state's interests as a controlling shareholder cloud the content and distort the development of the corporate law and other market regulatory regimes such as competition law. Real-world examples of this phenomenon can be found in Brazil, France and China.[257]

Third, the guidelines simultaneously stress the importance of "active ownership" on the part of the state and the need to avoid politically motivated interference in management. But there is a tension inherent in pursuing these two goals, since active ownership by the state creates the mechanism for political interference in management and the pursuit of noncommercial objectives by SOEs. A closely related tension exists between the principle of active state ownership on the one hand, and board independence on the other. Given that "the state" is by definition a political actor—moreover, a political actor that is not a monolith but a diverse agglomeration of interests—favorably resolving these tensions is a highly complex undertaking.

We highlight these issues not to denigrate attempts to formulate best practices in the governance of SOEs, but to highlight the complexity of the task, and the inherent limitations of a general-principles-based-approach to SOE governance in countries with widely divergent economic and political institutions.

V. Policy Responses

In reviewing the foreign experience for policy suggestions, we avoid attempting to crystallize conclusions as to "what worked" and "what did not work" in these countries. A number of reasons justify this approach. First, defining success in the SOE context is difficult, given the variety of normative objectives that these firms may pursue. Does "successful" SOE performance mean solid financial results, the implementation of effective industrial policy, the maximization of local employment, or something else? Second, it is problematic to make strong causal claims about the effects of different governance mechanisms, regardless of how success is defined. As suggested above, it is possible, indeed likely, that other features of the institutional and economic environment in a given country affect the performance of SOEs. Third, even if it were possible to unambiguously identify a "successful" SOE governance mechanism in a foreign jurisdiction, adopting it as a policy roadmap for reform in a given country may be problematic, given the well-known role of local context in determining the success of legal transplants. We therefore approach the foreign narratives as an instrument for institutional critique and imagination in the hope of providing policymakers with ideas about a range of governance arrangements that go beyond those usually considered in domestic circles and international organizations.

[257] *See* Pargendler, *supra* note 39; Pargendler, *The Unintended Consequences*, *supra* note 156.

Similarly, the diversity of approaches we have encountered in this study makes us reluctant to recommend a specific formula or checklist of best practices in the governance of mixed-ownership enterprises. Indeed, the thrust of our analysis would counsel against such an approach. Short of complete privatization, there is no fail-safe method of resolving the distinctive governance problems of listed SOEs. And, of course, private firms also face significant governance challenges, which are similarly resistant to a check-the-box approach.

Recognizing this reality, however, does not mean that SOE governance is in a hopeless state around the world. Quite to the contrary, several of the countries in our study—countries with a diverse array of political systems and institutional structures for SOEs—are providing a healthy governance environment for their mixed enterprises.

The principal objective of any governance framework for SOEs is to insulate the management of the enterprise from political interference that distorts its public mission and commercial orientation and makes public (including both investor and citizen) understanding and oversight of the firm more difficult. The specific means a given country chooses to accomplish this objective are not particularly important, provided that they fit the institutional setting in that country. In Singapore, insulation from political intervention has been accomplished structurally, through the design of the Temasek holding company and the surrounding laws that support a purely commercial orientation of the GLCs. In Japan and, to a lesser extent, in Norway, insulation of mixed enterprises from political interference appears to be less the result of robust structural design than of a "hands off" approach of political and bureaucratic actors. Brazil is experimenting with innovative private sector and legislative initiatives on SOE governance that find no direct parallel elsewhere.

To be sure, designing and implementing the optimal institutional infrastructure for SOEs is no easy task. In fact, as noted above, the quality of public governance itself is arguably as important, if not more important, than the quality of specific corporate governance arrangements for SOEs. Moreover, the challenges associated with the state's involvement in capital markets go beyond its role as a controlling shareholder of SOEs. In Brazil, state-controlled institutional investors such as SOE pension funds and BNDESPAR play a major role as prominent blockholders in public companies.[258] In Japan, the giant Government Investment Pension Fund owns shares in hundreds of Japan's leading companies, while the central bank owns 60% of Japan's exchange traded fund (ETF) market. The influence of state-controlled institutional investors on corporate governance raises important questions, whose treatment we leave for future research and policy discussion.

Based on the foreign experience we have surveyed and our own analysis of the governance challenges of listed SOEs, we suggest that the following subjects are worth careful consideration by policy makers seeking to improve the regime for mixed-ownership enterprises.

[258] On Brazil *see* Pargendler, *Governing State Capitalism*, *supra* note 175.

Of course, not every subject will be relevant for every country, and not every proposal will be optimal for the particular circumstances of an existing regime. The list that follows is offered as a way of extending and reframing the policy discussion outside the parameters of the Guidelines on SOE governance set by the international agencies.

A. Ownership structure

Ownership structure is a key determinant of behavior in corporate governance. Scholars have suggested that the separation between voting and economic rights in the firm can increase the incentives of controlling shareholders to extract private benefits of control. The use of "control-minority structures" that permit shareholders to exercise uncontested control over the company while holding only a minority of the firm's equity interest exacerbates the agency problem between controlling and minority shareholders.[259] Such a problem tends to be even more severe in SOEs, given the greater misalignment of incentives between private and public shareholders, with the state being even more tempted to promote political objectives through the firm when it does not have a commensurate financial interest in the corporation.

With the notable exceptions of France and Brazil, all other jurisdictions have either granted one vote per share or, in the case of the United States, affirmatively restricted the voting rights of the state. In Colombia, the state has not only adopted a single class of shares but has also maintained a high equity stake in its controlled firms, which has likely reinforced the state's interest in their financial performance. France has historically employed formal mechanisms that magnify the power of the state as a shareholder, such as special appointment rights and a tenured voting regime giving double voting rights to long-term shareholders. Brazil, in turn, is exceptional among the countries examined in making broad use of dual-class shares and pyramidal structures in SOEs that greatly enhance the power of the state.[260]

In view of the theoretical findings and the predominant foreign experience, non-voting preferred shares, pyramidal structures by listed SOEs, and other means of magnifying state power should be avoided, given their effect on the controlling shareholder's incentives to pursue its private benefits to the detriment of the company.

B. Board composition and independence

Should politicians and regulators be allowed to serve on the boards of listed SOEs? Countries have answered this question in different ways. Norway has a broad ban that encompasses not only politicians but also civil servants of the federal government. Brazil has

[259] Lucian A. Bebchuk, Reinier H. Kraakman & George G. Triantis, *Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Creation and Agency Costs of Separating Control from Cash Flow Rights*, *in* CONCENTRATED CORPORATE OWNERSHIP (Randall Morck ed., 2000).

[260] For instance, Petrobras adopts a dual-class structure that permits the federal government to exert uncontested control over the company despite holding only a minority of its equity capital. Other listed SOEs, such as BB Seguridade, are part of a pyramidal structure.

newly banned the appointment of regulators, politicians and union leaders to SOE boards. An alternative approach would seek to increase the participation of appointees by minority shareholders.[261] Unlike directors who are appointed and dismissed by the government as controlling shareholder at any time, minority-shareholder appointees enjoy structural independence, and therefore may be well suited to monitor firm insiders.

These approaches seek to increase the independence of SOE boards, a major principle of the international guidelines on SOE governance. But there is a tension between a board's independence from the government as controlling shareholder (thought to be healthy from a corporate governance perspective) and a board's independence from the government as public policy maker (problematic if one assumes that the reason for continued government ownership is the accomplishment of a public policy objective). Recognizing this tension suggests that board composition and independence should not be considered solely within the standard corporate governance rubric.

C. The role of the board

It is important to recognize that SOE reforms focusing on board composition must take account of the legal balance of power in the corporation in a given jurisdiction. The recent SOE Statute in Brazil illustrates the issue. As noted, board composition is a central feature of the statute. Yet from a comparative perspective, Brazil's system of corporate governance is unusually shareholder centric—with shareholders possessing far more, and the board of directors proportionately less, decision-making power than in other jurisdictions.[262] This suggests that board reform will be of limited effectiveness in the Brazilian context, unless the reform is coupled with a strengthening of the role of the board in SOE governance.

D. Remuneration

Managers of listed SOEs serve two masters—minority private shareholders and "the citizens." As we noted in Part I, the interests of these two masters sometimes converge but often conflict. To date, compensation issues in SOEs have focused on the question whether the compensation of government officials serving on SOE boards should be subject to special regulation. Again, countries have answered this question in different ways. Despite its statist

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[261] This mechanism is favored by Brazil's Constitution. Brazilian Constitution, Art. 173, §1º, IV (requiring the special statute on wholly-owned and mixed SOEs to regulate the "constitution and functioning of the board of directors and the board of supervisors, *with the participation of minority shareholders*") (emphasis added).

[262] *See* Mariana Pargendler, *How Universal Is the Corporate Form? Reflections on the Dwindling of Corporate Attributes in Brazil*, Working Paper (2017) (on file with author). For instance, one prominent controversy in recent years concerned the renegotiation of the concession contracts between state-owned power company Eletrobras and the federal government, on terms that were allegedly unfavorable to the firm. This decision to approve the renegotiated agreement was submitted directly to the shareholders meeting—and approved with the vote of the state as majority shareholder—without any disclosure of the board's position or recommendation on the transaction. For a discussion of this case, *see* Mario Engler Pinto Junior, *Exercício do Controle Acionário na Empresa Estatal: Comentários a Decisão da CVM no Caso Eletrobrás* (2016), http://ssrn.com/abstract=2765264.

tradition, France does not permit government officials serving on SOE boards to receive additional compensation for their board service. By contrast, board appointments in Brazilian SOEs have historically served as a means of supplementing the earnings of government officials, creating incentives to propagate insider-dominated boards and to maintain SOEs in non-core sectors. Brazil's new SOE Statute now limits the remunerated participation of government officials to two boards of directors or boards of supervisors of SOEs. In China, the compensation of senior SOE executives is regulated by SASAC, the state holding company, in cooperation with a senior Party organ. Amounts of compensation are low by international standards. But beneath the surface of state control over SOE compensation lies a vast domain of managerial autonomy. In fact, informal forms of compensation often exceed the amounts formally provided for by regulation.[263]

Perhaps a more important, rarely asked question is how compensation for SOE managers should be structured. In private firms, compensation arrangements should be designed to incentivize managers to maximize shareholder value. But what is to be maximized in an SOE? The continued presence of state ownership in a listed SOE suggests that something other than or in addition to maximizing shareholder value should be the goal of SOE managers. The design of optimal contracts for SOE compensation is well beyond our ambition here, and in any event optimality will depend on the specific goals of a given SOE. Our point is that, as with board composition and independence, compensation issues should not be cabined exclusively within a binary framework. The important question is not whether government officials should be compensated for SOE service. The question is how to structure compensation arrangements that advance the commercial and non-commercial objectives of a listed SOE.

E. Structural incentives

SOEs are not only subject to relevant economic and industry-specific regulations along with private firms; they also are frequently impacted by their home government's fiscal and industrial policies. In Japan, the postal savings system grew to enormous size, and its gradual privatization took decades to initiate, because it provided funding for the government's "second budget," a font of pork barrel politics. Recent reforms in Brazil's budgetary laws indirectly encouraged the use of SOEs to promote non-economic objectives. Since 2009, the legislature has excluded SOEs Petrobras and Eletrobras from the calculation of Brazil's primary surplus or deficit—a key concept under existing fiscal responsibility laws. With this exclusion, investments and expenditures by these SOEs were taken "off-the-books" from the perspective of the government. This created an incentive for the government to pursue costly public policies through SOEs rather than directly.[264] Even the US economy where staunch resistance to government ownership prevails, federal policies promoting home ownership greatly influenced

[263] Milhaupt & Zheng, *supra* note 250, at 680-81.
[264] For a more detailed description of this argument, *see* Mariana Pargendler & Bruno Salama, *A Contabilidade Paralela das Empresas Estatais,* VALOR ECONÔMICO, May 11, 2016.

the risk taking behavior of Fannie and Freddie, leading to government intervention when they ran into serious trouble during the global financial crisis.

As these examples indicate, policy makers and investors must be conscious of the incentive effects of the government's fiscal and industrial policies on SOE behavior. While there is no way to completely insulate SOEs from these structural incentives, as we discuss below, disclosure of, and special decision rules for, SOE conduct that serves non-commercial purposes may be a means of mitigating potentially negative consequences of these effects.

F. Disclosure and treatment of non-commercial decisions

The distinctive governance challenges of listed SOEs result from the *Janus-faced* nature of a mixed-ownership enterprise: part commercial actor; part public policy actor. Improving the governance of SOEs requires attention to both the commercial and non-commercial dimensions of these enterprises.

The OECD Guidelines for State-Owned Enterprises address the second dimension in providing that "costs related to public policy objectives should be funded by the state and disclosed."[265] Colombia follows this approach. Its state owned oil giant Ecopetrol sells subsidized fuel to the public. But since the company's public listing, the government has consistently reimbursed the company for the cost of the subsidy. In Brazil, Bovespa's SOE Governance Program and the new SOE Statute require the specification of the public policy objectives pursued by each company, as well as disclosure of the costs of such policy interventions. Neither the Program nor the Statute, however, imposes any substantive constraints on the pursuit of public policies that lack a commercial justification, nor any requirement that the state compensate the SOE for the costs of such policies. Thus, the government could continue to direct Petrobras to sell fuel at below market prices as long as this practice is publicly disclosed. Colombia's approach in reimbursing the SOE for the cost of pursuing a public policy goal is both fairer to minority shareholders and a more effective constraint on expansive use of SOEs to pursue policy goals than the Brazilian approach of disclosure alone.

It may be useful to consider responses to the public policy dimension of SOEs that go beyond disclosure and reimbursement. For example, directors of SOEs may be required to consider, justify, formally approve, and disclose to shareholders the pursuit of specific public policy objectives in a manner similar to the process used by boards of directors for conflict-of-interest transactions.[266]

[265] OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 22, 49 (2015).
[266] *See* Milhaupt & Pargendler, *supra* note 12.

G. Enforcement

One striking finding from our review of the national experiences with SOE governance is the relative rarity of public enforcement efforts against SOEs.[267] Perhaps it is unsurprising that public agencies are reluctant to bring enforcement actions against an SOE—where one instrumentality of the government challenges the actions of another. But this suggests the importance of private enforcement. Yet shareholder-plaintiffs often face significant obstacles in bringing claims against an SOE. These range from extreme reluctance on the part of the judiciary to hear certain categories of claims against politically powerful SOEs[268] to procedural rules that increase the cost and risk of minority shareholder claims against the state in its role as controlling shareholder.[269] In Brazil, both the premium stock exchange listing segments and the charters of various SOEs impose arbitration as the mandatory method of dispute resolution between the company, its shareholders and managers. This is problematic insofar as arbitration proceedings in Brazil can be more expensive than judicial lawsuits. Moreover, arbitration proceedings are confidential, reducing the amount of information available to outside investors as well as the reputational cost to the government associated with their filing.

At least at a conceptual level, strengthening public and private enforcement capacity against listed SOEs is the low-hanging fruit of SOE reform and an obvious means of supplementing the diminished role of market forces in disciplining mixed-ownership firms.

Conclusion

In this article, we have provided insights from national experiences and theoretical analysis relevant to policymakers seeking to improve the governance of listed SOEs. Several sobering facts emerge from our study. In contrast to the implicit message of the international best practice guidelines, there is no set "roadmap" for successful SOE governance, and indeed "success" in this field may be a contestable term. Moreover, at least a level of informal observation, the quality of SOE governance appears to be quite closely correlated with the

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[267] Norway has made use of external oversight by Accounts Tribunals, Parliament, and the stock exchange. The Singapore Stock Exchange (SGX) launched an investigation into a Chinese SOE listed on the SGX, resulting in a US$4.4 million settlement with the Monetary Authority of Singapore and criminal sanctions against the CEO and several members of the board. But the targeted SOE was foreign, and the actions of SGX can be viewed as a strategy to bolster Singapore's international reputation as a rule-of-law market. *See* CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW AND CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD 125-48 (2008). Brazil's CVM has imposed an administrative fine on the federal government for casting votes in the shareholders' meeting to approve a conflicted transaction involving Eletrobras. Processo Administrador Sancionador CVM nº RJ2013/6635. But the deterrent effect of CVM's enforcement activity is affected by the statutory limitations on the size of the fines it can impose. For a critical evaluation of this decision, *see* Pargendler & Salama, *supra* note 264. For another similar decision in which the CVM fined the State of São Paulo as a controlling shareholder for abuse of control power, *see* Processo Administrativo Sancionador CVM nº RJ2012/1131.

[268] For a discussion of this problem in China, *see* Zheng Lei, Benjamin L. Liebman & Curtis J. Milhaupt, *SOEs and State Governance: How State-Owned Enterprises Influence China's Legal System, in* REGULATING THE VISIBLE HAND (Benjamin H. Liebman & Curtis J. Milhaupt eds. 2015).

[269] A loser-pays regime in Brazil illustrates this problem.

quality of political governance in a given country. But clearly there are examples of sound SOE governance around the world and innovative approaches to the challenge of SOE governance that may offer guidance to policymakers elsewhere. The diversity of approaches to SOE governance revealed by our study—even among countries that have managed the challenges relatively well—may be cause for optimism, by suggesting that effective governance strategies can be forged with the tools at hand in a given institutional environment, when coupled with appropriate doses of imagination and political will.

Chart 1. Governance of SOEs

	Importance of SOEs to National Political Economy	Listed SOEs Subject to General Corporate and Securities Laws	Nonbinding Principles of Corp. Gov. for SOEs	Stock Exchange Regime for SOEs	Special Governance Rights for State Shareholder	Use of Disparate Voting Rights for Shares of Listed SOEs	Publicly Disclosed Policy on State Ownership	Restrictions on SOE Board Membership by Politicians/Gov't Officials	Special Rules on Compensation for SOE Managers	Centralized State Ownership of SOE Shares	State Holding Company for SOEs	Cross-Listing of SOE Shares
Brazil	High	✓	0	✓	✓ (pursuit of public interest)	✓	✓ (anual letter; new)	✓ (new)	0	0	0	✓
France	High	✓	0	0	✓	✓	✓	0	✓	✓ (with minor exceptions)	0	0
U.S.	Low	✓	0	0	0	0	0	0	0 (exception-bailout of GM etc.)	0	0	0
Norway	High	✓	✓	0	0	0	✓ (categories of SOEs)	✓	✓ (comply or explain basis)	✓ (with exceptions)	0	✓
Colombia	High	✓	✓ (forthcoming)	0	0	0	✓ (forthcoming)	✓ (new)	0	✓ (forthcoming)	0	✓
Japan	Medium	✓	0	0	✓	0	0	0	0	✓	0	✓
Singapore	High	✓	0	0	0	0	✓ (Temasek Charter)	0	0	✓	✓ (Temasek)	✓
China	High	✓	0	0	✓	0	✓ (SOE Asset Law and Categories of SOEs)	0	✓	✓	✓ (SASAC)	✓

✓= Yes
0 = No

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