

The Government Controlling Shareholder as a Fiduciary: Implications for Climate Change Management and Litigation

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Roadmap

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2. No corporate law mechanisms to constrain the government shareholder
3. The government as a fiduciary
4. The government controlling shareholder as a fiduciary
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SOEs and Climate Change

Approximately 300 state owned enterprises (SOEs) are responsible for greenhouse gas emissions equivalent to at least 7.5 billion metric tons of carbon dioxide annually:

- Chinese SOEs account for 69% of the emissions and Indian SOEs 4%.

Government Shareholders

- ▶ Government shareholders form the largest category of shareholder after institutional investors:
 - The shares held by government shareholders are worth US\$10 trillion, constituting 13% of the world's global market capitalisation
 - 20% of the world's largest companies are owned by the government
- ▶ The government has used SOEs to pursue a variety of public oriented, socio-economic objectives
- ▶ SOEs include some of the most crucial financial institutions, oil and gas companies, utility companies, telecommunications and technology providers in the world

Corporate Law and Government Shareholder

- ▶ No corporate law mechanisms to regulate self-serving or abusive behavior by the government shareholder
- ▶ Corporate law and governance have focused mainly on two types of agency problems that are ill-suited to the context of SOEs:
 - principal-agent problem
 - tyranny of majority problem

The Issue

Because the state should exercise its powers in the public interest instead of pursuing its partisan ends, and in view of the considerable economic and social impact of SOEs on societies and economies, particularly where it is both the cause of and the solution to the climate crisis, should the state be subject to fiduciary duties when it is the controlling shareholder of SOEs?

Government as a Fiduciary: summary

- The government and its entities possess and exercise discretionary powers.
- The government represents the members of the polity when it exercises these powers as it has the mandate to do so. This is because of the authorisation by the members of the polity.
- The exercise of discretionary power by the government affects the interests and rights of the members of the polity whose dependence on the government means they could be vulnerable to the misuse of power by the government.
- Members of the polity are not capable of exercising state power.

Government as a Fiduciary

The state stands in a fiduciary relationship with its people:

- **State powers must be used for the good of the public and not for the benefit of the power holders**
- **State powers are purposive: they must be exercised for the purposes for which they are granted**
- **State powers are institutional: the powers may be held and exercised by institutions**

Government *Shareholder* as a Fiduciary

The government controlling shareholder should be subject to fiduciary duties when it:

- Exercises formal power (voting rights)
- Exercises informal power (influence or pressure)
- Uses its position to benefit itself (at the expense of the public interest)

Shareholder's significant and substantial voting powers

- Appoint and remove directors
- Require directors to call a general meeting if threshold met
- Approve or ratify breach of directors' duties
- Approve transactions between the company and director
- Approve mergers and acquisitions
- Approve related party transactions
- Approve significant transactions
- Change the corporate constitution
- Overrule directors if permitted by the constitution
- Inspect the company's documents
- Wind up the company

Limited Constraints on Shareholders' Exercise of Voting Powers

General principle: shareholders can vote as they please for their own selfish interests even if it is against the company's interests

Abuse of Powers by the Government Controlling Shareholder: Conflicts of Interest

- ▶ A key mechanism through which the government controlling shareholder tunnels corporate wealth is related party transaction (RPT).
- ▶ Despite listing and securities rules regulating RPTs, RPTs involving the government are outside the scope of these rules.
 - ⇒ RPTs between the government controlling shareholder (or another governmental entity) and the SOEs are likely to require only the approval of the board of directors of SOEs. But the government controlling shareholder has the power to appoint and remove these directors

Politicians' Use of SOEs for Personal Gains

- ▶ Board and management of the SOEs are often expected to do the government's bidding
- ▶ Directors and managers are often themselves bureaucrats or politicians whose promotion and reappointment depend on whether they have adhered to the government controller's wishes
- ▶ Government controller will pressure or influence the board and managers to divert value from the SOEs to entities affiliated with the state in order to promote social and economic policies

Conflicts of Interest

The heart of the specific problem of value-decreasing related party transactions (RPTs) and the broader problem of the SOEs being used to advance the personal interests of the government controller and management

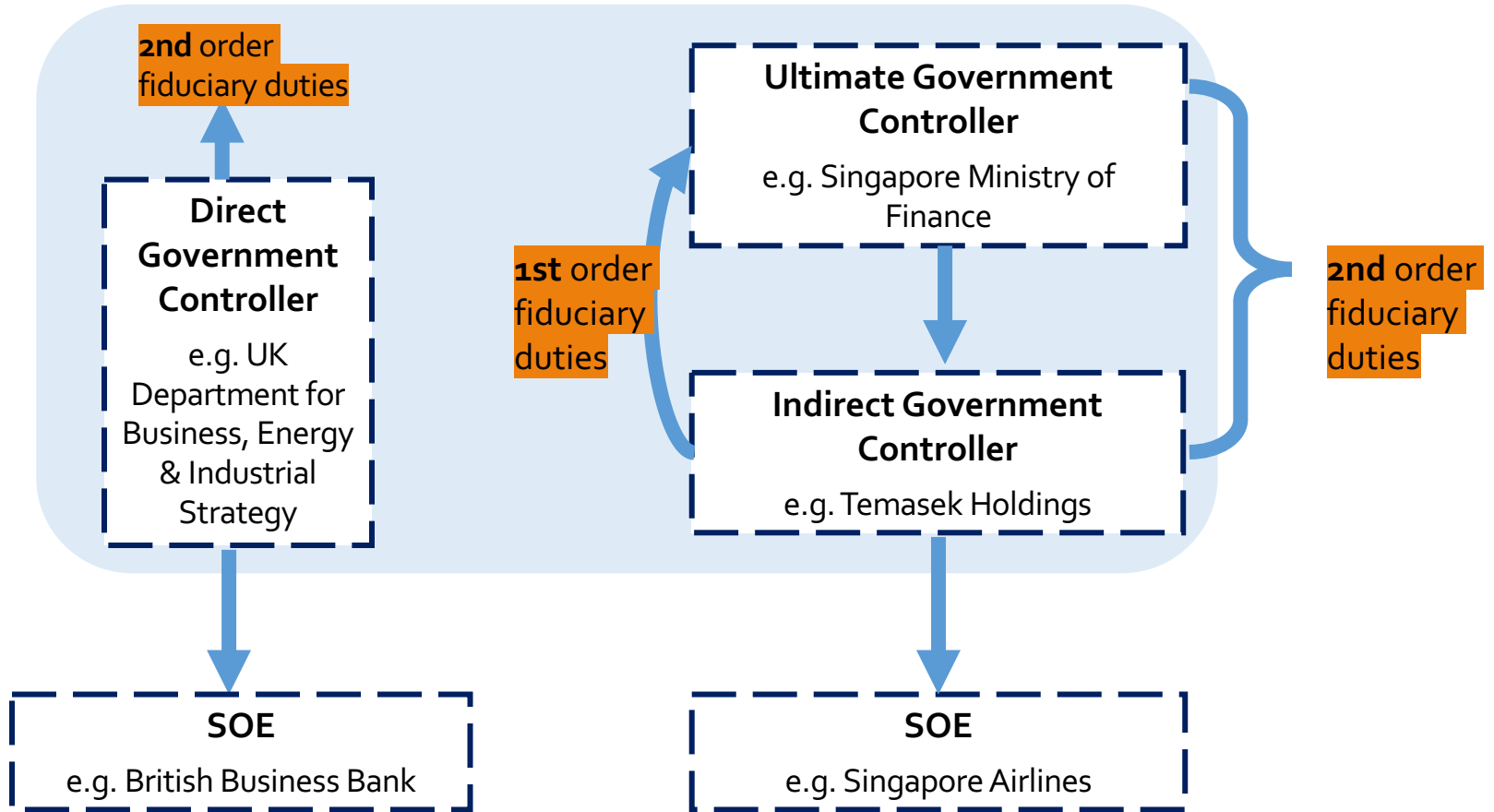
Extension of Fiduciary Government Theory to the Government Controlling Shareholder

- The government and its entities exercise discretionary powers.
 - Likewise when the government shareholder exercises its voting powers
- The government represents – acts for – the members of the polity when it exercises discretionary powers because of authorisation by the members of the polity.
 - The power to control and manage state resources or investments rests with the government because of implied authorisation by members of the polity
 - OECD regards SOEs as “a main conduit for states to exercise their roles as economic actors.”
- The exercise of discretionary power by the state affects the rights and interests of the members of the polity.
 - Likewise, when the government shareholder exercises its power to vote for or against climate related resolutions
- The power to control and manage state resources lies with the government through the SOEs.

Case law

“Fiduciary duties typically arise where one person undertakes and is entrusted with authority to manage the property or affairs of another and to make discretionary decisions on behalf of that person... The essential idea is that a person in such a position is not permitted to use their position for their own private advantage but is required to act unselfishly in what they perceive to be the best interests of their principal.”

Sheikh Tahnoon Bin Saeed Bin Shakhboot Al Nehayan v Kent EWHC 333 (Comm) [159] (HC 2018) (Leggatt LJ); *Lehtimaki v. Cooper*, UKSC 33 (SC 2020).



1st and 2nd Order Fiduciary Duties

- ▶ **1st order** fiduciary duties: duties owed to specific beneficiaries/principals
- ▶ **2nd order** fiduciary duties: arise from the relationship between the fiduciary and the public regarding institutions entrusted to the fiduciary's administration

Enforcement of Fiduciary Duties

- ▶ Breach of *1st* order fiduciary duties: the asset owner (the government who is the ultimate controlling shareholder) can sue the asset manager (the government interposed entity who is the direct controlling shareholder of SOEs)
- ▶ Breach of *2nd* order fiduciary duties: a public ombudsman can be established to sue the the duty bearer

Potential objections

- Multiple beneficiaries with divergent interests?
- Public law constraints suffice?
- Corporate law constraints suffice?

Implications for Climate Change Management

- Investment Approach and Governance Structure
- **Avoiding Conflicts of Interest**
- Monitoring the SOEs
- **Engagement Practices**
- Exercise of Formal and Informal Powers

Implications for Climate Change Litigation

Two benefits of using breach of fiduciary duties as a cause of action:

- **Supplements existing causes of action** (breach of constitutional law, human rights law, tort law, corporate law, environmental law, public international law etc)
- **May be easier to prove causation:** court will presume the defendant's breach has caused the claimant's loss and defendant has to rebut presumption

Time to rethink...

- **Who should be held accountable?**
 - **Companies and directors (see eg EU CSDDD). What about the government controlling shareholder?**
- **Why corporate law fails to address conflicts of interest and misuse of powers by the government controlling shareholder?**
 - **Majority v minority; directors v shareholders; what about the government controller v the public?**
- **How can governmental controller fiduciary duties facilitate climate change management and litigation?**

THANK YOU!