The Radical Transformation of Company Law – Global Trends and Local Initiatives*

*John H Farrar***

I am honoured to be the first holder of the Tun Ismail Mohamed Ali Foundation Chair and to give this lecture. Tun Ismail was an outstanding public servant of Malaysia. After winning the Queen's scholarship, he read Economics at Cambridge, and then was called to the Bar at the Middle Temple. He rose through the ranks of the Civil Service to the Governorship of the Bank Negara, a post which he held for eighteen years. It is therefore very fitting that we honour his memory in this way. I have chosen to speak on "The Radical Transformation of Company Law – Global Trends and Local Initiatives".

I. Introduction

Since the 1960s, and particularly over the last 20 years, there has been a radical transformation of company law in a number of jurisdictions. In many countries, the basic objectives of the law have been changed. The form of constitution has changed. The capital maintenance doctrine has undergone fundamental change. Directors' duties have

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**Holder of the Tun Ismail Mohamed Ali Foundation Chair for Corporate and Securities Law, Faculty of Law of the University of Malaya, Malaysia; Dean of the School of Law, University of Waikato, New Zealand; Emeritus Professor of Bond University, Australia; Professorial Fellow, University of Melbourne, Australia; LLM, LLD (London); PhD (Bristol); Barrister of the High Courts of New Zealand and Australia.

changed. Shareholder remedies have been recast. The subject matter of Companies Acts has undergone revision. And so on. This transformation is due to a variety of reasons, some of which are quite complex and which interact with each other. Added to this is the fact that they are still in a state of flux and it is difficult to discern the emerging pattern. The prevailing Western theory of shareholder wealth maximisation has been under attack in the aftermath of corporate scandals like Enron, World Com and HIH. Some commentators say this marks the failure of Corporate Law and self regulation.[1] Following on claims about the end of history and the triumph of the Anglo-American model,[2] this is somewhat ironic. The purpose of this lecture is to trace these trends and to consider how Malaysia may be affected by them, and what lessons can be learned from them.

Historically, corporations were a matter of public law and a privilege or concession granted by the State in its primitive form.[3] In the 19th century, within a statutory framework, it became more a matter of private law and private contract subject to minimal regulation by the State.[4] Over time, and particularly after the first stock market crash in 1929, there was a gradual development of some public regulation.[5] This was aimed at investor protection and was largely characterised by disclosure requirements. After the Common Market was set up within Europe, there was the question of the harmonisation of company laws which has had limited success.[6] The impact of technology and globalisation has led to the so-called international financial revolution, and to the capital liberalisation and increased internationalisation of business and financial services. As a result of these developments, there has been a significant increase in financial services regulation. In

[1] See Greenfield, K, *The Failure of Corporate Law* (Chicago: The University of Chicago Press, 2006).

[2] See Hansmann, H and Kraakman, R, "The End of History for Corporate Law" (2001) 89 *Geo LJ* 439.

[3] See Farrar, JH and Hannigan, BM, *Farrar's Company Law* (London: Butterworths, 4th ed, 1998) Ch 2 at p 16 et seq.

[4] *Id* at p 19 et seq.

[5] *Id* at p 22.

[6] *Id* at Ch 3.

the United Kingdom, this has largely been based on the premise of market failure but in Australia, the reforms have been made on a broader basis.

The development of financial services regulation has resulted in a substantial invasion of traditional company law and changed a number of its regulatory objectives.

Historically, states differed in their treatment of corporate bankruptcy. The United Kingdom originally had separate legislation but it eventually integrated the provisions on receivership and winding-up in the Companies Acts in 1985. European countries, the USA and Canada have had separate legislation. Australia and New Zealand continue to integrate the provisions.

Traditionally, the United Kingdom companies legislation has included provisions on the registration of company charges, although the USA, Canada and European countries deal with this in separate legislation. New Zealand has adopted the Personal Property Securities legislation based on the Canadian model.[7] The United Kingdom and Australia are still considering this.

Since 1945, there has been a significant increase in domestic institutional investment and with the technological developments and financial requirements, this has acquired an international dimension.[8] Traditionally, institutions have been relatively passive investors but from time to time, they adopt a more active involvement in portfolio companies either individually or collectively.

Since the second stock market crash in 1987, there has been an increased focus on corporate governance. This started with the UK Cadbury Report[9] and its sequels, and the formulation of the General

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[7] The Personal Property Securities Act 1999.

[8] See Farrar, JH, *Corporate Governance: Theories, Principles and Practice* (Melbourne: Oxford University Press, 2004), Ch 26.

[9] The Committee on the Financial Aspects of Corporate Governance, *Report on the Financial Aspects of Corporate Governance* (London: Gee & Co Ltd, 1992).

Motors Guidelines in the USA. Since then, there have been the Organisation for Economic Corporation and Development (OECD) Principles of Corporate Governance[10] in 1999 which have led to significant developments in European countries. The relationship between the systems of self regulation and the law is potentially quite complex.[11]

Takeovers have been the subject of debate in recent years. The UK and US systems which allow hostile bids were not originally followed in continental Europe. The European Commission obtained a report by Professor Robert Pennington and it was the subject of much debate and a proposed directive which was defeated due to German resistance but has now been adopted in a modified form.[12]

Added to this are the general impacts of globalisation which "has had ambiguous and contradictory consequences for the new regulatory state".[13] Commentators have distinguished between the outsider based systems (the Anglo-American models) and the insider based systems (continental European and Japanese models).[14] They have also distinguished between three major types of capitalism; stakeholder capitalism in Europe, shareholder capitalism in the USA and UK, and collective capitalism in Japan. Due to the economic significance of the USA and UK, and the fact that much international institutional investment is centred in New York and in London, there has been an inevitable impact of shareholder capitalism on the other two types.

Let us look at these topics in more detail.

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[10] OECD, Paris, 2004.

[11] See Farrar, *supra*, n 8.

[12] Council Directive (EC) 2004/25 on Takeover Bids (2004) OJ L142.

[13] Moran, M, *The British Regulatory State: High Modernism and High Innovation* (Oxford: Oxford University Press, 2003).

[14] See Farrar, *supra*, n 8 at Ch 34.

II. Early Approach Based on Privilege or Concession

Early law does not distinguish clearly between public and private law, nor does it even recognise the separation of powers.[15] Most legal systems, however, regarded corporations as a form of a privilege or a concession granted by the State. The reason for this was the fear of subversive groups. Thus Hobbes wrote, "The infirmity of a commonwealth is the great number of corporations: which are as it were many commonwealths in the bowels of a greater, like worms in the entrails of natural man".[16] Hobbes saw this in terms of a danger to the monarchy.[17] Rousseau saw it as a danger to democracy.[18] The interests of a member of a corporation might easily conflict with the interest of a member of being a nation. Such hostility was seen in the decrees of the Assemblée Nationale in France in 1792.[19] At common law, corporations had to be the subject of a royal charter or an act of parliament. Corporate charters were difficult and expensive to obtain. Many corporations depended on private acts of parliament which, again, were expensive and difficult to obtain. The "Bubble Act" of 1720, passed after the South Sea Bubble, prescribed corporations which were not incorporated in either of these two ways. Nevertheless, in the 18th century, businessmen attempted to avoid the legislation by the so-called deed of settlement companies, which were a hybrid form of partnership and trust. With the growth of railways and in the aftermath of the industrial revolution, pressures built up for a more flexible form of incorporation.[20]

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[15] See generally Baker, JH, *An Introduction to English Legal History* (London: Butterworths, 3rd ed, 1990).

[16] Hobbes, T, *Leviathan* (1651) ed by Plamenatz, J (London: Fontana, 1962) at p 294; Hollis, F, *Corporate Personality: A Study in Jurisprudence*, (London: Oxford University Press, 1930). See also Carr, CT, *The General Principles of the Law of Corporations* (Cambridge: Cambridge University Press, 1905).

[17] Hobbes, *ibid.*

[18] Carr, *supra*, n 16 at p 166; Shklar, JN, *Men and Citizens: A Study of Rousseau's Social Theory* (Cambridge: Cambridge University Press, 1969) at p 92 et seq.

[19] Carr, *supra*, n 16 at p 167.

[20] See Farrar, *supra*, n 3 at Ch 2.

III. The Switch to a Freedom of Contract Approach

In the first half of the 19th century, pressures were building up for easier forms of incorporation and a more *laissez-faire* approach. The United Kingdom Companies Act 1844, essentially an anti-fraud measure, provided for registration of deeds of settlement with a registrar of companies, and in 1855, limited liability was recognised.[21] Already, the United Kingdom was experiencing competition from the USA and France. The early legislation contained relatively little regulation and where present, this took the form of disclosure requirements. As Lord Bramwell said, "All that the advocates of *Laissez-Faire* demand is that freedom of contract shall not be interfered with without good reason".[22] Gradually, the modern form of constitution was adopted and fiduciary principles were developed in the case law and disclosure requirements increased. In the aftermath to the stock market crash in 1929, there was an increase in legislation requiring disclosure. This represents the beginning of investor protection. Bramwell fought a rear guard action against avuncular legislation. "A Legislature which treats people as helpless, and instead of teaching them to struggle for themselves, adds to the problem by mischievous taking care of them".[23]

In the aftermath of the first stock market crash, the USA set up the Securities and Exchange Commission in 1933 and introduced the modern form of securities regulation. Although primarily using the technique of disclosure, this led to the development of an elaborate system of administrative regulation of the securities industry. In the UK, the matter was largely left to self-regulation subject to the legislation on prevention of fraud.

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[21] *Ibid.*

[22] "*Laissez-Faire*", Pamphlet 521 (No 2 London Library).

[23] *Ibid.*

IV. The United Kingdom and the European Community[24]

The UK's entry into the European Community led to decline of the old imperial model and the development of regional attempts at harmonisation of company laws.

Article 2 of the Treaty of the European Community sets out the basic objectives of the Community. It is to establish a common market and economic and monetary union, and to promote through the community sustainable development of economic activities, a high level of employment and of social protection.

Article 3 provides *inter alia* for the approximation of the laws of member states to the extent required for the functioning of the common market.

Title III provides for free movement of persons, services and capital and provides for a right of establishment.

Article 44 (2)(g) provides that the Council and the Commission shall coordinate to the necessary extent, the safeguards which, for the protection of the interests of members and others, are required by member states of companies or firms with a view to making such safeguards equivalent throughout the community. There is the wide definition of companies or firms in Article 48.

Article 94 is a general provision on approximation of laws.

Article 293 provides that the member states shall, as far as is necessary, enter into negotiations with a view to securing *inter alia* the mutual recognition of companies or firms, the retention of legal personality in the event of the transfer of their seat from one country to another, and the possibility of mergers between companies or firms together with the simplification of formalities for reciprocal enforcement of judgments.

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[24] See Dorresteijn, A, Kuiper, Ina and Morse, G, *European Corporate Law* (Deventer, Boston: Kluwer Law and Taxation Publishers, 1994).

Lastly, Article 308 contains sweeping up provisions. If action by the European Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community, and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament, take the appropriate measures.

Therefore, the three basic legal techniques of integration used are:[25]

i. the removal of all restrictions which discriminate on the basis of nationality;
ii. the putting into effect of common rules and policies; and
iii. the approximation of national laws.

The Treaties also used the terms "harmonisation" and "coordination" but there seems to be little consistency. The usual pattern is for drafts to be prepared by the Commission. The drafts are then discussed in a group convened by the Commission and consisting of experts. They then go to the European Parliament and the Economic and Social Committee. They are then presented to the Council of Ministers for discussion by a working group of officials. Thereafter they go to a Committee of Permanent Representatives which then refers it back to the Council of Ministers for final decision.[26]

As a result of this over-elaborate procedure which does not have adequate democratic safeguards, there has been relatively little progress of corporate governance reforms. Although there has been some success in the area of accounts and share capital, attempts to harmonise company law and corporate governance have somewhat failed. On the other hand, there has been some successful work on the European company and takeovers.

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[25] Farrar, *supra*, n 3 at Chs 3 & 29.

[26] *Ibid.*

In recent years, the harmonisation programme seems to have faltered but a 7-member High Level Group of Company Law Experts chaired by Jaap Winter was set up which reports to the Commission favouring a number of planned actions in corporate governance and certain other areas. However, some commentators have questioned the wisdom of further continuation of the harmonisation programme. Harmonisation law-making is seen as a cartel among national legislators. There is a risk that regulation will be excessive and experimentation will become more difficult. There is a high cost to harmonisation because of the growing size of the European Union and the methods of consultation, and this could easily lead to petrification of the law. As Gérard Hertig recently put it, the Commission should "have the courage of doing [almost] nothing".[27] The recent *Parmalat* case demonstrates that it is not necessarily the absence of law so much as a question of culture and a will to enforce the law which is at stake.[28]

It is significant that the United Kingdom saw fit to engage in comprehensive reform proposals independent of the European Union and these are now the subject matter of the Companies Act 2006.

V. The United Kingdom Companies Act 2006[29]

The United Kingdom Companies Act 2006 was the result of nearly nine years' debate to develop a "modern Company Law for a competitive economy".

These are some of the key features:

[27] "Optional Rather than Mandatory EU Company Law: Framework and Specific Proposals", ECGI Law Working Paper 078/2007, January 2007.

[28] See Ferrarini, G, "Financial Scandal and the Role of Private Enforcement: The Parmalat Case", ECGI Working Paper Series in Law, May 2005 (Law Working Paper No 040/2005).

[29] See *Blackstone's Companies Act 2006* (Oxford: Oxford University Press, 2007). See also Ferran, E, "Company Law Reform in the UK: A Progress Report", ECGI Law Working Paper No 27/2005, March 2005.

i. a single constitution in the Articles of Association;
ii. a statutory statement of directors' duties;
iii. a statutory derivative action;
iv. the legalisation of electronic communications with shareholders;
v. the possibility of negotiated limited liability for auditors;
vi. reforms to private companies which include no AGM, no financial assistance regime, no need for a company secretary and easier written resolutions; and
vii. the Takeover Panel given statutory recognition and powers.

One of the most interesting reforms is contained in s 172 which provides for a new duty to promote the success of the company. This section is controversial as it attempts to deal with the stakeholder debate and will no doubt lead to litigation. The government has announced that it plans to bring the whole Act into force by October 2008.

VI. Reform in other Jurisdictions

Since the 1970s, the US Model Business Corporations Act and state statutes have undergone revision responding to case law and market forces.[30] A number of states adopted "constituency statutes" to widen the interests which directors could take into account in defending against junk bond financed tender offers which were common in the period between 1980 to 1905. These provisions can be compared with s 172 of the United Kingdom Companies Act 2006. After much debate, the American Law Institute produced the Principles of Corporate Governance. These are a summary of state case law and legislation. They do not have the force of law but represent high level doctrine and are cited in the courts.

In the early 1970s, the federal and provincial governments in Canada engaged in the reform of company laws.[31] Each province is a separate

[30] *Principles of Corporate Governance* (Philadelphia: The American Law Institute, 1992).

[31] Iacobucci, F, Pilkington, M and Prichard, JRS, *Canadian Business Corporations* (Agincourt: Canada Law Book Ltd, 1977).

jurisdiction and the national government also has federal legislative powers.

After the UK joined the European Union in 1973, other commonwealth jurisdictions considered that they should take an independent approach to company law reform. Australia engaged in elaborate reforms in the last 25 years and the present policy on reform is summed up in the Corporate Law Economic Reform Programme (CLERP).[32] The reform programme is well intentioned and pursues the following fundamental economic principles:[33]

i. *Market freedom*

Competition plays a key role in driving efficiency and enhancing community welfare. However, free markets do not always operate in a sufficiently competitive, equitable, or efficient manner. Business regulation can and should help markets work by enhancing market integrity and capital market efficiency. At the same time, the regulatory framework needs to be sufficiently flexible so that it does not impede market evolution (for example, new products and technologies) and competition.

ii. *Investor protection*

With an increasing number of retail investors participating in the markets for the first time, business regulation should ensure that all investors have reasonable access to information regarding the risks of particular investment opportunities. Regulations should be cognisant of the differences between sophisticated and retail investors and their respective competencies in relation to access to information and the ability to analyse it.

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[32] See Austin, RP and Ramsay, IR, *Ford's Principles to Corporations Law* (Chatswood: LexisNexis Butterworths, 13th ed, 2007) at para 2.170.

[33] Farrar, *supra*, n 8 at pp 16-17. See also Llewellyn, David, "The Economic Rationale for Financial Regulation" (UK Financial Services Authority, Occasional Paper Series 1, April 1999).

iii. *Information transparency*

Disclosure is a key to promoting a more efficient and competitive marketplace. Disclosure of relevant information enables rational investment decision-making and facilitates the efficient use of resources by companies. Disclosure requirements increase the confidence of individual investors in the fairness and integrity of financial markets and, by fostering confidence, encourage investment. Different levels of disclosure may be required for sophisticated and retail investors.

iv. *Cost-effectiveness*

The benefits of business regulation must outweigh its associated costs. The regulatory framework should take into account the direct and indirect costs imposed by regulation on business and the community as a whole. What Australia must avoid is outmoded business laws that impose unnecessary costs through reducing the range of products or services, impeding the development of new products or imposing system-wide costs.

The regulatory framework for business needs to be well targeted to ensure that the benefits clearly exceed the costs. A flexible and transparent framework will be more conducive to innovation and risk-taking, which are fundamental elements of a thriving market economy, while providing necessary investor and consumer protection.

v. *Regulatory neutrality and flexibility*

Regulation should be applied consistently and fairly across the marketplace. Regulatory distinctions or advantages should not be conferred on particular market structures or products unless there is a clear regulatory justification. The regulatory framework should also avoid creating incentives or opportunities for regulatory arbitrage. The regulatory framework should be sufficiently flexible to permit market participants to respond to future changes in an innovative, timely, and efficient manner. Regulation should be designed to facilitate predictability and certainty.

vi. *Business ethics and compliance*

Clear guidance regarding appropriate corporate behaviour, and swift enforcement if breaches occur are key elements in ensuring that markets function optimally. Fostering an environment that encourages high standards of business practice and ethics will remain a central objective of regulation, as well as effective enforcement.

The policy is sound; however, the same cannot be said of the implementation, which does not have a coherent *modus operandi*, and is still relying on piecemeal reforms and an over-technical style of drafting.[34]

In spite of the Closer Economic Relations Agreement between Australia and New Zealand, New Zealand chose to follow the Canadian model rather than the Australian model and the result is a much simpler Companies Act which was adopted in 1993.[35]

New Zealand has a modern Companies Act based on the North American model. It was based on the small incorporated firm rather than the publicly listed company model and left detailed regulation of the latter to the Securities Act 1978 and Stock Exchange listing regulations. It was drafted in a straight-forward manner and on the basis that it would be intelligible to a non-lawyer. These were all advantages. However, in practice, it is proving complex for the small firm, it is unclear on key issues of directors' duties, it is arguably too lax on self-dealing, and it is weak on enforcement. The Securities Act 1978 pre-dates modern financial services regulation, is idiosyncratic in content and style and has not fully kept pace with international developments. There have been confused attempts at self-regulation of corporate governance and a complacent response to the US Sarbanes-Oxley Act. To some extent, this is due to the decline of New Zealand listed companies and the shift of management and control of key companies to Australia and Singapore. New Zealand has never been a

[34] Farrar, *id* at p 17.

[35] *Id* at p 15.

large player but it has become smaller and less significant since the 1980s. Nevertheless it still needs to complete the radical transformation of Company Law by adopting a more modern securities regulation and self-regulation which is more consistent with Australia and the UK if it is to be taken seriously by international institutions such as The World Bank, IMF and institutional investors. To some extent there was a libertarian capture of law reform in the late 1980s with a withdrawal of the state but this resulted in incomplete reforms which neglected accountability and are not compatible with modern financial services regulation and global trends in corporate governance. New Zealand needs to rethink the role of the state in the emerging international order.

VII. Company Law Reform in Malaysia

Malaysia has engaged in elaborate work in Corporate Governance and Capital Markets but was slower to engage in Company Law Reform other than by piece-meal amendments. Now with the Companies Commission of Malaysia (hereafter referred to as "CCM"), the pace of reform has significantly increased.[36] Working towards a strategic framework adopted in 2004, the Commission set up four working groups – A, B, C and D. Group A covers company formation. Group B covers capital raising and maintenance. Group C covers corporate governance and shareholder rights. Group D covers corporate securities and insolvency.

Let me make a few comments. Malaysia is opting for a single statute.[37] Small and medium sized enterprises are to be accommodated within the statute. Only South Africa has opted for a separate close company statute.[38] This seems to have been a great success although it may have been due to tax incentives and it may be integrated in a

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[36] CCM, Consultative Document I on "Strategic Framework for the Corporate Law Reform Programme of Companies Commission of Malaysia".

[37] *Ibid.*

[38] Close Corporations Act 1984 (SA).

new Companies Bill. My experience of the New Zealand and Australian reforms is that they do not serve small and medium sized enterprises well. The legislation is too complicated for them.

Malaysia is opting for a statutory statement of the basic directors' duties.[39] This follows the UK's and the New Zealand's system. I think that it is important to be clear as to the purpose of the statute and its relationship to the case law. The Australian provisions make it clear that they are there for civil and criminal penalty purposes and do not replace the case law which is still relevant regarding civil proceedings. The position of the Canadian and New Zealand provisions is less clear.[40]

Malaysia is considering the adoption of a statutory business judgement rule.[41] Although the business judgement rule emanates from US jurisdictions, none of them have codified the rule in statute. Australia has done so following the American Law Institute's *Principles of Corporate Governance* but departed from the US wording in certain ways which makes the US case law less useful.[42]

Malaysia is considering reform of shareholder remedies[43] but what is important is to encourage the use of alternative dispute resolution techniques such as mediation.[44]

Malaysia is updating its winding-up provisions[45] but what is needed is voluntary administration on the Australian lines.[46]

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[39] Corporations Act 2001, s 185.

[40] Farrar, *supra*, n 8 at p 105.

[41] CCM, Consultative Document 5 on "Clarifying and Reformulating Directors' Role and Duties".

[42] Farrar, *supra*, n 8 at p 142 et seq.

[43] CCM, Consultative Document 6 on "Members Rights and Remedies".

[44] Farrar, JH and Boulle, L, "Minority Shareholder Remedies – Shifting Dispute Resolution Paradigms" (2001) 13 *Bond Law Review* 272.

[45] CMM, Consultative Document 4 on "Company Liquidation – Reform and Restatement of the Law".

[46] *Ford's Principles to Corporations Law*, *supra*, n 32 at Ch 27.

Malaysia is updating the rules for shareholder communication[47] which in future must allow for electronic communication. The amendment of the rule for written resolutions is welcome.

All modern jurisdictions have relaxed the capital maintenance rule and Malaysia is following suit.[48]

Malaysia might consider following the New Zealand reforms[49] which replaced the system of company charges by a North American Personal Property Securities Act. This is based on the Canadian adaptation of Article 9 of the Uniform Commercial Code of the USA. Australia is now likely to follow suit.[50] The UK has dithered on this question for years.[51] The advantage of such a reform is that it greatly simplifies the law, allows fixed charges over circulating assets, provides much clearer priority rules and facilitates computerization. Under such a system, the floating charge is not abolished but withers away.[52]

With the decline of the UK as a leading reform jurisdiction, each Commonwealth country must pursue its own path through the corporate jungle but in doing so, it is useful at least to learn from the mistakes of others. Although the UK has now managed to pass a reform act, much of its content is derivative and in some places problematic. Ultimately Malaysia must choose a company law regime which is best suited to the conditions in Malaysia.

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[47] CCM, Consultative Document 3 on "Engagement with Shareholders".

[48] CCM, Consultative Documents 2 and 8 on "Capital Maintenance Rules and Share Capital".

[49] Personal Property Securities Act 1999 (NZ).

[50] See "Proceedings of a Workshop of Personal Property Security" (2002) 14 *Bond Law Review* Number 1 (special issue).

[51] See Law Commission of England and Wales, "Registration of Security Interests: Company Charges and Property other than Land".

[52] See Farrar, JH and O'Regan, MA, "Reform of Personal Property Security Law", Preliminary Paper No 6 (a report to the NZ Law Commission).

VIII. Financial Services Reforms

Financial deregulation combined with technological developments led to the abolition of exchange controls and the freeing up of international investment. Pressures gradually built up in the UK to adopt a more legally based system similar to the US Securities and Exchange Commission. The first step was the setting up of the Council for the Securities Industry. This was followed by the Financial Services Act 1986 which set up a Securities and Investment Board which exercised supervision over a number of self-regulatory agencies. The Financial Services Act replaced the earlier law contained in the Prevention of Fraud (Investments) Act 1958 and the Stock Exchange listing rules. In 1997, the Securities and Investment Board changed its name to the Financial Services Authority. This is a regime which is largely predicated on market failure and operates now under the Financial Services and Markets Act 2000.[53] As Michael Moran states, "The 1986 and 2000 Acts show that the changes have not just involved small markets and institutions, they have been accompanied by, and in some instances are integrated with, a wholesale restructuring of the larger architecture of financial regulation".[54] This has lessened the distinctiveness of the City of London system, traditionally based on self-regulation, and has transformed it into a more centralised State-controlled hierarchy characterised by a growth in the volume and complexity of rules and powers vested in the regulator. This is very much an invasion of traditional company law and markets, and represents a change from a private law to a public law system at least in relation to publicly listed corporations.

While the premise of market failure is debatable, there are, or should be, further goals of regulation such as those recognised in the Australian legislation as follows:[55]

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[53] See Fisher, J QC, Bewsey J, Waters, M QC and Ovey, E, *The Law of Investor Protection* (London: Thomson Sweet & Maxwell, 2nd ed) at Ch 2.

[54] Moran, *supra*, n 13 at p 77.

[55] Corporations Act 2001, s 760 A.

i. informed decision-making;
ii. flexibility and invention in products and services;
iii. the monitoring of professionalism by market operators;
iv. orderly markets;
v. the reduction of systemic risk; and
vi. effective clearing and settlement facilities.

IX. Dealing with Corporate Bankruptcy

Since 1862, the UK and most British Commonwealth jurisdictions included the provisions on receivership and winding-up in the companies legislation. In the UK, this continued until 1985 when separate insolvency legislation was adopted which integrated personal and corporate insolvency provisions. The USA and continental European jurisdictions have had separate legislation and Canada followed suit. Commonwealth countries like Australia, New Zealand and India still retain the old system although there is an Insolvency Bill before parliament in New Zealand to take corporate insolvency out of the companies legislation.

From an earlier period there have been company charges registration provisions in the UK Companies Acts and this is still the case in Australia. Canada and New Zealand have adopted personal property securities legislation which has replaced these provisions. These have resulted in the replacement of the floating charge.

X. The Impact of Institutional Investment[56]

Insurance companies in all jurisdictions have historically invested in corporate bonds. However, the rise of equity investment by institutions is largely a post-1945 phenomenon. This has been more pronounced in the USA and the UK than continental Europe for a variety of reasons. There has been a substantial increase in institutional invest-

[56] Farrar, *supra*, n 8 at Ch 26.

ment in equity shares since the 1960s in the USA and the UK. The reasons for this growth have been:

i. the growth of pension and superannuation schemes;
ii. the relaxation of the trustee investment rules;
iii. the rise of insurance linked investment schemes; and
iv. the favourable tax treatment of insurance companies and unit and investment trusts.

In spite of this increase and potential power, there has been in the past relatively little evidence that the power has been exercised in any significant way. Institutions have generally been relatively passive investors and the development of modern funds management has made the investment division more remote from active participation in governance. However, now there is direct and indirect industry-wide and firm-level monitoring, but here are certain inbuilt reasons for caution:

i. there is the risk that institutions collectively might be regarded as controlling shareholders and trigger mandatory bid requirements under particular takeover regimes;

ii. they may get themselves in the situation of conflict of interest; and

iii. access to inside information may restrict dealings and run the risk of insider trading liability.

In the last 20 years there has been an increasing involvement by institutional investors in the corporate governance movement but at the same time, calls for greater transparency and better corporate governance by the institutional investors and funds managers themselves.

XI. The Corporate Governance Movement[57]

Self regulation of the insurance and takeovers fields predated the corporate governance initiatives of the 1990s in the United Kingdom.

[57] See generally Farrar, *supra* n 8.

In 1992, the Cadbury Report on the Financial Aspects of Corporate Governance was published in the UK and represented the first serious attention to corporate governance. This was defined as "the system by which companies are directed and controlled". In 1995, the Greenbury Committee reported on directors' remuneration and this was followed by the Hampel Committee in 1998. Consideration of these reports led to the Combined Code in the UK. Since then, there has been the Turnbull Report commissioned by the Institute of Chartered Accountants of England and Wales in 1999 and the Myners Report on Shareholder Activism. After the Enron collapse in the USA and the Sarbanes-Oxley Act of 2002, the UK Department of Trade and Industry commissioned three further studies:

i. the Higgs Report on Non-Executive Directors;
ii. the Combined Code Guidance for Auditors; and
iii. a report of the coordinating group on audit and accounting issues.

All of these were reported in 2003 and the new Combined Code was adopted with effect from the 1 November 2003. The UK self regulatory initiatives can be characterised as a movement away from the club-like character of the 1950s-1970s and towards greater institutionalisation, codification and jurisdiction in terms of rules and principles. These supplemented conventional law but increasingly resembled it.

In the USA, corporate governance was dealt with by the General Motors Guidelines and later by initiatives of the California Public Employees Retirement Scheme. However, in the aftermath of the Enron and other major collapses, federal legislation was enacted in the form of the Sarbanes-Oxley Act of 2002, which represented the first significant federal intervention in corporate governance since 1933, and put the emphasis more on legal regulation.[58] This has led to other countries considering a more distinctly legal approach.

[58] See Ribstein, LE, "Market vs Regulatory Responses to the Sarbanes-Oxley Act of 2002" (2002) *The Journal of Corporation Law* 1. For an interesting recent study of the loss of reputational capital of the professions, see Coffee, JC Jr, *Gatekeepers: The Professions and Corporate Governance*, Oxford: Oxford University Press, 2006).

An interesting question is the role of the courts.[59] Clearly they have a role in civil and criminal proceedings. In the UK, the courts have recognised fairly minimal judicial review of self regulation[60]. In addition, the courts in the UK and Australia have begun to look at self regulation recommendations to flesh out open textured concepts such as the standard of care of auditors, just and equitable winding-up and the modern role of the Chair of the Board of Directors.[61]

XII. Takeovers and the Market for Corporate Control

In common law systems, mergers have been dealt with by three mechanisms, which are reconstruction, amalgamation and takeovers.

Reconstruction was a method which was used in the 19th century and is similar to that still in place in some European systems. It ultimately involves the absorption of the target company into the bidder. Amalgamation is where two companies of comparable size get together under the umbrella of a new holding company. Takeovers were originally a phenomenon of the 1950s in the UK, and a little later in the USA. Takeovers and tender offers, as they are called in the USA, led to the possibility of a hostile bid over the heads of the Board of the target company. This was the subject of little regulation in the UK other than the City of London Takeover Code. In the USA, it was the subject of the Williams Act which was largely concerned with disclosure. In Malaysia, Singapore and New Zealand, it has been the subject of statutory codes. In Australia, the power of the Takeovers Panel has been held to be unconstitutional and is the subject of an appeal to the High Court of Australia.[62]

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[59] See Farrar, JH, "Corporate Governance and the Judges" (2003) 15 *Bond Law Review* 49.

[60] See Wade, Sir HWR and Forsyth, C, *Administrative Law* (Oxford: Oxford University Press, 8th ed, 2000) at pp 629-631.

[61] Farrar, *supra*, n 59.

[62] *Australian Pipeline Ltd v Alinta Ltd* [2006] FCA 1378. Reversed on appeal by the Full Court [2007] FCAFC 55, (22 April 2007).

The European Commission obtained a report by Professor Robert Pennington and eventually a directive was prepared. But at the eleventh hour, it was not adopted due to strong opposition from Germany. Eventually a revised Directive 2004/25 on Takeovers Bids[63] was adopted and was to be implemented by member states by 20 May 2006. This was implemented in the UK by the Companies Act 2006.

The argument in favour of takeovers is that the freeing up of a market for corporate control with the possibility of a hostile bid represents the ultimate monitoring of management.

XIII. The Failure of Corporate Law?

The dominant Anglo-American theory of share wealth maximisation has recently come under attack in the light of recent corporate scandals.[64] In Australia, the James Hardie asbestosis investigation led to powerful criticism of the Board of Directors, and the institution of civil penalty proceedings against them. The company, faced with a large number of claims, set up a foundation to meet the claims and then transferred its registration to the Netherlands, a country with which there was no reciprocal enforcement of judgments treaty. This transfer had to be approved as part of a scheme of arrangement by the Supreme Court of New South Wales. The company substantially underestimated the amount of the claims and gave misleading information to the court. The New South Wales Government appointed David Jackson QC to conduct an enquiry. The report was very critical of the company and its directors, and this led the Australian Securities and Investments Commission to bring civil penalty proceedings and to consider criminal proceedings.

This has led to a public debate of corporate social responsibility and citizenship in Australia which echoes some of the UK stakeholder debate.

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[63] OJ L142, 30 April 2004

[64] Greenfield, *supra*, n 1.

The main argument is that the traditional view neglects the other stakeholders in the company. A company has responsibilities to its employees, customers, creditors and the community who all have an interest in it. The problem is that it is one thing to say that they have an interest, and another to say that they have enforceable rights. Sometimes they do but the rights are usually in contract. The latest development is for institutional investors like the Australian Council of Superannuation Investors to say that this is a matter of intelligent risk management for the company and its investors.

Nevertheless, the approach of the Corporations and Markets Advisory Committee[65] and the Joint Parliamentary Committee on Corporations and Securities Regulation[66] in Australia is to resist the call for legislation. The view is that this issue is still fluid and should be left to self regulation. Eventually, if legislation is necessary, it should not be in the companies legislation but in the appropriate Acts such as health and safety at work or environment protection. Corporate Law has not necessary failed because it does not encompass everything. The attempt by the Blair Government to impose a duty to take account of stakeholder interests in s 172 of the Companies Act 2006 is bound to confuse company directors and lead to litigation.

XIV. The Impact of Globalisation

Much has been written on globalisation and its advantages and disadvantages. Some US commentators see it as the end of history and representing a triumph of the American system of capitalism.[67] Of course, this is nonsense. There is no end of history and globalisation is not necessarily a triumph of the US system. On the other hand, there seems to be an inevitable rise in international influences on company law. This was recognised sometime ago by the work of the

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[65] Corporations and Market Advisory Committee, "The Social Responsibility of Corporations Report", December 2006.

[66] Parliamentary Joint Committee on Corporations and Financial Services, "Corporate Responsibility: Managing Risk and Creating Value", June 2006.

[67] See Hansmann and Kraakman, *supra*, n 2.

Organisation for Economic Co-operation and Development (OECD) on guidelines for regulation of multinational enterprises. The OECD has continued its work by the adoption, in 1999, of principles of corporate governance, which were reissued in 2004. While the harmonisation of company law within the European Union seems to have stalled, there is an increasing trend towards common rules on the corporate governance of public listed companies. In so far as non-US companies are listed on US stock exchanges, they have to comply with the Sarbanes-Oxley Act but even beyond this, the requirements of the OECD principles and that Act are having an impact on the law and practice of other countries. There is now an increasing congruence between the new regulatory state and the developing world of globalisation. These trends, however, contain within themselves certain contradictions. Just as the state intervenes more in domestic company law, so the power of the state diminishes internationally and the state itself is subject to increasing international influences. Another problem is the conflict between regulation and market freedom. Some of the arguments against the continuation of the European Union harmonisation programme are that it is an attempt to monopolise regulation at a time when international trends suggest that there would be advantages in greater freedom to experiment and innovate subject to residual international restraints. There are two levels to this argument. One is that each state should be free to have its own regime subject to prevention of a race to the bottom, and the other is that within each state, companies should be allowed as much freedom as possible.

The Sarbanes-Oxley Act of 2002 and its overseas siblings, however, contradict these trends and represent a move backwards to increased legal regulation.

Professor Jeffry Frieden of Harvard University in *Global Capitalism: Its Fall and Rise in the Twentieth Century* states, "The challenge of global capitalism in the twenty-first century is to combine international integration with politically responsive, socially responsive government".[68]

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[68] See Frieden, JA, *Global Capitalism: Its Fall and Rise in the Twentieth Century* (New York: WW Norton & Co, 2006) at p 476.

The problem for the present decade is how to resolve these contradictions. To live with the dialectic of constant change is the fate of modern companies. It is a new version of the old Chinese curse – "May you live in interesting times".

Constitutionalism – Concept and Application in the Federal and State Governments of Malaysia

Johan S Sabarudin[*]

I. Introduction

This article seeks to briefly explore the meaning of constitutionalism in the constitutional system of Malaysia and how this is applied in both the Federal and State Governments.

II. Current Thoughts on Constitutionalism

Described as being in danger of becoming one of the world's forgotten "isms" that is on its way to obscurity,[1] constitutionalism nevertheless remains one of those concepts that are "evocative and persuasive in its connotations, no matter how cloudy it may be in its analytic and descriptive content".[2] Its modern roots stem from the struggles for personal freedom and escape from arbitrary rule in Western Europeand America which have taken place since the sixteenth century. McIlwain

[*] LLB (Hons)(Mal), LLM (Lond), Senior Lecturer, Faculty of Law of the University of Malaya, Kuala Lumpur, Malaysia.

[1] De Smith, SA, "Constitutionalism in the Commonwealth Today" (1962) 4 *Malayan Law Review* 205. See also Schochet, GJ, "Introduction: Constitutionalism, Liberty and the Study of Politics" in Pennock, JR & Chapman, JW, (eds), *Constitutionalism* (New York: New York University Press, 1979) 1 at p 5.

[2] Grey, TC, "Constitutionalism: An Analytic Framework" in Pennock & Chapman, *id* at p 189.