From Double Board to Unitary Board System

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From Double Board to Unitary Board System:  
The Corporate Governance Reform in Taiwan  
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I. Introduction

This Chapter reviews the regulatory strategies in corporate board reform and analyses the impact of introducing the institution of independent directors to Taiwan’s public companies. Taiwan’s corporate governance model has been strongly influenced by the German and Japanese models. For example, the Taiwan’s Company Act traditionally follows a double board system: the board of directors constitutes the decision-making institution, and the statutory supervisor monitors the company. However, in the past decade, Taiwan’s corporate governance has also been influenced by the Anglo-American model; consequently, independent directors, along with the unitary board model, have been introduced.

Before February 2013, Taiwan’s regulatory authority took a minimalist approach to the regulation of the internal governance structure of public companies. Generally, Taiwan’s public companies could choose either to maintain a double board, switch to a unitary board, or adopt a hybrid structure. To enhance board independence, the regulatory philosophy was to mandate the introduction of independent directors in stages, starting with the largest companies. This state of affairs triggered various problems because the distribution of authority between the different corporate organs was ambiguous. On the one hand, the introduction of independent directors was intended to resolve the problem of statutory supervisors’ failing to effectively monitor boards of directors. However, independent directors also had insufficient incentives to fulfil their duties, and their true independence remains highly questionable without the existence of a corresponding effective system of judicial review.

To further enhance corporate governance and streamline the governance structure of public companies, the Financial Supervisory Commission (FSC) of Taiwan

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mandated in December 2013 that all public companies with paid-in capital over NTD 2 billion (USD 60 million) were to abolish the double board model and switch to the unitary board structure. A decade after the introduction of the institution of independent directors to Taiwan’s corporate governance, the government felt that the time was ripe to intervene in the internal governance of public companies and took a reformist approach to corporate board reform. This Chapter reviews the reform process since 2002 and critically analyses the challenges of an optional model, along with the legal transplantation process.

Part II introduces the reform of the board structure and presents some statistics regarding the percentage of public companies with independent directors, as well as the occupations of independent directors in Taiwan. In particular, this section analyses the problems with each corporate governance structure option, along with the main functions of corporate directors in Taiwan. As of 2014, 66.34% of Taiwan Stock Exchange (TWSE)-listed and Over-The-Counter (OTC)-traded companies have independent directors on their boards. However, this means that 33.66% are still resisting this change. According to a new rule promulgated in December 2013, the 33.66% of companies that do not currently have independent directors will be required to introduce at least two independent directors to their board by the end of 2017. The effect of this regulatory policy is yet to be seen. However, it is clear that Taiwan is definitely switching from a double board system to a unitary board system.

Part III builds on this analysis by discussing the incentives that drive independent directors in Taiwan. In particular, it explores the balance that has been struck between the risk of liability and reward of remuneration for the burgeoning class of independent directors in Taiwan. It is noteworthy that the Taiwan’s Company Act applies the same standard of fiduciary duties to both inside directors and independent directors. However, we have observed that, in some decisions the court will take into account the position, information, time, knowledge, and other factors to reduce or exempt independent directors from liability. Moreover, we observe that to attract highly skilled and qualified people to serve as independent directors, the availability of appropriate Directors and Officers Liability Insurance (D&O insurance) is essential. As of 2014, only 62.51% of TWSE-listed companies provided D&O insurance for their directors. With the introduction of the new rule that requires all listed companies to have independent directors by 2017 and the uncertainty of the liability regime, the government should encourage more companies to provide D&O insurance for their directors. With respect to truly independent directors in Taiwan, research studies have shown that substantial social ties exist between controlling shareholders/insiders and independent directors. Absent effective judicial review or regulatory monitoring mechanism, the impartiality and monitoring function of independent directors will be substantially impaired.
Part IV concludes by asserting that Taiwan has clearly made a formal change in its corporate governance by legislating the adoption of independent directors. It is far less certain, however, that this formal change has caused a significant shift in how Taiwan’s corporate governance actually functions. Ultimately, we suggest that for significant functional change to occur, Taiwan must do more than merely ensure there are “independent directors” in its boardrooms. Rather, the key to real functional change appears to reside in changing the complimentary institutions that are discussed in this chapter, which are critical to ensuring that independent directors can fulfill their intended purpose—but are far too often overlooked.

II. Corporate Governance in Taiwan

1. The Reform of the Board Structure

The structure of a board is often path dependent in relation to the given country’s political and economic conditions. Taiwan’s corporate board structure generally follows the Japanese governance structure, which is, in turn, a modified version of the German structure. The governance structure in Taiwan and Japan differs from the typical German model in that the statutory supervisor position in Japan and Taiwan is weaker than its German counterpart—the supervisory board. In Germany, the supervisory board has the right to appoint or remove directors; however, in Japan and Taiwan, supervisors are nominated by the board, in principle, and elected by the shareholders. Unlike their German and Japanese counterparts, statutory supervisors in Taiwan do not act collectively as a board; rather, they act individually. To distinguish the Taiwanese model from the German two-tier model, where the supervisory board elects the management board, we use the term “double board” to describe the board structure in Taiwan throughout this Chapter.

Following the enactment of the Sarbanes–Oxley Act of 2002, which relied heavily on independent directors as a means of monitoring US public companies, many Asian countries initiated corporate board reforms to align themselves with the US-style governance structure. Given that there was controversy surrounding the adoption of the US-style unitary board structure among legal scholars in Taiwan, as well as resistance from the business community with regard to increasing board independence, the government authority decided not to invoke drastic reforms of the governance structure, and decided to adopt changes gradually.

4[Reference to Chapter 1]
The first action was taken by the TWSE in 2002 through the amendment of its listing rule, which required all newly listed companies to have at least two independent directors and one independent statutory supervisor. At that time, the TWSE was still hesitant to apply such requirements to all listed companies, due to the fierce opposition from such companies. The TWSE thus adopted the “comply or disclose” approach, requiring all listed companies to disclose the TWSE-defined “independence” of their directors and supervisors. Since then, an increasing number of public companies have voluntarily inducted independent directors and independent supervisors.  

The Taiwanese government’s proposal for corporate board reform triggered much debate among scholars in Taiwan, the most prominent issue being whether or not Taiwan should introduce independent directors and audit committees and abandon the institution of statutory supervisors. The Taiwanese Congress finally settled the dispute by revising the Securities and Exchange Act (SEA) in 2006 to give public companies the option to have independent directors and the unitary board system.  

Paragraph 1 of Article 14-2 of the SEA provides that “A company that has issued stock in accordance with this Act may appoint independent directors in accordance with its articles of incorporation.” In addition, paragraph 1 of Article 14-4 of the SEA provides that “[a] company that has issued stock in accordance with this Act shall establish either an audit committee or a supervisor.”

Therefore, under existing laws, there are three types of governance structures in Taiwan’s public companies: (1) a traditional board, without independent directors, with statutory supervisors (the double board type); (2) a board with independent directors and statutory supervisors (the hybrid type); and (3) a board with independent directors and an audit committee without statutory supervisors (the unitary type). The first two types maintain the double board model, and the last type is the unitary model.

In principle, a company can choose from among the three above-mentioned types. However, Paragraph 1 of Articles 14-2 and 14-4 of the SEA authorize the competent authority (i.e., FSC) to, as necessary and in view of the company’s scale, shareholder structure, type of operations, and other essential factors, require public companies to appoint independent directors of no less than two in number and no less than one-fifth of the total number of directors and to order companies to establish an audit committee.

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6 Ibid.

7 See Regulatory Appendix.

8 Non-public companies in Taiwan may not appoint independent directors and remain a double board structure—that is, a traditional board of directors and a statutory supervisor.
in lieu of a supervisor. Based on the belief that independent directors and audit committees are better institutions than statutory supervisors for corporate governance, the FSC is gradually expanding the scope of public companies, subject to the compulsory appointment of independent directors and the establishment of audit committees (See Tables 1 and 2 below).

Further, to enhance the monitoring of remuneration of directors, statutory supervisors, and managerial officers, Taiwan added Article 14-6 of the SEA in November 2010 to compulsorily require all TWSE-listed and OTC-traded companies to establish a remuneration committee to determine salary, stock options, and any other substantive incentive measures for directors, supervisors, and managerial officers. Members of the remuneration committee have to be either independent directors or non-directors who meet the independence requirements set out in the relevant rules. The committee must have at least three members. Since the old law only requires a minimum of two independent directors on each board, most companies have to either add more independent directors to the board or attempt to retain some independent non-directors to serve on the remuneration committee.

Based on the most recent regulation promulgated by the FSC in December 2013, the boards of all TWSE-listed, OTC-traded companies and public companies in the financial industry, such as banks, insurance companies, and securities firms, should appoint at least two independent directors. TWSE-listed and OTC-traded companies with paid-in capital of more than NTD 10 billion (USD 330 million), as well as public companies in the financial industry, should establish an audit committee. TWSE-listed and OTC-traded companies with paid-in capital of between NTD 2 billion and 10 billion (USD 60 to 330 million) should establish an audit committee as of 1 January 2017. In the near future, we can expect that the double board system will be gradually phased out and the unitary board will become the norm in all TWSE-listed and OTC-traded companies.

Table 1: Public Companies Subject to the Compulsory Appointment of At Least Two Independent Directors in the Board

<table>
<thead>
<tr>
<th>Date of Promulgation by FSC</th>
<th>Compliance Date</th>
<th>Scope</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2006(^{10})</td>
<td>1 January 2007</td>
<td>TWSE-listed and OTC-traded companies with paid-in capital of NTD 50 billion (USD 1.6 billion) and public companies in the financial industry</td>
</tr>
<tr>
<td>March 2011(^{11})</td>
<td>22 March 2011 (no later than 31 December 2014)</td>
<td>TWSE-listed and OTC-traded companies with paid-in capital of NTD 10 billion (USD 330 million) and public companies in the financial industry</td>
</tr>
<tr>
<td>Dec. 2013(^{12})</td>
<td>31 December 2013 (no later than 31 December 2017)</td>
<td>All TWSE-listed, OTC-traded, and public companies in the financial industry</td>
</tr>
</tbody>
</table>

Table 2: Public Companies Subject to the Compulsory Establishment of Audit Committees (which shall be composed of the entire number of IDs and shall be no fewer than three in number)

<table>
<thead>
<tr>
<th>Date of Promulgation by FSC</th>
<th>Compliance Date</th>
<th>Scope</th>
</tr>
</thead>
<tbody>
<tr>
<td>Feb. 2013(^{13})</td>
<td>20 February 2013</td>
<td>TWSE-listed and OTC-traded companies with paid-in capital of NTD 50 billion (USD 1.6 billion) and public companies in the financial industry</td>
</tr>
</tbody>
</table>

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\(^{10}\) Order No. Financial-Supervisory-Securities-I-0950001615 of the Financial Supervisory Commission, Executive Yuan, 12:60 Executive Yuan Gazette 10601 (28 March, 2006).

\(^{11}\) See 19:248 Executive Yuan Gazette 50294, (note 9, above).

\(^{12}\) Ibid.

2. **Empirical Data**

a. Public Companies with Independent Directors

In 2005, 612 out of 1,194 (51.26%) TWSE-listed and OTC-traded companies had independent directors on their boards. Around 38.02% companies had two independent directors, which is in line with the regulatory requirements at that time. The percentage of companies that complied with the minimum requirements slowly rose to 41.45% in 2010. In November 2011, the law changed to require at least three independent directors or independent members to be on the remuneration committees for all public companies. Hence, the percentage of companies with two independent directors dropped to 40.09% at the end of 2011, with a corresponding increase in the percentage of companies with more than three independent directors to 18.32% from only 4.94% in 2005.

At the end of 2014, the percentage of companies with more than three independent directors rose to 29.43%, with a corresponding decrease in the percentage of companies with only two independent directors to 35.87%. As of 2014, 66.34% of TWSE-listed and OTC-traded companies have independent directors on their boards. The most recent regulation promulgated by the FSC in December 2013 requires all TWSE-listed and OTC-trade companies to appoint independent directors to the board. As this regulation does not come into effect until the expiration of the three-year term for incumbent directors, we expect the number of independent directors to rise sharply in the next two to three years. Table 3 provides the statistics for the number of TWSE-listed and OTC-traded companies that have no independent directors, one independent director, two independent directors, and over three independent directors. Table 4 provides the percentage of the same.

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14 See 19:248 Executive Yuan Gazette 50294, (note 9, above).
Table 3: Number of TWSE-Listed and OTC-Traded Companies with Independent Directors

<table>
<thead>
<tr>
<th>Year</th>
<th>No Independent Director</th>
<th>One Independent Director</th>
<th>Two Independent Directors</th>
<th>Over Three Independent Directors</th>
<th>Total Number of TWSE and OTC Companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>582</td>
<td>99</td>
<td>454</td>
<td>59</td>
<td>1,194</td>
</tr>
<tr>
<td>2006</td>
<td>587</td>
<td>88</td>
<td>476</td>
<td>68</td>
<td>1,219</td>
</tr>
<tr>
<td>2007</td>
<td>590</td>
<td>61</td>
<td>512</td>
<td>82</td>
<td>1,245</td>
</tr>
<tr>
<td>2008</td>
<td>566</td>
<td>44</td>
<td>529</td>
<td>118</td>
<td>1,257</td>
</tr>
<tr>
<td>2009</td>
<td>580</td>
<td>33</td>
<td>531</td>
<td>143</td>
<td>1,287</td>
</tr>
<tr>
<td>2010</td>
<td>553</td>
<td>28</td>
<td>548</td>
<td>194</td>
<td>1,322</td>
</tr>
<tr>
<td>2011</td>
<td>552</td>
<td>29</td>
<td>560</td>
<td>256</td>
<td>1,397</td>
</tr>
<tr>
<td>2012</td>
<td>530</td>
<td>21</td>
<td>562</td>
<td>334</td>
<td>1,447</td>
</tr>
<tr>
<td>2013</td>
<td>515</td>
<td>28</td>
<td>557</td>
<td>396</td>
<td>1,496</td>
</tr>
<tr>
<td>2014*</td>
<td>518</td>
<td>16</td>
<td>552</td>
<td>453</td>
<td>1,539</td>
</tr>
</tbody>
</table>

Source: Compiled by the authors from the Market Observation Post System of the TWSE.

* The statistics for 2014 are up to October 2014.

Table 4: Percentage of TWSE-Listed and OTC-Traded Companies with Independent Directors

<table>
<thead>
<tr>
<th>Year</th>
<th>Companies with No Independent Directors</th>
<th>Companies with One Independent Director</th>
<th>Companies with Two Independent Directors</th>
<th>Companies with Over Three Independent Directors</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>48.74%</td>
<td>8.29%</td>
<td>38.02%</td>
<td>4.94%</td>
</tr>
<tr>
<td>2006</td>
<td>48.15%</td>
<td>7.22%</td>
<td>39.05%</td>
<td>5.58%</td>
</tr>
<tr>
<td>2007</td>
<td>47.39%</td>
<td>4.90%</td>
<td>41.12%</td>
<td>6.59%</td>
</tr>
<tr>
<td>2008</td>
<td>45.03%</td>
<td>3.50%</td>
<td>42.08%</td>
<td>9.39%</td>
</tr>
<tr>
<td>2009</td>
<td>45.07%</td>
<td>2.56%</td>
<td>41.26%</td>
<td>11.11%</td>
</tr>
<tr>
<td>2010</td>
<td>41.83%</td>
<td>2.12%</td>
<td>41.45%</td>
<td>14.67%</td>
</tr>
<tr>
<td>2011</td>
<td>39.51%</td>
<td>2.08%</td>
<td>40.09%</td>
<td>18.32%</td>
</tr>
<tr>
<td>2012</td>
<td>36.63%</td>
<td>1.45%</td>
<td>38.84%</td>
<td>23.08%</td>
</tr>
<tr>
<td>2013</td>
<td>34.43%</td>
<td>1.87%</td>
<td>37.23%</td>
<td>26.47%</td>
</tr>
<tr>
<td>2014*</td>
<td>33.66%</td>
<td>1.04%</td>
<td>35.87%</td>
<td>29.43%</td>
</tr>
</tbody>
</table>

Source: Compiled by the authors from the Market Observation Post System of the TWSE.

* The statistics for 2014 are up to October 2014.
Figure 1 below illustrates the trend that more independent directors are being added to the boards of public companies. The total number of companies with independent directors has risen sharply since 2011. The numbers almost doubled in the period from 2005 to 2014. In particular, the number of companies with more than three independent directors has increased sharply, and there has been a decrease in the number of companies that have only one independent director, thereby illustrating a trend towards more independent boards. The curves in Figure 1 further demonstrate the power of regulation in shaping the behavior of firms. For TWSE-listed companies, which are typically large companies, the effect of regulation is even more salient because most reforms are targeted towards larger companies.

Figure 2 below shows that, in 2013, the number of TWSE-listed companies that have more than three independent directors exceeded those that have two for the first time. This trend has been observed since 2011, and may have arisen due to the new law that requires at least three independent directors or members to be on the remuneration committee, which applies to all public companies. Since the law allows the companies to appoint independent members who are not directors to serve as members of the remuneration committee, as long as the members meet the independence requirement, companies are, in fact, not required to have three independent directors under the new law. However, we have still seen a surge in the number of companies that have three independent directors since 2011, especially in TWSE-listed companies. This indicates that larger companies are adapting more rapidly than smaller companies in increasing the number of independent directors and are more willing to enhance the independence of the board.

Another interesting observation is that the number of companies that chose not to have any independent directors in 2005 stayed roughly the same, despite the many reforms in the past decade. Table 3 shows that, in 2005, there were 582 companies that had no independent directors. In 2014, the number went down slightly to 518. That means only 10.9% of those companies decided or were forced to introduce independent directors to their board. Conversely, for companies that already had one independent director back in 2005, 84% of them have increased their number of independent directors to two or more. There is an apparent resistance from those companies who had no independent directors in 2005 towards the whole concept of having independent directors on the board. The question that arises is: why is it that companies with no independent directors and companies with one independent director have acted differently over the past decade?

From the regulation in March 2011 (see Table 1), we can reasonably infer that companies with no independent directors at all are smaller companies with paid-in
capital of less than NTD 10 billion (USD 330 million) and are not in the financial industry. In addition, these companies are companies who went public before 2002 because all newly-listed companies after 2002 have to have at least two independent directors. As such, these companies are smaller companies with a long listing history, and they represent 42.7% of TWSE-listed companies.

The difference between these companies and those with one independent director in 2005 is that these companies resisted the idea of bringing independent directors to the board from the beginning, while those with one independent director embraced the idea of independent directors on a voluntary basis. Those companies resisted to have independent directors either because the controlling shareholder did not believe that independent directors would bring value to the firm and/or because the shareholder did not want outsiders monitoring them. It would be very interesting to see the impact of the December 2013 compulsory requirement to appoint at least two independent directors on these companies, and to test whether these companies are acting rationally in choosing board structures. While only companies over NTD 2 billion are required to switch to the unitary board model, companies under NTD 2 billion will operate under the hybrid model. The effect of the regulatory choice of the hybrid model over the traditional double board model has yet to be tested.

Figure 1: Number of TWSE-Listed and OTC-Traded Companies with Independent Directors

Source: Compiled by the authors from the Market Observation Post System of the TWSE.

* The statistics for 2014 are up to October 2014.
b. The Occupations of Independent Directors

The quality and professional expertise of independent directors is an important factor in assessing the effectiveness of this corporate governance mechanism. With the increasing popularity of independent directors, an analysis of their occupations in Taiwan provides a qualitative lens through which policymakers can understand the profiles of these new additions to the board and the functions they might carry out, given their expertise. This study classifies the occupation of independent directors into 12 categories and compiles data from the Market Observation Post System (MOPS), where the descriptions of each independent director’s current occupation are available.

The top three occupations of independent directors for both TWSE-listed and OTC-traded companies are the same: (1) corporate directors (31.49% in TWSE-listed and 26.36% in OTC-traded companies, respectively); (2) professors (24.69% in TWSE-listed and 22.34% in OTC-traded companies, respectively); and (3) managers (7.83% in TWSE-listed and 11.33% in OTC-traded companies, respectively) (Table 5). In comparison with a study conducted in 2008, according to which the top three occupations of independent directors are corporate directors (29.03%), professors
(24.91%), and managers (12.36%) in TWSE-listed companies, the major occupation of independent directors seems to have remained unchanged for the past six years. In addition, accountants and lawyers constitute a significant portion of independent directors, which rank in the fourth and fifth positions, respectively.

One interesting observation regarding the occupation of independent directors in Taiwan is that “professors” comprise a popular and important group, accounting for 24.69% of TWSE-listed companies and 22.34% of OTC-traded companies, respectively. Possible reasons for this include the fact that the public image of professors fits well with the concept of “independence” and that professors are generally thought of as experts in their chosen field. However, as such professors may not be entirely familiar with the practical aspects of business operations, there are some doubts as to whether they are able to function effectively as independent directors.

Table 5: Occupations of Independent Directors

<table>
<thead>
<tr>
<th>Occupation</th>
<th>TWSE-listed companies</th>
<th>OTC-listed companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Directors</td>
<td>398</td>
<td>335</td>
</tr>
<tr>
<td>Professor</td>
<td>312</td>
<td>284</td>
</tr>
<tr>
<td>Manager</td>
<td>99</td>
<td>144</td>
</tr>
<tr>
<td>Accountant</td>
<td>93</td>
<td>119</td>
</tr>
<tr>
<td>Lawyer</td>
<td>72</td>
<td>68</td>
</tr>
<tr>
<td>Director of NGO</td>
<td>52</td>
<td>21</td>
</tr>
<tr>
<td>Consultant</td>
<td>40</td>
<td>27</td>
</tr>
<tr>
<td>CEO, CFO, or COO</td>
<td>19</td>
<td>39</td>
</tr>
<tr>
<td>Physician</td>
<td>7</td>
<td>4</td>
</tr>
<tr>
<td>Government official</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>Politician</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Other</td>
<td>167</td>
<td>225</td>
</tr>
<tr>
<td>Total</td>
<td>1264</td>
<td>1271</td>
</tr>
</tbody>
</table>

Source: Analyzed and categorised by the authors based on data from the Market Observation Post System, TWSE (17 December, 2014).


Ibid., 399.

Ibid., 399–400.
3. Problems with Multiple Corporate Governance Structures in Taiwan

For double board type companies, which have the traditional board and statutory supervisors, one of the major forces driving the introduction of independent directors and audit committees is the malpractice of statutory supervisors. Such companies continue to face problems with regards to increasing the independence and professional competence of statutory supervisors; however, this is an issue that is beyond the scope of this chapter.

For hybrid type companies—those with both independent directors and statutory supervisors—the role and functions of independent directors can be very confusing. Article 14-3 of the SEA expressly provides that:

When a company appoints independent directors, the following matters shall be submitted to the board of directors for approval by resolution. Moreover, when an independent director has a dissenting opinion or qualified opinion, it shall be noted in the minutes of the directors meeting for the following matters:

1. adoption or amendment of an internal control system, pursuant to Article 14-1;
2. adoption or amendment, pursuant to Article 36-1, of handling procedures for financial or operational actions of material significance, such as acquisition or disposal of assets, derivatives trading, extension of monetary loans to others, or endorsements or guarantees for others;
3. a matter bearing on the personal interest of a director;
4. a material asset or derivatives transaction;
5. a material monetary loan, endorsement, or provision of guarantee;
6. the offering, issuance, or private placement of any equity-type securities;
7. the hiring or dismissal of an attesting Certified Public Accountant (CPA), or the compensation given thereto;
8. the appointment or discharge of a financial, accounting, or internal auditing officer; and
9. any other material matter so required by the Competent Authority.

The malpractice of statutory supervisors includes lack of independence, lack of professional competence due to family relationships or voting mechanism, poor performance of his or her duties as a supervisor due to insufficient time and effort and their part-time nature, etc. See Y. Z. Lai, 最新證券交易法解析 (The Newest Analysis of Securities Exchange Act), 2nd ed., (2009), 198.
Undoubtedly, the listed items are matters that are relatively material to a company, and the law requires independent directors to have a say in these matters to protect shareholders’ interests. However, the listed items are similar to the supervising responsibilities that were originally performed by statutory supervisors in a double board system. The division of work between independent directors and statutory supervisors is therefore an essential but unsettled issue.

Some scholars have attempted to distinguish between the responsibilities of independent directors and statutory supervisors, viewing them as having a “supervising nature” and “supervising timing,” respectively. Firstly, independent directors are still members of the board of directors and can therefore participate in and vote on business decisions. As such, the nature of their responsibilities is “internal supervision by participating in board decisions,” which constitutes “*ex ante* supervision”. In contrast, statutory supervisors can attend board meetings and express their opinions, but have no voting rights.\(^\text{19}\) Hence, their responsibilities consist of “outside supervision without participating in board decisions,” which constitutes “*ex post* supervision.”\(^\text{20}\) Ideally, this “dual supervision” by both independent directors and statutory supervisors would have a “dual effect.” It might also have negative effects of redundancy and wasted costs and, more seriously, create incentives for independent directors or statutory supervisors to shirk their responsibilities or to blame each other. Therefore, an unambiguous division of work between independent directors and statutory supervisors is an urgent task for the legislature.\(^\text{21}\)

In the case of companies with unitary boards at least three problems remain in Taiwan. First, the authority of the audit committee on critical issues is weak as a result of the board’s ability in most cases to usurp its authority. Specifically, in most cases, the board can overrule the decision of the audit committee if two-thirds or more of the directors pass a resolution.\(^\text{22}\) In cases where the audit committee’s decision is essentially disregarded, the only thing it can do is to record the board’s reversal of its decision in the minutes of the directors’ meeting and hope that public scrutiny will provide some

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\(^{19}\) Article 218-2 of the Taiwanese Company Act sets forth that “Supervisors of a company may attend the meeting of the board of directors to express their opinions.”


\(^{21}\) *Ibid.*, 135. Some scholars suggest the deletion of Article 14-3 from the SEA for type 2 companies so that independent directors are responsible for decision-making and execution only and statutory supervisors remain in charge of the supervisory work.

\(^{22}\) Article 14-5 of the SEA.
sanction. This calls into question the effectiveness of the audit committee in companies with unitary boards in Taiwan.

Second, audit committees in Taiwan have a much broader mandate than in other unitary board dominated jurisdictions. This has the potential to interfere in the efficient decision making of companies it may allow audit committees to try to interfere with the board’s ability to make business decisions. Specifically, Article 14-5 of the SEA provides audit committees with the broad mandate to make decisions on “all material asset or derivatives transaction,” “all material monetary loans, endorsements, or provision of guarantees”; and, “on the offering, issuance, or private placement of any equity-type securities.” These types of matters all clearly fall within the scope of business decisions which the audit committee should not directly be involved.\textsuperscript{23} Indeed, the equivalent provisions regulating audit committees of companies listed on the NYSE and LSE do not provide such a broad mandate for audit committees to get involved in business decisions, which should be allocated to the board.

Third, according to Taiwanese law, every independent director on the board automatically becomes a member of the audit committee (i.e., the audit committee is composed of the total number of independent directors on the board).\textsuperscript{24} Therefore, the success of the audit committee is highly dependent on who is nominated to be elected as the independent directors. There are two ways to nominate an independent director in Taiwan: (1) nomination by the board of directors; or, (2) by minority shareholders who hold 1% or more of the total number of outstanding shares issued by the company.\textsuperscript{25} Nevertheless, the relevant laws in Taiwan do not require or even encourage public companies to establish a nomination committee of which all or at least half of the members are independent directors.\textsuperscript{26} As such, the independence and professional

\textsuperscript{23} W. R. Tseng, ‘半套公司治理移植經驗—以審計委員會與特別委員會為例’ (‘An Analysis of Taiwan’s Alterations and Misconceptions during Transplantation of Foreign Laws Regarding Corporate Governance: An Exploration of Taiwan’s Audit Committee and Special Committee’), Cross-Strait Law Review, 43 (March 2014), 33, 36.

\textsuperscript{24} Paragraph 2 of Article 14-4 of the SEA.

\textsuperscript{25} Article 192-1 of the Taiwanese Company Act provides that “In case a candidate’s nomination system is adopted by a company offering its shares to the public for election of the directors of the company, the adoption of such system shall be expressly stipulated in the Articles of Incorporation of the company; and the shareholders shall elect the directors from among the nominees listed in the roster of director candidates.”

\textsuperscript{26} Only two TWSE-listed and OTC-traded companies have voluntarily established a nomination committee. Please see http://mops.twse.com.tw/mops/web/t100sb03_1.
competence of both independent directors and audit committees are questionable in
Taiwan.  

However, Article 198 of Taiwan’s Company Act mandates cumulative voting
basically for all corporations, except for close corporations at the time of incorporation,
to empower minority shareholders in the election of directors. This mechanism might
mitigate the concern caused by the lack of the nomination committee.

4. The Characteristics of Corporate Ownership in Taiwan

The corporate ownership of Taiwan’s public companies is characterised by its
concentrated, family-dominated nature, as well as by the prevalence of business groups.
The largest shareholders of the non-financial firms in Taiwan control 62.69% of board
seats and comprise 49.55% of statutory supervisors. Hence, large shareholders in
Taiwan not only own public firms but also manage and control them. Yeh and Ko
(2006) found that the average control rights of the largest shareholders in non-financial
firms was 29.81%, but average cash-flow rights were only 22.13%. Before the
introduction of independent directors in 2002, many corporate boards in Taiwan
conducted “paper” meetings. Board members were either founding family members or
top executives and family members were usually highly involved in the management
of the company.

Another characteristic of Taiwan’s corporate ownership structure is the prevalence
of business groups. Business groups control most of the firms in Taiwan and contribute
to a very large portion of Taiwan’s total economic revenue. The top 100 business groups
in Taiwan owned more than 7,914 companies in 2013. Among the top 10 business
groups, eight were in the financial industry. Family businesses continue to dominate
Taiwan’s economy.

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28 Article 198 and Article 356-3 of the Taiwanese Company Act.
29 Y. H. Yeh, S. L. Tsun, and T. Woidtke, ‘Family Control and Corporate Governance: Evidence
30 Y.H. Yeh and C.E. Ko, The Law and Practice of Independent Directors, Audit Committees and
Other Functional Committees in Germany, Japan, the US, and Korea (Financial Supervisory
Commission of Taiwan, 2006), 294-95.
31 China Credit Information Service Ltd., Business groups in Taiwan, 2014.
32 The major families include: the Tsai family of the Cathay and Fubon groups; the Wu family of
the Shin Kong and Tai Shin groups; the Wang family of the Formosa Plastics Group; the Gu family of
With concentrated corporate ownership, the key role of independent directors in Taiwan is to mitigate agency problems that arise between controlling and minority shareholders by monitoring the private benefits of control enjoyed by the controlling shareholders. In the following section, the functions of independent directors in monitoring executive compensation, mergers and acquisitions, and self-dealing transactions are investigated.

5. The Role of Independent Directors in Major Board Functions

The major role of an independent director in the Anglo-American style unitary board is to reconcile conflict of interests situation faced by directors when performing their monitoring function. Compared with the functions of boards of directors in the US, the role of boards of directors in Taiwan is more like that of managing boards than monitoring boards. Article 202 of the Taiwan’s Company Act provides that the “business operation of a company shall be executed, pursuant to the resolutions to be adopted by the board of directors.” Generally speaking, the board of directors in Taiwan has the power of “business decision-making” and “business execution.” One scholar makes the criticism that Article 202 is more suitable for small or medium-sized companies and ignores the needs of large public companies. For small and medium-sized companies, the powers of business decision-making and execution are often tied together and exercised by the board of directors. However, for larger public companies, the board of directors in practice serves more of a monitoring function by establishing functional committees to execute certain decision-making and delegating business operations to a chief executive officer or general manager. The introduction of independent directors to Taiwan’s corporate boards also help these boards transform

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33 Article 202 of the Taiwan’s Company Act “Business operations of a company shall be executed pursuant to the resolutions to be adopted by the board of directors, except for the matters the execution of which shall be effected pursuant the resolutions of the shareholders' meeting as required by this Act or the Articles of Incorporation of the company.”

34 However, allocating the powers of decision-making between the meetings of both the board of directors and the shareholders involves the debate of shareholder primacy or director primacy and remains a controversial issue in Taiwan.

35 Wallace W. Y. Wang, 公司法論 (Corporate Law), 4th ed. (Taipei: 元照 Yuan Chao, 2008), 539.

36 Ibid.
from managing boards to monitoring boards. In light of such role change, this section reviews how independent directors are incorporated in the process of legal transplantation.

The function of the board of directors in Taiwan includes, but not limited to the following: appointing and removing top managers (in particular, the CEO); determining the compensation of managers; making decisions concerning corporate strategies; and, executing business decisions. In this section, we will address three particular functions and the significant ways in which these functions have evolved over time by emphasising the role that independent directors play in these particular aspects.

a. Determination of executive compensation

For non-public companies, the board of directors has the exclusive authority to determine executive compensation according to Article 29 of the Taiwan’s Company Act. In 2010, as previously mentioned, for all the TWSE-listed and OTC-traded companies, Article 14-6 of the SEA requires these companies to establish a remuneration committee to determine executive compensation. It is important to note that not all TWSE-listed and OTC-traded companies have independent directors. Therefore, the members of a remuneration committee may be comprised of independent directors, independent non-directors, and corporate insiders. In addition, as a result of the specific legislation governing remuneration committees, they suffer from the same lack of authority as we have seen with audit committees. Specifically, the board can overrule the decision of a remuneration committee if two-thirds or more of the directors pass a resolution. In cases where the remuneration committee’s decision is essentially disregarded, the board only needs to specify the circumstances and cause for the difference between the remuneration determined by the remuneration committee and its decision. In this case, the board’s

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37 The qualifications and definitions of independent experts are the same as those of independent directors. Please see Articles 5 and 6 of Regulations Governing the Appointment and Exercise of Powers by the Remuneration Committee of a Company Whose Stock Is Listed on the Stock Exchange or Traded Over the Counter.

38 Such members cannot exceed one-third of the remuneration committee members and may not serve as the convener or as chair of a meeting. Please see Article 6 of Regulations Governing the Appointment and Exercise of Powers by the Remuneration Committee of a Company Whose Stock Is Listed on the Stock Exchange or Traded Over the Counter.

explanation must be publicly announced and reported on a website designated by the regulatory authority. However, the effectiveness of this public shaming tactic is questionable. There is empirical evidence that suggests that the functional effect of the remuneration committee in Taiwan may be weak as a result of its flawed design.

b. Control over mergers and acquisitions

Taiwan’s Business Mergers and Acquisitions Act requires that the board of directors act in the best interest of the company and fulfill its duty of care when conducting a merger or acquisition. Therefore, when making a decision regarding the mergers or acquisitions of a company, the board of directors has a duty of care to maximise the interests of the company and, in turn, of its shareholders as a whole.

In a recent watershed case in Taiwan, the Chairman of the Yageo Corporation (Yageo, 国巨) and Kohlberg Kravis Roberts & Co. L.P. launched a management buyout through a tender offer for Yageo and planned to delist it from the TWSE if the tender offer succeeded. Since Yageo was the largest supplier of passive components for electronic products in Taiwan, the government authority raised its concerns about the pricing and fair conduct of the takeover. On 8 April, 2011, the Securities and Futures

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40 Article 7 of the Regulations Governing the Appointment and Exercise of Powers by the Remuneration Committee of a Company Whose Stock Is Listed on the Stock Exchange or Traded Over the Counter (“Regulation governing remuneration committee”) provides that “If the board of directors will decline to adopt, or will modify, a recommendation of the remuneration committee, it shall require the consent of a majority of the directors in attendance at a meeting attended by two-thirds or more of the entire board, which in its resolution shall give the comprehensive consideration under the preceding paragraph and shall specifically explain whether the remuneration passed by it exceeds in any way the recommendation of the remuneration committee.” Further, “[i]f the remuneration passed by the board of directors exceeds the recommendation of the remuneration committee, the circumstances and cause for the difference shall be specified in the board meeting minutes and shall be publicly announced and reported on the information reporting website designated by the competent authority within two days, counting from the date of passage by the board of directors.”


42 Business Mergers and Acquisitions Act, amended on July 8, 2015.

43 Article 5 of the Taiwanese Business Mergers and Acquisitions Act provides that “[w]hen a resolution of merger/consolidation or acquisition is passed, the Board of Directors shall, in the course of conducting the merger/consolidation or acquisition, be in the best interest of the company and fulfill its duty of care.”
Investors Protection Center (SFIPC) urged Yageo to establish an independent special committee to review the tender offer price and the reasonableness of the takeover plan to protect investors. Yageo then convened a special board meeting and resolved that the tender offer price was within a reasonable range, indicating that the board did not intend to establish a special committee. Although this deal was disallowed due to the lack of approval for the requisite foreign investment by the Investment Committee of the Ministry of Economic Affairs of Taiwan, this case revealed the potential conflict of interest between the board of directors, managers and the shareholders as a whole in the face of a takeover bid.

In response to the above case, in July 2012, Taiwan added Article 14-1 of the Regulations Governing Public Tender Offer for Securities of Public Companies to require the target company to form a review committee to review the fairness and reasonableness of a public tender offer and make recommendations to the target’s shareholders, when receiving a tender offer from the Acquirer. It states that the review committee shall have no fewer than three

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44 The SFIPC is an organization that provides consultation on the trading of securities and futures, as regulated by related laws and regulations, the mediation of disputes arising from the trading of securities and futures, and litigation services on behalf of investors. In addition, the center manages a protection fund to compensate investors if a securities or commodities firm is unable to do so due to financial difficulties. For details, please see www.sfipc.org.tw/english/about/02.asp.


47 Based on the statistics of the Ministry of Economic Affairs, the numbers of merger and acquisition cases in the past five years in Taiwan are 191 (2011), 186 (2012), 184 (2013), 197 (2014) and 224 (2015), respectively. It shows that the merger and acquisition cases are steadily increasing in recent years. Please see http://gcis.nat.gov.tw/mainNew/subclassNAction.do?method=getFile&pk=126, last visited Feb. 2016.


49 Article 14-1 of the Regulations Governing Public Tender Offer for Securities of Public Companies, which provides that “After a public company whose securities are being acquired has received the copy of the Public Tender Offer Report Form, the public tender offer prospectus, and other documents reported and publicly announced by the offer or…, it shall promptly form a review committee, and publicly announce the results of the review within 10 days. The review committee of the preceding paragraph shall review the fairness and reasonableness of the public tender offer conditions and make recommendations to the company shareholders, with respect to the present tender offer.”
members and shall be composed of independent directors or independent non-directors. All decisions rendered by the review committee require the assent of one-half or more of all the committee members, and the specific assenting or dissenting opinions of the committee members, as well as the reasons for any dissent.

Similarly, the newly amended Article 6 of the Business Mergers and Acquisitions Act also requires a public company to establish a special committee before the board resolution regarding the mergers or acquisitions is decided on. The special committee shall review the fairness and reasonableness of a merger or acquisition plan and report the results of the review to the meeting of the board of directors and shareholders.

It is important to note, however, that such a review or special committee in Taiwan does not have the representative authority to negotiate, nor does it have veto power regarding a takeover bid, merger, or acquisition plan. The review or special committee is currently more like an advisor or consultant to the board of directors and aims to indirectly protect the interests of the minority shareholders. Moreover, the legal consequence of failing to establish a review or special committee has never been clear. The effectiveness of a review or special committee, with respect to substantial controlling conflicts of interest between the board of directors, controlling shareholder and the shareholders remains unclear.

c. Control over self-dealing

The existing literature and history of corporate scandals in Taiwan indicate that wealth tunnelling is a significant threat to Taiwan’s corporate governance, and that the major channel for wealth tunnelling is through related party transactions. The Taiwan’s Company Act essentially allocates to statutory supervisors the power to control self-dealing or tunnelling. Article 223 of the Taiwan’s Company Act deals with self-dealing by requiring the supervisor to act as the representative of the company in case of an interested transaction between a director and the company. One of the most controversial issues on this matter is whether statutory supervisors have the authority to determine the terms and conditions of transactions without the prior approval from the board of directors, or whether statutory supervisors are merely rubberstamps who represent the company.

The court decisions are split on this issue. Some decisions opine that “the legislative purpose of Article 223 of the Taiwan’s Company Act is to avoid conflicts of

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51 Article 223 of the Taiwanese Company Act provides that “In case a director of a company transacts a sale with or borrows money from or conducts any legal act with the company on his own account or for any other person, the supervisor shall act as the representative of the company.”
interest when a director of a company transacts with the company. Given the considerations of the friendly relationships among directors and the protection of corporate interests, statutory supervisors can represent the company to transact with a director without the prior approval of the board of directors.”

Conversely, other decisions have held that “the design of Article 223 is not to empower statutory supervisors to determine the terms and conditions of a transaction between a director and the company” and that “the business decision-making function of the board of directors cannot be replaced by statutory supervisors. Therefore, before representing a company, statutory supervisors shall obtain the approval of the board of directors regarding such a transaction.”

In addition, for public companies, the aforementioned Article 14-5 of the SEA shall apply and thereby make the audit committee responsible for policing self-dealing or wealth tunneling. Specifically, all related party transactions will be subject to the consent of one-half or more of the audit committee and must then be submitted to the board of directors for a resolution. Despite this system, there is empirical evidence indicating that related party transactions in Taiwan’s public companies are common, but are rarely prevented by the audit committee or board. In this sense, it appears that the oversight of independent directors has generally performed ineffectively as a mechanism for preventing deleterious related party transactions in Taiwan’s public companies.

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52 Please see, for example, ZuigaoFayuan [Sup. Ct.], Civil Division, 100 Tai-Shang No. 964(21 June, 2011) (Taiwan); Taiwan GaodengFayuan [Taiwan High Ct.], Civil Division, 101Zhong-Shang No.273(24 September, 2013) (Taiwan).

53 Please see, for example, Taiwan GaodengFayuan [Taiwan High Ct.], Civil Division, 98 Zhong-Su-Geng-Yi No. 121(21 May, 2014) (Taiwan); Taiwan GaodengFayuan [Taiwan High Ct.], Civil Division, Civil Division, 97 Zhong-Shang No.337(8 October, 2008) (Taiwan).

54 Item (4) of the Article 14-5 of the SEA.

III. The Incentives and Independence of Independent Directors

1. Potential of Liability for Independent Directors

a. The courts role in reducing liability for independent directors for breaches of fiduciary duties

Article 23 of the Taiwan’s Company Act provides that directors owe their corporations fiduciary duties, including the duties of care and loyalty. In principle, this provision requires the same standard of conduct for inside directors and independent directors to perform their fiduciary duties. However, we have observed that, in some court decisions, the judge will take into account the position, information, time, and knowledge, along with other factors of independent or non-executive directors, to reduce their liability or even exempt them from liability.

An example of this can been seen in the Procomp Informatics (博達) case.\(^56\) In this case, the court was of the opinion that the defendant who was a non-executive director was not a member of management and had limited information regarding the actual operation as well as the financial and accounting matters of the company. Moreover, the court found that the financial statements audited by a CPA was categorized as an ‘unqualified opinion’ and showed no abnormalities. In turn, the court decided that the defendant non-executive director was not responsible for the false financial statement of Procomp. We suggest that, based on the court’s reasoning, it is likely that the defendant would have been found to have breached his fiduciary duties if he was an executive director.

In a similar vein, the court in the Gold Rain (金雨) Enterprises Corp. case, appears to have lowered the bar for a director to fulfill his fiduciary duties based on factors related to him being an independent director.\(^57\) In this case, the court exempted the defendant independent director from liability for a false financial statement. In arriving at this decision, the court found that the defendant’s expertise was in freezing technology and not finance or accounting. Moreover, the court held that the defendant was not a core member of the company and did not actually participate in the decision-making process of the company due to a health condition. Finally, the court reasoned

\(^{56}\) Taiwan ShilinDifangFayuan [Shilin Dist. Ct.], Civil Division, 93 Jin No. 3 (11 March, 2004) (Taiwan).

\(^{57}\) Taiwan GaodengFayuan TaichunFenyuan [Taiwan High Ct. Taichung Branch Ct.], Civil Division, 100 Jin-Shang No. 2 (26 February, 2013) (Taiwan).
that the financial statements had been audited by a CPA. It appears that the court set a lower standard in this case, which allowed the independent director to effectively discharge his fiduciary duties by simply relying on audited financial statements as he lack the means of an insider to effectively take any other action.

Nevertheless, it is important to note that the courts have differing opinions on whether defendant director—regardless of if they are independent directors—can be exempted from liability by relying on financial statements audited by a CPA in cases involving fraudulent financial statements. A vivid example of is in the case of King’s International Multimedia Co. In this case, the court held that a financial statement audited by a CPA was an external supervisory mechanism. In contrast, the board of directors is in charge of operating the business of the company and making financial statements. In turn, the board of directors has broader powers than merely retaining a CPA to handle financial statements. As such, the court held that the defendant directors (none of them are non-executive or independent directors) failed to prove that they have performed their fiduciary duties.

At this point, based on the conflicting court decisions, we cannot definitively conclude that Taiwan’s courts have generally or systematically lowered the bar for independent or non-executive directors to satisfy their fiduciary duties. However, it does appear that at least in some cases the courts apply a more lenient standard to independent or non-executive directors than executive directors in cases involving alleged breaches of fiduciary duties.59

b. Lower proportional liability in cases of false financial statement by the SFIPC

In Taiwan, the Securities Investors and Futures Traders Protection Act (Protection Act)60, which went into effect on 1 January 2003, authorized the establishment of an institution for investor protection.61 In accordance with the Protection Act, the SFIPC

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58 Taiwan Shilin DifangFayuan [Shilin Dist. Ct.], Civil Division, 95 Jin No.19 (17 December, 2013) (Taiwan).

59 Another possible way to limit the liability of independent directors is to modify the articles of incorporation with a resolution adopted at a meeting of shareholders in advance. This should only be used in the case of slight negligence on the part of the independent director. However, if Article 23 of the Taiwanese Company Act, which provides that directors owe their corporations a fiduciary duty, is recognized as a mandatory rule, a provision of the articles of incorporation that limits the liability of independent directors might conflict with Article 23 and thus be invalid.

60 Securities Investors and Futures Traders Protection Act, amended on Feb.4, 2015.

61 For details regarding the SFIPC, please see http://www.sfipc.org.tw/MainWeb/Index.aspx?L=2.
was established in 2003. In addition to consultations and mediations, the SFIPC handles investor complaints, files class-action lawsuits on behalf of investors, and manages an investor compensation fund.

One of the SFIPC’s main functions is to file class-action suits for securities fraud cases with 20 or more victims, and it functions as an authorized representative of the victims. Based on the internal calculation model of the SFIPC, when it refers to the settlement of securities fraud cases with the defendants, including the issuer, and the directors, supervisors, accountants, and officers of the issuer, the proportion of liability claimed against the inside directors is higher than the proportion against independent or non-executive directors. In other words, the SFIPC recognizes that it should treat inside directors and independent or non-executive directors differently in terms of securities fraud liability to mitigate the responsibility of the latter.

c. Directors and Officers Liability Insurance

D&O insurance is an ex ante mechanism for directors to insulate themselves against personal liability for breaching their fiduciary duties. As explained above, the Taiwan’s Company Act formally requires the same standard of conduct for both inside directors and independent directors to perform their fiduciary duties. As such, technically the Act places a heavy burden on independent directors. Even though, as explained above, Taiwan’s courts appear to sometimes apply a lower standard of fiduciary duties to independent directors, the uncertainty of this approach makes D&O insurance particularly important for independent directors in Taiwan.

Neither the Taiwan’s Company Act nor the SEA provide that a company can purchase D&O insurance for its directors. However, Article 39 of the Corporate Governance Best-Practice Principles for TWSE-listed and OTC-traded Companies provides that a TWSE/OTC-listed company may take out D&O insurance for its directors. To do this, Article 39 suggests that a company should either include a provision related to D&O insurance in its articles of incorporation or pass a resolution at a shareholders’ meeting. Although the Corporate Governance Best-Practice Principles is soft law (i.e., not a mandatory rule), it appears to have had a significant impact on the practice of companies as both the number of listed companies which provide D&O insurance and the limits of coverage D&O provided by insurance have increased significantly. As such, it is increasingly common for independent directors in Taiwan to have D&O insurance coverage.

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62 Corporate Governance Best-Practice Principles for TWSE-listed and OTC-traded Companies, amended on Dec. 31, 2014, promulgated by TWSE and OTC in Taiwan.
6. Remuneration of Independent Directors

In Taiwan, the law does not require public companies to disclose each director’s individual remuneration. Instead, public companies have to disclose only the range of each director’s remuneration and the total amount of all directors’ remuneration. According to an academic study, in 2007, the average annual remuneration of independent directors of TWSE-listed companies was NTD 1 million (approximately USD 33,333). For companies that have established an audit committee, the average annual remuneration was NTD 4 million (approximately USD 133,333)—which is markedly different from those that follow the traditional board model. This discrepancy may be due to the fact that in companies with audit committees the company law essentially allocates all of the work that would have been handled by the statutory auditors to the audit committee. As such, the workload of a member of an

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64 Ibid.
66 Ibid.
67 Regulations Governing Information to Be Published in Annual Reports of Public Companies, art. 10 sec. 2.C.a. (2013.12.31.) (“The company may opt either to disclose aggregate remuneration information, with the name(s) indicated for each remuneration range, or to disclose the name of each individual and the corresponding remuneration amount.”)
audit committee is much heavier than that of an independent director of a company that has a statutory auditor. Another reason may be that, in 2007, when the reform just started, most companies that voluntarily opted for the unitary board model were large companies which could afford higher remuneration.

In contrast, the average remuneration of independent directors of OTC-traded companies is far lower than the remuneration of those in listed companies. The average annual remuneration is only NTD 300,000 (approximately USD 10,000). Additionally, in 2007, when the reform just started, most companies that voluntarily opted for the unitary board model were large companies which could afford higher remuneration.

Interestingly, this level of remuneration also applies to OTC-traded companies that have switched to the unitary board model. One reason for this might be that the average market capitalization of OTC-traded companies is much smaller than that of TWSE-listed companies. On the one hand, the workload maybe less or perhaps such companies may be unable to afford higher remuneration.

Table 7: Average Annual Remuneration of Independent Directors of TWSE-Listed Companies

(Thousand NTD)

<table>
<thead>
<tr>
<th>Average Remuneration</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Directors</td>
<td>612</td>
<td>801</td>
<td>923</td>
<td>1,173</td>
</tr>
<tr>
<td>Non-Independent Directors</td>
<td>-</td>
<td>1,828</td>
<td>1,941</td>
<td>2,146</td>
</tr>
<tr>
<td>Audit Committee Member</td>
<td>2,656</td>
<td>3,364</td>
<td>4,440</td>
<td>4,199</td>
</tr>
</tbody>
</table>

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69 Ibid., 118.
Table 8: Average Annual Remuneration of Independent Directors of OTC-Traded Companies

(Thousand NTD)

<table>
<thead>
<tr>
<th>Average Remuneration</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Independent Directors</td>
<td>223</td>
<td>309</td>
<td>343</td>
<td>353</td>
</tr>
<tr>
<td>Non-Independent Directors</td>
<td>595</td>
<td>639</td>
<td>773</td>
<td>745</td>
</tr>
<tr>
<td>Audit Committee Member</td>
<td>208</td>
<td>1,734</td>
<td>1,641</td>
<td>344</td>
</tr>
</tbody>
</table>

7. The True Independence of Independent Directors

1. The Definition of Independence

In March 2006, the FSC of Taiwan issued regulations governing the appointment of independent directors (‘Independent Directors Appointment Rule’). The regulations require an independence test, professional qualifications, and elections for independent directors. In general, an independent director should have at least five years of work experience in business, law, finance, accounting, or another relevant field. In the prior two years and during their tenure, the directors and their immediate family members should not hold substantial shares of the firm or maintain employment relationships with the firm, affiliated firms, major shareholders, firms that have substantial business or financial relationships with the firm or firms that provide business, legal, financial, accounting, or consultation services to the firm. To ensure adequate participation, an independent director can serve on no more than three corporate boards. In response to the criticism about the nomination process, and to promote shareholder participation, the rule further provides that any shareholder who holds more than 1% of the shares can submit a nomination list of independent directors to the board.

70Financial Supervisory Commission, Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies (2015.08.27).
In an economy in which corporate ownership is mostly concentrated, such as Taiwan, the definition of independence should emphasize independence from the controlling shareholders. Hence, the independence test in Taiwan emphasizes the relationship between independent directors and the firm’s major shareholders. Moreover, the Independent Directors Appointment Rule stipulates that a director shall not qualify as ‘independent’ if, in the past two years before appointment or during the term of office, he or she was or is:

1. an employee of the company or any of its affiliates;

2. a director or statutory supervisor of the company or any of its affiliates (the same does not apply, however, in cases in which the person is an independent director of the company, its parent company, or any subsidiary in which the company holds directly or indirectly more than 50% of the voting shares);

3. a natural-person shareholder who holds shares, together with those held by the person’s spouse or minor children or which are held by the person under others’ names, in an aggregate amount of 1% or more of the total number of issued shares of the company or ranking in the top 10 in holdings;

4. a spouse, relative within the second degree of kinship, or lineal relative within the fifth degree of kinship of any of the persons in the preceding three subparagraphs;

5. a director, statutory supervisor, or employee of a corporate shareholder who directly holds 5% or more of the total number of shares issued by the company or that holds shares ranking in the top five in holdings;

6. a director, statutory supervisor, officer, or shareholder holding 5% or more of the shares of a specified company or institution that has a financial or business relationship with the company; or,

7. a professional individual who is an owner, partner, director, statutory supervisor, or officer of a sole proprietorship, partnership, company, or institution that provides commercial, legal, financial, accounting, or consultation services to the company or to any affiliate of the company, or a spouse thereof.

Independent directors in Taiwan are only subject to cursory checks. The law defines independence from employment, financial, familial, shareholding and business relationships, but not social and personal relationships. It is inherently difficult to define and exclude social and personal relationships through ex ante regulation. Ex post judicial review on the true independence of directors in specific transactions should be a better way to address this issue. Absent substantive judicial review of director independence, independent directors could be a tool used by controlling shareholders to eliminate investors’ concerns over the potential extraction of private benefits. By
introducing independent directors to the board, controlling shareholders can not only improve their company’s corporate governance ranking but also enhance investor confidence.

2. Social Ties with Controllers

Lin (2013) surveyed 40 independent directors of Taiwan’s public companies to identify and characterize the kinds of personal relationships that exist between independent directors and controlling shareholders and to determine whether social ties serve as a useful source of information exchange. Of the 40 independent directors interviewed, 19 used the term “very close friend” to describe their relationship with controlling shareholders, other directors, or CEOs within a given firm, and 14 other independent directors stated that they were personally acquainted with controlling shareholders, other directors, or CEOs within a given firm but were not “very close friends” with these individuals. Only seven of the interviewees had not known the controlling shareholders, other directors, or CEOs before being invited to join the board.

The interview results are stunning because almost half of the independent directors described the controlling shareholders, other directors, or CEOs of the firms as “very close friends.” While public companies are required to disclose the financial, familial, and business relations among the independent directors, companies, and corporate insiders, almost no formal sources of information identify their close personal relationships, even though social ties might hinder the monitoring ability of independent directors. Although it is difficult to generalize from the interview results because of the limited sample, most interviewees agreed that the majority of independent directors in Taiwan had some degree of social ties with their controlling shareholders or other corporate insiders.

Lin (2014) conducted an empirical investigation of the social ties between 505 remuneration committee members (168 independent directors and 337 independent members) and corporate insiders and found that around one-third of the members have social ties with insiders. This study further classified social ties into six categories: former insiders, professional consultants, friends, business relationships, academic or social group relationships, and interlocking directors. Of the independent remuneration


committee members in Taiwan, 10% are previous employees or managers of the firm and are categorized as prior insiders. Since prior employees were under the supervision of directors, this previous supervisory relationship could impair the independence of “former insider” independent directors.

The study also casts doubt on the independence of directors who served as professional consultants of the firm. The law restricts only those who served as consultants in the previous two years and contracted with the firm only. This law is, therefore, not applicable to those who served as lawyers or accountants for the chairperson or other directors personally. Finally, the study calls for bans on interlocking directors.73

Close relationships between independent directors and controlling shareholders are not a phenomenon that is unique to Taiwan; rather, it is a common issue that most Asian countries face. In Taiwan, as in many other Asian countries (e.g. China, India, Japan, and South Korea), a sophisticated system of commercial courts and a complementary legal system do not exist to provide the kind of ex post judicial review that is found in the US.74 Shareholder derivative suits, for example, are almost unheard of in Taiwan, due to the various procedural hurdles that exist in the country’s corporation law.75 Due to these local conditions, ex post judicial review of director independence does not exist in Taiwan’s current legal system and is unlikely to become a reality there in the near future.

In addition, Taiwan’s legal system has yet to recognize the role of independent committees in resolving conflicts of interest, and this, in turn, limits the function of independent directors and the value they can create. Therefore, corporate insiders generally lack incentives to hire truly independent directors not only because no one would review the substantive independence of these directors but also because

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73 Ibid., 294–295.
74 R. J. Gilson and C. J. Milhaupt, ‘Choice as Regulatory Reform: The Case of Japanese Corporate Governance’, *American Journal of Comparative Law*, 53 (2005), 343, 369–372; U. Varottil, ‘Evolution and Effectiveness of Independent Directors in Indian Corporate Governance’, *Hastings Business Law Journal*, 6 (2010), 281. (presenting survey and interview data revealing that the general practice of nominating independent directors in Indian listed companies has been for the promoters to identify people known to them or with whom they have significant comfort levels).
corporations would not benefit from having truly independent directors. This is the problem that arises when attempting to transplant an isolated legal mechanism into a different legal system that lacks complementary institutions.

IV. Conclusion

The issue of whether Taiwan should abandon the institution of the statutory supervisor and consequently deprive corporations of their autonomy to choose a different corporate governance structure is highly controversial. Nevertheless, the transition from the double board to the unitary board structure has been an established direction in Taiwan, given the competent authority’s ruling at the end of 2013.

However, challenges remain regarding the adoption of the independent director mechanism in Taiwan. For example, given the concentrated ownership structure, most independent directors are nominated by controlling shareholders or top executives. Therefore, the establishment of a nomination committee is crucial to ensure the independence of directors. In addition, the overlapping functions of statutory supervisors and independent directors require further clarification, and complementary institutions, such as the courts or stock exchanges, need to monitor the true independence of directors.

The empirical studies discussed in this chapter demonstrate the power of regulation in shaping the “form” of corporate governance in Taiwan. However, how each governance measure “functions” still depends on the local conditions. Absent complementary institutions that help each measure fulfill its intended function, regulatory changes over the form of governance measures would not help much. In the past decade, the FSC in Taiwan gradually introduce independent directors and audit committees to Taiwan’s public companies, forcing them to transit from double board to unitary board system. We believe that the regulatory mandate will continue to play an important role in the development of independent directors in the near future. However, more attention should be paid to the true independence and substantive monitoring effect of independent directors in order for such institution to thrive and function in Taiwan.