

Article

Common Law Influences in Private Law —Taiwan’s Experiences Related to Corporate Law

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ABSTRACT

The term “common law” generally refers to the legal principles derived from judicial decisions and is distinguished from statutory laws enacted by legislative department. The legal systems of the United Kingdom and the United States of America are typically referred as the representatives of common law legal systems. Taiwan is categorized as a civil law country. However, the Anglo-American corporate law and securities law principles and judicial decisions have significant influence on the regulatory reform as well as court decisions.

Although most areas of private law are not codified in the common law countries, there is a need for enactment in some subjects of private law, such as the corporate law and securities law, because there are strong incentives for effective supervision. Although most common law countries have enacted corporate law statutes, judicial decisions still play an important role and sometimes influence the trend of legislation and regulatory reforms. Therefore, the content and development of the common law have great influences on the amendments of corporate law. In contrast, in civil law countries, the statutory law confines the freedom of the court to exercise its discretionary power in applying and interpreting the statutory provisions.

This article explores Taiwan’s experiences regarding the influences of common law on private law, particularly in the field of corporate and securities laws. This

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article broadly interprets the scope of common law. Part II of this article begins to discuss the influences of the statutory law of the common law countries, particularly the United States, on Taiwan's corporate and securities law. It is followed with examining the influences of the U.S. federal and state common law on Taiwan's corporate and securities laws in Part III. Part IV further discusses whether Taiwanese courts refer to and apply common law rules in the corporate and securities cases. Part V is conclusion.

Keywords: *Common Law, Business Judgment Rule, Piercing the Corporate Veil, Fraud-on-the-Market Theory, Fiduciary Duty*

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I. INTRODUCTION

The term “common law” generally refers to the legal principles derived from judicial decisions and is distinguished from statutory laws enacted by legislative department.¹ The legal systems of the United Kingdom and the United States of America are typically referred as the representatives of common law legal systems.² In the common law countries, the courts play an important role in law making by creating the legal principles and rules or confirming the existing customs or usages that the courts deem just and appropriate. This is true especially in private law field, such as the laws of contracts and torts. It is perceived that common law countries seldom enact or codify the common law rules in the private law field.³ This characteristic allows the courts to flexibly adjudicate the controversies. In contrast, civil law countries, such as most Continental European countries codify most field of private law.⁴ By doing so, the statutes tend to set forth relatively precise requirements that leave limited room for judicial discretion. Consequently, the courts of the civil law countries are normally bound by the wording of the provisions and under which chapter or section the provisions are set forth in interpreting the law and are less creative than the courts of the common law countries.⁵ By saying so, it does not indicate that the courts of the common law countries are not bound by the statutory laws and judicial precedents. Instead, it emphasizes that the courts in the common law countries are more flexible to adjudicate the controversies by looking at specific scenarios of each case and applying the rules of the precedents, adopting different rules or creating new principles by distinguishing the present case from the precedents so that fairness and justice can be ensured in every case.

Taiwan is categorized as a civil law country. Most areas of private law are codified and so does the commercial law field. Many of Taiwan’s statutes are patterned after or receptive from foreign laws. Therefore, it is helpful to study relevant foreign laws and evaluate their influence on the private law of Taiwan, particularly in the civil code and commercial law area. Taiwan’s Company Act was initially enacted in December 1929 comprising 233

1. BLACK’S LAW DICTIONARY 276 (6th ed. 1990).

2. “[T]he common law comprises the body of those principles and rules of action, relating to the government and security of persons and property, which derive their authority solely from usages and customs of immemorial antiquity, or from the judgments and decrees of the courts recognizing, affirming, and enforcing such usages and customs; and in this sense, particularly the ancient unwritten law of England.” *Id.*

3. 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, 62 (2001).

4. ARTHUR T. VON MEHREN, *THE CIVIL LAW SYSTEM* 3 (1957), *quoted in* Coffee, *supra* note 3, at 62 n.232.

5. *See* Coffee, *supra* note 3, at 62 n.232.

articles and was heavily influenced by German, Japanese, and Swiss corporate law.⁶ However, the Anglo-American corporate law principles began to influence Taiwan's corporate law reforms after World War Two beginning from the 1946 Company Act Amendment.⁷ Taiwan's Securities and Exchange Act (TSEA) expressly indicates in the legislative material that the TSEA is patterned after the U.S. Federal Securities Act of 1933 (1933 Act) and the Securities and Exchange Act of 1934 (1934 Act). In order to have an overall picture of Taiwan's corporate law, it is necessary to look into the Company Act as well as the TSEA because the Company Act contains provisions governing the incorporation, corporate structure, the powers of internal corporate organs, corporate finance, business consolidation, and other relevant issues that can be found in the regular corporate law statute everywhere of the world, and a major portion of the TSEA contains provisions regulating the publicly held corporations.

Although most areas of private law are not codified in the common law countries, there is a need for enactment in some subjects of private law, such as the corporate law and securities law, because there are strong incentives for government intervention in this field.⁸ The enactment of corporate law codifies existing legal principles and adds new contents into the statute. Although most common law countries have enacted corporate law statutes, judicial decisions still play an important role and sometimes influence the trend of legislation and regulatory reforms. Therefore, the content and development of the common law have great influences on the amendments of corporate law. In contrast, in civil law countries, the statutory law confines the freedom of the court to exercise its discretionary power in applying and interpreting the statutory provisions. In the corporate law field, even in the common law country like the United States, there has been literature discussing the interaction between the common law and the statutory law, and influences of the federal common law on the state legislation.⁹ To be sure, when the language of the statutes leaves room for interpretation, the courts are expected and usually would utilize its

6. WEN-YU WANG, KUNG SSU FA LUN [CORPORATION LAW] 83 (2d ed. 2005); I-CHOW WU, KUNG SSU FA LUN [CORPORATION LAW] 3-6 (1998). The latest amendment of the Kungssufa [Company Act] was promulgated in May 27, 2009, comprising 449 provisions.

7. WU, *Id.* at 4.

8. There have been arguments on whether company laws and securities laws are private law or public law. This article agrees with the opinion that both company law and securities law have both private law and public law characters, but the company law has more private law nature and the securities law has more public law nature. Robert B. Ahdieh, *From "Federalization" to "Mixed Governance" in Corporate Law: A Defense of Sarbanes-Oxley*, 53 BUFF. L. REV. 721, 731-33 (2005); Amir N. Licht, *Stock Exchange Mobility, Unilateral Recognition, and the Privatization of Securities Regulation*, 41 VA. J. INT'L L. 583, 585 (2001); Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence*, 20 CARDOZO L. REV. 227, 278-84 (1998).

9. See, e.g., Bradford C. Mank, *Should State Corporate Law Define Successor Liability?: The Demise of Cercla's Federal Common Law*, 68 U. CIN. L. REV. 1157 (2000).

law-making power to fill the gap of the statutory provisions.¹⁰

This article explores Taiwan's experiences regarding the influences of common law on private law, particularly in the field of corporate and securities laws. This article broadly interprets the scope of common law. Part II of this article begins to discuss the influences of the statutory law of the common law countries, particularly the United States, on Taiwan's corporate and securities law. It is followed with examining the influences of the U.S. federal and state common law on Taiwan's corporate and securities laws in Part III. Part IV further discusses whether Taiwanese courts refer to and apply common law rules in the corporate and securities cases. Part V is conclusion.

II. THE INFLUENCES OF THE U.S. CORPORATE & SECURITIES LEGISLATION ON TAIWAN'S CORPORATE & SECURITIES LAW

During the last decade, the corporate laws of the United States have increased influences on the amendments of Taiwan's Company Act.¹¹ With respect to the TSEA, there is no doubt that the U.S. federal securities laws have had dominant influences since TSEA was enacted in 1979. The following discussions include the major corporate and securities law reforms after the year of 2000.

A. *Influences of the U.S. Unitary Board Structure on Taiwan's Corporate Structure*

Corporate governance reform was initiated by the Securities and Futures Commission, the predecessor of the Financial Supervisory Commission, and co-sponsored by the Taiwan Stock Exchange, the GreTai Securities Market (GTSM), the Securities and Futures Institute, and the Corporate Governance Association. Since paying attention to the corporate governance of publicly held corporations, how to enhance the monitoring function to watch the board of directors and management, at least to prevent self-dealing and fraudulent misconducts, has been the focus of the corporate governance reform in Taiwan. Regarding internal monitoring mechanisms, four major forces interactively monitor the performance of the board of directors and management: they are (1) exercising shareholders' rights and votes at shareholders' meeting; (2) corporate supervisors; (3) self evaluation via

10. See, e.g., Scott Rogers, *Corporate Law: Looking to Federal Common Law to Determine Parent Corporation Liability under Cercla*, 4 U. FLA. J.L. & PUB. POL'Y 123 (1991).

11. Because the United States does not enact a single "Company Act" universally applicable throughout the U.S. territory, if not specifically identified, the term "corporate laws of the United States" or "U.S. corporate laws" refers to the Corporation Law enacted by each State legislature, the Model Business Corporation Act, and the Federal securities laws and regulations.

internal control and internal audit system; (4) independent directors and/or audit committee.

With the influence of the Sarbanes-Oxley Act of 2002,¹² the TSEA was amended on January 11, 2006 to officially introduce independent directors and audit committee into the corporate structure of publicly held corporations to enhance the internal monitoring mechanism.¹³ The amendment sets forth that beginning from January 2007, publicly held corporations may be required by the competent authority to appoint independent directors into the board of directors and set up an audit committee to replace supervisors.¹⁴ Because not every publicly held corporation is required to appoint independent directors or set up an audit committee, there will be three major models of corporate structure for publicly held corporation in Taiwan after January 1, 2007. Generally speaking, a publicly held corporation has the option to decide the model of its internal corporate structure. However, the Financial Supervisory Commission (FSC) may designate certain types of corporations to appoint independent directors but maintain supervisors as the monitoring organ (Model Two), and designate certain types of corporations to establish an audit committee, composed of all independent directors, to replace supervisors (Model Three). Therefore, three different models will coexist after January 2007. The following discussion will introduce three different models of internal corporate monitoring mechanisms.

1. *Model One—Two-Tier System*

The first model is the traditional and current corporate structure as required by the Company Act since its enactment in 1929. Under Model One, a company has a shareholders' meeting, a board of directors and supervisors. Shareholders elect both directors and supervisors. The board is composed of executives and some outside directors. Supervisors serve as the monitoring organ to monitor the performance of the board of directors and the management. Under this old fashioned two-tier corporate structure, supervisors are criticized for not being able to exercise the monitoring role because of the passivity and the close relationship with the controlling shareholders and directors.

After the amendment of the TSEA 2006, non-publicly held corporations

12. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

13. Relevant provisions regarding the independent directors and audit committee were added into the Chengchung Chiaoyifa [Securities and Exchange Act], arts. 14-2 to 14-5, 26-3 (Taiwan) [hereinafter TSEA].

14. Although the provisions regarding independent directors were added into the TSEA in January 2006, those provisions, including arts. 14-2 to 14-5, and 26-3, do not become effective until January 1, 2007. TSEA, art. 183.

will maintain this two-tier corporate structure. As for publicly held corporations, if not designated by the FSC to appoint independent directors or to establish an audit committee, it may maintain the traditional two-tier board corporate structure.

2. *Model Two—Two-Tier System with Independent Directors*

As discussed in the earlier section, the FSC may order certain corporations to appoint independent directors into the board of directors but still maintain supervisors as the official monitoring organ. Under Model Two, supervisors serve as the monitoring organ. Although independent directors play some monitoring function, under this model, they are directors and do not have comparable supervisory powers held by supervisors according to the Company Act. Articles 14-2 to 14-3 and Independent Director Regulation promulgated by the FSC govern the appointment, qualifications, missions, and powers of the independent directors.¹⁵ The major function of the independent directors is to participate the board meeting and provide their professional and independent opinions regarding material corporate affairs as listed in Article 14-3 of the TSEA. It requires that the dissenting and reserved opinion of the independent directors be recorded in the minutes of the board meeting and published on the Market Observation Post System.¹⁶ According to the FSC order, beginning from January 2007, financial institutions and listed companies with more than NT\$50 billion of paid-in capital will be required to appoint independent directors.¹⁷

3. *Model Three—One-Tier System and Audit Committee*

The FSC may require certain publicly held corporation establish an audit committee. The TSEA does not clearly point out whether audit committee is a subcommittee of the board. However, if a company establishes an audit committee, it has to abolish supervisors. Therefore, audit

15. Kungkai Fahsing Kungssu Tuli Tungshih Shechih Chi Yingtunhsun Shihhsiang Panfa [Regulations Governing Appointment of Independent Directors and Compliance Matters for Public Companies] (Taiwan), promulgated by the Financial Supervisory Commission, Executive Yuan (Mar. 28, 2006) [hereinafter the Independent Director Regulation].

16. TSEA, art. 14-3; Kungkai Fahsing Kungssu Tungshihhui Yishih Panfa [Regulations Governing Procedure for Board of Directors Meetings of Public Companies], art. 17, para. 2 (Taiwan), promulgated by the Order of Financial Supervisory Commission, Executive Yuan, No. 0950001615, 12 EXECUTIVE YUAN GAZETTE 10593, 10597-600 (Mar. 28, 2006) [hereinafter BOD Regulation]. The Market Observation Post System can be accessed via http://emops.twse.com.tw/emops_all.htm (last visited Aug. 25, 2009).

17. Order of Financial Supervisory Commission, Executive Yuan, No. 0950001616, 12 EXECUTIVE YUAN GAZETTE 10601, 10601 (Mar. 28, 2006).

committee is established to replace supervisors and serves as the supervisory organ. The TSEA explicitly delegate supervisory powers of supervisors to both the audit committee and its members.¹⁸ Therefore, unlike the independent directors of Model Two, independent directors under Model Three serve not only as a director but also enjoy the supervisory powers. In addition to the supervisory powers set forth under Article 14-4, important corporate affairs, as listed under Article 14-5, must obtain approval from the audit committee before it goes to the board meeting. However, the audit committee does not have the veto power. Although the audit committee disapproves the proposal, the board meeting still can approve it by approval of more than two thirds of all board members.¹⁹ It is necessary to note that the board is not required to be composed of majority independent directors. However, under such circumstances, the TSEA requires the minutes of the board meeting to record the disapproval of the audit committee and publish such information on the Market Observation Post System.²⁰ As of the end of October, the FSC has not designated any publicly held company to establish an audit committee.

B. *Anti-Securities Fraud*

Section 10(b) of the 1934 Act and Rule 10b-5 not only have gained recognition of their importance in regulating securities fraud activities within the U.S. jurisdiction but also have been receptive as a regulatory model by other countries. Taiwan's TSEA is also influenced by such anti-securities fraud regulation. Article 20 of the TSEA is Taiwan's anti-securities fraud provision patterned after the U.S. federal anti-securities fraud regulation. Paragraph 1 of Article 20, modeled after Section 10(b) and Rule 10b-5 of the 1934 Act, prohibits anyone from making misrepresentations or employing any fraudulent or misleading conducts in connection with public offerings, private placements, issuance or trading of securities. Paragraph 2 of Article 20, modeled after Sections 10(b) and 18 of the 1934 Act, prohibits making untrue disclosures of financial reports and other financial or business documents.

Private securities litigations based on Article 20 Paragraph 2 are rarely successful in the past for several reasons. First of all, investors aggrieved from securities fraud usually are unable to seek compensations by bringing securities litigation against the wrongdoers because of lack of financial and legal supports to engage in complicate securities litigation and very few successful precedents against the wrongdoers. Secondly, the courts are

18. TSEA, art. 14-4, paras. 3, 4.

19. TSEA, art. 14-5, para. 2.

20. *Id.*; BOD Regulation, art. 17, para. 2.

relatively inexperienced in securities litigations because securities market and securities transactions are relatively new and complicate for the judges too. Securities law is not a required course to take in the law school and therefore not many judges are familiar with securities regulatory regime in the past.²¹ Moreover, because Article 20 does not spell out detail elements of civil liabilities, the courts basically treat securities fraud conducts as tortious acts under the Civil Code and therefore the heavy burden of proof falls upon the plaintiffs who must show the intention of defendants, reliance and loss causation between the misconduct and the damages. Consequently, very few plaintiffs could successfully win the lawsuits. If the law cannot stop securities fraud conducts, it shall at least make it possible for the aggrieved investors to recover damages from the wrongdoers. The competent authority and scholars have perceived this issue and the regulatory reform was initiated. Led by the Honorable Justice In-Jaw Lai of the Constitutional Court, Judicial Yuan, securities law scholars convened and engaged in a series of seminars to discuss important issues of the securities law and proposals were forwarded to the competent authority. In the meantime, the competent authority initiated the TSEA amendment that has gone through three-reading procedure and was promulgated on January 11, 2006.

A new provision, Article 20-1, is added to the TSEA to deal with civil liabilities for violation of Paragraph 2 of Article 20 the issuer has reported and disclosed untrue financial reports. This addition is in response to the issues arising from the private securities litigations regarding the burden of proof in securities fraud cases and intends to increase investor protection. The new provision expressly lists the issuer, the responsible persons of the issuers, the employees involving in the fraudulent financial reporting, and accountants as potential defendants. Moreover, the above named persons, except for accountants, are presumed to be negligent for the misrepresentations or omissions of the financial reports.²² The issuer, chairperson and general manager are strictly liable for the untrue disclosure.²³ The responsible persons of the issuers other than the chairperson and general manager, and employees who sign on the financial reports are provided due-diligence defense to escape civil liabilities if they can successfully prove that they have exercised due care and has just cause to believe that the financial report contains no misrepresentations or

21. Recently, the government has engaged in a series of legal education reform programs and it is proposed that Securities Law shall become one of the subjects for the Bar Exam and Civil Service Special Examination for Judicial Personnel (judges and prosecutors).

22. Originally, it is proposed that every named defendant is presumed to be negligent in the Bill of the TSEA Amendment. However, owing to strong objection and lobby from the Accountants' Association, the presumption of negligence does not fall on accountants when the Legislative Yuan pass the Bill.

23. TSEA, art. 20, para. 2.

omissions.²⁴ For accountant's liability, because there is no presumption of negligence, plaintiffs must prove that the accounts that audit the financial reports and prepare for the audit report have misconducts, violate their duties or are negligent while performing their obligations as auditors of the financial reports.²⁵

In order to increase the scope of protection, the newly added Article 20-1 further expands the scope of plaintiffs to include not only those who rely on the untrue financial reports to buy or sell securities, but also the securities holders who do not sell securities.²⁶ This expansion of plaintiff's scope materially affects the securities litigation and has aroused critiques from commentators for at least two reasons. The first one is the weak transaction causation. Because they do not trade, it will be very difficult for the securities holders to establish transaction causation. It will not be appropriate either if they don't have to prove transaction causation. The second one is that to include securities holders as the plaintiffs will further dilute the amount of recoverable damages payment distributed to each plaintiff because in practice defendants have only limited assets left against the huge damages payments. Moreover, the TSEA has gone a little bit too far by imposing strict liability on the issuer, chairperson, and the general managers. This article suggests that this approach need to be reconsidered. At minimum, the TSEA should provide these defendants an opportunity to exercise due-diligence defense.

III. THE INFLUENCES OF THE U.S. COMMON LAW ON TAIWAN'S CORPORATE AND SECURITIES LAWS

In addition to the U.S. statutory laws, the federal and state common laws have also great influences on Taiwan's corporate and securities legislation. To examine the content of the Company Act and the TSEA, some common law doctrines have also been introduced and codified into these two pieces of legislation. For example, two important common law doctrines—the theory of “piercing the corporate veil” and “fiduciary duty” were introduced into the Company Act in 1997 and 2001 respectively.²⁷ The following paragraphs will discuss how these two legal doctrines are transplanted and how they are applied.

24. *Id.*

25. TSEA, art. 20, para. 3.

26. TSEA, art. 20, para. 1.

27. Taiwan's Company Act was amended and added Chapter 6-1 “Affiliated Enterprises” on June 25, 1997. The theory of piercing the corporate veil was adopted and set forth in Article 369-4 of the Company Act. The Company Act introduced the concept “fiduciary duties” on November 12, 2001 by imposing such duties on the responsible persons, such as directors, supervisors and managers. Company Act, art. 23, para. 1.

A. *The Theory of Piercing the Corporate Veil*

The theory of piercing the corporate veil is an equitable principle evolved from the U.S. common law.²⁸ In the limited liability corporations, shareholders bear only limited liability not beyond the amount of capital they subscribed.²⁹ After making payment to the corporation for the value of the subscribed shares, a shareholder owes nothing more to the corporation and is not responsible for the debts of the corporation. This is the general principle that shareholders of corporation are not responsible for the acts or debts of the corporation.³⁰ However, if the corporate entity is utilized by shareholders as a “dummy” or a “sham” for the purpose to avoid liabilities and such corporation was used as a sham that causes damages to its creditors or other shareholders of the corporation, the court may pierce the corporate veil and ask the controlling shareholders of that corporation to be responsible

28. See generally, Wilson McLeod, *Shareholders' Liability and Workers' Rights: Piercing the Corporate Veil Under Federal Labor Law*, 9 HOFSTRA LAB. L.J. 115, 121-39 (1991) (discussing the veil-piercing doctrine in common law with related problems arising under federal cases).

29. Shareholders of corporation did not enjoy complete limited liability in the 19th Century when some of the U.S. state statutes did not provide limited liability for shareholders. Timothy P. Glynn, *Beyond “Unlimiting” Shareholder Liability: Vicarious Tort Liability for Corporate Officers*, 57 VAND. L. REV. 329, 336-43 (2004).

30. “Except as stated in this Section, a judgment in an action to which a corporation is a party has no preclusive effects on a person who is an officer, director, stockholder, or member of a non-stock corporation, nor does a judgment in an action involving a party who is an officer, director, stockholder, or member of a non-stock corporation have preclusive effects on the corporation itself.

(1) If a relationship exists between a corporation and an officer, director, stockholder, or member of a non-stock corporation, such as that of principal and agent, indemnitee and indemnitor, or successor in interest to property, from which preclusive effects follow under rules governing that relationship, the judgment has preclusive effects in accordance with those rules.

(2) The judgment in an action to which the corporation is a party is binding under the rules of *res judicata* in a subsequent action by its stockholders or members suing derivatively in behalf of the corporation, and the judgment in a derivative action by its stockholders or members is binding on the corporation.

(3) If the corporation is closely held, in that one or a few persons hold substantially the entire ownership in it, the judgment in an action by or against the corporation or the holder of ownership in it is conclusive upon the other of them as to issues determined therein as follows:

(a) The judgment in an action by or against the corporation is conclusive upon the holder of its ownership if he actively participated in the action on behalf of the corporation, unless his interests and those of the corporation are so different that he should have opportunity to relitigate the issue; and

(b) The judgment in an action by or against the holder of ownership in the corporation is conclusive upon the corporation except when relitigation of the issue is justified in order to protect the interest of another owner or a creditor of the corporation.

(4) A judgment assessing a stockholder or member of a corporation for payment of an obligation of the corporation is binding upon the stockholder or member only if the proceeding leading to the assessment provided adequate notice to him individually or adequate representation of his interests in accordance with §§ 41 and 42.

(5) A judgment against a corporation that is found to be the alter ego of a stockholder or member of the corporation establishes personal liability of the latter only if he is given notice that such liability is sought to be imposed and fair opportunity to defend the action resulting in the judgment.”

RESTATEMENT (SECOND) OF JUDGMENTS § 59 (1982).

for the damages.³¹ This is the theory of piercing the corporate veil. It is important to note that limited liability corporation is an important form of business association under the modern corporate statutes. The courts usually are reluctant to pierce the corporate veil unless certain conditions are met. The following cases are examples that the courts agreed to pierce the corporate veil and require the controlling shareholders to be responsible for the damages they caused to the sham corporation.

There are different theories that the court would pierce the corporate veil:

1. *Denuding the Corporation Theory*

This theory applies when officers or directors misappropriate the corporate assets that the corporation has nothing left to pay creditors.³² Under this circumstance, the director or officer that denudes the corporate assets will be held personally liable to creditors of the corporation for the unsatisfied claims against the corporation to the extent he denudes the corporate assets.³³ In *World Broadcasting System, Inc., v. Bass*, the Supreme Court of Texas reversed the judgments of the District Court and the Court of Civil Appeal, holding that shareholders who had denuded the corporate assets are liable to the creditors of the corporation to the extent of the assets they appropriated from the corporation.³⁴

2. *The Corporate Trust Fund Doctrine*

The Supreme Court of Texas officially recognized the “trust fund doctrine” in 1893.³⁵ The application of the trust fund theory is to create a

31. In Virginia, the court will not pierce the corporate unless two factors are shown: (1) “a showing that the corporate entity was the alter ego, alias, stooge, or dummy of the individuals sought to be held personally liable;” and (2) “a showing that the corporation was used as a device or sham to disguise wrongs, obscure fraud, or conceal crime.” Robert L. Freed, *Corporate and Business Law*, 32 U. RICH. L. REV. 1067, 1077 (1998) (Cheatle v. Rudd’s Swimming Pool Supply Co., 234 Va. 207, 212 (1987)).

32. Leslie M. Summerford, *Bankruptcy: Creditor’s Alter Ego Action against Debtor’s Parent Corporation Was Deemed Property of Debtor’s Estate to Which The Automatic Stay Applied: S.I. Acquisition, Inc. v. Eastway Delivery Service, Inc. (In re S.I. Acquisition)*, 817 F.2d 1142 (5th Cir. 1987), 19 TEX. TECH L. REV. 1213, 1224-25 (1988).

33. *Id.*

34. *World Broadcasting System, Inc., v. Bass*, 160 Tex. 261, 267 (Nov. 18, 1959). In this case, the Supreme Court of Texas cited the opinion from a judgment of the Federal Supreme Court: “The law which sends a corporation into the world with the capacity to act imposes upon its assets liability for its acts. The corporation cannot disable itself from responding by distributing its property among its stockholders, and leaving remediless those having valid claims. In such a case the claims, after being reduced to judgments, may be satisfied out of the assets in the hands of the stockholders.” *Pierce v. United States*, 255 U.S. 398, 403 (1921).

35. This doctrine was first recognized by the Supreme Court of Texas in *Lyons-Thomas*

hypothetical trust fund that holds all of the corporate assets when a corporation becomes insolvent and can no longer operate in good faith.³⁶ The trust fund was theoretically created for the protection of corporate creditors. When directors and officers are not able to manage the corporate assets for the benefit of corporate creditors, they will be held personally liable to corporate creditors. In *Fagan v. La Gloria Oil & Gas Co.*, defendants were held liable under the trust fund doctrine.³⁷

3. *The Alter Ego Theory*

As a general rule, shareholders are insulated from corporate debt or liabilities. However, the plaintiff may seek to pierce the corporate veil and hold shareholders directly liable for the corporate debts or liabilities if the corporate form is used as an instrumentality or alter ego of the shareholders to shield liabilities.³⁸ The courts normally are reluctant to pierce the corporate veil unless it is found that the corporation is used merely as an instrumentality or alter ego of the owners, that the owner has strong domination over the corporation, and there involves fraud or wrongdoing.³⁹

If certain conditions are not met, the courts normally are reluctant to pierce the corporate veil even though there is only one shareholder holding 100 percent of shares. For example, in an Illinois case where plaintiff (Fullco Lumber Co.) filed the lawsuit against the estate of Roy K. Wallen (decedent), who was the sole owner of the R.K. Wallen Lumber Sales, Inc. prior to his death, asking the court to pierce the corporate veil to collect money judgment from Alabama Circuit Court against the Wallen Lumber Sales Inc.⁴⁰ The Circuit Court denied the claim. Plaintiff appealed the case and the Appellate Court affirmed in part and reversed in part and the case was remanded. The Appellate Court Justice McLaren delivered the opinion

Hardware Co. v. Perry Stove Mfg. Co., 86 Tex. 143, 156-65 (1893). Christian Otteson, *Current Application of the Trust Fund Doctrine in Texas*, 55 BAYLOR L. REV. 313, 314 (2003).

36. Otteson, *supra* note 35, at 314-15.

37. In this case, the Court of Civil Appeal of Texas found that "the evidence sustains the implied finding by the trial court that . . . Cooper was not only insolvent, but also ceased doing business in good faith and its management had no expectation that it ever again would resume such good faith operation," and affirmed the judgment of the District Court holding that defendant should be held liable under the "trust fund doctrine." *Fagan v. La Gloria Oil & Gas Co.*, 494 S.W.2d 624, 631 (Apr. 25, 1973).

38. Joshua M. Siegel, *Reconciling Shareholder Limited Liability with Vicarious Copyright Liability: Holding Parent Corporations Liable for the Copyright Infringement of Subsidiaries*, 41 U. RICH. L. REV. 535, 535 (2007).

39. Timothy E. Graulich, *Substantive Consolidation—A Post-Modern Trend*, 14 AM. BANKR. INST. L. REV. 527, 533 n.28 (2006) (citing *Geyer v. Ingersoll Publ'n Co.*, 621 A.2d 784, 793 (Del. Ch. 1992), and *Morris v. NYS Dep't of Taxation and Fin.*, 623 N.E.2d 1157, 1161 (N.Y. 1993)).

40. *In re Estate of Wallen v. Donat*, 262 Ill. App.3d 61 (May 6, 1994), cited from Cameron H. Goodman, *Piercing the Corporate Veil and Holding a Non-Shareholder Liable in Illinois?*, 18 DCBA BRIEF 6, 6 n.8 (2006).

of the court. The Justice first recognized the applicability of the veil-piercing theory with some conditions, stating, “some element of unfairness, something akin to fraud or deception, or the existence of a compelling public interest must be present in order to disregard or ‘pierce the corporate veil.’”⁴¹ Moreover, in determining whether to pierce the corporate veil, the courts must examine many factors such as inadequate capitalization; failure to issue stock; failure to observe corporate formalities;⁴² nonpayment of dividends; insolvency of the debtor corporation; nonfunctioning of the other officers or directors; absence of corporate records; commingling of funds; diversion of assets from the corporation by or to a stockholder or other person or entity to the detriment of creditors; failure to maintain arm’s length relationships among related entities; and whether, in fact, the corporation is only a mere facade for the operation of the dominant stockholders.⁴³

The piercing of the corporate veil theory is applied to make shareholders of the sham corporation be responsible for the damages caused by the sham corporation. Taiwan’s Company Act borrowed the concept of this theory to regulate affiliated enterprises. Article 369-4 requires the controlling corporation to make necessary compensation to the subsidiary or controlled corporation by the end of the fiscal year for the losses incurred as a result of irregular business practices (non-arm’s length transactions) or unprofitable transactions caused by the controlling corporation.⁴⁴ If the controlling corporation does not make appropriate compensation to the subsidiary, the controlling corporation shall be liable for the damages.⁴⁵ The subsidiary’s shareholders holding more than one percent of outstanding shares for more than one year and creditors of the subsidiary have the standing to bring derivative suits against the controlling corporation and its responsible persons.⁴⁶

Taiwan has not officially adopted the piercing corporate veil doctrine. The principle under Article 369-4 of Taiwan’s Company Act does not exactly resemble the piercing corporate veil doctrine. It only partially reflects the spirit of piercing corporate veil doctrine by redressing the aggrieved

41. *In re Estate of Wallen*, 262 Ill. App.3d 61, 68 (May 6, 1994). Justice McLaren cited opinion of another case, stating that to pierce the corporate veil, “two principal requirements must be met: ‘(1) there must be such unity of interest and ownership that separate personalities of the corporation and the individual no longer exist; and (2) circumstances must exist such that adherence to the fiction of a separate corporate existence would sanction a fraud, promote injustice, or promote inequitable consequences.’” *Id.* at 68-69.

42. If the corporate formalities are not followed, for example, failure to elect directors, the courts normally will weigh this factor against the shareholders seeking protection from limited liability. Eric Fox, *Piercing the Veil of Limited Liability Companies*, 62 GEO. WASH. L. REV. 1143, 1162-63 (1994).

43. *Id.* at 1169.

44. Company Act, art. 369-4, para. 1.

45. *Id.*

46. Company Act, art. 369-4, para. 3.

shareholders and creditors of controlled corporation providing them a right to bring derivative suit against the controlling company. Even so, there have not been many cases applying Article 369-4 of the Company Act to pierce the corporate veil. In *President Securities Corporation* (President Securities) (plaintiff) v. *King-Ho Investment Corporation* (King-Ho) (defendant), plaintiff filed a derivative suit against King-Ho and I-Hwa Corporation (I-Hwa) and the responsible person Ms. Wang to compensate the damages of King-Ho.⁴⁷ Defendant King-Ho opened a margin trading account with President Securities in 1999. Ms. Wang was the agent of King-Ho when opening the account and was the Vice-President of I-Hwa, the parent corporation of King-Ho. The margin trading account was used to purchase the parent corporation I-Hwa's shares at the open market. When King-Ho bought I-Hwa's shares from the market, I-Hwa had financial difficulties. Obviously, the purchasing of I-Hwa's shares by King-Ho was not successful to maintain I-Hwa's share price. Instead, the share price plunged and soon the value of the equity position fell below the minimum maintenance margin level. King-Ho and Ms. Wang received a margin call from plaintiff but failed to meet the margin requirement. Plaintiff was forced to liquidate shares from King-Ho's margin trading account but still short of NT\$679,160. Plaintiff brought this action and alleged that King-Ho and Ms. Wang should be jointly and severally liable for the debt of NT\$679,160. In addition, plaintiff, as the creditor of King-Ho, based on Article 369-4, sued and alleged that I-Hwa, as the controlling corporation, must compensate King-Ho for the same amount of damages, arising from the trading of I-Hwa's shares caused by I-Hwa. Taipei District Court held that I-Hwa, the controlling corporation of King-Ho, inadequately used the account of its subsidiary King-Ho to trade its own shares while it encountered financial difficulties that is contrary to the orthodox business practice and caused damages to King-Ho, should be liable for the damages of the King-Ho. The judgment is agreeable because it may deter other affiliated enterprises to use similar schemes to maintain or manipulate the company's share price. Unlike the judgments of the U.S. courts, Taipei District Court did not provide a guideline as to under what circumstances the court would pierce the corporate veil. The court actually could have provided more analysis on the relationship of King-Ho and I-Hwa to establish their controlling-subordinating relationship to justify why it decided to pierce the corporate veil.

While Taiwan has not officially introduced the theory of piercing the corporate veil into the Company Act, it is still necessary to consider the following three issues if the court is considering applying the piercing corporate veil doctrine. First, if the controlling shareholder is an individual

47. Taipei Tifang Fayuan [Taipei D. Ct.], Civil Division, 94 Chin No. 3 (2005) (Taiwan).

rather than a controlling corporation as set forth in Article 369-4, whether the plaintiff can base on this theory to ask the court pierce the corporate veil and make the individual controlling shareholders be responsible? Second, if the controlling person is not a shareholder but directly or indirectly controls the corporation, whether the court would apply the theory of piercing the corporate veil to hold a non-shareholder liable? Third, whether the creditors or shareholders of the sham corporation may ask the court to pierce the corporate veil and ask the controlling person to pay damages directly to them, or may only bring derivative suit for the sham corporation to recover damages? Simply put, because currently the Company Act, as set forth in Article 369-4, only applies to affiliated enterprises, the question is whether the theory of piercing the corporate veil can be applied beyond the affiliated enterprises context. More than likely, the answers to these issues might be negative if the statute does not expressly allow the court to do so. It is perceivable that the actual application of the theory of piercing the corporate veil is slightly different from that in the United States.

Taiwan is a civil law country. It does not mean that the court cannot apply common law principles developed by common law courts from other jurisdictions. However, because there is Article 369-4 in the Company Act, Taiwan's courts usually are reluctant or very cautious in applying the corporate veil doctrine. It will take more time for the courts to develop the rationale or for the legislative department to consider amending the Company Act if Taiwan want to seriously consider to apply the corporate veil doctrine.

B. *Fiduciary Duty*

The concept of “fiduciary duty” derives from the law of trust and has become a well-known common law rules.⁴⁸ Generally speaking, the fiduciary duty can further be distinguished as “fiduciary duty of loyalty” and “fiduciary duty of care” and in recent cases “good faith” has been recognized added as an independent element of the fiduciary duty.⁴⁹ Legal scholars have identified the breach of fiduciary duty as torts.⁵⁰ This view is further

48. Jerry W. Markham, *Fiduciary Duties under the Commodity Exchange Act*, 68 NOTRE DAME L. REV. 199, 207-34 (1992). There are disagreements on where the concept of trusts came from. From literatures, Roman Law, German Law or Islamic Law are possibilities where the concept of trusts originated. *Id.* at 207-08. However, evidences show that it was officially adopted in England in 1536 and later on transplanted into the United States. *Id.* at 208, 210.

49. Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131 (2006). Some U.S. courts identified “good faith” as a subsidiary element of the “duty of loyalty.” *Id.* at 1185. *See also* Hillary A. Sale, *Delaware's Good Faith*, 89 CORNELL L. REV. 456 (2004).

50. *See* Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925, 927-40 (2006).

evidenced by the Restatement (Second) of Torts Section 874 stating that a person standing in the fiduciary relation with another person will be held liable to that person if he breaches the duties imposed by the relation.⁵¹ The fiduciary relationship exists in many different situations. In a corporation or other types of business entities, it is a well-established rule that directors and officers owe fiduciary duties to the corporation and its shareholders. The directors and officers, as fiduciaries, manage the business and affairs of the corporation not for their own benefits but for the corporation and beneficiaries, i.e., the shareholders.⁵² The fiduciary duty has been imposed in the corporate statutes to prevent self-dealing and other conflict of interest conducts of officers and directors.⁵³

The concept of fiduciary duty did not exist in Taiwan until the amendment of the Company Act in November 2001 to introduce this term into this Act by adding the fiduciary duty into this Act.⁵⁴ Article 23 Paragraph 1 provides that “[t]he responsible persons of a company shall have the duty of loyalty and duty of care as a good administrator in managing the corporate affairs, and shall be liable for damages incurred to the company as a result of his breach of those duties.” After codifying the fiduciary duties into the Company Act, there have been many relevant literatures discussing the law of fiduciary duties and its application. However, because the concept of fiduciary, particularly the fiduciary duty of loyalty, is new to Taiwan’s legal system and the provision does not provide any detailed elements or guidance for determining whether the responsible person has breached the fiduciary duties, there have only been a few judicial decisions holding defendants liable for breach of fiduciary duties under Article 23 Paragraph 1.⁵⁵

51. RESTATEMENT (SECOND) OF TORTS § 874 (1979). *See also* DeMott, *supra* note 50, at 927.

52. Edwin W. Hecker, Jr., *Fiduciary Duties in Business Entities*, 54 U. KAN. L. REV. 975, 976 (2006).

53. For example, Delaware’s General Corporation Law regulates the transactions between the corporation and interested directors and imposes special quorum requirement. DEL. CODE ANN. tit. 8, § 144 (2006). Taiwan’s Company Act requires that directors cannot represent the corporation in any transaction between the corporation and directors. Company Act, art. 223. Moreover, interested directors are prohibited from voting in the board meeting. Company Act, art. 178; art. 180, para. 2; art. 206, para. 2.

54. Company Act, art. 23, para. 1.

55. In recent Supreme Court judgments, although plaintiffs alleged that defendants have breached the fiduciary duties of care and loyalty, the Supreme Court have rarely affirmed or denied the allegations. For example, the Supreme Court remanded a case asking the lower court to reconsider the claim based on breach of fiduciary duties that the Taiwan High Court failed to determine on its merits. Zuigao Fayuan [Sup. Ct.], Civil Division, 94 Tai-Shang No. 2406 (2005) (Taiwan); Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 93 Chung-Shang No. 19 (2004) (Taiwan). In another case, plaintiff also claimed that defendant, as a management of a securities firm, breached his fiduciary duty to illegally authorize excessive amount of trading causing the securities firm huge damages. The Taiwan High Court did not apply Article 23 of the Company Act. Instead, it applied the duties of the mandatory to the principal under Articles 535 and 544 of the Civil Code. Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 94 Chin-Shang No. 3 (2005) (Taiwan). The Supreme Court

There are several possible reasons why there are not many judicial decisions applying this provision yet. First, the fiduciary duty arose from the law of trust and the law of trust is a new law in Taiwan too. Although there have been literatures discussing the law of trust, Taiwan officially enacted the Trust Act in January 1996 and Trust Enterprise Act in July 2000. The concepts of fiduciary duty and trust have existed and developed in England and the United States for hundreds of years.⁵⁶ It would be relatively easier for the U.S. and English courts to determine whether the trustee or administrator has breach of the fiduciary duties but it may not be an easy task for Taiwanese courts to determine a person's liability based on a concept that is new and developing in Taiwan's society. It is still in the transitional period for the courts to figure out how to make this concept into play. Second, more in-depth discussions and literatures on how the laws of fiduciary duty operate are needed and best of all if a guideline on how to determine whether the fiduciary duties are breached can be developed. Because there is no comparable concept in Taiwan, there have been different terms used to translate the fiduciary duty. People in Taiwan are still curious to know the answers of the following questions. What constitutes a fiduciary relation? Who can be treated as a fiduciary? What is the content of the fiduciary duty and how to determine whether it is breached? Whether the responsible person of a company owes fiduciary to the company only or to the shareholders also? Shall we completely recognize the law of fiduciary duties and widely applied, or incorporate only in selected statutes? All of these issues need more discussions to make the courts feel more comfortable to apply the law of fiduciary duty. Furthermore, in Paragraph 2 of Article 23, which provides that the responsible person shall be jointly and severally liable for the damages caused by the responsible persons during the course of business operations having violated any applicable law or regulation. Because this provision provides a relatively precise standard "in violation of the law or regulation during the course of business operation," it becomes easier for the court to apply Paragraph 2 rather than Paragraph 1 of Article 23 of the Company Act.

remanded the case because the High Court did not clarify the validity of defendant's status as a manager. Zuigao Fayuan [Sup. Ct.], Civil Division, 96 Tai-Shang No. 1561 (2007) (Taiwan). Again, both the High Court and the Supreme Court did not focus on the issue of breach of fiduciary duties under Article 23 of the Company Act.

56. Tara Helfman, *Land Ownership and the Origins of Fiduciary Duty*, 41 REAL PROP. PROB. & TR. J. 651 (2006).

IV. THE INFLUENCES OF THE U.S. COMMON LAW ON TAIWAN'S JUDICIAL DECISIONS RELATED TO CORPORATE AND SECURITIES CASES

From previous discussions, it is perceivable that both the statutory laws and common law rules have influences on Taiwan's legislation in the corporate and securities law areas. The following discussions will further exam the influences of the legal theories evolved from the U.S. judicial decisions on Taiwan's judicial decisions related to corporate and securities cases. Although the corporate law and securities law have already been codified in the United States both in the federal and state levels, judicial decisions still play important role not only to interpret what the laws are but also to fill the gap or deficiencies of the law.⁵⁷ For example, the U.S. Federal Supreme Court has recognized that investors have a private right of action, a common law principle, under Section 10(b) and Rule 10b-5 of the 1934 Act but has not granted an independent private right of action under Section 17 of the 1933 Act yet.⁵⁸ In terms of the proof of transaction causation (or reliance), the courts have developed the fraud-on-the-market theory based on the assumption of the existence of the efficient capital market hypothesis to make the regulation workable and applicable in the securities fraud cases. In addition, following the invention of the Delaware courts in dealing with the breach of the fiduciary duty cases, in most states the courts have adopted the business judgment rule that presumes directors and officers to have conducted the corporate affairs with due care and in good faith. All of these legal theories invented by the U.S. federal or state courts not only influences the development of the corporate and securities regulatory regimes, but also influences Taiwan's courts in rendering the

57. The power to enact corporation law belongs to the legislature of each state. Each state also has its own securities law. The federal securities law governs nationwide or interstate affairs rather intra state activities. The limited power for the federal government to enact corporation law arising from the U.S. Constitution in which no specific provision authorizes the federal government to legislate the corporate law. Donald E. Schwartz, *Federalism and Corporate Governance*, 45 OHIO ST. L.J. 545, 571 (1984). However, there has been a trend that federal government is pursuing more power to regulate corporate through securities regulation, particularly in the corporate governance issues. Renee M. Jones, *Does Federalism Matter? Its Perplexing Role in the Corporate Governance Debate*, 41 WAKE FOREST L. REV. 879, 894 (2006). In contrast, Canada, also a federal nation, both the federal and state governments have legislative power to enact corporate law, and in fact, there coexist the federal corporation law, i.e., the Canada Business Corporations Act, and provincial corporate statutes. Ryan R. Cox, *Canada: Governing the Future for Investor Confidence*, 38 INT'L LAW. 971, 973-74 (2004).

58. The private right of action is a common law rule that grants injured individual a right to seek remedies against persons who violate statutes and cause damages. Thomas C. Daniels, *The Existence, Necessity, Recognition, and Contradiction of an Implied Right of Action under Section 17(a) of the 1933 Securities Act*, 28 SANTA CLARA L. REV. 43, 43 (1988). This principle was founded in an English case *Couch v. Steel* in the mid 19th Century (118 Eng. Rep. 1193, 1196 (Q.B. 1854)), first adopted by the U.S. Federal Supreme Court in 1946, recognized under Section 14(e) of the Securities and Exchange Act of 1934 in 1964. *Id.* at 44. For discussions of cases that Supreme Courts refused recognition of implied private right of action, see *id.* at 46-47.

judgment. The following discussions use “fraud-on-the-market theory” and “business judgment rule” as examples to analyze how common law rules influences Taiwan’s judicial decisions.

A. *Fraud-on-the-Market Theory*

The fraud-on-the-market theory is a theory created by scholars and federal courts in securities fraud cases for the purpose to show the existence of plaintiff’s reliance on misrepresentations or omissions of material information disclosed by defendant corporation.⁵⁹ In the securities market, because the transaction pattern is different from the traditional face-to-face transaction and most investors normally do not read the financial reports disclosed by the issuers, if defendant need not be responsible for the untrue disclosure because investors do not read the financial reports, the regulatory purpose of disclosure requirements will be undermined. Therefore, fraud-on-the-market theory was invented to show the indirect reliance on the misleading financial reports.⁶⁰ The invention of fraud-on-the-market theory is not derived from law but is based on the “efficient capital market hypothesis” and it is applied in the open and developed market.⁶¹ The Federal Supreme Court in *Basic Inc. v. Levinson* officially recognized and supported lower courts’ adoption of the fraud-on-the-market theory. The Supreme Courts opined that lower courts properly applied the fraud-on-the-market theory and relieved each plaintiff’s burden to prove the existence of reliance.⁶² In *Basic*, the Supreme Court gave the

59. For discussion of the fraud-on-the-market theory, see generally *In re Seagate Tech. II Sec. Litig.*, 843 F. Supp. 1341, 1355-59 (N.D. Cal. 1994) (on its impacts and effects); Jonathan R. Macey & Geoffrey P. Miller, *Good Finance, Bad Economics: An Analysis of the Fraud-on-the-Market Theory*, 42 STAN. L. REV. 1059, 1076-83 (1990) (arguing that courts should make the theory compatible with economic theories).

60. In the securities fraud cases, the reliance (or transaction causation) and loss causation are two separate elements. See Jeffrey L. Oldham, *Taking “Efficient Markets” out of the Fraud-On-The-Market Doctrine after the Private Securities Litigation Reform Act*, 97 NW. U. L. REV. 995, 996 n.7, 1004 n.65 (2003).

61. See generally Paul A. Ferrillo et al., *The “Less Than” Efficient Capital Markets Hypothesis: Requiring More Proof from Plaintiffs in Fraud-on-the-Market Cases*, 78 ST. JOHN’S L. REV. 81 (2004) (arguing that the hypothesis provides less than efficient grounds for the market and suggesting plaintiffs to show inefficient behavior of the sued stock); Lawrence A. Cunningham, *From Random Walks to Chaotic Crashes: The Linear Genealogy of the Efficient Capital Market Hypothesis*, 62 GEO. WASH. L. REV. 546 (1994) (arguing that the hypothesis and relevant law designs can learn lessons from the chaos theory); Mark H. Van De Voorde, *The Fraud on the Market Theory and the Efficient Markets Hypothesis Applying a Consistent Standard*, 14 J. CORP. L. 443 (1989) (arguing for the development of a coherent standard to be applied in fraud suits premised upon the hypothesis).

62. *Basic Inc. v. Levinson*, 485 U.S. 224, 240-48 (1988). In fact, the fraud-on-the-market theory was first applied by the 9th Circuit Court of Appeal in 1975: “We think causation is adequately established in the impersonal stock exchange context by proof of purchase and of the materiality of misrepresentations, without direct proof of reliance. Materiality circumstantially establishes the reliance of some market traders and hence the inflation in the stock price when the purchase is made

fraud-on-the-market theory a pass that is applicable in Rule 10b-5 securities fraud cases.⁶³ In addition, the Supreme Court set forth the uniform standard for the fraud-on-the-market theory.⁶⁴ However, it must be noted that Justice White and Justice O'Connor, in *Basic*, did not agree with the majority opinion regarding the application of the fraud-on-the-market theory.⁶⁵

The fraud-on-the-market theory is applicable not only in the United States but also in other countries, including Taiwan.⁶⁶ Taiwan's securities law is patterned after the U.S. securities law. Similar to Section 10(b) and Rule 10b-5 of the 1934 Act, Taiwan's Securities and Exchange Act (TSEA) expressly prohibits securities fraud activities and untrue disclosures and provides *bona fide* investors suffering damages arising from the securities fraud or untrue disclosures to recover damages.⁶⁷ In the securities fraud civil liability litigation, a liability based on torts, plaintiffs encounter similar difficulties on how to prove that they made their investment decision relying on the untrue disclosures. The following paragraphs will discuss how this issue is handled.

The Securities Investors and Futures Traders Protection Center (Investor Protection Center), a non-for-profit organization established in January 2003, according to the Securities Investors and Futures Traders Protection Act (Investor Protection Act), bring most of the securities fraud litigations based on Article 20 of the TSEA.⁶⁸ As of the end of 2006, the Investor Protection Center has instituted 44 class actions against securities law violators.⁶⁹ Among them, 23 cases involve misrepresentations and omissions of material

the causal chain between defendant's conduct and plaintiff's loss is sufficiently established to make out a prima facie case." (*Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975)). *In re Seagate Tech. II Sec. Litig.*, 843 F. Supp. 1341, 1354 (N.D. Cal. 1994).

63. *In re Seagate Tech. II Sec. Litig.*, 843 F. Supp. 1341, 1354 (N.D. Cal. 1994).

64. *Id.*

65. *Basic Inc. v. Levinson*, 485 U.S. 224, 249-50 (1988).

66. For discussion of the application of the fraud-on-the-market theory in other countries, see Michael Duffy, 'Fraud on the Market': *Judicial Approaches to Causation and Loss from Securities Nondisclosure in the United States, Canada and Australia*, 29 MELB. U. L. REV. 621 (2005); Thomas M. J. Möllers, *The Progress of German Information Disclosure Requirements: A Comparative Law Perspective in Light of Recent Developments in European Capital Markets Law*, 30 N.C. J. INT'L L. & COM. REG. 279, 334 (2004) ("Germany . . . leads other member states in the development of liability laws designed to strengthen confidence in the capital market. The new draft of a general liability provision Section 37b of WpHG is strongly correlative to United States law, particularly the fraud-on-the-market theory.").

67. TSEA, art. 20.

68. According to Article 28 of the Chengchuan Toutzujen Chi Chihuo Chiaoyijen Paohufa [Securities Investor and Futures Trader Protection Act], the Investor Protection Center, after receiving empowerment from more than 20 injured investors, may bring civil class actions for investors for claims based on the TSEA or the Futures Exchange Act.

69. Statistical number is obtained from the Investor Protection Center. Major types of class actions brought by the Investor Protection Center are related to (1) untrue financial reports (TSEA, art. 20, para. 2); (2) untrue prospectus (TSEA, art. 32); (3) insider trading (TSEA, art. 157-1); (4) market manipulation (TSEA, art. 155).

information in the financial reports. When the counsels of the Investor Protection Center prepare the arguments, the fraud-on-the-market theory is used to serve as the proof of reliance. In several cases, the courts expressly applied the fraud-on-the-market theory to ease plaintiff's burden of proving the transaction causation (reliance). Although some courts have adopted the fraud-on-the-market theory in the judgment to switch the burden of proof from plaintiffs to defendants,⁷⁰ it is necessary to note that most of the courts did not provide clear interpretation in how this theory is applicable in Taiwan's securities market and its interaction with the transaction causation and loss causation.⁷¹ However, in a recently decided case, both the district court and high court reject the application of the fraud-on-the-market theory.⁷² In the judgment of the Taiwan High Court, the judge in response to the assertion of using the fraud-on-the-market theory for proving reliance, the judge opines that such theory mentioned by the plaintiff is either for academic research purpose or a theory of the United States that cannot be applied to replace plaintiff's burden of proof of the causation.⁷³

B. *Business Judgment Rule*

The business judgment rule (BJR) is a standard of judicial review initially developed by the Delaware courts.⁷⁴ This common law standard or rule is created for the protection of the management from litigations without merits that would disturb the normal business operations. The BJR presumes that directors and officers make the business decisions in good faith, on an informed basis and for the best interest of the corporation. The BJR is applicable in at least two types of cases—the “transactional justification

70. Once the court applies the fraud-on-the-market theory, and coupled with the application of Article 277 of the Minshih Susungfa [Code of Civil Procedure] (reducing plaintiff's burden of proof), it becomes the defendant's obligation to prove that there is no causation between the untrue disclosure and plaintiffs' damages.

71. As commented by a famous securities law scholar, also a current Grand Justice of the Constitutional Court, the courts usually mix up the transaction causation and loss causation when applying the fraud-on-the-market theory. IN-JAW LAI, KUSHIH YUHSI KUEITSE—TSUIHSIN CHENGCHUNG CHIAOYIFA CHIEHHSI [GAME RULES OF THE STOCK MARKET—THE NEWEST ANALYSIS OF SECURITIES AND EXCHANGE LAW] 527 (2006).

72. Taipei Tifang Fayuan [Taipei D. Ct.], Civil Division, 92 Su-Keng-Yi No. 35 (2004) (Taiwan); Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 94 Chin-Shang-Yi No. 1 (2005) (Taiwan).

73. Taiwan Gaodeng Fayuan [Taiwan High Ct.], Civil Division, 94 Chin-Shang-Yi No. 1 (2005) (Taiwan).

74. As stated by Professor Douglas M. Branson in an Indiana Supreme Court Lecture Program delivered on Sept. 20, 2001, he said: “The much misunderstood business judgment rule is not a ‘rule’ at all. It has no mandatory content. It involves no substantive ‘do’s’ or ‘don’ts’ for corporate directors or officers. Instead, it is a standard of judicial review, entailing only slight review of business decisions. Alternatively, it could be called a standard of non-review, entailing no review of the merits of a business decision corporate officials have made.” Douglas M. Branson, *The Rule That Isn't a Rule—The Business Judgment Rule*, 36 VAL. U. L. REV. 631, 631 (2002).

cases” and “personal liability cases.”⁷⁵ In transactional justification cases, the BJR is applied to presume the legality of the transaction that such transaction was decided on an informed basis and was for the best interest of the corporation that plaintiffs cannot challenge the legality or try to invalidate such transaction if the BJR is applied and the presumptions are sustained.⁷⁶ In personal liability cases, if the BJR applies, the officers and directors also enjoy the presumptions, i.e., making the business decisions on an informed basis, in good faith, and for the best interest of the corporation, and are insulated from personal liabilities.⁷⁷

The BJR, originated in Delaware and fully followed or slightly modified by other states, has focused on two elements—i.e., the presumption that business decision was formulated on an “informed basis” and another presumption that the directors have satisfied the statutory duty of care.⁷⁸ The purpose and prominent consequence of adopting the BJR are to reduce the litigations involving business decisions. However, this inevitably makes it more difficult, if not impossible, to sue directors or officers who have in fact breached of the fiduciary duty of care.⁷⁹ Disregarding the potential defects, the procedural element presumes that the business decisions are made on an informed basis, in good faith and in the best interest of the corporation. Unless the plaintiffs successfully rebut the presumptions, the court will not go further to review the merits of the business decision, and directors participating the business decision will not be responsible for a business decision that is not profitable or has cause damages to the corporation.⁸⁰

Smith v. Van Gorkom is the first case that has stopped the “curse” of the BJR. The Supreme Court of Delaware in this case held that the board of directors approved the proposed cash-out merger was not an informed business decision and denied the presumption of the BJR.⁸¹ This judgment serves as a warning signal to the management that BJR is not an absolute protection anymore. In *Van Gorkom*, the Supreme Court of Delaware focus on the procedure of reaching the business decision, holding that the board meeting was in a hurry to authorize a cash-out merger and directors failed to inform themselves all available information and held directors personally

75. R. Franklin Balotti & Joseph Hinsey IV, *Director Care, Conduct, and Liability: The Model Business Corporation Act Solution*, 56 BUS. LAW. 35, 37 (2000), quoted in Bernard S. Sharfman, *Understanding Maryland's Business Judgment Rule*, 8 DUQ. BUS. L.J. 1, 4 n.25 (2006). See also *Unitrin, Inc. v. American Gen. Corp.*, 651 A.2d 1361, 1374 (1995).

76. E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992-2004? A Retrospective on Some Key Developments*, 153 U. PA. L. REV. 1399, 1422 (2005).

77. *Id.*

78. Sharfman, *supra* note 75, at 20-21.

79. *Id.* at 21.

80. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (1971).

81. *Smith v. Van Gorkom*, 488 A.2d 858, 864 (1985).

liable for the damages for breach of duty of care.⁸²

It is necessary to note that the BJR has incurred vigorous debate among the U.S. scholars. For shareholders and investors protection, both corporate and securities laws emphasize the fiduciary duties and accountability of the responsible persons. However, another direction of development aiming at reducing the litigations associated with the business decisions to ensure that the management may exercise their discretionary power in making the business decisions. Scholars supporting the BJR mainly focus on the reason that it is necessary to encourage the directors and officers to manage the corporate affairs with their expertise and without fear of being sued by shareholders arbitrarily.⁸³ Therefore, some statutes, such as the Delaware law, Model Business Corporation Act, etc., have developed BJR, exculpatory provisions, and indemnification provisions to reduce the exposure of liabilities for directors and officers.⁸⁴ Some scholars have also criticized that the BJR actually increases the cost to the corporation and the shareholders and provides no benefits.⁸⁵ This is an uneasy task to balance these two tracks of regulatory regimes that are conflicting in their natures.

Taiwan does not expressly include the BJR into any provision of the Company Act. There have been discussions on whether Taiwan should introduce this common law rule into the Company Act or whether the courts should employ this rule when deciding cases regarding complaints against directors, managers and other responsible persons. Although Taiwan has not adopted the BJR, it does not mean that officers and directors are easily attacked or sued by shareholders. Currently, under the Company Act, there are two provisions that provide shareholders to sue directors—(1) based on Article 23 Paragraph 1 to sue directors who breach fiduciary duties and cause damages to the company; (2) base on Article 193 Paragraph 2 to sue directors if the board of directors makes a business decision that violates laws, regulations, articles of incorporation, or resolutions of the shareholders' meeting and causes damages to the corporation.⁸⁶ However,

82. *Id.* at 875, 893. See also Patricia A. Terian, "It's Not Polite to Ask Questions" in the Boardroom: *Van Gorkom's Due Care Standard Minimized in Paramount v. QVC*, 44 BUFF. L. REV. 887, 889 (1996).

83. Kent Greenfield & John E. Nilsson, *Gradgrind's Education: Using Dickens and Aristotle to Understand (And Replace?) the Business Judgment Rule*, 63 BROOK. L. REV. 799, 827 n.124 (1997).

84. See Mae Kuykendall, *Symmetry and Dissonance in Corporate Law: Perfecting the Exonerated Directors, Corrupting Indemnification and Straining the Framework of Corporate Law*, 1998 COLUM. BUS. L. REV. 443, 445-57 (1998).

85. Lynn A. Stout, *In Praise of Procedure: An Economic and Behavioral Defense of Smith v. Van Gorkom and the Business Judgment Rule*, 96 NW. U. L. REV. 675, 676-77 (2002). It is criticized that in order to avoid liabilities, directors may have the incentives to adopt a procedural rule, like the standard operating procedure (S.O.P.), that requires every business decision follow the "elaborate and costly decision-making routines" and hire expensive external consultants. *Id.* at 676.

86. There are other provisions impose liabilities on directors, such as art. 23, para. 2 when directors violates law and regulations and cause damages to other persons, and art. 369-4. However,

these provisions do not seriously pose pressure on directors for the following reasons. First, shareholders can only bring the derivative suits against directors and if successfully win the litigation, the damages payments are made to the company and shareholders do not have direct interest from the result of the derivative suits. Shareholders will be benefited only if the directors committing wrongdoings are replaced. Second, the right of action against directors belongs to the corporation and it is not easy to initiate the litigation. There are three means triggering the litigation against directors: (1) the company suffering damages resulting from directors' wrongdoing voluntarily sues directors; (2) a resolution adopted by the shareholders' meeting to sue directors;⁸⁷ (3) a derivative suit initiated by shareholders.⁸⁸ Unless other directors agree to sue the director who breaches the fiduciary duty or commits the wrongdoing, it is unlikely that the board would decide to sue the directors. To put an agenda to sue directors at the shareholders' meeting is similarly difficult. Moreover, there is a threshold that is relatively high for bringing derivative suits and there is no incentive for shareholders to bring derivative suits.⁸⁹ Therefore, very rarely can we find derivative suits in Taiwan.

To sum up, the BJR is a common rule that has its special historical background. If introducing the theory into Taiwan's statute or applying to the judicial decisions, we must be aware of how this theory is actually applied and to avoid the defects or critiques. Taiwan Company Act has already contained many provisions very friendly to the management and it might not be that urgent to consider importing the BJR theory.

V. CONCLUSION

Taiwan is a civil law country. However, common law rules, particularly those developed from the U.S. courts, have significant influences on Taiwan's private law. Examining Taiwan's corporate and securities laws and related judicial decisions, there are many footprints of common law rules.

the person that can bring litigations against directors is not the shareholder of the company.

87. Company Act, art. 212.

88. Company Act, arts. 214, 215.

89. In order to bring a derivative suit, only shareholders holding more than 3% of outstanding shares for a period of more than one year are qualified to bring a derivative suit against directors. Company Act, art. 214, para. 1. Even though shareholders satisfy the threshold requirement, shareholders must first request supervisors of the company to bring the litigation and only if supervisors do not bring the litigation within 30 days after receiving the request from qualified shareholders may those shareholders bring the litigation for the company. Company Act, art. 214. Moreover, if shareholders did successfully file the suit against directors, the defendant directors may request the court to order the plaintiffs to deposit appropriate amount of money for security purpose, and plaintiff shareholders may incur liability to the company if they lost the case and cause damages to the company.

From the foregoing discussions, many common law rules, such as the theory of piercing the corporate veil, fiduciary duties, fraud-on-the market theory, and business judgment rule, have already influenced Taiwan's legislation and judicial decisions. However, while introducing or citing the common law rules, it is important to fully understand the historical development of the common law rules and their compatibility to Taiwan's special cultural background, social and economic status and the legal system. It is recommended that more efforts need be devoted to complete the law-transplantation task.

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