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EDITOR'S INTRODUCTION

Introduction to the JGLR special issue on corporate and financial laws

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1 Introduction

Five core structural characteristics make up the business corporation in virtually every jurisdiction, irrespective of the prevalent legal regime. These include legal personality, limited liability, transferable shares, centralized management under a board structure, and shared ownership by contributors of capital. When acting together, these five basic characteristics combine in a variety of ways, giving rise to a complex system of rules we refer to as corporate law. The manner in which corporations behave with each other and the world around them assumes great importance, given that corporations themselves have grown beyond being mere legal devices through which the private business transactions of individuals have been carried out. The growth of corporations, in terms of economic power and prominence, has effectively ensured that the corporation has now attained the status of a major social institution and emerged as one of the foundations of modern global society. The corporate system commands further attention due to its progressive nature. While the fundamental characteristics remain the same, the body of law applicable to companies is in a state of constant flux.

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2 Significant trends

Through the 1980s and into the twenty-first century, a number of wide, sweeping changes have been witnessed in the way corporations are governed. Primarily in the last two decades, modern corporate governance has seen a significant resurgence, following the calamities concerning Enron and WorldCom. These events have led to a number of changes in the way corporations are run and the manner in which their activities are disclosed. In the United Kingdom, these changes are mostly encapsulated within the *Cadbury Report* of 1992 and in the United States, within the *Sarbanes–Oxley Act* of 2002. A large number of jurisdictions follow similar norms of corporate governance inspired by the *Sarbanes–Oxley Act* and the *Cadbury Committee Report*. However, in recent times, there has been some resistance to this transplantation. Broadly speaking, corporate governance norms that have been transplanted from jurisdictions such as the Unites States and the United Kingdom follow the "outsider" model of corporate governance. Such norms are not likely to be suitable for implementation in addressing governance problems in emerging economies, which follow the "insider" model. The inappropriateness of corporate governance norms based on the "outsider" model was further highlighted in the events that led to the downfall of Satyam Computer Services Limited in India.

More recently, events involving the collapse of several leading financial institutions, including Lehmann Brothers and AIG, provide evidence, at least anecdotal in nature, that the corporate governance norms followed in the United States and the United Kingdom have not been effective in preventing large-scale corporate governance failures, particularly in the financial sector. The sub-prime mortgage crises between 2007 and 2010 raised questions about the efficacy of predominant laws and practices in the financial sector. The issue of managerial remuneration or "say on pay" has been of particular interest to a large number of scholars in the West. These issues have been partially addressed by the *Dodd-Frank Act* of 2010 which considered shareholder empowerment and enhanced executive pay disclosure. At the same time, jurisdictions worldwide continue to reform and amend laws relating to the banking and financial sector.

In India, the *Companies Act*, 2013, in its final form, brings about a large number of changes from its earlier iteration in 1956. Most of these changes relate to substantive or procedural provisions exiting in the 1956 Act, as necessary. However, there are rare changes made, bringing in concepts and rights or processes that were not present in the 1956 version.

In the aftermath of the 2008 financial crisis, small businesses found it increasingly difficult to raise funds. At the same time, the advent of technology, primarily the internet, caused a significant disruption in the manner in which corporations raise funds. A key responsibility of any securities regulator is investor protection. Securities laws, involving stringent eligibility criteria for fundraising companies and detailed disclosure requirements, have been instrumental in mitigating risks for public retail investors to some extent.

Policymakers continually face the challenge of effectively balancing the benefits of encouraging small business formation against the investor protection goals of the securities laws. This challenge becomes even more pronounced in the case of crowdfunded companies which typically are small and medium enterprises. This mechanism offers a number of advantages, primarily to the fundraiser, but also to the contributor and the portal. One of the biggest advantages that fundraisers have at the moment, curiously enough, is lack of regulation. Legislation exempting crowdfunding activities from traditional securities laws has been passed in a number of jurisdictions. In April 2012, the United States Congress adopted the Jumpstart Our Business Start-ups Act (JOBS Act), bringing about an exemption under its securities law that permits the sale of securities via crowdfunding, opening doors to those businesses that have been unable to utilize existing crowdfunding methods. Other countries, including Italy, New Zealand, the United Kingdom and Australia have followed suit.

3 Contributions

The current issue of the Jindal Global Law Review carries contributions from a particularly eclectic and international set of contributors. This reflects our belief in the importance of cross-pollination between different legal regimes when it comes to corporate and financial law and regulation. To this end, we carry contributions from legal academics and practitioners in India, China, Australia and Germany.

Corporate governance is central to the robust operation of any legal regime. A focused examination of corporate governance as experienced in one sector of the Indian economy is the subject of a paper titled *Corporate Governance of Energy Sector in India* by Indrajit Dube and Neha Jaiswal. They have undertaken a detailed survey of major players in the energy sector, looking at a number of heads including the internal structure and functioning of the board, audit mechanisms and their effectiveness, corporate functioning as reflected in compliance certification, disclosures, education, health and local community infrastructure development, responses to climate change standards and reporting on sustainability measures, among others. Through data collection and modelling, they find that the inclusion and participation of independent and executive directors in various aspects of the functioning of the board has increased over the years. Disclosure standards have also improved, except for in the area of climate change reporting. Risk management reporting is also an area where they find room for improvement.

An overview of *Banking Reforms in China* is offered in the next paper by Wen Si of the Shanghai Academy of Social Science. In an effort to provide a comprehensive review of the last four decades, the author reviews historical measures starting from the economic reforms of 1978, which resulted in the Chinese financial and economic system breaking away from the erstwhile Soviet model. The process of reform is described as gradual and considered, taking shape around the twin approaches of rehabilitating state-owned banks and allowing the entry of new banks. Three phases of reform are discussed: 1979–1991 (Phase 1), 1992–2001 (Phase 2), and 2002-present (Phase 3). The first phase was characterized by institutional

reforms to the banking sector, primarily through the creation of a two-tiered system. There was also a gradual relaxation in the difficulties foreign banks faced in entering the market. The second phase involved further structural reforms that were designed to separate commercial lending and policy lending. The third stage, which presently continues, overlapped with the entry of China into the World Trade Organization (WTO) and was principally characterized by the creation of the China Banking Regulatory Commission. The author examines in some detail the consequences of accession to the WTO, with special emphasis on the impact this has had on the operations of foreign banks in China.

Pratik Datta, in his paper titled *Intermediaries as Arbitrageurs: Revisiting the Motivations behind Overseas Listings*, uses his experience as a Consultant with the National Institute of Public Finance and Policy to examine the role that intermediaries play as arbitrageurs in the listing process. The author focuses on depository receipts, a form of security used to raise offshore equity. These instruments benefit foreign investors by allowing them to reap the benefit of securely investing in a jurisdiction outside their home, while the domestic investor gets to tap into resources in foreign financial markets. After examining the evolution of the depository regime in India, from the 1993 scheme through to the 2014 scheme issued by the government, the author highlights the limitations in the current theoretical framework utilized to examine recent trends in overseas listings. In his view, and as a consequence of the recent global financial crisis and changes to US securities law, all four prevalent theories—the portfolio theory, the market segment theory, the legal bonding theory and the consumer commercial market bonding theory—fail to adequately explain the rise of "unsponsored" depository receipts. He proposes that the intermediary arbitrage theory is better suited as an effective theoretical model. This is principally because, unlike earlier theories that focused on the motivations of the firm in question, the intermediary arbitrage theory focuses on intermediaries like depository banks and exchanges in the listing process.

The global financial crisis has also led to a dramatic increase in the number of professional liability lawsuits around the world. Major and minor bankruptcies have led to suits being brought against auditors and financial advisers on a number of heads, including breach of contract, professional negligence and contravention of statutory duties. In the next paper titled *A Review of Financial Reporting Liability Lawsuits in Singapore*, Pelma Jacinth Rajapakse chooses Singapore as a base for analysis of a number of such lawsuits. Rajapakse suggests that, due to the unique nature of its regulatory structure, Singapore places auditors under a greater level of liability when compared with auditors in jurisdictions such as Australia, the United Kingdom, Australia, Canada and New Zealand. Prior studies have principally focused on the analysis of legal issues and concepts under the common law of negligence and legislation in relation to the legal liability of accountants and auditors. This paper, in contrast, comprehensively examines accounting and auditing errors and causes for negligent misstatements alleged in lawsuits against financial advisers in Singapore, with the aim of identifying factors that led to certified practicing accountants and independent auditors in Singapore being sued by their clients. Lowering standards of integrity and accuracy in financial statements, combined with a growing trend of the imposition of strict duties by

the judiciary on management and auditors, are one explanation. The author suggests best practices that can be followed by audit committees, boards and companies to avoid such liability arising in the future.

The insurance sector in India has long been an area that required a comprehensive legislative overhaul. In their paper titled *The Insurance Laws (Amendment) Act, 2015 and Life Insurance Policyholders*, Mangesh Patwardhan and S. Uma examine the recent amendments brought in this area through legislation. It is well known that insurance reform in India has followed a long and convoluted process spanning more than a decade, including a report by the Law Commission of India, a series of parliamentary standing and select committees and the use of ordinance powers. The authors focus not on the controversial issue of increase in foreign direct investment (FDI) limits but on the provisions that have a bearing on life insurance policy servicing. Their paper explains the impact that the amendments have on nomination and assignment with respect to life insurance policies, the legal issues that arise in case of subsequent assignment, the nature of insurable interests under the new regime and the applicability of this framework to assignment of non-life personal insurance policies. Their analysis leads them to suggest a framework that would do away with current notions of nomination and assignment, instead adopting the twin concepts of beneficiary and transferee. In this manner, problems that arise from the dual nature of life insurance, as protection and property, would partly disappear once the legal regime is more closely aligned with the underlying economic rationale behind such instruments.

Mandavi Jayakar reviews the judgment of the Supreme Court of India in *Securities and Exchange Board of India* v. *Pan Asia Advisors Ltd. and Others.*[1] This case involved the Supreme Court recognizing the jurisdiction of the Securities and Exchange Board of India (SEBI) in regulating Global Depository Receipts (GDRs). Jayakar explains the GDR mechanism and takes us through the facts at hand, the decision of the SAT tribunal and the eventual order of the Supreme Court. At the heart of this decision lies the recognition that GDRs, albeit issued abroad, nevertheless qualify as securities and hence fall within the ambit of SEBI regulation. From a policy perspective, the Court acknowledged the possibility that SEBI might need to regulate corporations, through coercive measures if necessary, in order to protect domestic markets from the possible machinations of domestic and foreign entities. The key element lies in the establishment of existing manipulation that adversely impacts the securities market.

In the book review section, Cicek Gurkan reviews *Corporate Ownership and Control: Corporate Governance and Economic Development in Sri Lanka* by Shalini Perera. At the outset of his review, Gurkan highlights the key role corporate governance plays in impacting economic development across developed and developing countries alike. He stresses on the important role that research on path dependencies plays in legal reform, especially when read harmoniously with the idiosyncratic nature of each developing country. In this light, he describes Perera's work on Sri Lanka, based on a doctoral dissertation at Oxford University, as a successful example of such research. In examining Sri Lanka, Perera adopts a

[1] 2015 (7) S.C.A.L.E. 694.

comparative approach and builds and adapts existing scholarship to apply to Sri Lanka, maintaining throughout what Gurkan describes as simplicity and clarity, despite the highly technical nature of the subject. Perera starts with a review of existing literature on the links between corporate governance and economic development, locates this debate in the Sri Lankan context through a detailed historical examination of ownership structures over time, highlights systemic constraints that policymakers and researchers need to keep in mind, develops a framework for examining the relation between controlling and minority shareholders in Sri Lanka and concludes by suggesting a reform agenda. Gurkan concludes his review of Perera's work by drawing comparisons with recent corporate reforms in Germany, using the latter as a predictive model for challenges that Sri Lanka and other developing countries may face in this area.