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Can a Global Legal Misfit be Fixed? Shareholder Stewardship in a Controlling Shareholder and ESG World

Law Working Paper N° 600/2021
August 2021

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Abstract

As demonstrated by one of the authors elsewhere, UK-style shareholder stewardship is a 'global legal misfit' because it was designed for a jurisdiction with dispersed shareholding where institutional investors collectively control a majority of the shares; however, it has been transplanted into jurisdictions where controlling shareholders predominate and institutional shareholders are collectively minority shareholders. This Chapter addresses an important question that naturally flows from this reality: what ought to be the role of shareholder stewardship in a world dominated by controlling shareholders?

This question is answered by analyzing the effectiveness of shareholder stewardship as a mechanism for advancing ESG in controlled jurisdictions – especially when compared to other viable alternatives. It then operationalizes this analysis by evaluating the effectiveness of the only stewardship code in the world – the Singapore Family Code – that has attempted to reorient UK-style stewardship to a controlling shareholder environment.

This Chapter concludes that the prospects for shareholder stewardship in jurisdictions where controlling shareholders predominate will likely be limited. Although a reoriented approach to shareholder stewardship may play a role in nudging controlling shareholders towards ESG, hard law will likely be necessary to bring about real change. Unfortunately, this suggests that shareholder stewardship may be used as a 'smoke screen' by controlling shareholders and governments to send a formal signal that they are addressing ESG in controlled jurisdictions – when, in reality, functional change will be limited in practice.

Keywords: Shareholder Stewardship, Controlling Shareholders, Comparative Corporate Law and Governance, ESG

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Ernest Lim & Dan W. Puchniak

in, GLOBAL SHAREHOLDER STEWARDSHIP (Dionysia Katelouzou & Dan W. Puchniak eds, Cambridge University Press, Forthcoming)

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I. Removing the Anglo-American Centric Blinders to Examine the Future of Stewardship

Prior to this Book project, the primary metric used by leading academics and pundits to evaluate whether a stewardship code was a success or failure appeared to be clear: did the code transform rationally passive institutional shareholders into actively engaged shareholder stewards? Since the United Kingdom issued the world's first stewardship code in 2010 (UK Code 2010),[1] a vigorous debate has raged, and a thoughtful academic literature has developed, attempting to answer this question.[2] In December 2018, the UK Government commissioned Kingman Review definitively provided an answer by pointedly concluding that the UK Code was 'not effective in practice'.[3] In short, the UK Code had failed to transform rationally passive institutional shareholders into actively engaged shareholder stewards.[4]

In response, the UK's Financial Reporting Council (FRC) issued its third edition of the UK stewardship code (the UK Code 2020), which makes Environmental, Social, and Governance (ESG) considerations its primary focus.[5] The FRC's hope is that this may finally achieve the UK Code's elusive goal to transform rationally passive institutional investors into actively engaged shareholder stewards.[6] Predictably, there has been a debate about whether this hope will become a reality, which has caused the academic literature – the latest of which is contained in this Book – to continue to grow.[7]

While this debate has raged on in the UK, as detailed in this Book, stewardship codes have been issued in many of the world's leading economies and now exist in 20 jurisdictions on six continents, with more jurisdictions considering adopting them.

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[1] Financial Reporting Council, *The UK Stewardship Code* (July 2010) <https://www.frc.org.uk/getattachment/e223e152-5515-4cdc-a951-da33e093eb28/UK-Stewardship-Code-July-2010.pdf> accessed 19 May 2021 [hereinafter UK Code 2010].

[2] Dan W Puchniak, 'The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit' (2021) *The American Journal of Comparative Law* (forthcoming); Gen Goto, Alan K Koh and Dan W Puchniak, 'Diversity of Shareholder Stewardship in Asia: Faux Convergence' (2020) 53 *Vanderbilt Journal of Transnational Law* 829; Koh, Puchniak and Goto, Shareholder Stewardship in Asia, Chapter 29.

[3] John Kingman, 'Independent Review of the Financial Reporting Council' (Department for Business, Energy and Industrial Strategy, December 2018) 8 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf> accessed 19 May 2021 [hereinafter Kingman Review].

[4] Puchniak (n 2).

[5] Financial Reporting Council, *The UK Stewardship Code 2020* (2019) <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf> accessed 19 May 2021 [hereinafter UK Code 2020]; Puchniak (n 2).

[6] Puchniak (n 2).

[7] Davies, The UK Stewardship Code 2010-2020, Chapter 2.

Virtually all these non-UK codes, except for the Singapore Family Code, focus on the goal that has been at the core of the UK Code since its inception: transforming rationally passive institutional investors into actively engaged shareholder stewards. Based on the UK-centric debate and academic literature prior to this Book project, the metric of success for these non-UK codes was assumed to be the same as in the UK.[8]

However, as explained by one of us in detail elsewhere, pundits and academics have overlooked a critical fact: outside of the UK/US it may not matter nearly as much if stewardship 'succeeds' in changing the behaviour of institutional investors.[9] This is because with the notable exception of the UK/US, institutional investors are collectively minority shareholders in most listed companies in almost every jurisdiction in the world.[10] Moreover, in most jurisdictions, with the notable exception of the UK/US, most listed companies already have a rationally active – non-institutional – controlling shareholder as their 'steward'.[11]

The impact of this observation on the 'success' of UK-style codes globally is difficult to overstate. It is uncontroversial that *if* a stewardship code in the UK/US succeeds in incentivizing institutional investors to become actively engaged shareholders, institutional investors will axiomatically steward the vast majority of UK/US listed companies.[12] This is an indisputable fact because institutional shareholders collectively control the vast majority of shares in UK/US listed companies.[13] As such, if a stewardship code succeeds in the UK/US it would solve the 'ownerless corporations' problem that stewardship in the UK was designed to solve.[14] Stewardship would also have a significant impact on the systemic corporate governance problems that drove its adoption because institutional investors would steward a large enough swath of UK/US listed companies for their actions to have systemic consequences.[15] In short, the design of the UK code 'fits' the shareholder structure in the UK/US because *if* it succeeds it will produce its intended result.

However, in non-UK/US jurisdictions the situation is entirely different: *if* a stewardship code succeeds in incentivizing institutional investors to become actively

[8] Puchniak (n 2); Goto, Koh and Puchniak (n 2); Koh, Puchniak and Goto, Shareholder Stewardship in Asia, Chapter 29.
[9] Puchniak (n 2).
[10] Puchniak (n 2).
[11] Puchniak (n 2).
[12] Puchniak (n 2).
[13] Puchniak (n 2).
[14] Puchniak (n 2).
[15] Puchniak (n 2). For a novel perspective on how stewardship can play a role in addressing systemic risk, see, Jeffrey Gordon, 'Systemic Stewardship' (2021) ECGI Law Working Paper No 566/2021 <https://ssrn.com/abstract=3782814> accessed 19 May 2021.

engaged shareholders, institutional investors *will not* steward the vast majority of listed companies. In turn, institutional investors will not have the ability to effectively act as a mechanism to address the type of systemic corporate governance problems that the UK Code was designed to solve.[16] Perhaps, more importantly, most listed companies in most non-UK/US jurisdictions have a controlling shareholder, who has the economic incentive and shareholder power to steward the company it controls.[17] However, nothing in the UK Code's history or text suggest that it was ever intended to apply to controlling shareholders – but, the (overlooked) reality is that controlling shareholders are the 'natural stewards' of most listed companies outside of the UK/US.[18] In short, the design of the UK code is a 'global legal misfit' because, even if it 'succeeds' by changing the behaviour of institutional investors in non-UK/US jurisdictions, this will not produce its intended result.[19]

An obvious question that arises is: why would jurisdictions around the world adopt UK-style stewardship codes if they are global legal misfits? A detailed answer to this question, which is based on fresh empirical evidence and the jurisdiction-specific case studies in this Book, is provided in a forthcoming article by one of us.[20] To summarize its conclusion, governments and institutional investors around the world have issued stewardship codes to serve their own purposes.[21] The result has been that stewardship codes have served diverse functions globally – acting as a mechanism that governments can use to engage in 'halo signalling',[22] a tool for governments to advance their own diverse political agendas, or as a mechanism for institutional investors to stave off being regulated by the government.[23] This development, which is likely to continue, is something that the original drafters of the UK Code would never have anticipated and which, prior to this Book project, had been overlooked in the literature.[24]

This Chapter addresses another question that naturally flows from the fact that UK-style stewardship codes are global legal misfits: what *ought* to be the role of shareholder stewardship in a world dominated by controlling shareholders? There are three important

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16 Puchniak (n 2).
17 Puchniak (n 2).
18 Puchniak (n 2).
19 Puchniak (n 2).
20 Puchniak (n 2).
21 Puchniak (n 2); Ernest Lim, 'Concentrated Ownership, State-Owned Enterprises and Corporate Governance' (2021) 41 *Oxford Journal of Legal Studies* (forthcoming)
22 Puchniak (n 2). 'Halo signalling' refers to the strategic adoption of regulation to attract foreign investment notwithstanding the apparent practical irrelevance of such regulation to the jurisdiction's corporate environment. See Puchniak and Tang, Singapore's Embrace of Shareholder Stewardship, Chapter 14.
23 Puchniak (n 2).
24 Puchniak (n 2).

factors that define the context in which we answer this question. First, as this Chapter is forward looking, we answer this question based on a prediction that was made and explained in the introductory Chapter of this Book: that if stewardship has a future, its future will most likely be as a mechanism to advance the ESG movement. As such, this Chapter will focus on the role that shareholder stewardship ought to play in helping to advance ESG in a world dominated by controlling shareholders. This makes sense as the UK Code 2020 has reoriented stewardship to focus on ESG and, therefore, this focus will provide a window into how stewardship ought to work globally in light of the new UK Code 2020 and the global rise of ESG.

Second, in evaluating the role of stewardship codes in jurisdictions where controlling shareholders predominate, we will consider viable alternatives to shareholder stewardship for advancing ESG. This is important as there are several corporate governance tools that may serve to advance ESG. An accurate understanding of the role that stewardship should (or should not) play in controlled jurisdictions cannot be evaluated in a vacuum. The utility of stewardship must therefore be juxtaposed against these functional substitutes to determine the value of shareholder stewardship in practice, as it is only one tool in the toolbox for improving corporate governance in controlled jurisdictions with a focus on ESG.

Third, the Singapore Family Code is the only stewardship code that does not see institutional investors as the primary target of shareholder stewardship.[25] Moreover, it is the only stewardship code in the world that focuses on a type of controlling shareholder.[26] As such, we will evaluate the strengths and weaknesses of the Singapore Family Code as it provides the only window into a stewardship code that attempts to 'fix' the UK stewardship code model by creating a code that 'fits' the shareholding structure of a jurisdiction dominated by controlling shareholders (and where institutional investors collectively own only a small minority of shares in listed companies).[27]

At risk of ruining the suspense, ultimately, we conclude that it will be difficult to 'fix' this global legal misfit to effectively address the core corporate governance problems in controlled jurisdictions, with a view towards advancing the ESG movement globally. Although a reoriented approach to shareholder stewardship may play a role in nudging controlling shareholders towards ESG, hard law will likely be necessary to bring about real change. Unfortunately, this suggests that shareholder stewardship may be used as a 'smoke screen' by controlling shareholders and governments to send a formal signal that

[25] Puchniak (n 2); Puchniak and Tang, Singapore's Embrace of Shareholder Stewardship, Chapter 14.
[26] ibid.
[27] ibid.

they are addressing ESG in controlled jurisdictions when, in reality, functional change will be limited in practice. If this occurs, the history of shareholder stewardship in controlled jurisdictions may not be a repeat of the UK experience, but it will likely rhyme.

II. Possible Approaches to Stewardship Codes in a Controlling Shareholder and ESG World

What ought to be the role of shareholder stewardship in a controlling shareholder and ESG world? As a starting point, consider the definition of stewardship in the UK Code 2020: 'Stewardship is the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.'[28] This definition applies to asset owners and asset managers – but not to controlling shareholders. Under UK law, unlike asset managers who owe fiduciary duties to their clients, and asset owners to their beneficiaries, controlling shareholders are generally not subject to fiduciary duties[29] – illustrating how issues involving controlling shareholders are distinct from those involving asset owners and asset managers, which are the focal points of the UK Code.[30]

In a similar vein, shareholder passivity, short termism, and complex investment chains associated with institutional investors are not the key issues facing concentrated ownership jurisdictions. Rather, a central and persistent issue is controlling shareholders extracting private benefits of control by diverting resources from the company to the controller at the expense of the company and minority shareholders.[31]

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[28] UK Code 2020 (n 5) 4.

[29] But controlling shareholders of Premium-listed companies on the London Stock Exchange are subject to certain governance arrangements with their companies in order to prevent disproportionate exercises of power that adversely affect minority shareholders: FCA Listing Rule 6.5.4. This is not a fiduciary duty on the part of the company or the controlling shareholder but merely a restriction imposed by the listing rules. One of us has also argued that controlling shareholders in the common law Asian jurisdictions should be subject to fiduciary duties: Ernest Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (CUP 2019) 205-272.

[30] Law Commission, *Fiduciary Duties of Investment Intermediaries* (Law Com No 350, 2014) 106, para 5.95-5.97 <http://www.lawcom.gov.uk/app/uploads/2015/03/lc350_fiduciary_duties.pdf> accessed 19 May 2021; but note that under US law, controlling shareholders owe fiduciary duties to minority shareholders (but usually in the context of freeze-outs and closely held companies), see *Jones v HF Ahmanson & Co.,* 460 P.2d 464 (Cal. 1969); Andreas Cahn, 'The Shareholders' Fiduciary Duty in German Company Law' in Hanne S Birkmose (ed), *Shareholders' Duties* (Kluwer Law International 2017) (under German law, shareholders are subject to fiduciary duties).

[31] For an overview of how private benefits of control work in different jurisdictions and types of companies, see Dan W Puchniak, 'Multiple Faces of Shareholder Power in Asia: Complexity Revealed' in Jennifer G Hill and Randall S Thomas (eds), *Research Handbook on Shareholder Power* (Edward Elgar Publishing 2015). See also Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (n 29).

But this does not mean that controlling shareholders play no role, or should play no role, in creating long-term sustainable benefits. On the contrary, the question is whether in the exercise of their formal powers (voting rights) and informal powers (influence over the board and managers), controllers should act responsibly, given that the exercise of such powers will not only impact the minority shareholders and companies (of which they are the controllers), but also the broader economy, environment, and society. It would be highly anomalous if institutional shareholders are expected to be stewards but not controllers because the latter wield more powers and play a more important role than the former in concentrated ownership jurisdictions. This is especially the case in today's world as ESG and a focus on 'corporate purpose' have become the zeitgeist of corporate law and governance, representing one of the more recent rationales cited as driving the adoption of stewardship codes.[32]

But what then should be expected of controllers? There are three main approaches. The first is to stick to soft law, that is, to either amend the existing stewardship codes to include controlling shareholders or to draft a new code for controllers or concentrated ownership companies. The second is not to use the stewardship code as a mechanism but to amend the rules regulating the extractions of private benefits of control by controllers – specifically the stock exchange rules on related party transactions (RPTs) – such that the bodies responsible for considering and approving the RPTs have to take into account ESG considerations. The third and final approach is to resort to directors' duties: to argue that directors are legally required to consider sustainability considerations as part of their duties of care and loyalty.

A. *First Approach: Reforming the Stewardship Codes*

Singapore is the only jurisdiction in the world to have created a separate stewardship code for non-institutional shareholders: the Singapore Family Code.[33] But as is evident in the title of the code, it is only directed at a specific type of company, namely family controlled ones, not State-Owned Enterprises (SOEs) which are the other dominant type of company in Singapore and in many other concentrated ownership jurisdictions.[34] It is

[32] Ernest Lim, *Sustainability and Corporate Mechanisms in Asia* (CUP 2020) ch 5; Katelouzou and Klettner, Sustainable Finance and Stewardship, Chapter 26, Part III.B.

[33] Stewardship Asia Centre, *Stewardship Principles for Family Businesses* (2018) <https://www.stewardshipasia.com.sg/sites/default/files/2020-09/SPFB-brochure-0913.pdf> accessed 19 May 2021 [hereinafter Singapore Family Code].

[34] For an excellent overview of the unique corporate governance issues involving SOEs, see Curtis J Milhaupt and Mariana Pargendler, 'Governance Challenges of Listed State-Owned Enterprises Around

curious that stewardship principles only apply to family businesses, but not to SOEs which play a more crucial role in the Singapore economy and society. After all, SOEs control and manage the key infrastructure, energy, and public utilities systems as well as the provision of vital financial and technological services.[35] In emerging economies especially, SOEs play a key role in preventing redundancy, income redistribution, and reducing prices of goods and services below market rate.[36] In addition, SOEs in China, which is now an economic superpower, are at the core of its economy and have become some of the most powerful companies in the world.[37]

There are three possible explanations for why SOEs are not subject to stewardship principles in Singapore. First, and most likely, given that the SOEs in Singapore are generally known for their efficiency and for taking a long-term approach to value creation,[38] it is unnecessary for the SOEs, at least in Singapore, to adhere to stewardship principles. Second, it may seem unlikely for the state as the controlling shareholder of SOEs to willingly propose and issue a set of rules that will constrain its powers. However, as Puchniak and Lan explain, in the context of Singapore, the state, somewhat counterintuitively, has created an institutional architecture to constrain its own controlling shareholder power[39] – which might make Temasek justified in referring to itself as a 'good steward'.[40] Finally, given that the body that issued the Singapore Family Code – Stewardship Asia – is a non-government organization that is affiliated with and is supported by Temasek Holdings, which is the controlling shareholder of the SOEs in Singapore, it would seem to present a direct conflict of interest if Stewardship Asia drafted rules for controlling shareholders. However, as highlighted in the introductory Chapter in this Book, somewhat curiously in the context of institutional investors this has been done in many jurisdictions (i.e., Australia, Brazil, Canada, Italy, Netherlands,

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the World: National Experiences and a Framework for Reform' (2017) 50 *Cornell International Law Journal* 473; see also Lim, *Sustainability and Corporate Mechanisms in Asia* (n 32).

35 Michael A Witt and Gordon Redding (eds), *The Oxford Handbook of Asian Business Systems* (OUP 2014).

36 ibid.

37 Tan Cheng Han, Dan W Puchniak and Umakanth Varottil, 'State-Owned Enterprises in Singapore Model: Historical Insights Into a Potential Model for Reform' (2015) 28 *Columbia Journal of Asian Law* 61, 62; Li-Wen Lin and Curtis J Milhaupt, 'We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China' (2013) 65 *Stanford Law Review* 697, 699.

38 James S Ang and David K Ding, 'Government Ownership and the Performance of Government-Linked Companies: The Case of Singapore' (2006) 16 *Journal of Multinational Financial Management* 64, 85-86; Carlos D Ramírez and Ling Hui Tan, *Singapore, Inc. Versus the Private Sector: Are Government-Linked Companies Different?* (IMF Working Paper 03/156, 2003) <https://www.imf.org/external/pubs/ft/wp/2003/wp03156.pdf> accessed 19 May 2021.

39 Dan W Puchniak and Luh Luh Lan, 'Independent Directors in Singapore: Puzzling Compliance Requiring Explanation' (2017) 65 *The American Journal of Comparative Law* 265, 306-310.

40 Dan W Puchniak and Samantha Tang, 'Singapore's Puzzling Embrace of Shareholder Stewardship: A Successful Secret' (2020) 53 *Vanderbilt Journal of Transnational Law* 989, 1009-1010.

Norway, South Africa, Switzerland, and the United States)[41] where institutional investors have drafted stewardship codes regulating institutional investors (i.e., themselves).[42]

Similar to Singapore's other stewardship code that applies only to institutional shareholders (the Singapore Stewardship Principles for Responsible Investors), the Singapore Family Code is purely voluntary and non-binding; no companies are required to sign-up to it and for signatories no sanctions or disincentives are imposed. The Singapore Family Code makes it clear that it is not intended to be prescriptive. Rather, it is merely a set of guidelines or 'signposts'.[43] The soft law nature of the Singapore Family Code is not necessarily problematic because soft law may perform a critical function in shaping, transmitting and normalising best practices and norms.[44] Further, precisely because the Singapore Family Code is merely a set of non-binding guidelines, they may be more acceptable to family businesses and arguably gain more traction.

The Singapore Family Code states in the preamble that 'stewardship encapsulates the essence of responsible and meaningful value creation in a sustainable way to benefit stakeholders, as well as the larger community that they are a part of.'[45] This is consistent with the 'central question'[46] that the Singapore Family Code seeks to address: 'How does Family Business thrive and sustain growth while enhancing the wealth of its stakeholders and the well-being of the societies in which it operates over the long term?'.[47] Thus, stewardship is to promote the long-term viability of the company and the goal is to benefit stakeholders (the term of which is undefined) and the society. For example, practice note (e) to Principle 2 states: 'Embrace the responsibility for creating long-term social and economic value to a wider group of stakeholders, and not just myopically focusing on family wealth to foster ownership mentality amongst all those who play a role in the success of the business.'[48] This is in accordance with the increasing global focus on 'corporate purpose' going beyond merely shareholder value and the desire for companies to address broader issues related to ESG.[49]

However, one glaring omission in the Singapore Family Code is that it does not

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41 Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1; Puchniak (n 2).

42 Bowley and Hill, Stewardship and Collective Action, Chapter 19, Part II.A; Williams, Stewardship Principles in Canada, Chapter 20, Part I; Fisch, The Uncertain Stewardship Potential of Index Funds, Chapter 21, Part II.

43 Singapore Family Code (n 33) 2.

44 Katelouzou and Klettner, Sustainable Finance and Stewardship, Chapter 26, Part IV.

45 Singapore Family Code (n 33) 1.

46 Singapore Family Code (n 33) 8.

47 ibid.

48 Singapore Family Code (n 33) 4.

49 Edward Rock, 'For Whom is the Corporation Managed in 2020?: The Debate Over Corporate Purpose' (2020) ECGI Law Working Paper No 515/2020 <https://ssrn.com/abstract=3589951> accessed 11 May 2021; Colin Mayer, *Prosperity: Better Business Makes the Greater Good* (OUP 2019).

explicitly state who is responsible for taking action under the principles: Is it the shareholders, directors, managers, or employees? It would seem logical that the controlling family shareholders should be made explicitly responsible under the Code to ensure compliance with it, as they – by definition – have the legal power through their voting rights to control the corporate governance in family companies. This appears to have been the design intention and impetus for creating the Code in the first place, as it reorients the core concept of shareholder stewardship to focus on controlling shareholders in family businesses and has nothing to do with institutional investors.[50] However, this is left ambiguous in the Code and, more importantly, if the family controllers are the intended target – which we assume is the case[51] – the Code should make their obligations as stewards under the Code clear. Without this being clarified it is impossible to hold the family controlling shareholders, or any other constituency within family companies, accountable – a problem in the Code which must be rectified.

By contrast, there is no dispute that all versions of the UK Code – and indeed every other stewardship code in the world – are directed at institutional investors and the obligations of institutional investors are made clear in the UK Code.[52] Moreover, at least under the UK model, for domestic UK qualified institutional investors, compliance with the code is mandatory and, under the UK Code 2020, all institutional investors bound by the code must 'apply and explain' its principles – a harder obligation than the UK's original voluntary 'comply or explain' approach.[53] For signatories who fail to furnish adequate disclosure, regulators can consider adopting a tiering mechanism, like the one deployed in the UK by the FRC, to put pressure on institutional investors to provide high quality disclosure.[54]

Another problem is that the subject of the Singapore Family Code – family companies – are not required to produce any disclosure or to take any follow-up action as to how they have implemented the principles. Nor has the issuer of the code, Stewardship Asia, put in place a mechanism to identify and monitor who has signed up to the Singapore

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[50] Puchniak and Tang, Singapore's Embrace of Shareholder Stewardship, Chapter 14; Puchniak (n 2). See Lim, *Sustainability and Corporate Mechanisms in Asia* (n 32) 188-195.

[51] Given its ambition of making Singapore the standard bearer for a new Asian model of corporate governance.

[52] Puchniak (n 2).

[53] Changes driven by the criticisms of the Kingman Review (n 3) 8, 46. See Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1 and Davies, The UK Stewardship Code 2010-2020, Chapter 2.

[54] Financial Reporting Council, 'Tiering of 2012 Stewardship Code Signatories' <https://www.frc.org.uk/investors/uk-stewardship-code/uk-stewardship-code-statements> accessed 11 May 2021. See Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1.

Family Code. As a result, there are no mechanisms to monitor its effectiveness.[55]

Considering the problems with the Singapore Family Code, it is suggested that should other concentrated ownership jurisdictions adopt stewardship codes for controlling shareholders, they should consider ensuring that the following actions are taken. First, the code needs to clarify that all controlling shareholders (regardless of whether they are the controllers of SOEs, family companies, or other types of companies) are subject to the code – expected to act as stewards – and they are the ones who are expected to take actions to promote stewardship.

Second, the code should make clear what stewardship means. It is suggested that stewardship in concentrated ownership companies is the responsible exercise of formal and informal powers by controlling shareholders[56] to create long-term value for the company leading to sustainable benefits for the society, environment, and economy. Thus, controllers are expected to consider and give effect to ESG considerations. The beneficiaries of stewardship include not only the shareholders as a whole, but also the stakeholders, and society in general.

Third, the code should specify the actions that are expected of controlling shareholders. It is suggested that controlling shareholders should be expected to provide clear and informative disclosure of: (a) the values, strategies and goals underlying their investments and how these are aligned with stewardship; (b) how they have promoted stewardship in their exercise of all their voting rights; (c) how they have engaged with the directors, managers and minority shareholders for the purpose of promoting stewardship; and, (d) actual or potential conflicts of interests related to stewardship and how they have managed these conflicts. Finally, mechanisms should be put in place to monitor who has signed up to the code and to assess the quality of disclosure of the controlling shareholders.[57]

However, it could be argued that to characterise controlling shareholders as stewards and to expect controllers to make the above disclosures is not only onerous but is highly

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[55] This can be contrasted with the more robust reporting expectations of the UK Code 2020: Davies, The UK Stewardship Code 2010-2020, Chapter 2, Part III. See also Katelouzou and Sergakis, Shareholder Stewardship Enforcement, Chapter 27.

[56] The definition of a controlling shareholder can be adopted from the listing rules. For example, the Singapore Exchange defines a 'controlling shareholder' as one who holds 15% or more of the issued shares or who in fact exercises control over the company: Singapore Exchange, 'SGX Rulebook: Definitions and Interpretation' <http://rulebook.sgx.com/rulebook/definitions-and-interpretation-0> accessed 19 May 2021.

[57] For empirical evidence that non-binding stewardship codes are likely to be ineffective see Lucian A Bebchuk, Alma Cohen and Scott Hirst, 'The Agency Problems of Institutional Investors' (2017) 31 *Journal of Economic Perspectives* 89, 90, 108. In the context of corporate governance, see Lucian Bebchuk and Roberto Tallarita, 'The Illusory Promise of Stakeholder Governance' (2020) 106 *Cornell Law Review* 91.

problematic. This is because it would make sense for institutional shareholders to take into account ESG considerations in their investment strategies and decisions insofar as these impact on the economic interests of their clients/beneficiaries to whom they owe fiduciary duties – a point which dovetails with ESG being the future of stewardship, which was highlighted in the introductory Chapter of this Book.[58] But controlling shareholders generally owe no fiduciary duties upwards (for they are usually the ultimate beneficiaries). Nor, at least in concentrated ownership commonwealth jurisdictions, do controllers owe such duties downwards (for they owe no duties to the company, unlike directors).[59] Further, to expect controlling shareholders to be stewards will subject their exercise of voting powers to constraints, but this is contrary to the principle in commonwealth jurisdictions that votes are property rights and shareholders can generally exercise them as they please[60] (subject to minimal restrictions, the most important of which is that shareholders must act bona fide for the company's benefit as a whole).[61] Finally, it is unlikely for the government, as the controlling shareholder of SOEs, to voluntarily come up with a stewardship code for itself unless there is an external impetus or pressure for doing so – but normally there appears to be none.

There are, however, several counterarguments that may suggest it would make sense to characterize controlling shareholders as stewards. First, it is morally and socially unacceptable that while the conduct of controlling shareholders, especially in concentrated ownership jurisdictions, has significant impact on companies, societies, and the environment, controllers are not expected to do anything – unlike institutional investors who are relatively less powerful and yet are expected to be stewards.[62] Second, expecting controlling shareholders to act as stewards pursuant to a stewardship code poses no effective constraint on their behaviour because the codes are generally voluntary and non-binding and no sanctions are attached for non-compliance.[63] Third, one cannot rule

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[58] Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1. Max M Schanzenbach and Robert H Sitkoff, 'Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee' (2020) 72 *Stanford Law Review* 381, 399-400.

[59] Cf Ernest Lim, 'Controlling Shareholders and Fiduciary Duties in Asia' (2018) 18 *Journal of Corporate Law Studies* 113, 115.

[60] See e.g. *North-West Transportation Co Ltd v Beatty* [1887] UKPC 39, (1887) 12 App.Cas. 589; *Burland v Earle* [1902] AC 83 (PC), 94 (Lord Davey); *Northern Counties Securities Ltd v Jackson & Steeple Ltd* [1974] 1 WLR 1133; *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch 258.

[61] *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch 656.

[62] The adoption of stewardship codes for institutional investors even in jurisdictions dominated by controlling shareholders may be driven by the goal of achieving jurisdiction-specific ESG goals, but is of dubious efficacy as minority institutional investors are generally passive: Puchniak (n 2) Part IV(e).

[63] Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1. It could be argued that the UK Code has become more mandatory – at least since domestic institutional investors became subject to it.

out the possibility that to promote its international standing and to enhance its legitimacy, the government as the controller may agree to have a code.[64] This will not only augment its reputation, but it could also attract more investments from minority shareholders.[65] Finally, the actions of shareholders, especially controlling shareholders, are already subject to significant restrictions, the three most important of which are: (1) minority shareholders remedies (e.g., minorities can often sue the company and its controllers for unfair treatment through direct or derivative actions);[66] (2) restrictions on Related Party Transactions (i.e., transactions between controllers (or their affiliates) and the company), which are often regulated by company law and/or the listing rules;[67] and, (3) fiduciary duties of controlling shareholders in the United States and equivalent duties in other jurisdictions,[68] with the notable exception of commonwealth jurisdictions which do not have such duties. However, it may be argued that these restrictions are not intended to promote stewardship; rather, they are intended to protect minority investors from oppressive behaviour or to minimise private benefits of control. Thus, it is worth considering whether instead of developing a brand-new stewardship code for controlling shareholders, the listing rules can be tweaked such that the approval of RPTs requires ESG considerations to be considered.

Financial Reporting Council, *The UK Stewardship Code* (September 2012) <https://www.frc.org.uk/getattachment/d67933f9-ca38-4233-b603-3d24b2f62c5f/UK-Stewardship-Code-(September-2012).pdf> accessed 11 May 2021 [hereinafter UK Code 2012] (under the UK Code 2012 they were required to 'comply or explain' — they could not opt out – which is unique to the UK Code); see also UK Code 2020 (n 5) 4 (the UK Code 2020 now employs the 'apply and explain' principle).

[64] Puchniak and Tang, Singapore's Embrace of Shareholder Stewardship, Chapter 14; Puchniak (n 2).

[65] Conversely, this may be ineffective where the motivation behind adopting stewardship is solely 'halo signalling', seeking to attract foreign investment by bolstering an image as a jurisdiction which embraces cutting-edge global norms of 'good' corporate governance without effecting any actual changes to the corporate governance mechanism: Puchniak and Lan (n 39) 272; Puchniak and Tang (n 40) 1004-1005; Goto, Koh and Puchniak (n 2) 874-880; Puchniak (n 2) Part IV(c). See generally Jeffrey Gordon, 'Convergence and Persistence in Corporate Law and Governance' in Jeffrey Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2018) 28-30.

[66] Harald Baum and Dan W Puchniak, 'The Derivative Action: An Economic, Historical and Practice Oriented Approach' in Dan W Puchniak, Harald Baum and Michael Ewing-Chow (eds), *The Derivative Action in Asia: A Comparative and Functional Approach* (CUP 2012); Arad Reisberg, *Derivative Actions and Corporate Governance* (OUP 2007).

[67] Dan W Puchniak and Umakanth Varottil, 'Related Party Transactions in Commonwealth Asia: Complicating the Comparative Paradigm' (2020) 17 *Berkeley Business Law Journal* 1, 20-28. See more generally Luca Enriques and Tobias Tröger (eds), *The Law and Finance of Related Party Transactions* (CUP 2019).

[68] Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (n 29) 318-328.

B. Second Approach: Reforming the Listing Rules on Related Party Transactions

RPTs are arguably the most pervasive means through which controlling shareholders extract private benefits of control. RPTs are commonly subject to three controlling techniques: opinions from the audit committee and independent financial adviser as well as approval from disinterested shareholders. The requirements of the contents of both sets of opinions slightly vary among jurisdictions.[69] But essentially, both opinions have to state whether the transaction is fair and reasonable and whether it is in the best interests of the issuer and the shareholders as a whole.[70] However, the listing rules do not provide any guidance as to what amounts to 'fair and reasonable' and what amounts to 'best interests'.

It is suggested that the stock exchange can provide clarification by requiring the opinions to state that in determining whether the transaction is in the issuer's interests, the opinions have to disclose how ESG considerations have been taken into account. After all, it is well-established that ESG considerations have a material bearing on corporate interest.[71] In doing so, an important effect of stewardship which is to produce long term benefits for the environment, economy and society can be met.

Modifying the listing rules in this way has several advantages. First, this modification should be acceptable to the controllers and issuers because the stock exchange is not imposing any additional duties or restrictions on the ability of controllers to engage in RPTs; nor does the exchange constrain the behaviour of controllers. The stock exchange is merely clarifying the requirements of the existing rules regulating RPTs. Second, requiring the opinion to state how ESG considerations have been considered is consistent with existing practices and norms. This is because boards of listed companies should incorporate (or are already incorporating) ESG considerations in their decision-making process (insofar as they impact on corporate interests) and companies are already required to furnish ESG/sustainability reports.[72] Thus, no significant cost is imposed on the company (through its audit committee) if it must consider ESG factors in assessing whether the RPTs are in its interests.

Finally, incorporating ESG considerations into the assessment of RPTs should bring

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[69] Puchniak and Varottil (n 67) 22-24; Enriques and Tröger (n 67) 12-14; Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (n 29) 218.

[70] In other jurisdictions, the listing rules require the opinions from the audit committee and the independent financial advisor to state that the transaction is not detrimental to the interests of the issuer and those of the minority shareholders.

[71] Lim, *Sustainability and Corporate Mechanisms in Asia* (n 32) 7-9.

[72] Lim, *Sustainability and Corporate Mechanisms in Asia* (n 32) ch 2.

about an increase in good RPTs (i.e., those that are consistent with the long-term value of the company leading to sustainable benefits for the environment, the economy and society). In doing so, the stock exchanges in concentrated ownership jurisdictions send a strong signal to minority investors that they are serious about integrating ESG considerations into their listing rules, not only pertaining to the reporting obligations by companies, but also in key transactions involving companies and their controllers. However, it must be remembered that an RPT regulatory regime is not simply about the black letter law, but about the manner and context in which the law is enforced. This suggests that for such an approach to work, rule of law and attention to how the rules should be applied in the local context must be carefully considered.[73]

C. Third Approach: Directors' Duties

The last approach – to require directors to consider, and where appropriate give effect to, ESG considerations as part of their duty of loyalty and duty of care insofar as ESG considerations are relevant to corporate interest – is an indirect mechanism to attain the goals of stewardship in concentrated ownership jurisdictions.[74] These directors could be the controlling shareholders themselves or the affiliates of the controllers. So, instead of targeting the controllers directly, this mechanism imposes requirements on the controllers, but not in their capacities as controlling shareholders but as directors. It is not uncommon in family-owned companies that the controlling shareholder is also a director and manager, or the controller's family members are directors and/or managers. In SOEs, the controlling shareholder, which is the state, will not be the director itself, but the controller's current or former affiliates or employees are likely to be the directors. These directors are often current or former politicians or who currently or previously worked with the controlling shareholder.[75]

However, there are two key problems with this approach. First, because controlling shareholders normally[76] wield the power to appoint and dismiss directors, insofar as the

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[73] Puchniak and Varottil (n 67).

[74] But remains more effective in achieving ESG goals than relying on the duties of institutional investors: Puchniak (n 2).

[75] For an example of this in Singapore, see Puchniak and Lan (n 39) 313-317.

[76] In certain jurisdictions, minority shareholders are given the right to appoint directors. Cumulative voting which benefits minority shareholders may allow them to successfully elect directors. But it remains uncommon for corporate law to grant minority board representation. See Luca Enriques, Henry Hansmann, Reinier Kraakman and Mariana Pargendler, 'The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies' in Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-

directors are not the controllers themselves, the directors are unlikely to defy the controllers if the latter's interests' conflict with ESG considerations.[77] For example, there could be situations when the reduction of carbon emissions or the switch to environmentally sustainable products would be costly insofar as it would have a clear negative impact on the company's short-term profitability, although there is tentative evidence that such actions will result in a long-term increase in share price. In this situation, it could be argued that the controllers' interests (at least in the short-term) will conflict with giving effect to climate change considerations; trade-offs may be required.[78] There is a risk that directors may prioritise the controller's interests at the expense of the long-term interests of the company and the environment.

Second, because the voting powers wielded by controlling shareholders are different from the functions and responsibilities of directors, there are important areas in which the controllers operate that will not be covered by the requirement to incorporate ESG considerations. In the context of most common law and civil law concentrated ownership jurisdictions, for example, the powers wielded and exercised by shareholders include but are not limited to the following: to appoint and dismiss directors without cause; alter the corporate constitution; dictate to or overrule the directors by altering the constitution; exercise management power if provided for in the constitution; authorise transactions between the company and directors by ordinary resolution that would otherwise amount to a breach of directors' duties; ratify breaches of directors' duties; approve mergers and acquisitions; and, approve significant transactions.[79] Of course, it is not always appropriate or relevant for controlling shareholders to incorporate ESG considerations whenever controllers exercise these powers. But the point remains that directors' duties are insufficient in themselves for the purpose of achieving the goals of stewardship in

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Georg Ringe and Edward Rock (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, OUP 2017), 80-81; see also Dan W Puchniak and Kon Sik Kim, 'Varieties of Independent Directors in Asia: A Taxonomy' in Dan W Puchniak, Harald Baum and Luke Nottage (eds), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (CUP 2017).

[77] Lim, 'Concentrated Ownership, State-Owned Enterprises and Corporate Governance' (n 21).

[78] Alan Schwartz and Reuben Finighan, 'Impact Investing Won't Save Capitalism' *Harvard Business Review* (17 July 2020) <https://hbr.org/2020/07/impact-investing-wont-save-capitalism> accessed 19 May 2021.

[79] Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (n 29) 11-12; Enriques, Hansmann, Kraakman and Pargendler (n 76) 80-81; Luca Enriques, Gerard Hertig, Hideki Kanda and Mariana Pargendler, 'Related-Party Transactions' in Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda, Mariana Pargendler, Wolf-Georg Ringe and Edward Rock (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, OUP 2017); Gen Goto, 'Legally "Strong" Shareholders of Japan' (2014) 3 *Michigan Journal of Private Equity & Venture Capital Law* 125; See Paul Davies and Klaus J Hopt, 'Corporate Boards in Europe—Accountability and Convergence' (2013) 61 *The American Journal of Comparative Law* 301.

concentrated ownership jurisdictions.

D. *Implementation: Stewardship as One Tool in the Toolbox to Control Controllers*

None of these three approaches is mutually exclusive. It is desirable to have all three, but we must consider how likely it is that these approaches will be implemented. The stewardship codes for institutional shareholders in jurisdictions with the highest concentration of shareholder ownership, which are mostly in Asia, have been drafted and issued by governmental bodies or entities that are affiliated with the state.[80] A stewardship code for controlling shareholders is likely to be issued by the same body. Thus, it is likely for now that the code for controllers (should there be one) in most jurisdictions will take the form of soft law (given that hard law will be opposed by the state in those jurisdictions where the state is a major controlling shareholder – which is common outside of the US/UK, particularly in Asia).[81] However, this does not mean that soft law is ineffectual provided that: (1) soft law includes provisions that controlling shareholders should disclose how they have promoted stewardship; (2) a tracking mechanism is put in place to ascertain which controllers have signed up to the code and which have not and appropriate pressure is applied to the latter group to sign up; and, (3) an independent and expert regulatory body or a non-government organization implements a system to assess whether and how the signatories have implemented the code.

In jurisdictions which have codes drafted by institutional investors themselves – which comprise most of the codes outside of Asia[82] – it is yet to be seen whether controlling shareholders may take a similar approach. In the past, this development may have seemed farfetched. However, if controlling shareholders observe stewardship codes for controllers emerging in other jurisdictions, they may see drafting a code to regulate themselves (insofar as they are not controllers in SOEs) as a strategy to pre-empt a government issued code from emerging in their own jurisdiction.[83] In addition, with the increasing pressure on companies to commit to ESG and demonstrate a purpose beyond maximizing shareholder value, controlling shareholders may see drafting a stewardship code as a cost effective way to signal their commitment to this agenda – without requiring

[80] See Puchniak (n 2).
[81] Puchniak (n 2).
[82] Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1. Puchniak (n 2).
[83] Puchniak and Katelouzou, Global Shareholder Stewardship, Chapter 1; Davies, The UK Stewardship Code 2010-2020, Chapter 2, Part I.

any real action. Most importantly, like codes drafted by institutional investors for themselves, it is unlikely that if controlling shareholders draft codes for themselves that such codes will have much of an impact on their actual behaviour – it will merely be another iteration of 'halo signalling'.

III. THE FUTURE OF STEWARDSHIP IN A CONTROLLING SHAREHOLDER AND ESG WORLD

The future of stewardship will be in jurisdictions in which institutional shareholders are collectively minority shareholders and listed companies are dominated by controlling shareholders.[84] This is clear because it describes the shareholder landscapes in almost every jurisdiction in the world, with the notable exceptions of the UK/US.[85] Given this reality, if the past is any predictor of the future, stewardship will not play the role intended by the UK Code in any non-UK/US jurisdiction – which debunks current conventional wisdom.[86]

This raises the question addressed in this Chapter: What ought to be the role of shareholder stewardship in a controlling shareholder and ESG world? With the increasing focus on corporate purpose and the related rise of ESG – both of which will likely increase post-Covid 19 – the need for governments and institutional investors to be *seen* to be acting in the interests of society as a whole, and especially the environment, is likely to intensify. As the UK Code 2020 has been reframed as a signal for societal and ESG interests, it will likely serve as an appealing mechanism for governments and institutional investors that already have UK-style codes to reform towards as a signaling device. As such, even though they are 'global legal misfits', jurisdictions that already have UK-style codes may amend them towards the UK Code 2020, citing their commitment to society, ESG, and corporate purpose. In Asia, some jurisdictions may decide to follow the Singapore Family Code model and claim that they are tailoring their approach to a new form of Asian corporate governance – with family owners as the natural stewards of a significant portion of listed companies.[87] Other non-UK/US jurisdictions outside of Asia, may see the Singapore model as a better 'fit' given their relative dearth of institutional

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[84] Puchniak (n 2).

[85] Puchniak (n 2).

[86] Puchniak (n 2); Goto, Koh and Puchniak (n 2); Koh, Puchniak and Goto, Shareholder Stewardship in Asia, Chapter 29.

[87] For an analysis of the Singapore Family Code and how it aims to create a model for Asia see, Puchniak and Tang (n 40). Kowpatanakit and Bunaramrueang, Thai Institutional Investors Stewardship Code and its Implementation, Chapter 16, Part V (suggesting that it may make sense for Thailand to follow the Singapore model of stewardship given Thailand's similar shareholder structure).

investors and predominance of controlling shareholders.

However, if this occurs, based on our analysis above, most likely, these developments will merely be about *signaling* a shift in focus towards a more inclusive society, the environment, and corporate purpose using the bright lights of stewardship. This may shift attention away from the hard law regulations and reforms outlined in this Chapter that may advance ESG more effectively than stewardship. For example, it would appear more efficient and effective to tweak listing rules so that ESG considerations become part of the RPT approval process than to create a controlling shareholder stewardship code from scratch which, based on Singapore's experience, is unlikely to have much real bite. Also, as one of us has explained in detail elsewhere, it may be worth considering whether imposing fiduciary duties on controlling shareholders in concentrated ownership jurisdictions that presently do not have them (e.g., in common law Asian countries) may be more worthwhile than attempting to nudge controlling shareholders towards ESG through shareholder stewardship.[88] As emphasized above, shareholder stewardship could work together with these hard law solutions as they are not mutually exclusive. However, the risk is that shareholder stewardship serves as a 'smoke screen' for controlling shareholders and governments to signal a movement towards ESG to ultimately avoid the tough choices required to change the hard law governing controlling shareholders.

In sum, although reorienting stewardship codes in controlled jurisdictions to focus on controlling shareholders may provide a nudge towards ESG, it appears that hard law will likely be necessary to bring about real change. For this to occur in controlled jurisdictions, the entrenched interests of controlling shareholders will have to be challenged – something which powerful corporations, families, and governments, who themselves are the dominant controlling shareholders around the world, will likely be able to avoid.[89] As such, it is likely that shareholder stewardship in controlled jurisdictions will either be built on misfitted UK-style codes or new codes fitted to controlled jurisdictions with little bite. Hopefully, for the future of ESG – which must succeed in controlled jurisdictions to have a global impact – we are wrong.

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[88] Lim, *A Case for Shareholders' Fiduciary Duties in Common Law Asia* (n 29).

[89] Puchniak (n 2); Lim, *Sustainability and Corporate Mechanisms in Asia* (n 32).

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