Money, Family, Party: Governing Corporations with Multiple Motivation Matrices

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ABSTRACT

The 'Berle & Means corporation' does not present the global norm, yet prevailing theories of corporate governance still operate within its historical path. This paper contributes to our understanding of governance dynamics in corporations where motivation matrices like family and political party coexist within the company together with the pure profit incentive and legal duty. It also attempts to move corporate law forward, beyond the inefficient model of merely prohibiting, restricting or disclosing the actions of individuals motivated by incentives from other such alternative value systems.

This paper begins the project of incorporating the alternative networks of relationships actually found in the corporation into a modern framework of corporate governance. It does so using Hong Kong law as a starting point. This is because Hong Kong company law originated in and remains very close to that of the UK, which together with the US presents the dominant model of governance theory today. Moreover, the rules of the Stock Exchange of Hong Kong (SEHK) draw on Anglo-American best practices. At the same time, family businesses are common among the leading firms in Hong Kong, and companies owned by the People's Republic of China represent many of Hong Kong's largest listed corporations.

The paper sets out to define a framework of corporate governance that can both ensure the diligent and faithful service of corporate actors and account for the layer of duties deriving from family and party systems. It does so to achieve a more efficient form of governance in the dominant corporate constellation found globally – the corporation that contains multiple motivation matrices. The framework draws on notions of ethics currently found at the borders of corporate law and applied in doctrines such as "unfair prejudice" and in motivations such as "corporate social responsibility."

CONTENTS

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I. CORPORATE LAW SHOULD INCORPORATE ALTERNATIVE MOTIVATION MATRICES

A. Governance rules focus on individuals and their interests

The governance rules of corporate law seek to align the interests and behavior of individual corporate actors in a way that best serves corporate performance.[1] This is achieved through the framing of decision-making, restrictions on permitted actions, and a series of incentives and disincentives.[2] Governance rules use increasingly sophisticated techniques to channel the interests of *individual* players, but they are not designed to confront entire *networks* of motivations[3] that may conflict with the corporation's fair and efficient operation. The regulatory thrust is to bring individual interests of corporate actors into sync with the network of assigned corporate roles and tasks, yet some of these interests may derive from a second ordering matrix that is not fully congruent with the goals of the corporation. Corporate governance rules are generally designed to single out and check individual actions deriving from such competing networks of interest and behavior – such as the family, a political party or some other grid of norms – but treat these networks taken as a whole as

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1 While arguments about the exact definition of corporate governance abound, the general goal expressed above corresponds to what is found both in codes formulated by public bodies and in scholarly analysis. *See* e.g., the OECD PRINCIPLES OF CORPORATE GOVERNANCE Preamble (2004) ("Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring."); MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 1 (1976) ("Corporate law is constitutional law; that is, its dominant function is to regulate the manner in which the corporate institution is constituted, to define the relative rights and duties of those participating in the institution, and to delimit the powers of the institution vis-à-vis the external world."); MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE 203-204 (2003) ("Corporate governance can be analyzed in terms of the inner workings of the corporation: the mechanical requirements for the board of directors, the degree to which minority stockholders are protected from insider machinations … [But] [f]or corporate governance, the [major source of influence] are labor markets, politics, and capital and product markets."); JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 1 (2008) ("corporate governance is about reducing deviance by corporations where deviance is defined as any actions by management or directors that 'are at odds with the legitimate, investment-hacked expectations of investors. Good corporate governance, then, is simply about keeping promises.' Bad governance (corporate deviance) is defined as promise-breaking behavior.").

2 These strategies can be organized into a schema as appointment rights, decision rights, agent incentives, agent constraints and affiliation terms. REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 29 (2009, 2nd ed).

3 In this paper, 'motivation matrix' refers to a system of values and incentives that assigns its own unique functional values to objects or actions. This can be understood either objectively (a matrix of values established systemically) or subjectively (a matrix of value choices made by a member of the system), as the term is also used in psychology. The values determined in such a matrix may overlap with those fixed in other value systems or may differ therefrom. An understanding of the systemic value of an action within an alternative motivation matrix is important. For example, if a family matrix of motivations were to attribute a value like 'promotion of autonomous family control' to an action, while corporate law attributed 'entrenchment' and 'rent-seeking' to the same action, the act would be condemned in such a way that renders the corporate form a dangerous alternative for operation of the family business.

alien, disruptive and even sinister.[4] Only specialized studies, such as on the "family firm,"[5] attempt to incorporate such competing value systems within the dynamic of corporate interaction. Otherwise, the motivations such value networks generate are merely excluded or subjected to disclosure in their individual appearances.[6] Given the obvious presence of such competing normative systems among corporations and their potential value for the quality of corporate operation,[7] they should be brought expressly within corporate governance theory.

While no grid of corporate governance rules expressly excludes persons participating in alternative networks of motivation, the quality of such networks as an alternative source of supporting values is essentially ignored. Actions serving motivations that derive from such networks are then processed (prohibited, disclosed or sanitized) as individual conflicts of interest in piecework fashion. The apparent motivational assumption running in the background of modern corporate governance theory is that an *individual* profit motive drives the interests of company participants.[8] As a result, modern frameworks of governance rules seek to hold the self-interests of corporate actors in check when they conflict with the fair and profitable operation of the company. Through the work of Jensen and Meckling, we understand efforts spent to control divergences between individual interest and

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4 A typical analysis is that of La Porta *et al* in their 1999 study of global corporate ownership, which in contrast to other forms of corporate domination, finds families particularly suspicious: "Family control may facilitate corruption because it gives the controlling shareholders enormous autonomy in decision making, keeps the potential whistle-blowers out of major corporate decisions, and thus reduces the risk of getting caught. According to this theory, family control is especially important in the most corrupt countries." Rafael La Porta; Florencio Lopez-de-Silanes; Andrei Shleifer, *Corporate Ownership around the World*, 54 THE JOURNAL OF FINANCE 471, 510 (1999).

5 For example, MORTEN BENNEDSEN & JOSEPH P.H. FAN, THE FAMILY BUSINESS MAP (2014) and SABINE B. KLEIN, FAMILIENUNTERNEHMEN: THEORETISCHE UND EMPIRISCHE GRUNDLAGEN (2nd ed. 2004) incorporate in very different ways particular aspects of family relationships into the operation of stock corporations, but in doing so clearly see family firms as a particular subset of corporations. Similar treatment for, say, firms owned a parent in a related industry and tied by supply contracts or firms owned by a parent in an unrelated industry as part of a diversified group are not viewed with a like level of peculiarity.

6 Criteria for independence applied to directors filer out those with family ties to an interest to be avoided and disclosure of related-party transactions ensure that intersections with an alternative value network like a family are made known. Both are discussed in Part III.

7 Secondary motivational matrices like a family or political party do not exclusively conflict with the good of a stock corporation, but also reinforce ordinary corporate governance goals, as will be discussed in Part II.

8 This aspect of corporate law is so self-evident that it is never called out explicitly. However, an examination of law shows it is true of motivations whether they are viewed in a positive or a negative light by corporate law. In regulating conflicts of interest, §144 Delaware General Corporation Law (DGCL) refers to a "director's or officer's [individual] relationship or interest," and when specifying standing to demand a fair price for shares in connection with a corporate combination this law refers to "any [individual] stockholder of a corporation." §262 DGCL. Section 175(1) of the UK Companies Act 2006 also refers to the individual director: "he has, or can have, a direct or indirect interest that conflicts" with that of the company. Although the right to petition for relief against unfairly prejudicial action refers to the members generally, it is the individual rights of each member that are indicated ("the company's affairs are being or have been conducted in a manner that is unfairly prejudicial to the interests of members generally or of some part of its members") s 994(1)(a) Companies Act 2006. Although German law does refer to the management board (*Vorstand*) as a collective (*see* §§76-77 Aktiengesetz), it still deals with interests of individuals, such as in the noncompetition requirement expressed in §88, the duty of care expressed in §91, and the annual decision to waive liability expressed in §120 Aktiengesetz.

company interest under the concept of 'agency costs.'[9] During most of the 20th century, the work of Berle and Means led us to focus on an agency problem between shareholders and the self-interested control of management.[10] Since the 1990s, we have known that the 'Berle & Means corporation' in which central management dominates dispersed shareholders, is not the global norm.[11] During the 2000s, Kraakman et al. consolidated the theory of agency costs across the varying ownership structures found in major world economies, formulating a highly authoritative contemporary theory of comparative corporate law.[12]

The agency costs dynamic can be applied robustly to the relationship of any kind of delegated authority,[13] including that between controlling and minority shareholders (power delegated by means of the majority control rule) or between shareholders and creditors (power delegated by the fact that creditors remain corporate outsiders).[14] In each case, governance rules are designed to correct a situation in which an agent constituent might try to serve his or her own self-interest to the detriment of the principal constituent, which may or may not be the company itself. Differing political arrangements in corporate law and differing socio-economic circumstances can lead to different behavioral goals for corporate actors.[15] For example, if it is decided that the purpose of a company is to maximize profits for benefit of the shareholders, power will be given to shareholders and competing

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9 Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 JOURNAL OF FINANCIAL ECONOMICS 305, 308-309 (1976).

10 ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 84 (1932). On the question of dispersed shareholding also *see* e.g., John C. Coffee Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1, 37-39 (2001); Brian R. Cheffins and John Armour, *The Past, Present, and Future of Shareholder Activism by Hedge Funds*, 37 J. CORP. L. 51 (2011); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and Revaluation of Governance Rights*, 113 COLUM L. REV. 863 (2013).

11 As was noted in a well-known study published in 1999, "If we look at the largest firms in the world and use a very tough definition of control, dispersed ownership is about as common as family control. But if we move from there to medium-sized firms, to a more lenient definition of control, and to countries with poor investor protection, widely held firms become an exception. Berle and Means have created an accurate image of ownership of large American corporations, but it is far from a universal image." La Porta et al, *supra note* [●] at 498.

12 KRAAKMAN ET AL. *supra note* [●], at 35-37.

13 As Jensen and Meckling noted in 1976, "agency costs arise in any situation involving cooperative effort (such as the co-authoring of this paper) by two or more people even though there is no clear cut principal-agent relationship." Jensen & Meckling, *supra note* [●] at 309.

14 *See* KRAAKMAN ET AL. *supra note* [●], at 37-53.

15 Proving this point has been a central focus of the comparative corporate law work of Mark Roe. *See* ROE, *supra note* [●] at 3-5. Another important contribution on this topic is CURTIS J. MILHAUPT & KATHARINA PISTOR, LAW & CAPITALISM: WHAT CORPORATE CRISES REVEAL ABOUT LEGAL SYSTEMS AND ECONOMIC DEVELOPMENT AROUND THE WORLD (2008) ("We … use corporate governance as a lens through which to view a much larger set of institutional phenomena in a given country and to analyze, as rigorously as possible, the relation between the legal system and the portion of the economic system that is directly related to firms' structures and governance").

interests restricted.[16] If rather it is decided that object of a company is to thrive generally as an 'undertaking', power will be distributed among key corporate constituencies, and shareholder primacy restricted.[17] If we eventually come to see the legal person of the company as a person enjoying the same protection as any other person, free of prejudice arising from the fact that it is not a physical person, yet another arrangement of internal power will likely become appropriate.[18] The obverse of power allocations to privileged constituencies is the assignment of duties to corporate actors receiving power from or over such constituents. Thus members of the board of directors or controlling shareholders have duties ascribed to them in connection with the power they receive.[19] Duties of care and loyalty thus serve to bend directors' potentially self-serving behavior toward the diligent and faithful operation of the company or its constituents.

Comparative corporate scholarship has thus brought us to the point where governance mechanisms can be adjusted both to different manifestations of agency problems and to variations of corporate purposes, whether for profit maximization of shareholders or the benefit of a broader association of corporate constituencies. Yet, as observed above, despite this versatility, our understanding of corporate governance generally presupposes that the moving force within a corporation is the pursuit of individual profit, whether in the form of executive compensation, capital gains and dividends, reliable payment of interest and principal, an enduring employment relationship, or stable contracts of supply. Governance mechanisms are designed to allow profitable operation of the entity as a whole while checking the excessive drive for self-gain of the individuals who exercise delegated power on behalf of the entire company or another constituency. Motivations other than

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16 Profit maximization for the benefit of shareholders is an object found strongly represented in the "nexus of contracts" theory of corporate law. *See* e.g., Frank Easterbrook & Daniel Fischel, The Economic Structure of Corporate Law 91 (1991) ("[T]he corporate contract makes managers the agents of the equity investors but does not specify the agents' duties. To make such an arrangement palatable to investors, managers must pledge their careful and honest services.").

17 Pursuant to §76(1) of the German Stock Corporation Act, the managing directors have a duty to manage the company, "in the interest of the undertaking" (*Interesse des Unternehmens* or *Unternehmensinteresse*), which is understood as constituted by a pool of interests from shareholders, employees, creditors and the community. KATJA LANGENBUCHER, AKTIEN- UND KAPITALMARKTRECHT 38 (2008). This pool theory also underlines that the company 'in itself' is not seen as having an interest. FRIEDRICH KÜBLER & HEINZ-DIETER ASSMANN, GESELLSCHAFTSRECHT: DI PRIVATRECHTLICHEN ORDNUNGSSTRUKTUREN UND REGELUNGSPROBLEME VON VERBÄNDEN UND UNTERNEHMEN 178 (2006). The view of the company as an arrangement that serves and mediates the interests of a number of constituencies is also found in the US, under the corporatism model promoted in the 1950s and in the "team production" model promoted in the late 1990s by Blair and Stout. Cheffins presents an excellent history of ideas analysis of the evolving views of the corporation in the US. *See* Brian R. Cheffins, "The Team Production Model as a Paradigm" (August 2014). University of Cambridge Faculty of Law Research Paper No. 38/2014. Available at SSRN: http://ssrn.com/abstract=2463086.

18 This may be the direction the US Supreme Court is moving when it declares that "the Government cannot restrict political speech based on the speaker's corporate identity." Citizens United v. Federal Election Com'n 558 U.S. 310, 130 S.Ct. 876 U.S. (2010).

19 Although not identical to the duties assigned to a trustee, the underlying structure is the same, and the duties reflect the legitimate claims of the persons who should benefit from the agent's action. *See* D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 Vand. L. Rev. 1399 (2002).

profit are not entirely foreign to corporate law, as programs promoting "corporate social responsibility" evince, but permissible motivations do not include serving an entire grid of motivations centered on something other than the company or its owners.

B. Opening the company network to intersecting motivation matrices

The very name 'company' (*Gesellschaft, societé, societá,* 公司) indicates a social aspect, an association creating an enclosed society with its own set of rules.[20] Within the motivational matrix of governance rules applied to a stock corporation, little or no room is provided for interacting with alternative matrices of motivation. Instead, focus is placed the individual within the grid of company rights, duties and claims. Both the approved and the disapproved acts encompassed within the governance framework of this association are conceived as centered in the individual. If corporate law and theory deals at all with competing matrices of motivations co-existing within a company, it focuses on individual manifestation through acts of a corporate agent whose interest conflicts with those of the company.[21]

Of the motivational matrices that might co-exist with a company, perhaps the most common is the family. Family firms appear to be widespread, if not dominant, in most economies other than that of the United States.[22] It is argued that the family has its own organizational logic. This logic, as observed in the literature focusing on the specificity of family entrepreneurship, includes pronounced drives for both longevity and autonomy that set family firms apart from other businesses focused on profit maximization.[23] In a 'family firm' the collection of roles and loyalties assigned to corporate constituents by law will interact with another set of roles and loyalties deriving from relationships within the family to which company constituents belong. This explains why systems theory has been

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20 This aspect of companies is plainly visible from both historical and theoretical vantage points. The first companies chartered by the British crown operated as quasi-autonomous governments in colonies from North America to Asia. *See* e.g., Janet McLean, *The Transnational Corporation in History: Lessons for Today?*, 79 IND. L.J. 363, 367-375 (2004). From a conceptual perspective, German companies fall under the genus of club (*Verein*) or association. *See* e.g. KÜBLER & ASSMANN, *supra note* [●] at 1, citing Hueck/Windbichler, Wiedemann and Karl Schmidt ("*Privatrechtlich[e] Personenvereinigung, die zur Erreichung eines bestimmten gemeinsamen Zweckes durch Rechtsgeschäft begründet warden.*"). Recently, the US Supreme Court has decided that corporations should enjoy a certain level of protection for their exercise of political and religious rights. Citizens United v. Federal Election Com'n 558 U.S. 310, 130 S.Ct. 876 U.S. (2010), and Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751 (2014).

21 *See* the examples provided in note [●], above, and in Part III.

22 The prevalent citation for this statement is the 1999 study from La Porta *et al*, *supra note* [●]. However, that paper uses data from 1995 and 1996, which is now 20 years old ("Virtually all of our data are for 1995 and 1996, though for a few observations the data do come from the earlier years, and for a few from 1997.") *Id.*, at 475.

23 *See* e.g., Thomas Markus Zellweger, Robert S. Nason & Mattias Nordqvist, *From Longevity of Firms to Transgenerational Entrepreneurship of Families: Introducing Family Entrepreneurial Orientation*, 25 FAMILY BUSINESS REVIEW 136, (2012); Timothy G. Habbershona, Mary Williamsa & Ian C. MacMillan, *A unified systems perspective of family firm performance*, 18 JOURNAL OF BUSINESS VENTURING 451, 452 (2003).

used for decades to study the operation of family businesses.[24] In an early work on systems theory, Luhmann explains why a successful governance analysis must look beyond individual conflicts of interests to the action of alternative motivational matrices: "Classical organization theory contains many problems and tends to attribute the fault for this to individuals, particularly members of organizations condemned of not disclosing conflicts of role (duties). In this way, problems deriving from the relationship between the system and its environment are written off to weakness of character."[25] While corporate law theory is built on dealing with conflicts of interest, it has never set out to confront entire matrices of conflicting motivations. By grasping the effects of other motivational matrices merely through evidence of individual conflicts of interest, corporate governance theory remains incomplete. Relationship to environment should be expressly incorporated into a contemporary theory of corporate governance.

The specialized literature on family firms has successfully incorporated the alternative logic, values and aspirations of families into their studies of company operation. However, families are not the only value systems that coexist with corporate law within stock corporations. Although many other forms of social networks exist – including social, clan, religious and school affiliations – another organized nexus of relationships that in some jurisdictions has a concrete overlap with corporate organization is the political party. In China, as Teemu Rukola has observed, there are express conceptual links between the social expectations from extended families and from the Chinese Communist Party (CCP).[26] Today, the largest Chinese corporations are owned by the People's Republic of China and controlled by the CCP, which directly or indirectly controls appointment of senior management.[27] Like the family, a political party is not organized primarily to generate profits, and like a family, the roles, duties and motivations within the network of the party will not necessarily be congruent with the scheme projected by corporate law.

This paper examines both family and party as alternative matrices of motivation that interact with a system of corporate governance which has traditionally focused on individual action and accountability. The focus of this study is thus on two different views of social interaction that coexist

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24 Hopper and Powell provide an intial survey of the use of systems theory in management studies. *See* Trevor Hopper & Andrew Powell, *Making Sense of Research into the Organizational and Social Aspects of Management Accounting: A Review of its Underlying Assumptions*, 22 JOURNAL OF MANAGEMENT STUDIES 429 (1985).

25 Niklas Luhmann, *Zweckbegriff und Systemrationalität: über die Funktion von Zwecken in sozialen Systemen* (6th ed. 1999), pp. 73-74 (author's translation).

26 Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STANFORD LAW REVIEW 1599, 1608 (2000).

27 RICHARD MCGREGOR, THE PARTY: THE SECRET WORLD OF CHINA'S COMMUNIST RULERS 67-69 (2010); Wang JiangYu, *The Political Logic of Corporate Governance in China's State-owned Enterprise* 47 CORNELL INT'L L.J. 631 (2014). The role of the CCP in Chinese corporations is discussed in Part [●].

in a third type of relationship: first, according to prevalent governance theory, the individual corporate constituent enters a "nexus of contacts," but second, empirical data shows that in most companies directors are also a member of a network that lends identity to that person as member in a larger whole, such as a family or a political establishment, but third, corporate governance rules designed for individual accountability seeking to channel or discipline the activity of such persons will conceptualize activity merely as an individual conflict of interests regardless of whether it fulfills the logic of the second system as member. Such a model of company governance that essentially disregards the reality of the persons operating the corporation is ineffective and inefficient. We have been prepared to alter the form of business organization in many ways, such as to optimize tax treatment with limited liability companies or allow sole proprietors to incorporate alone,[28] so it is unusual that through roughly 200 years of modern corporate history[29] we have not taken the step toward creating a system of company relationships that seriously engages alternative motivation matrices.

Modern systems theory allows a broader, more articulated view of the dynamics within corporate law and its development; Deakin and Carvalho have already mapped out a possible system theoretic approach to legal questions previously dealt with through institutional economics.[30] The structural tools used in systems theory can be found in their early form in phenomenology, perhaps the most sophisticated philosophical school of modern era.[31] A precursor of 20th century phenomenology is G.W.F Hegel,[32] and his work on law presents a dynamic model of interaction between free individuals engaging in both contracting and systems understood to constitute the individual as member. The pattern of evolution explicated in Hegel's *Philosophy of Right* shows the human subject entering into contracts as a free and independent *individual*,[33] entering into the "ethical unity" of the family, as *member*,[34] entering into the civic community as a member,[35] and entering into the state as

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28 *See* e.g. Larry E. Ribstein, *Making Sense of Entity Rationalization*, 58 BUS. LAW. 1023 (2003).

29 The New York General Incorporation Act of 1811 can be seen as the first modern corporate law. *See* e.g. Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 Harv. L. Rev. 1333, 1393-1395 (2006).

30 Simon Deakin & Fabio Carvalho, "System and Evolution in Corporate Governance" (April 2, 2010). ECGI - Law Working Paper No. 150/2010. Available at SSRN: http://ssrn.com/abstract=1581746 ("The process is a cycle of inter-systemic interaction, a dynamic of coevolution between law and the economy").

31 The relationship between structuralism and phenomenology is mapped out very clearly in ELMAR HOLSTEIN, ROMAN JAKOBSONS PHÄNOMENOLOGISCHER STRUKTURALISMUS (1975).

32 Although Heidegger begins his Being and Time with a dismissal of Hegel's treatment of the question of 'being', his text then goes on to cite Hegel 73 times on key aspects of its investigation. MARTIN HEIDEGGER, SEIN UND ZEIT (1967, 11th ed).

33 G.W.F. HEGEL, GRUNDLINIEN DER PHILOSOPHIE DES RECHTS §72 (Suhrkamp edition 1986)

34 *Id.* at §158.

35 *Id.* at §182.

citizen.[36] Hegel's dialectical analysis of abstract actors and concrete systems offers thus offers a useful guiding thread for a study seeking to formulate governance rules suited to contracting individuals who are also members of various motivation matrices.[37] The goal of such rules would be to recognize and accommodate the operation of motivation alternative matrices within the corporation without sacrificing the fairness that the corporate law seeks to achieve.

C. Hong Kong presents a good starting point

A model of corporate governance that takes into account alternative motivation matrices like the family and the political party would be of significant use in Hong Kong, where both of these alternative systems interact with company organization. Moreover, Hong Kong law presents an ideal model from which to work on further development. Its company law originated in and remains very close to that of the UK, both in statutory and in common law elements.[38] The company law statute, referred to as the "Companies Ordinance," was recently rewritten and the new law entered into effect in 2014.[39] Even after entrance into force of the new law, the Hong Kong common law of companies remains closely tied to that of the UK and Commonwealth countries such as Australia, Canada and New Zealand. The rules of the Stock Exchange of Hong Kong (SEHK) draw on Anglo-American best practices with regard both to disclosure rules and the mandatory inclusion in boards of independent nonexecutive directors (INEDs) and committees for purposes of audit, remuneration and nomination.[40]

This Anglo-American corporate law framework with its focus on checking individual conflicts of interest applies to companies that are in most cases deeply enmeshed in another ordering framework – families and the CCP, in particular. Regulators and lawmakers are well aware of the governance challenges presented by the socio-economic character of Hong Kong, and have shown a readiness to make some, small adjustments to the standard corporate law models. However, in large part Hong Kong company law and listing rules mirror international best standards by fighting individual conflicts of interest and largely ignoring the presence of entire system that present an alternative motivational matrix to that expressed in corporate law. For this reason, Hong Kong presents a very suitable jurisdiction from which to begin moving corporate governance theory beyond its exclusive focus on

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36 *Id.* at §264.

37 Although this paper neither offers a Hegelian model for corporate governance nor criticizes the 'nexus of contracts' model of corporate law as being Hegelian in nature, the problematic discussed here is similar in structure to relationship presented in Hegel's *Philosophy of Right* between the individual on the one hand, and the networks of family, society and state on the other. *See* G.W.F. HEGEL, GRUNDLINIEN DER PHILOSOPHIE DES RECHTS § 157 (Suhrkamp edition 1986).

38 For a history of the development of Hong Kong company law, *see* DAVID C. DONALD, A FINANCIAL CENTRE FOR TWO EMPIRES: HONG KONG'S CORPORATE, SECURITIES AND TAX LAWS IN ITS TRANSITION FROM BRITAIN TO CHINA 22-33, 111-122 (2014).

39 Companies Ordinance, Law No. L.N. 163 of 2013, CAP 622.

40 *See* SEHK Listing Rules, Chapter 3.

individual motivations and the channeling of individual profit incentives toward a more realistic and efficient governance of the company.

Following this introduction, Part II will discuss the nature of companies operating at the intersection between corporate law and two major systems of roles and values, the family and the CCP. The first Section of Part II will address the prevalence of family firms in Hong Kong and discuss how roles and values of the family can influence corporate operation. The second Section will discuss the way in which the roles and duties of the CCP interact with many firms listed on the SEHK. Part III will then examine the very limited way in which modern corporate governance theory interacts with these major value systems, such as in the disclosure of connected party transactions or the definition of independence for INEDs. Part IV will develop a framework within which corporate governance can seek to engage other motivational matrices and interconnect its roles and duties within their own, such as through mandatory meetings and committees to buttress company operations against the forces of generational or electoral change. Part V will offer conclusions.

II. FAMILY AND PARTY AS ALTERNATIVE MOTIVATIONAL MATRICES IN COMPANY LAW

A. Value networks as motivational alternatives within companies

The company form is used for various purposes, including by individual entrepreneurs who may find it convenient to contribute their labor as capital to the company, and by other companies in order to operate a discrete division of operations or a particular activity with a concern. For those reasons, traditional rules of company law have over the years been amended to allow one-person companies, contribution of capital in kind through labor, and corporate body directors. These options are not available in all jurisdictions for all forms of company, but they exemplify the type of concessions that are generally considered reasonable for efficient use of the corporate form.

Interaction with motivation matrices beyond the corporate framework is treated differently. An extensive and sophisticated specialized scholarship on firms that are owned and managed by members of the same family has for decades worked to create models of operation so that the family can adapt itself to the corporate form. This scholarship has drawn information and insight from economics, management theory, sociology, anthropology and systems theory to define the special characteristics of the family. It has not made inroads in adjusting corporate law. The following section looks at the manner in which a family value matrix might be incongruent with the values and behavior expected in a stock corporation under prevailing corporate law.

B. Family firms: loyalty transcending contract

In his book, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations, and States*, Albert Hirschman uses family as his primary example of an organization where there is little

opportunity for exit and a high degree of loyalty.[41] As the family is an organization exhibiting a solidity that exceeds that of a company, it can be expected that this motivation matrix will have a powerful center of gravity. Thus it is not surprising that a characteristic observed in family firms is the desire to build a family legacy.[42] This implies a number of factors, including efforts to preserve a specific culture[43] and placing a high value on autonomous family control.[44] Loyalty to a group of owners (potentially a breach of fiduciary duty in a UK or Hong Kong company) and a desire to preserve the autonomous control of such owners (controller entrenchment) are generally considered to be signs to poor corporate governance. On the other hand, however, an economic characteristic of family firms is that large controlling shareholdings tend to bring higher valuations for the firm, provided that techniques such as dual-class share structures or pyramid holdings are not used to imbalance control and cash flow rights.[45]

C. Impact of family ties on corporate behavior

As a matter of system logic, it can be expected that when family integrity and dynamism is strong and congruent with the requirements of corporate law, a family firm will be robust. Along the same lines, if the motivations generated within a family were to deviate from the law or if the family system were to experience significant disruption through a rough intergenerational succession, the family motivation matrix would then drag on the efficiency of the company. In the first instance, the impact of family ties on corporate behavior would be positive, strengthening the firm's internal culture, reinforcing its competitiveness to protect its autonomy, and training the new generation in order to promote longevity. In Hong Kong, it appears that the Li family is focusing considerable effort both on succession and the future of Hong Kong firms in China by rationalizing the corporate group, making more investments outside of Asia, and moving its headquarters to the Cayman Islands – all while its patriarch, Li Ka-shing, approaches his 87th birthday.[46]

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41 ALBERT O. HIRSCHMAN, EXIT, VOICE AND LOYALTY: RESPONSES TO DECLINE IN FIRMS, ORGANIZATIONS, AND STATES 77-78 (1970).

42 PHILIP SELZNICK, LEADERSHIP IN ADMINISTRATION (1957).

43 Bennedsen and Fan recount how the Mulliez family created an academy to train its family members for the business over a 100 year period, distilling the culture of the group's founder and passing it on to family members to run the firm of some 175,000 employees. BENNEDSEN & FAN, *supra note* [●] at 2-4.

44 Zellweger, Nason & Nordqvist, *supra note* [●] at 18, citing G.T. Lumpkin, K.H. Brigham & T.W. Moss, Long-term orientation: Implications for the entrepreneurial orientation and performance of family businesses, 22 ENTREPRENEURSHIP & REGIONAL DEVELOPMENT 1–24 (2010).

45 Stijn Claessens, Simeon Djankov, Joseph P. H. Fan, and Larry H. P. Lang, *Disentangling the Incentive and Entrenchment Effects of Large Shareholdings*, 57 THE JOURNAL OF FINANCE 2741, 2743 (2002).

46 *See* the (1) Cheung Kong Reorganisation Proposal – Change of the Holding Company of the Cheung Kong Group from Cheung Kong to CKH Holdings by way of a Scheme of Arrangement; (2) Merger Proposal – (a) Proposed Acquisition by the Hutchison Group of 6.24% of the Common Shares of Husky in issue and (b) Proposed Share Exchange Offer to the Hutchison Scheme Shareholders for the Cancellation of all the Hutchison Scheme Shares by way of a Scheme of Arrangement and (3) Spin-off Proposal – Proposed Spin-

In the second instance, family problems or a rough succession can work to rip a firm apart. Following the death of Sun Hung Kai founder, Kwok Tak-seng, his three sons Walter, Raymond and Thomas ran the company, but the oldest son was kidnapped and experienced trauma from that event, effecting his management of the company in subsequent years.[47] In a 2014 corruption trial, it was shown that the uncertain competition of the two younger brothers to stimulate the business during these troubling events led Raymond Kwok to engage in bribery. Had the firm been a public company with professional management, the unfortunate damage to Walter might have led to a search for a new CEO rather than a return to duty and a forced entry of his younger brothers.

Both the positive and the negative potential effects of a family network employing a corporation in order to further their family ambitions indicate that corporate law should seek to accommodate the particular characteristics of family networks in order both to increase positive synergies and to avoid negative impacts. The alternative – that somehow family activities will evolve into the enlightened structure of the 'Berle and Means firm,' seems highly unlikely, particularly in Asia. As Teemu Ruskola observed in 2000, "just as contract is the paradigmatic form of private ordering in [the American] legal system today, so family was the ideological paradigm of traditional Chinese private ordering."[48] Although this fact has weakened over time, it does not appear poised to disappear any time soon.

D. Party Firms: ideology and ambition transcending the immediate profit motive

In China, the state is the ultimately owner of the country's largest banks, energy and industrial enterprises, with its holdings managed by the Chinese central government's State Owned Assets Supervision and Administration Committee (SASAC).[49] These enterprises currently exist as stock corporations, the result of a process of 'corportization' undertaken in the 1990s.[50] Many of them are listed on the SEHK and constitute over 20% of that exchange's market capitalization,[51] but in all these SOEs SASAC retains a controlling interest. While the executive management of such companies are duly appointed in conformance with shareholder vote under Chinese company law, decisions

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off and Separate Listing of the Property Businesses of the CKH Holdings Group on the Stock Exchange by way of Introduction (9 January 2015), available at http://www.hkexnews.hk/.

47 JOE STUDWELL, ASIAN GODFATHERS: MONEY AND POWER IN HONG KONG AND SOUTHEAST ASIA 264 (2007).

48 Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STANFORD LAW REVIEW 1599, 1608 (2000).

49 *See* the list of SASAC holdings at www.sasac.gov.cn.

50 Jiangyu Wang, *The Political Logic of Corporate Governance in China's State-owned Enterprises*, 47 CORNELL INT'L L.J 631, 646 (2014). The project or corporatization was undertaken in tandem with the promulgation of China's first Western-style companies act in the modern era. *See* JIANGYU WANG, COMPANY LAW IN CHINA: REGULATION OF BUSINESS ORGANIZATIONS IN A SOCIALIST MARKET ECONOMY 6 (2014).

51 DONALD, *supra note* [●] at 58-59.

regarding the nominees for such positions are made by the CCP's Central Personnel Committee, which Richard MacGregor calls "without a doubt the largest and most powerful human resources body in the world."[52] As a result of this appointment power, the CCP is understood to control all SOEs directly: "'In corporate law, the boards [of Chinese state companies] can choose to disregard the Party's advice. As a fact of life, they cannot.'"[53]

The CCP of course has its own ideological position, and this does not always correspond with ordinary operations under corporate law. "Far from being driven solely by making a profit for shareholders, the Party had to act in accord with social 'stability' and national 'macro-economic' policies laid down by the government."[54] As MacGregor notes, "[t]he corporate animal that emerged from the protracted and painful birth of China Inc. was a strange new beast…. it was both commercial and communist at the same time…. not just difficult for the rest of the world to deal with. China has struggled to adapt as well."[55] One notable discrepancy clearly places such SOEs in stark contrast to commercial companies: in accordance with international practice and expectations, executive managers of SOEs were given stock options when the companies were prepared for their IPOs. However, there was an understanding within the CCP that the options were not to be exercised. MacGregor notes that these executives were deprived of "huge windfalls" generated by rising stock prices, and quotes the dilemma as expressed by someone close to the situation: "'These executives say, I have added value, so I should be rewarded,' said a Chinese banker. 'The Party says, you have added value because we put you there.'"[56]

China later used its power as a sovereign to enact legislation capping executive compensation,[57] which removed the need to make unspoken arrangements. However, the real problem for a country like China is when it enters the international capital markets. MacGregor well sums up the negative international view of state-owned enterprises, particularly those controlled by the a communist party when he condemns expressions of policy loyalty by company officials as mere cronyism, "timely genuflections at the feet of the Party by officials, and indicative of political loyalty and reliability, both essential to a career in public life."[58] The idea that all public activity, particularly that in a socialist context, is somehow a deformed and imperfect reflection of market activity could explain the

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52 MCGREGOR, *supra note* [●] at 69.

53 *Id.* at 49, quoting a securities lawyer familiar with Chinese companies.

54 *Id.* at 52.

55 *Id.* at 53.

56 *Id.* at 102.

57 *Id.*

58 *Id.* at 67.

continuing support for use of an unyielding idea of corporate law to bring other organizations into shape. If corporate law did allow for alternative motivation matrices in the first place, micro-adjustments at each point of conflict in order to avoid conflict or corruption would perhaps not be necessary. That alternative would likely be much more efficient.

III. THE CURRENT STATE OF CORPORATE LAW IN SOCIAL CONTEXT

A. The corporate unity of interested individuals

The leading model of corporate law as currently formulated establishes an association in which individuals meet and transact through a "nexus of contracts" to create their respective rights and duties. While differing political positions may argue that rights, duties and the benefit of corporate operations be attributed among different constituents, neither law nor theory provide for wholesale inclusion of alternative value networks within the company system. Directors must act in the best interests of the company or some constituent thereof and avoid conflicts of interest, and such conflicts are expressed in terms of self-interest. The motivation matrix of concern is the company itself and other systems are recognized only through the creation of conflicts of interests in the activity of individual corporate actors or in the exceptional cases discussed in Part IV.A.

By disregarding deep-seated and powerful value systems that may interlock with most of the corporations in a given jurisdiction, corporate law generates conflicts with such systems, fails to benefit from synergies between such systems and the company, and is thus highly inefficient in certain circumstances. Particularly in light of the fact that the corporate form has been repeatedly adjusted to the needs of commerce by such changes as eliminating a minimum number of required members, permitting legal person directors, introducing more flexible decision-making, and rationalizing the issue of equity through eliminating both required capital and par value, it is highly unusual that changes have not yet been made to allow efficient use of the company by organizations such as families, whose driving logic may not always accord with the prevalent logic of corporate law.

In China, the fact that corporate law must reflect this model may lead to evasions and distortions of corporate governance, which create a significant and troublesome discrepancy between law-on-the-books and law-as-enforced. It appears that the only barrier to the Chinese government enacting corporate law that allowed for efficient use of the corporate form by SOEs or FOEs would be lack of theoretical acceptance internationally. Yet the current system is likely to provoke evasion, and is thus both opaque and misleading.

B. What "conflicts of interest" and "independence" tell us about current engagement

The manner in which corporate law distorts actions caused by alternative motivation matrices can be seen in rules designed to combat conflict of interests and criteria used to measure director independence. All directors must avoid or declare any interest that conflicts with that of the company,

and they will have such an interest if it appears that a secondary motivation matrix – like a family – is channeling it into their sphere as contracting individuals within the company.[59] When the conflict comes from a source beyond the individual corporate actor, it will be attributed to that person if the type of relationship is deemed capable of channeling the interest. The remainder of the network through which the interest is channeled rarely appears on the radar screen of corporate governance rules. The same reasoning process applies to tests for independent directors, which seek to weed out relationships of financial dependence between the director and the company. If a person who is linked to the company in financial dependence (through such connections as salary, fees or shareholding) is then connected to the director via an alternative motivation matrix such as nuclear family, then independence is denied.[60]

Each of these rules extends a safeguard against conflict of interests one step removed from the corporate director to persons connected with him in such a way that the interests of such persons can be attributed to the director. This is done to block an avenue of potential evasion and is done in binary fashion – if the relationship exists, the interest will be attributed. Protection against a company making loans to directors, as expressed in Hong Kong law, shows the simplicity with which corporate law treats alternative motivation matrices. Loans in various forms cannot be made to a director or a member of the director's nuclear family member without special shareholder approval.[61] The family relationship is contained in the definition of "connected entity" and although it is defined at some length,[62] the effect of such relationship is simple attribution of the interest. However, the realities of businesses – such as banks and international firms providing expatriate employees with housing – are addressed in a detailed set of exceptions to the prohibition which allow loans to be made in connection with ordinary business or employee housing schemes.[63] This is exactly what we would expect, given that corporate law provides society with an artificial construct for the convenience of associated undertakings of investors. The question remains, however, if most corporations of a certain size are operated by families, why does the Ordinance not provide a more articulated set of options for attributing interests between family members?

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59 For example, the Hong Kong company law provides that a company cannot make a loan to a director without special shareholder approval, and the prohibition also applies to loans to a "connected entity." Such entities include nuclear family and persons cohabiting with the director, but asks no more. HKCO, s 486.

60 *See* e.g., SEHK Listing Rules, Rule 3.13.

61 HKCO, ss 500-503.

62 HKCO, ss 486-487.

63 HKCO, s 509 (exception for home loan), s 510 (exception for leasing goods and land etc.), s 511 (Exception for transaction entered into in ordinary course of business).

C. Disadvantages arising from a failure to recognize value systems not based on immediate profit

By conceiving of the stock corporation as a closed system with only the most marginal recognition of the various matrices of values intersecting with it, we make the corporation form far less versatile than it could be. Brian Cheffins recently recounted a debate about the purpose of the company moving from a manager-centered corporatism to shareholder primacy and perhaps to a team production model, observing without deciding that this may be a cyclical trend in corporate law scholarship.[64] This tug of war between profit maximization and social engagement would not be necessary if the corporate form could be adapted to serve a number of recognized goals in society. However, neither the law itself nor the theory evaluating and explicating it appears open to such realism.

Something like engagement of alternative values is expressed in the concept of "corporate social responsibility," but the discussion about using the business corporation form to serve social ends can end in deadlock unless it circles back to an indirect avenue to raise share price through enhancement of reputation. While us of the corporate form does entail certain fixed characteristics – such as limited liability and transferable shares of stock – there is no reason whatsoever that other operational questions cannot be adjusted in a flexible manner. As discussed below, this could be done by leaving some flexibility in the company law stature, introducing custom objects and values in the corporate constitutional documents, and allowing courts to flesh out the details.

IV. CONTEXTUALIZED CORPORATE GOVERNANCE

A. Instances of alternative motivation matrices currently coexisting with corporate law

1. Equitable considerations as the first step in contextualization

In Hong Kong, the UK and a number of jurisdictions of the Commonwealth, a remedy for minority shareholders exists when the affairs of the company have been conducted in a manner unfairly prejudicial to the plaintiff shareholder (individually or as a class).[65] The activity complained of is not 'misconduct' – i.e. a breach of the law or a duty – but rather a course of action contravening some arrangement that has been reached among members. While breaches of formal contractual arrangements are included in the sources of this action, the more common situation is where some course of dealings among the parties have created an understanding for which it is equitable to bar contravention of the arrangement. These equitable considerations arise in connection with, *inter alia*, understandings among family members and persons in a 'quasi-partnership' relationship.

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64 Cheffins, *supra note* [●] at 17-26.

65 s 724 HKCO.

While the term 'quasi-partnership' refers to a network of fiduciary relationships among members rather than a secondary motivation matrix, the family relationship which can trigger unfair prejudice clearly brings a second system of values into the company in a meaningful way. A recent case decided by the Courts of First Instance and Appeals in Hong Kong and currently pending before the Court of Final Appeals shows how this can be significant.[66] A company's founder built up an international corporate group from 1930 until 2004, when he died. His two sons had worked with him for years managing the group. Following the father's death, one son began to skillful maneuver to exclude his brother and his brother's offspring from management and other benefits of control, increasing distributions to himself, his heirs and companies they control. Although the case turned on a lack of Hong Kong jurisdiction over the merits of the group which had been moved offshore decades earlier, the Court made clear that the family relationship as it existed during the founder's lifetime established expectations that the subsequent actions of the defendant brother unfairly prejudiced.[67] The motivations and values of the family system created the framework by which this equitable action was made possible.

If expectations generated by the special nature of relationships within a family system can be used to ground a personal action against another member, it should also be possible to use values constituted in a secondary motivational matrix both offensively and defensively. Such values could include autonomy, long-term interests, and national policy. Although it may seem that such motivations and values arising from a matrix of values outside of the law would offer only a nebulous standard for guidance, it is in the nature of case law to turn facts into integrated elements of a judicial *ratio decidendi*, or case law. Minimal statutory intervention, discussed in Section B, below, could be used to instruct courts that they can be sensitive to these alternative systems of values within company actions.

2. The second tier of the duty of care as a door to alternative value systems

Both the UK and Hong Kong companies laws codify the director's duty of care in a two-step standard. According to the first, objective part, the director must exercise "the general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company," and then according to a second, subjective element, the director must exercise "the general knowledge, skill and experience that the director has."[68] This personal level of knowledge, skill and experience would be determined by a value system beyond the corporate law, and thus would incorporate the functionality of an additional system of relationships as

66 Yung Kee Holdings Ltd, [2012] HKEC 1480; Re Yung Kee Holdings Ltd [2014] 2 HKLRD 313, CA.

67 *Yung Kee*, HKEC 1480, para 117.

68 Companies Act 2005, s 174; HKCO s 465.

part of the governance standard applied to directors. Indeed, this recourse to an outside system of value is not unusual in law generally, given that practices and usages are often brought into determinations on the basis of tort or contract law in order to supplement a standard of care and make it accurately applicable to professions or other circumstances with their own set of values.[69]

B. Facilitating intersection of motivational matrices in companies

The examples provided in the foregoing sections show that it is not at all difficult to bring elements from alternative motivation matrices into corporate law. This can be done with an open-ended standard such as "unfair prejudice" or "reasonable knowledge, skill and experience" that may then be expressly fleshed out by reference to a value system external to company law. If the law were to be adjusted to allow a director to incorporate values from an alternative value system into corporate decision-making, it could be formulated very much like a typical constituency protection provision. The UK Companies Act 2006 contains such a provision, expressly allowing directors to take into account the interests of the likely consequences of any decision on "the interests of the company's employees," "the need to foster the company's business relationships with suppliers, customers and others," and "the impact of the company's operations on the community and the environment," among other things.[70]

The law should make provision to include these adjustments on a voluntary basis, such as through provisions in the articles or charter, which would be adaptable to the type of alternative value system that operating within the management of a given company.

V. CONCLUSIONS

Corporate law in its current form is surprisingly rigid and blind to the other systems of value that operate in interlocking relationship with companies as essential parts of the corporate environment. This paper has singled out two ideologically opposed examples – the family and the CCP within Chinese SOEs – as two motivation matrices that operate around and within stock corporations. The values of such motivation matrices are not always congruent with the rights and duties provided for in traditional corporate law. Corporate law does recognize the existence of these systems, but only to the extent necessary to check their influence on corporate actors. This is highly inefficient.

Corporate law continuously adapts itself to the needs of its users by changing requirements for incorporation, operation and financing. A similar adaptation should be undertaken engage alternative motivation matrices. This could be done with the traditional tools of corporate law by allowing

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69 *See* MELVIN A. EISENBERG, THE NATURE OF THE COMMON LAW 37-38 (1991).

70 UK Companies Act 2006, s 172.

companies to declare guiding principles in the constitutional documents and empowering courts to apply such principles when assessing the behavior of corporate actors.