‘One Jurisdiction, Two Regimes?’:
A Socio-legal Perspective on how
Directors of Chinese Family Companies
in Hong Kong should be Regulated

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A thesis submitted in fulfilment of the requirements for
the degree of Doctor of Philosophy

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This decade long journey had been plague by years of heartache, setbacks, tears and occasional joy. I am ever so grateful for the collective wisdom of my supervisory team; Professor Michael Adams, Associate Professor Scott Mann and Doctor Marina Nehme. No words can express my gratitude and indebtedness for their kindness, guidance, and help, in particular, to Professor Michael Adams, because without his stewardship I could not have completed this thesis.

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Statement of Authenticity

The work presented in this thesis is, to the best of my knowledge and belief, original except as acknowledged in the text. I hereby declare that I have not submitted this material, either in full or in part, for a degree at this or any other institution.

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Angus Lester Ee Ken Young
## Table of Contents

Acknowledgments ......................................................................................................................... iii

Statement of Authenticity .................................................................................................................. v

Table of Contents ............................................................................................................................ vii

List of Tables .................................................................................................................................. xxi

List of Diagrams ............................................................................................................................... xxiii

Abbreviations .................................................................................................................................... xxv

Publications Based on this Thesis ................................................................................................... xxvii

Abstract ............................................................................................................................................ xxix

### Chapter 1: Introduction .............................................................................................................. 1

1.0 Introduction ................................................................................................................................ 1

1.1 Justification of the Research ....................................................................................................... 3

1.1.1 Maintaining Hong Kong’s Position as an International Financial Centre ........................................ 3

1.1.2 Asian Financial Crisis as Impetus for Further Reforms ............................................................... 6

1.1.3 Unresolved Corporate Governance Concerns in Hong Kong .................................................... 8

1.1.4 ‘Gaps’ in the Literature ........................................................................................................... 11

1.2 Thesis Research Questions, Methodology and Limitations ....................................................... 14

1.2.1 The Regulatory Problems and Research Questions .................................................................... 14

1.2.2 Methodology ........................................................................................................................... 17

1.2.2.1 Extra-legal and Non-legal Issues ......................................................................................... 18

1.2.2.2 Corporate Governance Regulation Research Methods ......................................................... 21

1.2.2.3 Cultural Factors .................................................................................................................. 22

1.2.3 Limitations ............................................................................................................................... 24
1.3 Structure of the Thesis .................................................................................... 25
1.4 Summary and Commentaries ........................................................................... 27

Part One: Corporate Governance and Directors’ Duties in Hong Kong:

The Reforms, Rationale, and Values ................................................................. 30

Chapter 2: Reforming Corporate Governance and Directors’ Duties in Hong Kong ........................................................................................................... 31

2.0 Introduction .................................................................................................. 31
2.1 Broader Considerations in Corporate Governance Reforms ......................... 31
   2.1.1 The Territory’s Economic Transformation ........................................... 32
   2.1.2 Regulatory Capture in Hong Kong ................................................... 35
2.2 Attempts to Reform Directors’ Duties .......................................................... 39
   2.2.1 Initial Efforts ................................................................................... 39
   2.2.2 Another Unsuccessful Attempt ...................................................... 40
   2.2.3 The Next Round of Reviews ......................................................... 43
   2.2.4 Introduction of Non-statutory Guidelines ...................................... 46
2.3 The Debates in the Most Recent Round of Reforms .................................. 47
   2.3.1 British Provisions as Model Law for Hong Kong ......................... 47
   2.3.2 Latest Round in the Epic on Codification of Directors’ Duties .......... 50
2.4 Summary and Commentaries ...................................................................... 59
## Chapter 3: Principles and Core Values Underpinning Directors’ Duties in Hong Kong

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.0 Introduction</td>
<td>62</td>
</tr>
<tr>
<td>3.1 The Principles of Corporate Governance and Directors’ Duties</td>
<td>62</td>
</tr>
<tr>
<td>3.1.1 The Fundamentals of Corporate Governance</td>
<td>63</td>
</tr>
<tr>
<td>3.1.2 The Importance of Accountability</td>
<td>65</td>
</tr>
<tr>
<td>3.1.3 Directors’ Role from a Legal Perspective</td>
<td>68</td>
</tr>
<tr>
<td>3.1.4 The Underlying Principles and Values of Directors’ Duties</td>
<td>70</td>
</tr>
<tr>
<td>3.2 General Law Fiduciary Duties in Hong Kong</td>
<td>76</td>
</tr>
<tr>
<td>3.2.1 Duty to Act in Bona Fide for the Benefit of the Company</td>
<td>77</td>
</tr>
<tr>
<td>3.2.2 Duty to Exercise Powers for a Proper Purpose</td>
<td>79</td>
</tr>
<tr>
<td>3.2.3 Unfettered Discretion</td>
<td>80</td>
</tr>
<tr>
<td>3.2.4 No Conflict of Interests and No Secret Profits Duties</td>
<td>81</td>
</tr>
<tr>
<td>3.3 General Law and Statutory Duty of Care in Hong Kong</td>
<td>86</td>
</tr>
<tr>
<td>3.3.1 The General Law Duty of Care</td>
<td>86</td>
</tr>
<tr>
<td>3.3.2 The Newly Enacted Statutory Duty of Care</td>
<td>91</td>
</tr>
<tr>
<td>3.4 Summary and Commentaries</td>
<td>95</td>
</tr>
</tbody>
</table>

### Part Two: Why Western Laws are Not Suitable for Chinese Family

**Companies in Hong Kong: Culture, Values and Norms Matter**

<table>
<thead>
<tr>
<th>Chapter 4 The Intricacies of Regulating Family Companies in Hong Kong</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>4.0 Introduction</td>
<td>100</td>
</tr>
</tbody>
</table>
## Chapter 4

### 4.1 The Importance of ‘the Family’ and Family Companies in Hong Kong

#### 4.1.1 Families and Family Companies in Hong Kong

#### 4.1.2 Family Share Ownership and its Impact on Governance

### 4.2 Statutory Provisions for Family Companies in Other Jurisdictions

#### 4.2.1 United States

#### 4.2.2 South Africa

#### 4.2.3 Australia

### 4.3 Indications that the Western Legal Rules are ill suited for Chinese Family Companies in Hong Kong

#### 4.3.1 Awareness amongst Directors Concerning their Legal Obligations

#### 4.3.2 Litigations Concerning Disputes in Family Companies

#### 4.3.3 Discounting Other Legal Possibilities

### 4.4 Early Attempt to Regulate Chinese Enterprises and Judicial Review in Hong Kong

### 4.5 Summary and Commentaries

## Chapter 5

### Chapter 5 Relation-centred Cultural Norms and Paternalistic Governance in Hong Kong’s Chinese Family Companies

### 5.0 Introduction

### 5.1 Value Differences between Hong Kong and Britain

### 5.2 Chinese Entrepreneurialism and Relation-centred Culture in Hong Kong

#### 5.2.1 Hong Kong’s Chinese Spirit of Entrepreneurialism

#### 5.2.2 Hong Kong’s Chinese Business Network Structure and Relational Traits
5.3 Paternalism in Hong Kong’s Chinese Family Companies ............................... 153
  5.3.1 Comparing Chinese Family and Anglo-American Governance Models ......................................................................................................................... 153
  5.3.2 An Analysis of Paternalism and Harmonious Relations ...................... 159
  5.3.3 Issues Incidental to Paternalistic Governance ........................................ 165

5.4 Summary and Commentaries ........................................................................ 171

Chapter 6 Making Sense of Confucian Notions of Governance and Regulation ........................................................................................................... 174
6.0 Introduction .................................................................................................. 174
6.1 A Foreword about Confucianism ................................................................ 175
6.2 Confucius’s Notion of Governance ............................................................ 179
  6.2.1 Confucius’s Notion of San Gang Wu Chang ........................................ 179
  6.2.2 Confucian Harmonious Order of Things ............................................. 195
6.3 Confucian Doctrine of Li as a Regulatory Norm ......................................... 199
  6.3.1 Traditional Chinese Characterisation of the Law and Jurisprudence .......... 199
  6.3.2 The Genesis of Li as a Moral Principle with Regulative Properties 205
  6.3.3 Establishing Social Order through the Doctrine of Li ......................... 208
6.4 A Glimpse into History about Confucian Influence on Governance and Regulation ........................................................................................................... 217
6.5 Summary and Commentaries ...................................................................... 223
Chapter 8: Conclusions .......................................................................................... 287

8.0 Summary and Key Arguments of the Thesis ................................................. 287
    8.0.1 Key Arguments and Conclusions in Part 1 ............................................. 289
    8.0.2 Key Arguments and Conclusions in Part 2 ............................................. 292
    8.0.3 Key Arguments and Conclusions in Part 3 ............................................. 297

8.1 Recommendations for Reform ..................................................................... 300
    8.1.1 Conceptualising Regulatory Standards for Directors of Chinese Family Companies .......................................................... 300
    8.1.2 The ‘Regulator’ or ‘Regulatory Arrangement’ in the Scheme of Things ......................................................................................... 301
    8.1.3 Limitations of the Recommendations ................................................ 303

8.2 Areas for Future Research .......................................................................... 303

8.3 Conclusions .................................................................................................. 305

Bibliography ........................................................................................................ 308
List of Tables

Table 1  Comparing Anglo-American and Chinese family centred models of corporate governance .............................................. 154
Diagram 1   Governance and organisation structure in Chinese family company .................................................. 160
<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
</tr>
</thead>
<tbody>
<tr>
<td>AFC</td>
<td>Asian Financial Crisis</td>
</tr>
<tr>
<td>CA</td>
<td>Companies Act 2006 (UK) c46</td>
</tr>
<tr>
<td>CCA</td>
<td>Close Corporations Act 1984 (South Africa)</td>
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<td>CCAA</td>
<td>Close Corporation Act 1989 (Cth)</td>
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<tr>
<td>CO</td>
<td>Companies Ordinance (Hong Kong) cap 32</td>
</tr>
<tr>
<td>CPO</td>
<td>Chinese Partnership Ordinance (Hong Kong) cap 53</td>
</tr>
<tr>
<td>EC</td>
<td>Euro-Crisis</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GFC</td>
<td>Global Financial Crisis</td>
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<td>HKEx</td>
<td>Hong Kong Exchanges and Clearing Limited</td>
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<td>HKID</td>
<td>Hong Kong Institute of Directors</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
</tr>
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<td>MO</td>
<td>Mediation Ordinance (Hong Kong) cap 620</td>
</tr>
<tr>
<td>NTO</td>
<td>New Territories Ordinance (Hong Kong) cap 97</td>
</tr>
<tr>
<td>SCCLR</td>
<td>Standing Committee on Company Law Reform</td>
</tr>
<tr>
<td>SFC</td>
<td>Securities and Futures Commission</td>
</tr>
<tr>
<td>STDIM</td>
<td>Sociedade de Turismo e Diversões de Macau</td>
</tr>
</tbody>
</table>
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Angus Young, ‘Rethinking Directors’ Duties in Hong Kong: General Law Obligations Ill-suited for Small Chinese Family Companies’ (2012) 33 The Company Lawyer 30-5

Angus Young, ‘Reforming Directors’ Duties in Hong Kong: The Journey, Stakeholders and Oversights’ (2012) 23 International Company and Commercial Law Review 142-54

Daniel Ho, Alex Lau and Angus Young, ‘Do Chinese Traditional Values Matter in Regulating China’s Company Directors? Preliminary Findings from Surveys in Hong Kong’ (2010) 31 The Company Lawyer 338-9


Angus Young, ‘Rethinking the Fundamental of Corporate Governance: The Relevance of Culture in the Global Age’ (2008) 29 The Company Lawyer 168-74

Alex Lau, John Nowland and Angus Young, ‘In Search for Good Governance for Asian Family Companies: A Case Study about Hong Kong’ (2007) 28 The Company Lawyer 306-11

Alex Lau and Angus Young, ‘Corporate Governance in Hong Kong: The State of Affairs’, (2006/7) 1 Compliance & Regulatory Journal 39-48
Abstract

This thesis argues that Hong Kong should establish a pluralistic regime to regulate directors, because amending the law cannot resolve the gap in regulation created by the incongruity between the law of directors’ duties, and the values that underpin the governance practices in Chinese family companies. This research is important for the reason that unless this incongruence is dealt with, experiences have suggested that governance and related problems in Chinese family companies could escalate into wind up action. Furthermore, this gap in regulation could affect more than half a million companies in Hong Kong.

At present, the law of directors’ duties in Hong Kong is essentially British, introduced during the colonial administration over a century ago. The legal obligations are fiduciary in nature. To date, amendments to the law of directors’ duties in Hong Kong are limited to discussions about codification along the lines of the British law reforms. And after two decades the government was finally able to achieve some consensus amongst the business and professional elites in Hong Kong to codify directors’ duty of care. However, fiduciary duties remained general law obligations.

British laws continue to be used as benchmarks for Hong Kong’s corporate governance regulation in order to encourage international investments into the Territory’s equity markets. Whilst it is appropriate for publicly listed and non-family companies, it is ill suited for Chinese family companies, because in these companies, the underlying values of governance focus on the control of the family company by the family patriarch, and on maintaining harmonious relationships amongst family members. These values and norms emanate from Confucian doctrines that have been embedded in the Chinese psyche for centuries.

In sum, there appears to be one set of formal legal rules and another informal norm-driven value based normative ordering regulating directors in Hong Kong. However, without a regulatory framework, compliance with the informal normative ordering is capricious. To resolve this, nodal governance theory proposes that networks are well
suited to be organised as a self-regulatory node or body. Since Hong Kong’s economy is built on networks of family companies, they can be effectively mobilised as a self-regulatory node or body to fill the current gap in the territory’s corporate governance regulatory regime.

The proposed Chinese self-regulatory node or body should deal with conflicts in Chinese family companies, because without a forum to address grievances they could escalate to the point of *fen jia* (division of assets leading to liquidation). Thus, culturally appropriate intervention and assistance is vital to find solutions to company disputes. Given that paternalism and harmonious relationships underpin the governance of Chinese family companies in Hong Kong, they are central to the regulatory proposal. However, these Confucian enthused values could not be regulated through legal rules. Instead, it is through persuasion and compromises that they are applied to bring about a mediated resolution.

Since governmental recognition and judicial practice direction on mediation in Hong Kong is already in place, the mediated outcomes by a Chinese self-regulatory node or body could be deemed by the courts to be an alternative dispute resolution procedure to settle disputes concerning the governance of Chinese family companies. Lastly, even though this reform proposal is conceptual and more research needs to be done, the recommendations of this thesis are aimed at addressing a long neglected area of corporate governance regulation in Hong Kong.
Chapter 1: Introduction

1.0 Introduction

Hong Kong was a British colony for well over a century. Yet, in spite of the British control and administration of the territory, the local Chinese residents have held on to their cultural values and identities. Since such value orientation affects the locals’ view of life, psyche, and social behaviour, it would be a mistake to think that laws transplanted from Britain to Hong Kong have been unproblematic for the local Chinese. However, this does not mean that the locals reject or oppose the transplanted laws outright. Rather, the differences in the value systems embedded in the laws and local Chinese culture have created some ideological tensions involving strongly held assumptions about value judgements with regard to what is right or good. Such differences in value-systems are often manifested in postcolonial societies where multiple discourses, emanating from various cultural orientations, compete for ideological, social and political domination.

One of the colonial legacies was a Westernised urban life with a reputation of a global city. Notwithstanding this, traditional Chinese morality and customs have remained entrenched in the psyches of local Chinese residents of Hong Kong. This socio-cultural plurality has emerged from the co-existence of indigenous and settled

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1 Benjamin Leung, Perspectives on Hong Kong Society (Oxford University Press, 1996) 49-52.
2 Steve Tsang, A Modern History of Hong Kong (Hong Kong University Press, 2004) 45-47. For more detailed discussions on this see Chapter 4.3.
3 For more discussions about Hong Kong’s views about rule of law see, Berry Hsu, The Common Law: In Chinese Context (Hong Kong University Press, 1992).
4 Sin Wai Man and Chu Yiu Wai ‘Whose Rule of Law? Rethinking Post-Colonial Legal Culture in Hong Kong’ (1998) 7 Social and Legal Studies 147. For more detailed discussions on this see Chapters 5 and 6.
6 Leung, above n 1, 49-52, 63, 65. Note that such plurality has been interpreted by some sociologist as hybridity, where both British and Mainland Chinese influences have shaped the creation of new local cultural identities. This hybridisation can be broadly characterised as a plural Hong Kong-British and Hong Kong-China cultural identifications. However, such plural hybridity does not change Hong Kong people’s strong identification with traditional Chinese culture as a core value. See Anthony Fung, ‘Postcolonial Hong Kong Identity: Hybridising the Local and National (2004) 10 Social Identities, 399; Tsang, above n 1, 190-6.
inhabitants.\textsuperscript{7} Pluralism has also been enshrined into the territory’s legal system where Chinese customary practices have been recognised as customary laws.\textsuperscript{8}

To a certain extent, the Hong Kong courts have tried to understand and adjudicate on matters concerning local Chinese traditional enterprise under customary laws known as \textit{tongs} (Chinese ancestral trust).\textsuperscript{9} However, they have found enormous difficulty in coming to terms with traditional Chinese values, customs, and practices.\textsuperscript{10} This could be due to the fact that the Chinese concept of law and justice is distinct from Western legal principles and values, and thus each should be understood and applied independently from the other.\textsuperscript{11} In light of this problem this thesis proposes the establishment of a separate regulatory framework for the directors of Chinese family companies where the governance norms and practices are incongruent with the prevailing transplanted British company laws in Hong Kong. This entails an appreciation of the values, norms, and practices of Chinese family companies in Hong Kong and an analysis of how their governance differs from Western standards.

At the outset, it is important to note that privately held Chinese family-owned and operated companies (Chinese family companies) in Hong Kong are characterised by an ‘insider’ system. Under this system no one outside the family, or extended family, is allowed to become a shareholder or a board member.\textsuperscript{12} Consequently, the line between family and company matters is often blurred because both shareholders and directors are the same individuals.\textsuperscript{13} In addition, the governance of these companies has embedded Chinese cultural influences that prompt the behavioural tendencies and mould the mindsets of these company

\textsuperscript{7} Reza Banakar and Max Travers, ‘Pluralism and Globalisation’, in Reza Banakar and Max Travers (eds), \textit{An Introduction to Law and Social Theory} 285.

\textsuperscript{8} Basic Law of the Hong Kong Special Administrative Region of the Peoples’ Republic of China arts 8, 40. For more detailed discussions on this see Chapter 7.2.

\textsuperscript{9} The definition of tong under s15 of the New Territories Ordinance (Hong Kong) cap 39 means family lineage trust – see Tang Man Kit and Foo Tak Ching (suing as Managers of Wah Yan Mo Fan Heung) v Hip Hing Timber Company Ltd [2001] HKCU 759, [26] as per Yuen J. Also note that Tong has been written as T’ong or known as Tso, see Belinda Wong, ‘Chinese Customary Law -- an Examination of Tsos and Family Tongs’ (1990) 20 Hong Kong Law Journal 13; Stephen Selby, ‘Everything You Wanted to Know About Chinese Customary Law (But Were Afraid to Ask)’ (1991) 21 Hong Kong Law Journal 45. For more discussion on tongs see Chapter 4.4.

\textsuperscript{10} Tang Man Kit & Anor v Hip Hing Timber Co Ltd [2003] 4 HKC 278, 291-299.


\textsuperscript{12} For more about this insider system see Chapter 5.

Thus, Western juristic norms have no place in regulating these types of companies. However, this research does not advocate the abolition of the transplanted British company laws because Hong Kong is an international business hub with many international and multinational companies having major operations in the territory. Further, corporate ownership structures in the territory comprise of two major groupings, one being Chinese families and the other made up of non-family, which includes foreign shareholders in large local companies as well as international corporations. Therefore, the commercial reality in Hong Kong points to the notion that a pluralistic corporate governance regime would be feasible.

This introductory chapter shall begin with the justification for this research followed by an analysis of the gaps in Hong Kong’s corporate governance regulation. Next, it will delve into the thesis research questions, methodology, and limitations with the aim of explaining the scope and approach of this thesis. The structure of this research will then be outlined while laying out the sequence of the arguments to be developed. The chapter will conclude with comments.

1.1 Justification of the Research

Corporate governance is an important regulatory and policy issue across the globe. For Hong Kong, there is an added significance, which this section will examine together with the impact of the Asian Financial Crisis (AFC) on reform. The Hong Kong Government’s regulatory reform efforts in corporate governance serve to highlight the many unresolved issues in practice. A survey of the key literature on Hong Kong’s corporate governance regulation uncovers and seeks to identify the gaps in the ongoing regulatory debate.

1.1.1 Maintaining Hong Kong’s Position as an International Financial Centre

15 SH Goo and Anne Carver, Corporate Governance: The Hong Kong Debate (Sweet & Maxwell, 2003) 87-8.
It has been a long-standing economic policy priority of the Hong Kong government to ensure the territory has a robust corporate governance regulatory framework. Though the same could be said of any country, what sets Hong Kong apart from the others is the vital role corporate governance plays in one of the territory’s four core industries - the financial sector. Since the British colonisation of Hong Kong in 1841, the territory has evolved economically from a small British trading colony into a major international business hub in Asia. The financial sector, according to statistical data, is currently the key ‘driving force of Hong Kong’s economic growth, providing impetus to growth of other sectors and creating employment.’ Hong Kong’s Census and Statistics Department data in 2012 reveals that the financial sector accounts for about HK$262 billion, approximately 15 per cent, of the territory’s Gross Domestic Product (GDP).

Furthermore, from a broader economic perspective, apart from the territory’s labour force, Hong Kong has few natural resources. With the combination of land scarcity, and technology imported from other countries, it is vulnerable to external economic shocks. Hence, the
territory has had to adapt to the demands of international market forces for investment and trade to maintain its economic growth.\textsuperscript{23} This helps explain why the Hong Kong government drew on British statutory provisions as an international benchmark to reform the territory’s company laws.\textsuperscript{24} The island needs the ‘tick of approval’ by international investors to secure foreign investment. The then Chair of Securities and Futures Commission, Eddy Fong said in a speech that:

As the third largest market in Asia by market capitalisation, and seventh place in world rankings, this speaks well of the listed companies in Hong Kong...[J]ust as investors will commit their money to companies that provide good corporate governance so they will commit their investments to markets that provide significant numbers of investment opportunities with good corporate governance.\textsuperscript{25}

Consequently, for Hong Kong, the key momentum to reform its corporate governance regime has been to ensure that the territory retains its prominent status as an international financial hub in Asia.\textsuperscript{26} Goo and Carver stated that:

Hong Kong relies on financial services. As a premier financial centre, it serves those seeking to invest as well as those seeking capital ... However, Hong Kong now faces heighten competition from a number of markets around the region each providing a growing range of easily accessible securitized products ... There is also the competition from the stock markets in Shanghai and Shenzhen ... While there are many factors that go into this competitive edge.\textsuperscript{27}

Further, the then Secretary for Financial Services and the Treasury, Frederick Ma said in a speech that:

The Government's policy direction is clear - we must maintain our market quality and continue to enhance our corporate governance. Our statutory and frontline regulators are determined to fulfil its gate-keeping role and will not compromise quality for quantity. In fact, we understand that the relevant authorities in the Mainland [China] also encourage the Mainland enterprises to seek listing in Hong Kong as a means to enhance their corporate governance.\textsuperscript{28}

\textsuperscript{23} Li, above n 19, 2-7, 17-20.
\textsuperscript{24} For more see Chapter 2.3.
\textsuperscript{26} Goo and Carver, above n 15, 16.
\textsuperscript{27} Ibid, 16.
Such is the importance of corporate governance that the then Chief Executive of Hong Kong Special Administrative Region, Donald Tsang, has underlined this issue as a policy priority in his annual policy addresses since 2005.29

Aside from the economic reasons, this goal of maintaining Hong Kong as an international financial hub is literally drafted in the Basic Law of Hong Kong Special Administrative Region of the Peoples’ Republic of China (Basic Law).30 Under Article 109 of the Basic Law:

The Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre.31

Thus, having a robust set of corporate governance regulations not only serves an economic function, it is ultimately of constitutional significance for Hong Kong. Evidently, the constitutional dimension reinforces the economic policy stance. This is not the only impetus for corporate governance reforms in Hong Kong, the overall economic health of the territory is another important factor.

1.1.2 Asian Financial Crisis as Impetus for Further Reforms

The 1997 AFC was perhaps the most devastating financial crisis for Asia since the Second World War.32 Gui and Tsui wrote that, ‘The [Asian finance] crisis involved both public and private institutions and, broadly speaking, the problems in the private sector can be attributed to excessive or unrealistic investor optimism.’33 And they added that, ‘During and immediately after the AFC, mainly to stem the tide of an erosion of investor confidence, several countries instituted corporate governance

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30 Note the Basic Law is equivalent to a ‘mini constitution’ for Hong Kong. See Yash Ghai, Hong Kong’s New Constitutional Order: The Resumption of Chinese Sovereignty and Basic Law (Chinese University Press, 1997).


33 Ibid.
reforms.’ For Hong Kong, the severity of the AFC had made a lasting imprint on the stock market. Prices were said to have plummeted as much as 60 percent from the peak in August 1997 to the bottom twelve months later. To stem the tide of investors’ panic, in August 1998, the Hong Kong Government intervened in the stock market by buying HK$120 billion worth of shares, using about 15 percent of Hong Kong’s reserves. The AFC also cost Hong Kong a reduction of 7.8 percent in real per capita gross domestic product in 1998. Lui remarked that it was, ‘a phenomenon totally unknown to Hong Kong, which had never experienced a year of declining GDP in its recorded economic history.’ Therefore, reforming the territory’s corporate governance regime was deemed by the government to be a key policy initiative.

Goo and Carver argued that one of the reasons behind the AFC was that accountability and transparency of the board of directors were largely ignored by regulators and big businesses while there had been decades of rapid economic growth. This lack served as another motivation for the Hong Kong Government to promote good corporate governance in line with international best practices. Since the AFC had a negative impact on Hong Kong’s economy and its share markets, investors’ protection became a policy priority. A series of corporate governance reforms in Hong Kong were introduced. Even though reforms to corporate governance had been ongoing, the AFC broadened the scope of the reforms to include the operation of the stock exchanges, listing rules, as well as other regulatory measures. Evidently, the emphasis of the reforms has been directed towards

34 Ibid, xiv.
35 Francis Lui, ‘Hong Kong’s Economy since 1997’, in Ming Chan and Alvin So (eds), Crisis and Transformation in China’s Hong Kong (Hong Kong University Press, 2002) 242, 243.
36 Goo and Carver, above n 15, 111.
37 Lui, above n 35, 242, 243.
38 Goo and Carver, above n 15, 111; Daniel Wong and Peggy Yeung, ‘Corporate Governance in Hong Kong’ in Ng Sek Hong and David Lethbridge (eds), The Business Environment in Hong Kong (Oxford University Press, 4th ed, 2000) 143, 151.
39 Goo and Carver, above n 15, 111.
40 Lui, above n 35, 247-254.
41 Berry Hsu, ‘Legal Facets of Hong Kong SAR Economic Development: Colonial Legacy and Constitutional Constraint’ in Ming Chan and Alvin So (eds), Crisis and Transformation in China’s Hong Kong (Hong Kong University Press, 2002) 220, 221.
42 Ibid.
43 Goo and Carver, above n 15, 110-1.
44 Katherine Lynch, ‘Stock Market Crises and Insider Dealing in Hong Kong: The Need for Regulatory Reform’ in Raymond Wacks (ed), The New Legal Order in Hong Kong (Hong Kong
enhancing the corporate governance of non-family and publicly listed companies.\textsuperscript{45} Due to the negative connotations about economic policies in Asia from the fallout of the AFC, the Hong Kong Government was more than usually inclined, to shore up international market confidence in the territory by picking international best practices as a benchmark for Hong Kong’s corporate governance reforms.\textsuperscript{46}

\textit{1.1.3 Unresolved Corporate Governance Concerns in Hong Kong}

The Hong Kong Government’s corporate governance reforms dating back to the 19\textsuperscript{th} century generally followed developments in Britain.\textsuperscript{47} Even though corporate governance reforms in Hong Kong had primarily drawn from the developments in Britain as the principal standards for the territory, in the 1990s there had been increasing references to the corporate governance regulations and guidelines from the United States, Australia and Canada as benchmarks.\textsuperscript{48} Whilst benchmarking from developed Western economies and the transplantation of British laws and listing rules might be important for publicly listed or non-family companies in Hong Kong seeking capital from the public and international investors, this was and is not the case for Chinese family companies as these companies do not seek to raise capital from share issues to non-family members. Thus, this discrepancy between the law that seeks to regulate the operation of all companies in Hong Kong and the actual conduct of those typical Chinese family companies poses a conundrum which has been neglected. This oversight on the Hong Kong Government’s part creates a ‘gap’ in the regulation of corporate governance as it ignores the fact that the governance of these companies stem from Chinese values and norms.\textsuperscript{49} Such embedded values and norms are the product of cultural influence.

\textsuperscript{45} See subsequent paragraphs and Chapter 2 for further details.
\textsuperscript{46} Gordon Jones, \textit{Corporate Governance and Compliance in Hong Kong} (LexisNexis, 2012) 21-3.
\textsuperscript{47} Gordon Redding, \textit{The Spirit of Chinese Capitalism} (Walter de Gruyter, 1990) 41-72; Li, above n 19, 8.
Whilst Hong Kong appears to be an international city with a modern outlook,\(^\text{50}\) the entrenchment of the Chinese values and norms amongst the local Chinese should not be underestimated. The territory has made rapid economic development since the 1960s and has seen the growth of the new-middle class who is professionals and highly educated. Irrespective that many of those professionals have received their university education in Western countries,\(^\text{51}\) many have still retained conservative views about family and related matters.\(^\text{52}\) Hong Kong is still a Chinese society. Accordingly Chinese values matter across all aspects of social and economic life. From a sociological perspective, King noted that, ‘[from a survey in 1994], it was found that 92.9 percent of the Hong Kong people agreed that in the present-day Hong Kong, traditional Chinese values (such as loyalty (zhong), filial piety (xiao), benevolence (ren) and righteousness (yi)) should still be respected.’\(^\text{53}\) Research by Bond and King also found that Chinese values amongst the residents of Hong Kong remain entrenched, especially on matters concerning the family.\(^\text{54}\)

It important to note that unlike in ancient China where Confucian classics were learnt from a tender age and moral excellence was a barometer of good character,\(^\text{55}\) the people of modern Hong Kong, are more pragmatic in their outlook about life and livelihoods\(^\text{56}\) and as such Confucian teachings do not feature prominently in the discourse of every life amongst the local Chinese. Rather, as noted in the above, Confucianism manifests itself in a more subtle manner, as an ideal and in traditions of family life in Hong Kong. This means relationships and behavioural norms

\(^{50}\) Gary McDonogh and Cindy Wong, *Global Hong Kong* (Routledge, 2005) xi, 8.


\(^{54}\) Michael Bond and Ambrose King, ‘Coping with the Threat of Westernization in Hong Kong’ (1985) *9 International Journal of Intercultural Relations* 351, 358-9. Note that this study was based on the survey results of 118 participants.

\(^{55}\) For more on Confucius’s teachings see Chapter 6.

\(^{56}\) Leung, above n 1, 49-52.
amongst family members are sub-consciously guided by Confucian doctrines.\(^57\) The same could also be said about the characterisation of Chinese family companies in Hong Kong.\(^58\) Given that such Chinese value driven behavioural tendencies define family relationships, it would be sensible for laws regulating Chinese family companies to take into account such cultural norms in Hong Kong.

This matter was raised more than a decade ago by Lawton in the following:

> Although the Western based legal business system in Hong Kong gave Chinese entrepreneurs a freedom of opportunity which was seized, it was adapted to their cultural context. Incorporation is used and limited liability welcomed, but the underlying nature of a Chinese family owned business has significant implications for a Western concept of corporate governance. Chinese family based organisations are described as being imbued with “patrimonialism”, which includes features such as paternalism, hierarchy, responsibility, mutual obligation, family atmosphere, personalism and protectionism … a distinct and particularly Chinese organisational characteristic. Viewed from a Western managerial perspective a defect arises because corporate power derives from ownership which is vested in a family rather than an individual. Nobody outside the owning group can generate truly legitimate authority for himself. Chinese family businesses are often unable to escape autocratic control because of a common inability to delegate and an inherent mistrust (especially of professionals) which makes it very difficult to graft into the organisation middle and senior management groups made up of competent professionals.\(^59\)

This issue is particularly acute for Hong Kong as Jordan finds that Confucianism as a value and belief shapes the way directors of Chinese family companies behave, which could help explain why directors in these companies had been reluctant to seek legal solutions to problems concerning governance and related issues.\(^60\) Furthermore, Lawton remarked that the failure of Hong Kong’s company law reformers in the late 1990s to examine the role of Chinese culture in the governance of Chinese family companies is, ‘a serious oversight’.\(^61\)

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\(^{57}\) Ibid, 79-89.


\(^{59}\) Lawton, above n 14, 29, 30.


\(^{61}\) Lawton, above n 14, 87.
Although, there are no current statistics on the number of family owned and controlled companies in Hong Kong, based on statistics in the late 1990s, Lau, Chan and Man estimated about 60 percent of small companies in Hong Kong are founded, controlled, and operated by families.\(^{62}\) Assuming that these percentages have stayed relatively similar over the years, and applying these to 2011 data from the Hong Kong Company Register, this regulatory oversight affects over 570,000 companies.\(^{63}\) Since the gap in regulation could affect an estimated half a million family companies in Hong Kong, the governance of these companies is of considerable importance to the territory’s economic future. Therefore, it should be given due attention and merits analysis on how these companies are governed.

1.1.4 ‘Gaps’ in the Literature

Thus far, much of the literature about regulating corporate governance and directors’ duties in Hong Kong focused on the ‘black letter’ law approach to ensure that there is accountability and that transparency is achieved, in particular, with regard to directors’ duties.\(^{64}\) At the heart of those duties are the transplanted British general legal obligations for directors. On matters about family companies in Hong Kong, several authors have made passing remarks about the awkwardness of how the laws envisage their governance.\(^{65}\) For example, Paul Kwan, a legal practitioner in Hong Kong, questioned the universality of directors’ duties in Hong Kong by stating that, ‘most of the companies in Hong Kong are private and family controlled, and the directors are appointed by the controllers who may themselves be members of the


\(^{63}\) Note that this figure exclude companies incorporate outside Hong Kong but have business operations in the territory.


\(^{65}\) Kwan, above n 64, 1031; John Brewer, The Law and Practice of Hong Kong Companies (Sweet & Maxwell, 2nd ed, 2010) 318-322.
board (if not shadow directors), and as such any breach of duty of care will be ‘tolerated’. Although, this remark was made in passing, it adds to the proposition that prevailing legal requirements for directors are ill suited for Chinese family companies and the law makes no clear distinctions between family or non-family ownership of companies.

Similarly John Brewer, another legal practitioner in Hong Kong, devoted a chapter of his company law book on family companies, to focus on legal issues emerging from divorce proceedings, the death of directors, and complications associated with succession. Even though he raises the point about the awkwardness of traditional Chinese values and succession matters in the context of modern legal principles, he does not go into details about the governance of these Chinese family companies in Hong Kong.

However, Goo and Carver did venture beyond legal texts, including an overview of corporate law, its history and developments. They explored the economic perspective of the law, the rising issue of the dominance of Chinese family-owned companies and the influence of Chinese values on governance practices in Hong Kong. Irrespective of the dominance of Chinese family owned companies, they have asserted that Hong Kong’s companies will eventually converge towards the Anglo-American model of governance and thus the Chinese family company model of governance will disappear over time. As such, the authors adopt the position that the Anglo-American model of corporate governance regulation is ideal for Hong Kong’s continued economic prosperity. However, they fail to provide any empirical data or primary sources to support their claims.

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66 Kwan, above n 64, 1031.
67 Even though the courts had on occasions decided that family companies are quasi-partnership, this does not depict how Chinese family companies are governed or operate. See Chapters 4.3.2 for more details.
68 Brewer, above n 65, 318-22.
69 Ibid.
70 Goo and Carver, above n 15, ix.
71 Ibid, 69.
72 Ibid, 69-72. See Chapter 7.1 on the re-examination of the merits about the convergence thesis.
Additionally, Gordon Jones, the former Hong Kong Company Registrar, wrote the latest book on Hong Kong’s corporate governance published in 2012. Whilst many of the topics were similar to Goo and Carver’s, he also examined professional organisations, small to medium sized enterprise (SME), and not-for-profit entities. Family companies were examined in the context of SMEs. Jones categorised SMEs into five types and incorporated discussions about family shareholders and directorships as a minor appendage to the governance of SMEs. There was however an explicit mention of family members on boards of SMEs in the following statement: ‘Making other family members part-owners of the business or bringing them onto the board (if such a body exists) in order to secure their loyalty and make them feel that they have been fairly treated.’ It seems for Jones fairness is an important element in the governance of family SMEs, but no explanation was offered. Clearly absent from this book is the way Chinese family companies are governed and the issue of Chinese cultural influences in the way these companies are governed.

As noted earlier, Lawton explored the issue of the domination of Chinese family companies in Hong Kong questioning whether prevailing legal duties for directors are appropriate. Even though he failed to come up with any recommendations for reforms, he did mention the Confucian influence on the directors of these Chinese family companies, a point that Lau and Young, and later together with Nowland examined further. Young drew from Licht to point out that the literature on corporate governance neglected the cultural perspective in the following statements:

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73 Jones, above n 47, 139-78, 675-764.
75 Ibid.
76 Ibid, 728.
77 Ibid.
78 Lawton, above n 14, 23.
Culture is part and parcel of corporate governance and thus needs to be addressed and incorporated into future governance regimes. The first step in this direction is to identify distinctive cultural attributes relevant to governance in certain countries and regions. Eventually a pluralistic governance framework should accommodate cultural specific norms to deliver a more effective framework without compromising on the objectives of good governance.  

In a recent article Ho, Lau and Young, continued this line of enquiry in the Chinese context. Whilst the data was not on Hong Kong’s corporate governance, the survey results from Hong Kong respondents showed Chinese values, especially family related views, have continued to be heavily influenced by Confucian doctrines. However, these articles only touched on this aspect. Therefore, the survey of the key literature about Hong Kong’s corporate governance shows that the gap in regulation lies with the Chinese family companies, for which no solutions or alternatives have been proposed.

1.2 Thesis Research Questions, Methodology and Limitations

The gap in regulation is the basis of this research. Drawing from the above, this section will discuss the research questions and methodological approach in seeking solutions to the regulatory problem. Furthermore, this section will justify the scope and limitations of this piece of research.

1.2.1 The Regulatory Problems and Research Questions


Also, refer to Chapter 5.3.1 for more details on the differences between the Anglo-American and Chinese family models of governance.
As noted above, the laws governing company directors are unmistakably British. While this may suit non-family and publicly listed companies with diverse shareholders that are targeting foreign investors, this thesis argues that these rules may not be suitable for Chinese family companies who are governed by Chinese values and norms rooted in Confucianism. However, until now this matter has not been addressed or resolved by the government. This regulatory problem can be traced to the source - the transplantation of a set of alien laws from Britain into Hong Kong during the era of Hong Kong’s colonial administration.\(^84\) Even though the borrowing of ideas between different jurisdictions and transplanting of laws has been increasingly common around the world under the auspices of globalisation,\(^85\) Teubner argues that those who believe that laws are readily transferable from one jurisdiction to another in a mechanistic sense neglect the social and institutional aspects of “law in action”.\(^86\) The law is more than a set of rules; it is an expression or aspect of culture in the sense of shared traditions, values or beliefs. Consequently, the recipients will be more acceptable and comply with the stipulated obligations if the transplantation of laws in both jurisdictions shares similar cultures.\(^87\) However, this is not the case for Hong Kong.

Therefore, the gap in regulation is created by the incongruities between the values underlying directors’ duties of companies and the Chinese value system that influence the behaviour of directors of Chinese family companies in Hong Kong. The discrepancy between the provisions of the law and the actual conduct of those typical Chinese family proprietary companies means that not only the law as it stands is ineffective, but it reads like an alien set of rules.

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\(^84\) The transplantation of laws refers to moving of a set of laws or legal system from one country to another. See Alan Watson, *Legal Transplants: An Approach to Comparative Law* (Scottish Academic Press, 1974) 21.

\(^85\) Peter de Cruz, *Comparative Law in a Changing World* (Routledge Canvendish, 3rd ed, 2007) 22. Watson came up the term ‘legal transplantation’ in his research on the history of the adoption of Roman laws in European countries. He argues that legal transplantation is common throughout European and has been relatively successful. However, he qualify his statements by noting when people move into different territory where there is a comparable civilisation or accepts a large part of the system of another people or peoples, transplantation of laws will be successful. See Alan Watson, *Legal Transplants: An Approach to Comparative Law* (Scottish Academic Press, 1974) 29-30.


Conceptually, a possible way to deal with the incompatibilities and differences,\(^\text{88}\) between legal systems, norms and values is to establish a pluralistic regulatory framework. Legal pluralism suggests that an awareness of the socio-cultural plurality in societies is sparked by transplantation of laws creating more than one form of normative ordering, which is common in many post-colonial societies.\(^\text{89}\) Generally, legal pluralism refers to the, ‘incorporation or recognition customary law norms or institution within state law, or to the independent coexistence of indigenous norms and institutions alongside state law (whether or not officially recognized)’.\(^\text{90}\) The recognition of customary laws in Hong Kong under the colonial government can be traced to the proclamation by Captain Charles Elliot on the 2\(^{nd}\) February in 1841.\(^\text{91}\)

It sets out a pluralistic regulatory platform to be adapted for other areas of regulations, especially when there is more than one form of normative order, legal or otherwise in existence within one jurisdiction.\(^\text{92}\)

The research question of this thesis is as follow:

Is a pluralistic framework more apt to deal with the incongruity between the law and practice in the regulation of the directors of Chinese family companies in Hong Kong?

A plain reading of the question raises a number of macro and micro issues and highlights contextual considerations. They incorporate a number of topics like legal, historical, cultural, sociological, economical, managerial, and public policy, all of which points to an answer that is based on certain premises stipulated in the three hypotheses below:

Hypothesis 1: Hong Kong’s corporate governance reforms do not reflect the needs and attributes of Chinese family companies.

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\(^{88}\) As briefly mentioned in Chapter 1.0

\(^{89}\) Reza Banakar and Max Travers, ‘Pluralism and Globalisation’, in Reza Banakar and Max Travers (eds), *An Introduction to Law and Social Theory* 285.

\(^{90}\) Brian Tamanaha, ‘Understanding Legal Pluralism: Past to Present, Local to Global’ (Legal Studies Research Paper No 07-0080, St John’s University, May 2008) 26.

\(^{91}\) Peter Wesley-Smith, *The Sources of Hong Kong Law* (Oxford University Press, 1994) 207.

\(^{92}\) For more about customary laws in Hong Kong see Chapter 7.2.1.
Hypothesis 2: The values and norms espoused in Hong Kong’s prevailing directors’ duties, transplanted from Britain, are ill suited to regulate directors of Chinese family companies because the way these companies are governed is based on a vastly different paradigm and value system.

Hypothesis 3: The differences between the transplanted laws and the indigenous Chinese value system and norms are irreconcilable. Thus, institutionalising Chinese governance practises under the umbrella of a pluralistic regulatory framework is expected to be a more receptive regime for Chinese family companies in Hong Kong.

Whilst each of the above hypotheses contains a number of assumptions about Hong Kong’s corporate governance laws and practices, they are like pieces of a jigsaw puzzle - putting them together lays the foundation for the development of an alternative regulatory framework for the governance of Chinese family companies in Hong Kong. As such, the next concern is how to piece them together in a coherent way whilst building towards a regulatory solution.

1.2.2 Methodology

Morris and Murphy noted that the methodology adopted in legal research is important to the structure and underpinnings of the arguments as well the perspective employed.\textsuperscript{93} Though there are no perfect methods, the choice must fulfil the needs of the research and should aid in the development of solutions to the problems posed.\textsuperscript{94} From the questions derived from the regulatory problems stipulated in the above, plainly, this thesis ventures beyond legal doctrinal concerns, entailing elements of extra-legal and non-legal subject matters.\textsuperscript{95} This does not mean legal analysis will be absent; an examination of prevailing laws will help develop a better understanding of why gaps in regulation exist. This is achieved by comparing what prescriptions the law expects, and compels, versus the non-legal, value centred, socio-cultural norms which drive practices.

\textsuperscript{93} Caroline Morris and Cian Murphy, \textit{Getting a PhD in Law} (Hart Publishing, 2011) 29.
\textsuperscript{94} Ibid, 29-30.
\textsuperscript{95} For more on research in law and the various methods, see Terry Hutchinson, \textit{Researching and Writing in Law} (Thomson, 3\textsuperscript{rd} ed., 2010).
Furthermore, this study encroaches on a range of issues including government policy and related matters, business studies, history, and a mélange of inter-related matters affecting how corporate laws are formulated and governance practices forged in the broader social context. Another important consideration is corporate law research methods. Corporate law research has evolved over time, creating a climate where laws, socio-economic transformation, and managerial innovation intermingle and traverse.96

Another facet of this research is the cultural dimension, since Hong Kong’s laws are notably British, whereas the cultural orientations of the populous are predominantly Chinese. Logically, examining cultural differences is part of this dissertation, for the reason that cultural differences will affect regulatees’ attitudes relating to the prescriptions and proscriptions in the stipulated standards, the legitimacy of those benchmarks, and their willingness to comply with the stated obligations.97 In sum, there are a number of key concerns that emerge from this research.

1.2.2.1 Extra-legal and Non-legal Issues

Thus far, this chapter has touched on a mixture of the subject matter this thesis aims to deal with. They include:

- laws (in terms of existing duties of directors);
- public policy (with regards to the discourses and predispositions in legal reforms);
- Asian business studies (in particular, Chinese business practices and culture);
- philosophy and ideologies (pertaining to Chinese and Western value systems);
- sociology (in connection with how rules, norms, and values shape behaviour),
- jurisprudence (pertaining to Chinese legal traditions), and;

97 For more detailed discussions see Chapters 4.1, 7.2 and 7.3.
regulation theories (concerning the development of an alternative solution to the research problem).

Hence, the issues raised in this thesis highlight the multi and interdisciplinary nature of the research. A socio-legal approach might be useful as a methodological tool to contend with such an array of issues, since it is capable of incorporating legal, extra-legal and non-legal issues to explore possible regulatory solutions.98

Socio-legal research deals with problems that might be polycentric or pluralistic orders emerging from the interactions between laws, norms and values in a dynamic social context.99 Some commentators have described socio-legal studies as a sub discipline.100 As a methodology, it is evolving, fluid, and broad.101 Even though it is common for sociological studies of the law to use quantitative or qualitative methods,102 a socio-legal approaches does not necessarily involve empirical studies; it examines legal change and reform from a melange of social and related factors,103 and the techniques and methods used range from empirical, historical, textual, to theoretical.104 Hence, Banakar and Travers called the use of this methodological approach as ‘an interface with a context within which law exists’,105 to produce new knowledge and solutions through theorising normative regulatory standards.106

100 Philip Thomas, ‘Socio-Legal Studies: The Case of Disappearing Fleas and Bustards’ in Philip Thomas (ed), Socio-Legal Studies (Dartmouth, 1997) 1, 4.
101 Alan Bradshaw, ‘Sense and Sensibility: Debates and Developments in Socio-Legal Research Methods’ in Philip Thomas (ed), Socio-Legal Studies (Dartmouth, 1997) 99, 100-111.
McConville and Chui stated that this approach draws from other disciplines to broaden the theoretical and conceptual framework. Vick concurred that most interdisciplinary legal research tends to be theoretical so as to integrate legal with non-legal issues. Postmodernist socio-legal studies place more focus on norms or other forms of social control functioning as modes of reproduction of social order. This is particularly valuable for the study of non-Western legal culture because they possess a multi-faceted view of either legal or non-legal types of rules like norms through the combination of values, religion, traditions, history, politics and customs. Pendleton attempted to consolidate socio-legal research methods by stating that it is important to develop legal imagination, a way to reconcile, reject or modify the law or rules. Findlay and Henham demonstrated that by integrating, linking and tying in the issues inductively, one can come up with nuances of old models or new paradigms for regulatory and related matters. In short, this method employs laws, norms and values, practices and other related aspects of knowledge, broadly labelled as socio-legal, to develop regulatory frameworks where law is not the centrepiece, but another consideration with which to conceptualise a normative order.

1.2.2.2 Corporate Governance Regulation Research Methods

The next key element of this research is corporate governance. It would be a mistake to think that this subject matter is solely in the legal domain. Siems classified research on corporate governance as a ‘non-legal approach’, because the law is only one of several elements that determine how a company is governed.\(^\text{113}\) Recently, there has been a proliferation of publications by economists, organisational theorists, sociologists, criminologists, and political scientists, laying claim to its meaning, interpretation and applications.\(^\text{114}\) Legal academics have also ventured to include extra-legal and even non-legal topics in their discussions about the regulation of corporate governance.\(^\text{115}\) For example, Du Plessis, McConvill and Bagaric, and Farrar explored the use and adoption of best practices as self or hybrid regulatory standards developed by Australian and international business or economic organisations.\(^\text{116}\) Parker goes further by examining the benefits of self-regulation in regulating corporate governance, and discusses management based self-regulatory programmes to achieve compliance.\(^\text{117}\) Therefore, research on this subject matter has evolved into a multi-faceted discourse.

In 1996, the *Canberra Law Review* published a special issue on corporate law research methods and theory. The publication contained articles using a variety of methodologies ranging from social science techniques, law and economics theory, legal history, comparative methods, gender based analyses, to critical studies perspectives on corporate law.\(^\text{118}\) The editors, Tomasic and Andrews added that, ‘it is clear that there are many other appropriate methods and theories available to corporate law researchers.’\(^\text{119}\) Farrar also supported the idea of using other non-legal methodology to research on this subject matter by stating that:

\(^\text{114}\) Young, above n 81, 162.
\(^\text{119}\) Ibid.
In the case of corporate governance research, we are necessarily going beyond law and looking at varieties of self-regulation and practice. In the area of comparative corporate governance, we are looking at comparative cultures and there are lessons to be learned from anthropology and political science. This is particularly true when we attempt to get to grips with post modernism and globalisation.\textsuperscript{120}

Furthermore, Tomasic in particular has used socio-legal theory to examine Australia’s experiences in reforming corporate law.\textsuperscript{121} His thesis is based on the interplay between the law and sociologic perspective on modernity to trace the debates in the modernisation of corporate law.\textsuperscript{122} He added that:

It is clear that corporate law modernisation is likely to continue in one way or another and this will take place in the context of broader changes in the role of the State and the emergence of more self regulatory and corporatist modes of legal regulation. However, this does not mean that there will be total legal convergence or even harmonisation…\textsuperscript{123}

This suggests that further development along the lines of a pluralistic self-regulatory regime will become more prevalent across the world. Young came to a similar conclusion by approaching this from a legal cultural perspective.\textsuperscript{124} Therefore, it would appear that there are similarities in socio-legal and corporate governance regulation approaches to research. Adding socio-legal perspectives to corporate governance research broadens the scope of the regulatory approach to explore values and non-institutionalised community of practices as a basis of regulations.

\textbf{1.2.2.3 Cultural Factors}

The study of culture is inexorably part of this thesis because it forms one of the core problems of regulating corporate governance of Chinese family companies in Hong Kong. Even though, culture is complex social phenomena, Pike pioneered a way of studying culture known as ‘emic’ and ‘etic’.\textsuperscript{125} This method has also been used to

\textsuperscript{122} Ibid, 4-20.
\textsuperscript{123} Ibid, 94.
\textsuperscript{124} Young, above n 81, 162.
analyse cross-cultural data in business research because it is able to incorporate more than one perspective in examining cultural issues.\textsuperscript{126}

The ‘etic’ approach orientates the research from a cross-cultural psychological perspective, and ‘emic’ attempts to orientate the research to view the phenomena through the eyes of the subjects.\textsuperscript{127} The assumptions of each approach differ: ‘emic’ believes that culture should be understood through a particular context – from an insiders’ view,\textsuperscript{128} whereas the ‘etic’ approach attempts to construct a system that is equally valid for all cultures so as to measure cross cultural data without posing compatibility problems.\textsuperscript{129} The difficulty with the ‘etic’ approach is the postulation that culture is an independent variable, but it is in fact made up of interdependent factors bundled together with other variables.\textsuperscript{130} The ‘emic’ approach is also problematic in a different way as critics point out it is systematically bias and vulnerable to arbitrary judgment.\textsuperscript{131}

To overcome the weakness of each approach and develop a more holistic view of culture, Berry proposes a combination of ‘emic’ and ‘etic’ approaches because of their symbiotic relationship.\textsuperscript{132} This thesis will follow Berry. It will adopt both approaches in dealing with cultural issues because it is integral to explaining and dealing with Chinese cultural values from ‘outsiders’ (non-Chinese) trying to understand and ‘insiders’ (Chinese) attempting to elucidate their way of thinking and ordering of things.

By combining socio-legal, cross-cultural and corporate governance research methods, this tripartite methodology enables each to help piece together a solution to the research questions of this thesis. In sum, the methodology adopted in this thesis is unusual when compared to the legal doctrinal research; however, the subject matter

\textsuperscript{126} Pervez Ghauri and Kjell Gronhaug, \textit{Research Methods in Business Studies} (FT Prentice Hall, 4\textsuperscript{th} ed, 2010) 220-1.
\textsuperscript{127} Hede Helfrich, ‘Beyond the Dilemma of Cross-Cultural Psychology: Resolving the Tension between Etic and Emic Approaches’ (1999) \textit{5 Culture and Psychology} 131, 132.
\textsuperscript{128} Ghauri and Gronhaug, above n 126, 220.
\textsuperscript{129} Ibid, 220; Helfrich, above n 127, 132.
\textsuperscript{130} Helfrich, above n 127, 134.
\textsuperscript{131} Ibid, 136.
\textsuperscript{132} JW Berry, ‘Emics and Etics: A Symbiotic Conception’ (1999) \textit{5 Culture Psychology} 165.
and the context in which the research problems are located and the questions posed provide ample basis for the use of such approaches.

1.2.3 Limitations

The object of this thesis is to conceptualise a normative framework, by drawing on Confucianism to put forward an alternative regulatory regime for the directors of Chinese family companies. As indicated in Chapter 1.0, this does not mean directors’ duties should be abolished. There is a place for British based laws in Hong Kong for non-family and public listed companies who seek capital from the public or foreign investors. Furthermore, this research does not contest the notion that these laws will help the territory maintain its status as an international financial centre.

Reiterating a caveat noted in Chapter 1.0, the arguments of this thesis are aimed at the privately held Chinese family owned and operated companies in Hong Kong with no outside members of the family having any shareholdings or being appointed as directors. Another point to note is that it is difficult to categorise these types of companies into either small to medium size or large because such ownership structures are atypical in Hong Kong,\textsuperscript{133} and there are no known published statistics on this.\textsuperscript{134} Even though there might be Chinese family partnerships in Hong Kong that fall under Partnership Ordinance (Hong Kong) cap 38, these types of entities are beyond the scope of this thesis. In addition, issues like doctrine of separate entity or other aspects of Hong Kong’s company law are also outside the reach of this work. Lastly, albeit the recent Global Financial Crisis (GFC) in 2008-9 and current Euro-Crisis (EC) negatively impacted on Hong Kong’s economy, according to the Hong Kong Monetary Authority (HK’s central bank):

\begin{quote}
[H]ong Kong’s financial system remained robust, and the impact on the labour market was much less severe than that experienced during the Asian financial crisis because financial institutions and the private sector in the region entered the recent crisis with strong balance sheets. In contrast, on the eve of the Asian financial crisis, the property market in Hong Kong was experiencing a bubble, and there were excessive borrowings by the private sector. When
\end{quote}

\textsuperscript{133} For indications about the extensiveness of Chinese family companies in Hong Kong, one can infer from the research about family dominated publicly listed companies in Stijn Claessens, Simeon Djankov, and Larry Lang, ‘The Separation of Ownership and Control in East Asian Corporations’, (2000) 58 Journal of Financial Economics 81.

\textsuperscript{134} Refer to estimates drawn from secondary data in Chapter 4.1.
the Hong Kong economy was hit by the external shock, corporate and personal bankruptcies rose sharply and non-performing loans increased significantly.\(^{135}\)

Therefore, the impact of these recent economic events did not have a flow on effect on corporate governance reforms in Hong Kong. Moreover, the regulatory and governance problems of these two crises have little to do with, or impact on the governance of Chinese family companies in Hong Kong.

Another important facet of this work is exploring the adoption of the Chinese values as the basis of an alternative regulatory framework for Chinese family companies. However, it is beyond the scope of this thesis to offer a comprehensive alternative set of rules, or prescriptive codes, for these companies like those found in fiduciary duties, in part because Confucian philosophy is a morally centred set of values and not codes made up of rules.\(^ {136}\)

### 1.3 Structure of the Thesis

This thesis will rely on both primary and secondary sources to build the case for regulatory reforms. Whilst the factual and descriptive arguments drawn from those various sources will lead to normative judgements, they shall be validated from the findings of empirical studies and content analysis drawn from a number of disciplines to develop an alternative regulatory framework that is receptive for the directors of Chinese family companies in Hong Kong. Given the many complexities in deciphering some of the concepts, the development of such a regulatory solution shall advance in stages.

This thesis consists of eight chapters including an introduction and a conclusion and is divided into three parts. Part one is comprised of two chapters, with a focus on the Hong Kong Government’s reforms and the prevailing directors’ duties. Chapter 2 will retrace and examine the debates about corporate governance and directors’

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136 For more criticisms about Confucianism from Western thinkers see Chapter 6.1.
duties reforms in Hong Kong by delving into the rationale of those reforms and examining the dynamics of policymaking. Apart from developing an insight into policy objectives, choices of governance benchmarks and views of the key members of the policy community in Hong Kong, this chapter will ascertain what is missing from the reform debate. Chapter 3 will examine the prevailing directors’ duties in Hong Kong and analyse the values espoused in those transplanted legal duties. The aim is to develop a deeper understanding of the laws, and, in the process offer a glimpse as to why these obligations are not apt for Chinese family companies in Hong Kong.

Part two consists of three chapters which examine why the duties are not suited for the privately held Chinese family owned and operated companies in Hong Kong. To explicate the intricate reasons for this, Chapter 4 will survey several common law jurisdictions with a separate set of laws for family companies and put forward arguments why these laws are ill-suited for Chinese family companies in Hong Kong. This is followed by Chapter 5 which shifts the discussion to Hong Kong’s brand of ‘entrepreneurial familism’ to illustrate its distinctive Chinese value traits, as well as offering a brief comparison of the governance of Chinese family companies with those in the Anglo-American model. Next, Chapter 6 delves into Confucian doctrines which form the roots of governance values held by Chinese family companies in Hong Kong. It is important to appreciate Confucius’s teachings so as to truly grasp the workings, meanings, and substance of this Chinese philosophy as a basis for understanding the key attributes of the governance of Chinese family companies in Hong Kong, and also to explore their contribution to the development of a culturally appropriate regulation for these types of companies which will be delineated in the following part of the thesis.

Part three consists of one chapter, Chapter 7. It explores the concept of a pluralistic corporate governance as an alternative to the convergence versus path dependency debate and then reflects on Hong Kong’s brand of legal pluralism. By building upon the discussions in part two, it will then conceptualise a social normative ordering system, based on Confucian values, to regulate directors of Chinese family
companies. The conclusion, Chapter 8, will summarise the core arguments in each chapter so as to provide more detailed recommendations for reform, as well as offering a reply to the thesis research question. It will conclude with suggestions for future research.

1.4 Summary and Commentaries

This introductory chapter has outlined the key issues of this thesis. It has proffered justification for this research, posed the thesis questions and explained and justified the methods. An outline of the structure of this thesis has also been incorporated.

In essence, this thesis is about developing a culturally appropriate regulatory framework for the directors of Chinese family companies in Hong Kong, whilst upholding the transplanted British laws for non-family and publicly listed companies. The territory is a modern cosmopolitan society where traditional Chinese values co-exist alongside a modern way of life. The territory’s market structure also reflects these bi-cultural influences. However, this means that many laws transplanted from the former colonial masters do not address the needs or practices of certain aspects of social life and commercial practices. In particular, there are incongruities between the prevailing directors’ duties and the Chinese value system that influences the behaviour of directors of Chinese family companies in Hong Kong. Whilst the Western-based law obliges all company directors to be accountable for their decisions and actions, the Chinese value system suggests an entirely different approach towards corporate governance, in which Confucian enthused practices are observed. This gives rise to a lack of compliance by directors from these companies with the formal legal rules. Instead, they comply with a normative order emanating from Chinese values and norms. This thesis intends to address this regulatory oversight, but the differences between legal duties and Chinese values system mean it is not simply a matter of amending the law to incorporate the Chinese values because weaving two different value systems into one set of regulatory standards is unachievable.
Furthermore, if directors’ duties have been resisted by the Chinese family companies in Hong Kong, critics might label them as rogues or crony capitalists. However, this would be a crude and presumptuous observation because these comments measure Chinese values and norms from Western standards and benchmarks. As noted earlier from a Chinese philosophical perspective, notions of morally right and ideal behaviour are not directly comparable to those in the West. This could account for why research in Confucian value based Chinese regulatory regime is barely heard of. Besides, the Chinese regulatory system is often misunderstood as corruptive or prone to nepotism because of its relation-based rather than rule-based criteria. This is a fundamental contention of this thesis. Therefore, references to Western governance ideals like fairness, justice, and equality are not helpful to the understanding of Confucian notions of governance and regulation because the value judgements and way of thinking are vastly and distinctively different from the West. What is more important for this thesis is to understand Confucianism rather than to critique it, because the aim of this study is to develop a culturally apt regulatory framework from a Chinese perspective and not about measuring Western governance standards against the Chinese.

Some might argue that as the gap in corporate governance regulation had not created upheavals in the Hong Kong business community, massive dislocation, or corporate collapses, then why is this thesis recommending the creation of a separate regulatory system for Chinese family companies? The reason is the lack of regulation for Chinese family companies in Hong Kong had not been trouble free as a growing number of case laws have shown that this regulatory gap has adversely affected the workings of those companies when tensions within families emerge, and in the worst case scenario fen jia (division of assets leading to liquidation) is realised. Given that Hong Kong has an estimated population of over half a million family companies, this bottleneck in regulation could trigger more corporate woes if left unaddressed.

137 For more discussions on this see Chapter 6.3.
138 For more discussions on this see Chapters 4.3.2 and 5.3.
139 For more details about this estimate see Chapter 4.1.
Lastly, as noted, this thesis does not advocate the forsaking of prevailing laws transplanted from Britain because these legal obligations may well be suited for non-family and publicly listed companies in Hong Kong. Therefore, this research looks towards existing forms of legal pluralism in Hong Kong’s legal system as a blueprint to explore ways to create an alternative regulatory regime for the governance of Chinese family companies, while leaving the current laws intact for the other types of companies.
Part One: Corporate Governance and Directors’ Duties in Hong Kong: The Reforms, Rationale, and Values

As mentioned part one consists of two chapters. Chapter 2 shall retrace the policy debates concerning corporate governance and directors’ duties reforms in Hong Kong, the views of elite members of the policy community, and the choice of regulatory benchmarks and standards. The aim is to develop insights into the Hong Kong Government’s rationale and key influences in corporate governance and directors’ duties reform. This is followed by Chapter 3. The goal of this chapter is to explain what the legal rules are, and the underlying values embedded in those legal rules. The aim of part one is to develop a greater understanding of the policy rationale and to extricate the values espoused in the laws. From this process these two chapters are also expected to reveal what is missing from the reforms and the unchallenged assumptions of directors’ duties versus the governance practices in Hong Kong’s companies.
Chapter 2 : Reforming Corporate Governance and Directors’ Duties in Hong Kong

2.0 Introduction

Looking into the territory’s history, one of the commercial goals of the colonial administrators during the colonial rule of Hong Kong was to establish uniformity in company laws amongst the commercial centres in the British Empire,\(^1\) as well as to safeguard British interests in the colony.\(^2\) Hence, this colonial mentality meant that the issues of suitability of British laws for the local Chinese population were not considered.\(^3\) In spite of the handover of the territory back to Chinese rule in 1997, the preoccupation of Hong Kong with adopting British laws as a benchmark seemed entrenched in the territory’s Basic Law:

> The laws previously in force in Hong Kong, that is, the common law, rules of equity, ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene this Law, and subject to any amendment by the legislature of the Hong Kong Special Administrative Region.\(^4\)

In order to examine the rationale behind the government’s preference for adopting British laws, this chapter will first consider the broader economic factors, the vested interests of elite members of the business and professional community, as well as the debates in reforming directors’ duties in Hong Kong. Furthermore, through these discussions, this chapter will reveal what is missing in the reform and regulatory debates.

2.1 Broader Considerations in Corporate Governance Reforms

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\(^3\) Tsang, above n 2, 47-55.

\(^4\) *Basic Law of the Hong Kong Special Administrative Region People’s Republic of China*, art 8.
Policy making can be a complex and intricate matter because policy decisions may affect many people and sections of a community. Furthermore, there are broad arrays of factors to consider when policy and laws are made. Identifying and understanding these issues would help explain why Hong Kong’s Government continues to adopt Western benchmarks for corporate governance and British directors’ duties as model laws for this territory.

2.1.1 The Territory’s Economic Transformation

Over a century ago, Hong Kong was hailed as ‘a barren rock’.\(^5\) Fast forward to the present, the territory is one of the world’s freest economies and has emerged as an iconic twenty-first century global city.\(^6\) This transformation began around 50 years ago. In the 1950s, when entrepot trade declined primarily due to political factors in China,\(^7\) a reorientation of Hong Kong’s industries was triggered. Out of necessity it was transformed into light industry exporting textiles, clothing and plastics.\(^8\) By the 1960s, the expansion of light industry production in Hong Kong generated rapid economic growth.\(^9\) The continued economic growth pushed property prices to new heights in the 1970s.\(^10\) As the growth of the manufacturing sector began to plateau, the focus began to shift towards capitalising on the organic development of banking, shipping and insurance.\(^11\) Consequently, the number of financial institutions multiplied and several new stock exchanges sprang up in the late 1970s,\(^12\) and so the

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6 Gary McDonogh and Cindy Wong, Global Hong Kong (Routledge, 2005) xi.
7 Tsang, above n 2, 162.
9 Tsang, above n 2, 170.
10 Ibid, 175.
11 Ibid.
12 Also note with the passing of Deposit-taking Companies Ordinance in 1976, the number of deposit-taking companies mushroomed (they were registered entities with the government to take time deposits of not less than HKDS$50,000). At the same time, many foreign banks began to establish branches in Hong Kong. See YC Jao, ‘The Development of Hong Kong’s Financial Sector, 1967-92’ in Benjamin Leung and Teresa Wong (eds), Twenty-five Years of Social and Economic Development in Hong Kong (Hong Kong University Press, 1994) 560, 572-3; Tsang, above n 2, 175.
colony reinvented itself into a regional financial centre. By this time, many international banks had established their Asian base of operations in Hong Kong.\textsuperscript{13}

By the 1980s, the opening up of China’s economy fuelled more investments across the border causing the financial sector in Hong Kong to grow exponentially.\textsuperscript{14} In conjunction with this, the influx of foreign investments to China via Hong Kong further boosted the demand for financial services that facilitated the territory to become the region’s international financial centre.\textsuperscript{15} Economic data revealed that in spite of the recent economic woes from the Global Financial Crisis, Hong Kong’s financial sector had continued to grow. The sector’s share in the territory’s Gross Domestic Product (GDP) increased from 12.7\% in 2005 to 15.4\% in 2010.\textsuperscript{16} According to the Hong Kong Government’s information services, ‘Hong Kong’s stock market was the seventh largest in the world and the third largest in Asia in terms of market capitalisation as at the end of August 2011’.\textsuperscript{17} In terms of the initial public offering (IPO) market, Hong Kong topped the world’s IPO league for the third consecutive year, with 89 IPO raising US$33.3 billion from the stock market.\textsuperscript{18}

Foreign investors from Western countries are substantial shareholders in Hong Kong’s Equity market. Data from the Hong Kong Exchanges and Clearing Limited (HKEx) between 2004 and 2009 revealed that Australia, Europe, The United Kingdom and The United States made up about 40 per cent of the overseas investors

\textsuperscript{13} Tsang, above n 2, 175.
\textsuperscript{14} Kui-Wai Li, \textit{The Hong Kong Economy: Recovery and Restructuring} (McGraw Hill, 2006) 57-60.
\textsuperscript{18} Hong Kong Trade Development Council, ‘Securities Industry in Hong Kong’ (12 March 2012) <http://www.hktdc.com/info/vp/a/bkfin/en/1/4/1/1X003VE1/Banking---Finance/Securities-Industry-in-Hong-Kong.htm#>. 
in the territory’s equity market.\(^{19}\) The most recent data in 2010 revealed a further growth at 42 per cent of the total shares traded. This growth was achieved in spite of the global economic crisis.\(^{20}\) Therefore, it is easy to understand why having laws that protect investors’ rights comparable to those of international standards are essential for Hong Kong’s equity markets.\(^{21}\) Those members of the policy community in Hong Kong who favoured adopting international regulatory benchmarks were elite business persons and executives from the following industries: banks, financial intermediaries, telecommunications and the service industry.\(^{22}\) These industries are the ones which benefit most from the international capital inflow.

In a rejoinder to discussions in Chapter 1.1.1, in 2011 for the first time the World Economic Forum’s Financial Development Report ranked Hong Kong first in their annual Financial Development Index.\(^{23}\) The 2011 report stated that, ‘One of the most notable changes is that Hong Kong SAR takes the top spot from the United States, which comes in at 2\(^{nd}\) this year, …’\(^{24}\) The index measures financial development in seven areas.\(^{25}\) Corporate governance as well as legal and regulatory issues is key factors in one of the seven areas under the category of institutional environment.\(^{26}\) More importantly, in the ranking by international organisations, like the World Economic Forum, Western benchmarks have been used in rating Hong Kong as the


\(^{21}\) Julian Roche, *Corporate Governance in Asia* (Routledge, 2005) 49-50.

\(^{22}\) Li, above n 14, 217-20, 322-5, 352-4.


\(^{24}\) Ibid, 11.

\(^{25}\) The seven areas of annual Financial Development Index are: institutional environment, business environment, financial stability, banking financial services, non-banking financial services, financial markets, and financial access.

\(^{26}\) World Economic Forum, above n 23, xiii.
world’s leading financial system and capital market.\textsuperscript{27} The combined comments made by the Chief Executive, the Secretary of Financial Services, the Treasury and others in Chapter 1.1.1 reinforce the significance of corporate governance regulations in Hong Kong’s economic priority. As foreign investors account for 40 per cent of the investors in Hong Kong’s equity market, there are incentives for the government to adopt Western corporate governance regulatory benchmarks like those in Britain. This view is also held by key members of the policy community in corporate governance reform.

\textbf{2.1.2 Regulatory Capture in Hong Kong}

Regulatory capture refers to the close relationship between, on the one hand, public authorities and regulators, and on the other hand sectorial interests and regulatees.\textsuperscript{28} This could mean, at the extreme, it breeds corruption, or that public authorities perpetuate the interests of the few.\textsuperscript{29} At the other end of the spectrum, if regulatory capture is present, the views of those who are close to the government would be amenable to adopting the government’s policy and laws.\textsuperscript{30} The same could be said about Hong Kong’s corporate governance reforms.

In general, elite businesspersons and professionals in Hong Kong have always had close relationships with the Hong Kong Government and key officials. This ‘club like’ liaison, dating back to the colonial administration, is fostered because of stakes in policy outcomes.\textsuperscript{31} Thus, these stakeholders carefully choose their battlegrounds to protect their vested interests in the government’s advisory committees.\textsuperscript{32} A former

\textsuperscript{27} Ibid, 393-402.
\textsuperscript{29} Ian Ayres and John Braithwaite, \textit{Responsive Regulation: Transcending the Deregulation Debate} (Oxford University Press, 1992) 55-6.
\textsuperscript{31} Leo Goodstadt, \textit{Uneasy Partners: The Conflict Between Public Interest and Private Profit in Hong Kong} (Hong Kong University Press, 2009) 19-26, 35.
\textsuperscript{32} Ibid, 126.
chief policy advisor to the Hong Kong Government from 1989 to 1997, Leo Goodstadt found:

[...]these official committees developed into pressure groups lobbying for business interest interests within the bureaucracy … As a result, in certain strategic areas of policy making, Hong Kong’s business and professional classes were able to exploit their involvement in the colonial business structure to shape economic policies and manipulate the distribution of profits between different sectors of the community. These instances were limited in number, but important in their consequences … In some areas, the colonial administration had no choice but to rely on the commercial and technical competence of the business and professional classes. Where this happened, the elite had a commanding influence over major policies.\textsuperscript{33}

Moreover, the laws enacted during the early years of colonisation were primarily as an instrument to keep the peace and create public order in Hong Kong.\textsuperscript{34} There were relatively few economic policies except for taxes and the trading concessions granted to the British ‘hongs’,\textsuperscript{35} in effect bestowing business monopolies into the hands of a selected few.\textsuperscript{36} This corporatist style of economic policymaking ensures the continuation of minimalist economic intervention by the government,\textsuperscript{37} also known as ‘positive non-intervention’ policy,\textsuperscript{38} and the key benefactors of this policy stance are elite businesspersons and professionals.\textsuperscript{39} Albeit the consultation of key policy

\textsuperscript{33} Ibid.
\textsuperscript{34} Carroll, above n 2, 49-53.
\textsuperscript{35} Note that the ‘hongs’ were major business houses in Hong Kong with significant influence on patterns of consumerism, trade, manufacturing and other key areas of the economy. See Wikipedia, ‘The Hongs’ < http://en.wikipedia.org/wiki/The_Hongs#1990s>.
\textsuperscript{36} Tsang, above n 2, 58-62, 173.
\textsuperscript{37} Goodstadt, above n 31, 69; Tsang, above n 2, 58-62; Wilson Wong and Sabrina Luk, ‘Economic Policy’, in Wai-man Lam, Percy Luen-tim Lui, Wilson Wong and Ian Holiday (ed), \textit{Contemporary Hong Kong Politics: Governance in the Post-1997 Era} (Hong Kong University Press, 2007) 181-204; Tony Latter, \textit{Hands On or Hands Off? The Nature and Process of Economic Policy in Hong Kong} (Hong Kong University Press, 2007) 137-42. In addition, the executive led government had preserved much the ‘corporatist’ structure in policy making with the institutionalised representation of business, industrial and professional groups forming a coalition with the civil service dominated the policy agenda and outcomes since the Colonial administration. Then again, the tensions between the bureaucrats, business elite, and professions can emerge in political sensitive and highly charged issues. See Ma Ngok, \textit{Political Development in Hong Kong: State, Political Society, and Civil Society} (Hong Kong University Press, 2007) 36-37, 91, 98.
\textsuperscript{38} Tsang, above n 2, 164-7. The term ‘positive non-intervention’ originated during Hong Kong’s colonial era, this means the administrators of the colony intervene in the economy as little as possible. In short, the maintenance of \textit{a laissez-faire} capitalism, see Carroll, above n 34, 160; Li, above n 14, 18.
\textsuperscript{39} Tsang, above n 2, 173.

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stakeholders in law reform is common practice in other jurisdictions, for Hong Kong this process is much more intimate with a selective few, namely, the small circle of local businesspersons and professional elites.

This corporatist style of policymaking endured into the post handover era (after 1997), as the political structure in Hong Kong ensures the elites in the business and professional communities are well represented in the Legislative Council (Parliament) and constitute a large portion of the votes under functional constituencies. Given the numbers of seats held by elite members of the business and professional community in the Legislative Council, the Hong Kong Government is unable to secure the enactment of a Bill into law without support. Moreover, such is the political and economic clout of the business elites, not only was the first Chief Executive handpicked by the Chinese Government from one of the elite business families, but also comments made in the media by these ‘godfathers’ in all likelihood have a considerable impact on the share markets and investment decisions of many in Hong Kong.

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41 Goodstadt, above n 31, 35.
42 Corporatism is defined as – ‘a mode of policy formulation, in which formally designated interest associations are incorporated within the process of authoritative decision making and implementation. As such, they are officially recognized by the state not merely as interest intermediaries but as co-responsible “parties” in governance and societal guidance. Ostensibly, private and autonomous associations are not just consulted and their pressures weighed. Rather they are negotiated with on a regular, predictable basis. Their consent becomes necessary for policies to be adopted; their collaboration becomes essential for policies to be implemented’. See Neil Andrews, ‘After Corporate Law and After Enforcement: The Regulation of Corporate Governance in Hong Kong Listed Companies’ (Paper presented at the Corporate Law Teachers Association Conference, Deakin University, Melbourne, 4-6 February 2007) 2-3.
43 Percy Luen-tim Lui, ‘The Legislature’ in Wai-man Lam, Percy Luen-tim Lui, Wilson Wong and Ian Holiday (eds), Contemporary Hong Kong Politics: Governance in the Post-1997 Era (Hong Kong University Press, 2007) 39, 40-7. Note that at present (4th legislative Council, from 2004-2008), the functional constituency representatives make up half of the legislative councillors (30 in total) who represent professional, businesses and other special interest groups. These legislative councillors are nominated and elected by the group or interests they represent, they also the same powers as a geographic member directly elected by eligible residents of Hong Kong. Businesses and professionals combined holds 26 out of the 30 seats. Also see Educational Service Section Legislative Secretariat, ‘Composition of Legislative Council, Fact Sheet No 1/11-12’ (August 2011) 2 <http://legco.gov.hk/english/education/files/Factsheet1_Composition%20of%20LegCo.pdf>.
Even so, there appears to be a gradual shift from ‘positive non-intervention’ towards ‘maximum support and minimum intervention’ in the post handover era. Economic policies have continued to generally favour big businesses and the professionals to the extent that there is often a blurring of public and private boundaries. Another reason for this close relationship between big business and the government is in part due to the considerable revenue for the government generated from the sale of land to property developers. This financial reliance by the government reinforces the corporatist legacy. Government intervention, like business laws, is likely to be deemed by big businesses as disincentives to invest in large-scale property and other related business development projects. This pro-big business stance was also alleged by critics when the Hong Kong Government intervened in the share market to prop up share prices of listed companies from the fallout of the Asian Financial Crisis in 1998. Such is the sway of big businesses and professional elites in Hong Kong that their sphere of influence is apparent in company and securities law reforms in Hong Kong.

This most influential body in company law reform in Hong Kong is possibly the Standing Committee on Company Law Reform (SCCLR). The SCCLR was set up in 1984 primarily to advise the Financial Secretary on amendments to the Companies Ordinance (Hong Kong) cap 32 (CO) when the need arose, and was chaired by a Hong Kong Supreme Court judge. Other members of this committee were made up senior officials of various governmental departments, academics, businesspersons,

45 Tony Latter, Hands On or Hands Off? The Nature and Process of Economic Policy Hong Kong (Hong Kong University Press, 2007) 21. This is due to a number of reasons: the Asian Economic Crisis in 1997, severe acute respiratory syndrome in 2003, Global Financial Crisis in 2008-9, as well increasing public demand for more welfare support, public housing, universal suffrage, and growing anti-big business sentiments amongst the poor and middle class in Hong Kong. This induced a moderate shift in policy stance towards more selective intervention in the economy.
46 Latter, above n 45, 130-4.
47 Wensheng Peng et al, ‘The Fiscal Deficit and Macroeconomic Stability in Hong Kong SAR’ (BIS Paper No. 20, Bank for International Settlements, 1 October 2003) 133-5. The authors found from 1995 to 2003, the land sales accounts for between 0.8 to 4.4 percent of the government’s revenue in the fiscal accounts (as a percentage of GDP). See table on page 135 of this article.
48 Leo Goodstadt, Reluctant Regulators: How the West Created and How China Survived the Global Financial Crisis (Hong Kong University Press, 2011) 100-1.
and professionals like accountants and lawyers. The current committee membership is made up of lawyers, legal academics, senior bureaucrats, accountants, business executives and chaired by a senior member of the bar, who also sits on many government agency boards. Whilst it is difficult to speculate on whether the composition of the SCCLR has anything to do with the views and recommendations made to the government over the years, given the small circle and regulatory capture in Hong Kong, the views expressed by the SCCLR are likely to represent views of the elite members of the business and professional community. This could help explain the SCCLR’s ‘luke warm’ reception, and at times outright opposition, towards the government’s attempts to codify directors’ duties. The possible reason for this was that codification might increase the regulatory burdens of big businesses.

2.2 Attempts to Reform Directors’ Duties

2.2.1 Initial Efforts

Whilst it is not the aim of this thesis to go into the finer points of Hong Kong’s repeated attempts to codify directors’ duties, it is important to appreciate the difficulties associated with these reforms. As briefly noted in Chapter 1, directors’ duties in Hong Kong are based on British laws, even though the territory has not kept up with changes to the British company law. The issue of codifying directors’ duties in Hong Kong was first raised in the early 1970’s following the recommendations of the Jenkins Report in Britain. On the basis of this report attempts to enact statutory provisions were made in the Companies (Amendment) Bill 1980 but failed. The Bill was withdrawn from the Legislative Council after its first reading. There are no details available as to why the Bill was rejected. In 1991, another attempt to enact directors’ duties had the initial support of the Standing Committee on Company Law.

51 Gordon Jones, Corporate Governance and Compliance in Hong Kong (LexisNexis, 2012) 24.
53 Jones, above n 51, 23.
Reform (SCCLR).\textsuperscript{55} The \textit{Companies (Amendment) Bill} was gazetted in January 1991, but was later withdrawn due to a lack of support from legislators, many of whom were prominent members of the business and professional community in Hong Kong.\textsuperscript{56} Again, scarce information is available as to why this had occurred. A short passage in the SCCLR’s eighth annual report 1991/1992 stated that,

At the meeting in June, we were advised by the representative of the Monetary Affairs Branch that, while the Bill had received support from a number of organisations, there had been strong objections, particularly from the Law Society of Hong Kong and the Hong Kong Bar Association… [I]n the end, it had been decided not to proceed with the Bill.\textsuperscript{57}

No other reasons or explanation of the objections to the Bill were released in the annual report or other public document.

\textbf{2.2.2 Another Unsuccessful Attempt}

Later in 1994, the Hong Kong government appointed the former Deputy Chairman of the Securities and Futures Commission (SFC), Ermanno Pascutto to undertake a comprehensive review the CO.\textsuperscript{58} The review was again prompted by the changes in the United Kingdom.\textsuperscript{59} In particular, the government felt that the existing laws may no longer be adequate to meet the demands of the rapid internationalisation of trade and finance that had been taking place over the last 15 years.\textsuperscript{60} The full report of the review (Pascutto Report) was submitted to the Financial Secretary (Donald Tsang), on the 27 March 1997. Interestingly, the Pascutto Report did not refer to the earlier 1980 and 1991 failed attempts by the government to reform the company law.

\begin{itemize}
\item \textsuperscript{56} Ibid.
\item \textsuperscript{59} Ibid, 3-4.
\item \textsuperscript{60} Ibid, 4.
\end{itemize}
With respect to directors’ duties, the Pascutto Report recommended that, ‘there should be a statutory statement of directors’ duties to act honestly and in the best interests of the company, and to exercise the care, diligence and skill that a reasonably prudent person would. These duties should also be made applicable to those corporate officers appointed by the board.’\textsuperscript{61} In the commentary section of this recommendation, the report states, ‘a statutory statement of directors’ duties would have the beneficial effect of clearly setting out the standard against which actions by directors would be measured. As in other jurisdictions, there is no doubt that the long history in the case law would continue to inform the statutory language, but the statutory standard would prevail.’\textsuperscript{62} Furthermore, the report noted that the standards of the duty of care for directors in Hong Kong were too low. Modern views of the expectations of directors necessitate a revision of this standard. As for the introduction of a business judgement rule defence, similar to the present one in the US, the review claimed that there was no need for such provisions in Hong Kong.\textsuperscript{63} Though the report was not explicit in its explanation, it did point to case laws that demonstrate that there was implicit recognition of such principles in existing laws.\textsuperscript{64} With respect to fiduciary duties it stated that, ‘consideration should be given to placing directors and executive officers (i.e. those appointed directly by the board) under a duty of fair dealing with respect to transactions they enter into with the company.’\textsuperscript{65} However, the Pascutto Report did not contain any discussion of family companies in Hong Kong. It was as if the family company’s needs and concerns were identical to those that had diverse shareholdings, or that they were not important enough to be considered.

In response to the recommendations of the Pascutto Report, the SCCLR published a report in February 2000.\textsuperscript{66} The SCCLR rejected the recommendations about the duty

\textsuperscript{61} Ibid, 121.
\textsuperscript{62} Ibid.
\textsuperscript{63} Ibid, 121-6.
\textsuperscript{64} Ibid, 125-6.
\textsuperscript{65} Ibid, 129.
of care for directors, contained in the Pascutto Report with the following justification:

Despite the rhetoric, it remains the case that few directors have been held liable for mere negligence untainted by conflict of interests. This is not necessarily bad. A low standard of care is justifiable on at least three grounds. First, directors are expected to take risks and it is too easy to be wise after the fact. Secondly, in the case of a slow decline, it is difficult to prove that a single director could have saved the company. Thirdly, too onerous a burden would simply scare off good managers.\(^67\)

Furthermore, the SCCLR summarised comments from a number of public submissions on the Pascutto Report stating that:\(^68\)

Respondents were evenly split over the question of a statutory duty of care, but there was little support for including a statutory right of reliance. It was pointed out that this is a function of the standard of care and a separate provision is not necessary. Given the difficulties of codification, its limited effect and the press of other business, codification should not be undertaken now.\(^69\)

Regarding the introduction of the duty of loyalty, the SCCLR committee felt that a statutory statement on ‘proper purpose test’ may create more confusion by citing differences between academic literature and consultants’ recommendations, as well asserting it was not the appropriate time to codify those duties.\(^70\) On matters concerning conflicts of interest, the Pascutto Report recommended the enactment of statutory provisions on ‘fair dealing’ and ‘transactions where directors have an interest’. The SCCLR committee believed that the consultants misstated the general law obligations, and the consultants did not discuss why the Companies Ordinance obligations were in an unsatisfactory state.\(^71\) In terms of the Pascutto Report’s recommendations for a statutory statement on the issue of corporate opportunity and

\(^{67}\) Ibid, 74.

\(^{68}\) Note the Secretary for Financial Services launched a public consultation on the Pascutto Report on 1 May 1997. There were 28 written submissions by individuals, firms of accountants and lawyers, and professional and trade institutions and associations.


\(^{70}\) Ibid, 75. Note that case laws have established that the notion of proper purpose is part of fiduciary duties in terms of the use of powers by fiduciaries. But to specify what constitute proper purpose is difficult as the facts of each case would vary and thus defining and stimulating proper purpose might be best left to the courts. For more see Saul Fridman, ‘An Analysis of the Proper Purpose Rule’ (1998) 10 Bond Law Review, 164.

\(^{71}\) Ibid, 80. Note that under s162 of the CO, there is a duty for directors to disclose material interests in contracts. This provision was enacted in 1984. This obligation is comparable to the British s317 of the CA.
review of management decisions, the SCCLR committee felt that there were no defects in the prevailing laws, and case law had been developed satisfactorily. Accordingly, they believed there was no need for such provisions to be enacted into legislation.\(^\text{72}\)

Consequent to the SCCLR’s responses on the Pascutto Report, the Hong Kong Government did not pursue the codification of directors’ duties. What this exercise has revealed is the conservative attitude of the SCCLR and the key stakeholders (as reflected in the views of the submissions). As mentioned in the above, the close-knit or corporatist style policy making in Hong Kong meant that the elite few with their unprecedented influence did not agree to the government’s reform initiatives.\(^\text{73}\) In addition, much of the focus of the reformers was on what the Britain and other jurisdictions in Western countries like the United States, Canada, and New Zealand had done. As a result, there was no mention of family companies, or any references to the Chinese cultural influences in corporate governance practice in Hong Kong.\(^\text{74}\) Again, it was as if these companies operated in a similar fashion to those in Western countries.

### 2.2.3 The Next Round of Reviews

Earlier failed attempts to reform directors’ duties did not appear to dampen the government’s spirits. Again, in the 2000/1 Financial Secretary Budget speech, it was announced that there would be a Corporate Governance Review (CG Review).\(^\text{75}\) According to the Financial Secretary’s speech it was intended to gauge, ‘institutional investors’ perception of corporate governance standards in Hong Kong, the correlation between shareholder profile and corporate performance and the latest

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\(^{72}\) Ibid, 83-4.

\(^{73}\) Neil Andrews, ‘After Corporate Law and After Enforcement: The Regulation of Corporate Governance in Hong Kong Listed Companies’ (Paper presented at the Corporate Law Teachers Association Conference, Deakin University, Melbourne, 4-6 February 2007) 4, 29-30.

\(^{74}\) See Chapter 3 for more on the Chinese cultural influences in family companies.

developments in enhanced corporate governance standards in other regions.’ He added that:

Our aim is to establish Hong Kong as a paragon of corporate governance, ensuring that those investing in Hong Kong are afforded the best protection and that our listed companies are managed with excellence, complying with the highest international standards including those relating to risk management and disclosure of information.’

Whilst the reasons for another try at the reforms sounded familiar, instead of massive changes the aim of this CG Review was more subtle. It aimed to identify and plug any gaps in Hong Kong’s corporate governance regime. This time round the government conducted the enquiry in two phases.

The responsibility of conducting the CG Review was delegated to the SCCLR. This CG Review was given the task to review three key areas of corporate law in Hong Kong - directors' duties and responsibilities, shareholders' rights and corporate reporting. Concerning directors’ duties, a report known as Phase I was published in 2001. Phase 1 stated that the SCCLR did not see the need to enact these duties into statute for the following reasons:

- finding of a breach of duty would depend on the complexities of the facts;
- a broad statement of principles would have to be framed in very general terms;
- a broad statement of principles may not necessarily assist directors to clearly identify the extent of their duties;
- statutory provisions would be inflexible and not accommodate judicial developments to take into account changing standards;
- a broad statement of principles was unlikely to be of any additional assistance to shareholders.

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77 Ibid.
79 Ibid.
80 Ibid.
On the issue of self-dealing by directors the SCCLR noted that general law duties on self-dealing by directors did not prohibit an interested director voting on a matter in which he had a material interest if a company’s constitution so permitted. The SCCLR considered the current provisions under the CO could be improved in order to give effect to the general principle that a director should abstain from voting on a transaction in which he had an interest. However, no amendments to the CO were introduced. Yet again, the SCCLR rejected the codification of directors’ duties. Instead, the SCCLR recommended a more pragmatic approach with the publication of a non-statutory guideline to aid directors in understanding their legal obligations. The assumption was guidelines were easier to understand compared to case law. Even if this was a token approach (because it is in effect preserving status quo), it is not surprising because the SCCLR had been critical of the Pascutto Report, and so it was another set back by the government to codify directors’ duties.

Another matter of importance was the lack of interest by the SCCLR concerning the family dimensions in the governance and operation of companies in Hong Kong even though a footnote in their report pointed to the fact that family-led listed companies (describing companies with dominant shareholders held by a family), made up a large proportion of the total amount of listed companies in Hong Kong.

Phase II of the CG Review was published in 2003. In this report, the SCCLR revisited codification of directors’ duties by examining the approach taken in Britain. It noted that Britain did not, at that time, have statutory provisions to act in good faith for the benefit of the company under a directors’ duty. In terms of the duties to avoid conflict of interest and use of company’s information, property and

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82 Ibid, x.
83 Ibid.
84 Note the last amendment made was in 1990 before the report, see Roman Tomasic and Ted Tyler (annotators) Butterworths Hong Kong Company Law Handbook, (LexisNexis, 8th ed, 2006) 641-645. Also, note that s 162 of the CO, this provision deals with disclosure by directors of material interests in contracts.
86 Ibid.
87 Ibid, 5.
88 Ibid, 15.
89 Ibid, 18.
opportunities, the Phase II report concurred with the Phase I report by rejecting to codify these duties.\textsuperscript{90} The recommendations of Phrase II were to introduce non-statutory guidelines for directors’ duties.\textsuperscript{91} It stated that:

The objective of these guidelines is to outline the general principles for a director in the performance of his functions and exercise of his powers… [I]t is important to note that the statements in these guidelines are principles only and are not intended to be exhaustive statements of the law… [I]f directors are at all in doubt about the nature of their responsibilities and obligations, they should seek legal advice.\textsuperscript{92}

The underlying motivation of the non-statutory guidelines for directors was, ‘to help company directors to better understand their roles.’\textsuperscript{93} Even though, the intent of this guideline was educative in nature, and since it was a non-statutory guideline, the extent to which directors would take on board the contents of the guideline was difficult to quantify. Tomasic observed that despite massive corporate law reforms in Britain, Canada, and Australia and even in the relatively small jurisdiction like New Zealand, Hong Kong law reformers had been reluctant to engage in the kind of massive law reform.\textsuperscript{94} The reasons for the unwillingness to reform this area of the law is perhaps due to the resistance of big business and professional bodies in Hong Kong to embrace change.

\subsection*{2.2.4 Introduction of Non-statutory Guidelines}

Following the SCCLR recommendations, non-statutory guidelines on directors’ duties were published in 2004.\textsuperscript{95} Since then, the Companies Registrar has published and circulated the non-statutory guidelines to all directors upon incorporation of a company in Hong Kong. There are 11 principles stipulated in the non-statutory

\textsuperscript{90} Ibid, 19-23.
\textsuperscript{92} Ibid, 15-16.
guidelines. Principles one to nine mirror the spirit and objectives in general law obligations of directors’ fiduciary duties and the duty of care. The directors’ duties in principle ten is, in essence a contractual obligation between the director and the company. As for principle eleven, it relates to the obligations laid down in s275 of CO on fraudulent trading provisions. Whilst the non-statutory guidelines help to explain the complexities of directors’ fiduciary duties to directors in both English and Chinese, these guidelines have no legal effect. The purpose, as the document states, is primarily informative and educative. Therefore, there is no incentive for the directors to comply with the contents. More importantly, there has been generally a lack of discussion on whether these guidelines were suited for family companies.

2.3 The Debates in the Most Recent Round of Reforms

This latest round of reform that began in 2006 has produced three outcomes, the first two echoed past experiences. The first was the use of British statutory obligations as model laws for Hong Kong, and the second concerned the continued resistance from the elite members of the business and professional community for the codification of directors’ fiduciary duties. The third was somewhat surprising, the government garnered enough support to codify directors’ duty of care.

2.3.1 British Provisions as Model Law for Hong Kong

In the latest round of reform, the government proposed the use of new provisions in the British Companies Act 2006 (UK) c46 (CA) as model laws to codify directors’ duties in Hong Kong. Even though it is beyond the scope of the thesis to examine

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97 Paul Kwan, Hong Kong Corporate Law (LexisNexis, 2006) 213-6. Also, refer to s 23(1) of CO.
98 Also refer to the duty of directors not to trade while the company is insolvent, see Re Millie’s Shoes Factory Ltd (in lig.) (no.1) [1985] 1 HKC 548.
100 The British CA 2006 provisions concerning directors’ duties considered by this recent CO rewrite exercise include ss170-181.
in detail the United Kingdom’s new Companies Act, briefly the directors’ general law duties have been codified in ss170-181 of CA. According to Lady Justice Arden (who was then the Chair of the Law Commission in the United Kingdom), the Law Commission’s recommendations to codify directors’ duties was primarily due to the economic and modern business challenges. apart from a review of the literature, the Law Commission conducted a survey of about 3000 directors seeking their views on whether the duties should be codified. Responses to the codification of directors’ duties were overwhelmingly ‘yes’. Following the Law Commission’s work, the Department of Trade and Industry set up a full-scale review called the Company Law Review. This review produced a number of publications arising from discussions by the panel and views from the public submissions. The contents of these publications were far-reaching, as they took into account the impact of European Union Directives as well as a broader view of the shareholders’ interests (subsequently known as ‘enlightened shareholders value’).


104 David Kershaw, Company Law in Context Text and Materials (Oxford University Press, 2009) 346-347; Lady Justice Arden, ‘Clause 173 [section 172]: the United Kingdom’s Proposal Re-formulation of the Directors’ Duty of Good Faith’ (Conference Paper presented at Banco Court of the Supreme Court of New South Wales, Sydney, 21 August 2006) 4-5. Note it is beyond the scope of this thesis to go into the details of what is ‘enlightened shareholder value’ - briefly, this doctrine proposition shareholders’ instrests are no longer the only considerations (even though it remains the priority) for directors, the interests of non-shareholder groups like employees, suppliers, creditors, and the community would all be taken into account when determining the best interests of the company. This doctrine is now stipulated in s 172 of CA (UK). See David Kershaw, Company Law in Context: Text and Materials (Oxford University Press, 2009) 350-2. For more detailed debate about ‘enlightened shareholders value’ see Janice Dean, Directing Public Companies: Company Law and the Stakeholder Society (Cavendish, 2001).
The product of this review in the United Kingdom was the enactment of statutory directors’ general duties in the 2006 CA.  

The statutory provisions were described as a ‘high level statutory statement’ based on general law principles. The enactment of directors’ duties was also a watershed for the United Kingdom because it not only codified those duties, but the new provisions in particular s172(1) of CA, reformulated general law obligations. Prior to the enactment of this provision, general law required directors to act bona fide in the best interest of the company. This meant that a director’s power had to be exercised honestly and in good faith for the shareholders as a general body, including present and future shareholders as a whole.

Whereas the new s172 (1) of CA stipulates that:

A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to —

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others,

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

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108 *Greenhalgh v Arderne Cinemas Ltd and Others* [1951] Ch 286. For more on this general law duty see Chapter 4.

109 Gaiman v National Association for Mental Health [1971] Ch. D. 317 at 330 per Megarry J. For group of companies, see *Charterbridge Corp. Ltd v Lloyds Bank Ltd* [1970] Ch 62 – was held directors should regard the group’s interest over the interest of separate entities. This position contrasted with an Australian case, *Walker v Wimborne* (1976) 137 CLR 1. As for interests of creditors - only when the company is trading while insolvent – see *Liquidator of West Mercia Safetywear Ltd v Dodd* [1988] BCLC 250. Note Davis argued that, ‘[i]t is up to directors, not the court, to identify the period over which of promoting the shareholders’ interests can most appropriately be achieved; and it is up to the directors to decide how far the promotion of shareholders’ interests requires corporate largess to be expended upon others (including, of course themselves).’ See Davies, above n 105, 389.
(f) the need to act fairly as between members of the company.

Davis commented that:

The ESV [enlightened shareholders value] approach can be said to embody the insight that the interests of the shareholders are not likely to be advanced if the management of the company conducts its business so that its employees are unwilling to work effectively, its suppliers and customers would rather not deal with it, it is at odds with the community in which it operates and its ethical and environmental standards are regarded as lamentable.\(^{110}\)

However, Sealy and Worthington expressed concern with this section by stating that:

Although the ‘enlightened shareholder value’ approach was designed to avoid the problems of director accountability inherent in the ‘pluralist approach’, it is not clear that this ambition is fully achieved. Subs (1) sets out proper considerations for directors’ decision-making, but these considerations will allow directors to justify almost any \textit{bona fide} approach to delivering the success of the company.\(^{111}\)

Setting aside the concerns of s172(1) of the CA, the UK’s experience in the codification of the duties is more than a re-statement of the case laws. There are some revisions. The ensuing question is – how did this new set of UK statutory obligations fare in the latest round of corporate governance reform initiatives amongst members of the policy community in Hong Kong.

\section*{2.3.2 Latest Round in the Epic on the Codification of Directors’ Duties}

In mid 2006, the Hong Kong government launched another round of CO reforms. The impetus this time according to the government was to update and modernize the CO, ‘[t]o make it more user-friendly and facilitate the conduct of business to enhance Hong Kong’s competitiveness and attractiveness as a major international business and financial centre.’\(^{112}\) The responsibility for the CO rewrite was delegated to a

\(^{110}\) Davies, above n 105, 509.

\(^{111}\) Len Sealy and Sarah Worthington, \textit{Cases and Materials in Company Law} (Oxford University Press, 8\textsuperscript{th} ed, 2008) 295.

\(^{112}\) Financial Services and Treasury Bureau, ‘About Companies Ordinance Rewrite’ (29 October 2010) <http://www.fstb.gov.hk/fsb/co_rewrite/eng/home/home.htm>. Topically, the modernisation of corporate law in Asia is usually associated with ‘bottle necks’ in economic development. In addition, Asia’s modernisation of law usually is transplanting or adopting statutory provisions from developed
steering committee chaired by the Secretary of the Financial Services and Treasury. The committee was also assisted by several Advisory Groups comprising existing members of the SCCLR, legal academics, representative from the professional bodies, as well as prominent business people from large and publicly listed companies.113

As part of the consultation process in the rewrite of the CO, the committee published a number of consultation papers and made them available to the public for comments. In particular, the second consultation paper on the rewrite, released on the 4th April 2008, included the codification of directors’ duties.114 In the consultation paper under the heading of executive summary it states:

We [the CO rewrite committee] would like to hear views on whether the UK approach [new statutory provisions] should be followed. The UK has included a duty for directors to promote the success of the company having regard to a wider list of factors, such as the interests of employees, and the impact of the company’s operations on the community and the environment...115

Chapter 3 of this document, under the heading of background states:

Some common law jurisdictions such as the UK, Australia and Singapore have codified some of the fiduciary duties and the duties of care and skill in statute law. The main reason is that the case law on the topic is complex and often inaccessible to the public. Codification can improve clarity and certainty for company management and members... [T]here are, however, arguments against codifying directors’ duties. For example, fiduciary duties cannot be codified without being stated in detailed terms in which case there will be a loss of flexibility. If codification co-exists with common law and its development through judicial
interpretation, this may lead to greater uncertainty and would not resolve the question of accessibility.\textsuperscript{116}

This document went on to describe the United Kingdom’s statutory provisions of directors’ general duties that the proposed codification in Hong Kong was to be modelled upon.\textsuperscript{117} As a comparison, the consultation paper also included a brief overview of the statutory obligations in Australia and Singapore.\textsuperscript{118} Furthermore, under the heading of considerations, it states:

While the SCCLR saw some advantages in codifying directors’ duties along the UK model to make the law clearer and more accessible to the public, it also noted that the UK approach on directors’ duty to promote the success of the company might cause some concerns among the business community. The Government would therefore like to hear the views of the public before taking a final view on the issue.\textsuperscript{119}

The wording of this consultation document demonstrates that the government suspected the new British statutory provisions on directors’ duties would be controversial judging from past experiences, and explains why the tone of the above quote seemed measured.

The consultation paper listed three questions directed towards the issue of whether or not Hong Kong should adopt the United Kingdom’s statutory provisions for directors’ duties. The questions were as follows:

(a) Do you agree that the general duties of directors should be codified in the Companies Bill?

(b) If your answer to Question (a) is in the affirmative, do you agree that the UK approach, including the duty to promote the success of the company for the benefit of its members as a whole having regard to such factors like the long-term consequences of a decision, the interests of employees, the impact of the company’s operations on the community and the environment, etc., should be adopted? OR

\textsuperscript{116} Ibid, 16.
\textsuperscript{117} Ibid, 17-9.
\textsuperscript{118} Ibid, 19-20.
\textsuperscript{119} Ibid, 20.
(c) If your answer to Question (a) is in the negative, do you have any views on how the directors' duties could be clarified or made more accessible?\textsuperscript{120}

Whilst question (a) mirrored proposals from the Pascutto Report, which was rejected previously by the SCCLR, question (b) is specifically directed at the reformulation of general law found in s172(1) of CA, and question (c) appears to suggest that the government’s intention of codification is to make those duties clearer and accessible to the public.

Apart from the use of the new British provisions as model laws for Hong Kong, it demonstrates the government’s resolution to codify directors’ duties in spite of past failed attempts. However, one key aspect remains the same. There is no mention of family companies anywhere in the document.

The rewrite CO committee received 61 public submissions.\textsuperscript{121} The opponents to the codification of directors’ fiduciary duties included a number of business associations like the Hong Kong General Chambers of Commerce, the Association of Bank, Chambers of Hong Kong Listed Companies, and the Hong Kong Institute of Directors.\textsuperscript{122} Big businesses also put forward their strong objections to the codification of directors’ duties. For example, CLP Holdings Limited submitted that:

\begin{quote}
We do not agree that the general duties of directors should be codified in the Companies Bill. In fact we strongly disagree with this proposition... \[I\]t should also be noted that fiduciary duties cannot be codified without being stated in detailed terms, in which case there will be a loss of flexibility.\textsuperscript{123}
\end{quote}

Another Swire Pacific Limited, stated that:

\begin{quote}
We do not agree that the law relating to directors’ duties lacks clarity (in the sense of being confused or unclear), although, being largely derived from case law, it may be inaccessible and misunderstood... \[C\]odification will achieve little if the codified statements are very
\end{quote}

\textsuperscript{120} Ibid.
\textsuperscript{122} Ibid, 8.
\textsuperscript{123} Ibid, 59.
general (since the courts will in practice continue to have to interpret the statements in the same way as they now interpret the legal principles derived from case law).

Hutchison Whampoa Limited noted that:

We are of the view that the codification exercise should not be undertaken because, for the following reasons, the proposed exercise is incapable of achieving its legislative objective…[W]e believe that clarity and accessibility are better achieved by continuing with the current practice of the Companies Registry’s issuance of Non-statutory Guidelines on Directors’ Duties from time to time.

Professional bodies such as the Law Society, Bar Association, the Hong Kong Institute of Chartered Secretaries, Hong Kong Stockbrokers Association, and the Institute of Accountants in Management, have also voiced their opposition to codify those duties. This is not the first time the Law Society of Hong Kong and the Hong Kong Bar Association had objected to the codification. On this occasion, the Law Society of Hong Kong stated:

Fiduciary duties which encompass all the common law developments cannot be codified unless written in great detail. This will result in a loss of flexibility as the expectations of directors’ responsibilities are constantly evolving especially as corporate governance develops. A codification which summarises only the broad principles as in the UK is inadequate unless such codification co-exists with common law, and this will create new uncertainties.

Similarly, the Hong Kong Bar Association wrote:

[the Bar has reservations as to whether codification would lead to any substantial change. First, the court would still retain a central role in the exposition and application of the statutory duties, as it does in the case of common law and equitable duties. Thus, the public would still have to look to the case law to ascertain the scope and nature of the statutory duties. Second, currently the major common law and equitable duties have been set out in non-statutory guidelines which are widely distributed and the directors are required to sign an

124 Ibid, 62.
125 Ibid, 70-1.
126 Ibid, 8.
acknowledgement of receipt and perusal of the same when submitting a company’s annual return. … Unless there is to be a radical change in the nature or content of director’s duties (which the Bar does not understand to be the proposal), it may be preferable to follow the common law to allow the law to be developed on a case-by-case basis, taking into account the new demands arising from changing circumstances … The Bar also takes the view that codification, depending on its scope, may also bring about confusion. For instance, whether codification is to be complete or partial will have an effect on the application and relevance of existing case law as well as future judicial determinations.129

Even if the reasons or justification for objecting to the codification of directors’ duties varies between the business associations, big business and professional associations, the central message is clear – codification of directors’ fiduciary duties is unacceptable to Hong Kong’s big businesses and elite members of the professional community.

There were particularly strong views against the adoption of the British s172 of CA.130 The CO re-write committee noted that:

[о]nly a few supported incorporating the “enlightened shareholder value” into the statutory duties. Many expressed strong reservation, citing such reasons like heavy burden on directors, the requirement being unclear and difficult to comply with, and the concept of “enlightened shareholder value” was not widely accepted in Hong Kong.131

Those who were opposed included big businesses and professional bodies like the CLP Holdings Limited, CCIF CPA Limited, Hong Kong’s Trustees’ Association Ltd, The Law Society of Hong Kong, The Chamber of Hong Kong Listed Companies, The Society of Chinese Accountants and Auditors, Hutchison Whampoa Limited, The Hong Kong Association of Banks, The Hong Kong Institute of Chartered Secretaries, and Hong Kong Institute of Certified Public Accountants.132 Therefore, the CO re-write committee concluded that:

129 Ibid, 82-3.
130 For discussions about the British s172(1) of CA see Chapter 2.3.1.
Responses are highly divided save as the issue regarding the proposal to incorporate the “enlightened shareholder value” concept into the duties of directors, which has received only limited support. It would be premature to go down the route of comprehensive codification at this stage.\textsuperscript{133}

However, when it came to the directors’ duty of care, a number of the submissions were supportive of the introduction of such a duty in the statute. For example, the Hong Kong and Shanghai Banking Corporation Limited submitted that:

\begin{quote}
We believe that the standard of care, skill and diligence required to be exercised by directors should be codified, but not the other general duties which can be left to Guidelines such as those issued by the Companies Registry.\textsuperscript{134}
\end{quote}

Another supporter is the Hong Kong General Chamber of Commerce observing that:

\begin{quote}
We consider that the standard of care, skill and diligence required to be exercised by a director of a company should be codified in the Companies Bill, but not for the other general duties of directors introduced under the CA 2006,… [T]he main reasons for supporting the codification of the standard of care, skill and diligence are to improve the corporate governance in Hong Kong and to provide clarification of the standard against which the directors will be measured under the common law… [r]ecent case law in UK suggested that a more objective approach in assessing the director’s standard of care towards the company (i.e. taking into account the knowledge, skill and experience that may reasonably be expected of a person carrying out his function) should be adopted.\textsuperscript{135}
\end{quote}

To summarise, the CO re-write committee noted that:

\begin{quote}
Views of the respondents were divided and finely balanced … A slightly larger number of respondents disagreed with the proposal to codify directors’ general duties. Some of them believed that codification of the directors’ duties, unless to the full extent, would not clarify the law but only cause confusion. They considered that while a general statement of directors’ duties would not achieve any useful purpose, detailed codification would reduce the flexibility that the court had for interpretation and development of the law.\textsuperscript{136}
\end{quote}

Further, the committee’s response to the 61 public submissions was as follows,

\begin{quote}
The consultation indicates that the idea of codifying the directors’ general duties remains highly controversial … It would be premature to go down the route of comprehensive codification at this stage. Nevertheless, we see some merit in clarifying the directors’ standard of care, skill and diligence as proposed by some respondents … the absence of a clear authority under the common law in Hong Kong in this respect, there is some
\end{quote}

\textsuperscript{133} Financial Services and Treasury Bureau, above n 131, 9.
\textsuperscript{134} Ibid, 69.
\textsuperscript{135} Ibid, 76-7.
\textsuperscript{136} Ibid, 8.
uncertainty as to how far the mixed objective/subjective test will be adopted and applied by the Hong Kong court … We believe that the adoption of the mixed test approach along the lines of section 174 of CA 2006 would be conducive to enhancing corporate governance in Hong Kong. We propose that the statutory statement should replace the corresponding common law rules as the retention of the latter may result in dual standards and hinder the development of the statutory provision.\textsuperscript{137}

There are three things to note from the committee’s interpretation of the public submissions,\textsuperscript{138}

- the rejection of codification of directors’ duties (with the exception of the duty of care) because the exercise, ‘would not clarify the law but only cause confusion’.
- there is overwhelming consensus that the United Kingdom’s approach in defining what is ‘the best interest of the company’ from a shareholder centred model to a mixed shareholders/stakeholder approach known as ‘enlightened shareholders’ value’ (found in the new provisions, section 172(1) of the CA), was rejected by many public submissions from big businesses and professional bodies in Hong Kong.
- growing consensus in the public submissions (especially from big business and professional bodies) to increase the standards of care placed on directors along the lines of the United Kingdom’s section 174 of the CA and for it to be codified in Hong Kong.

The government moved on the one item where there was some consensus (the duty of care). In February 2009, in the final report to the Hong Kong Legislative Council, the government estimated that the drafting of the changes to the CO, including codifying the directors’ standard of care, skill and diligence would be undertaken in the third quarter of 2009.\textsuperscript{139} The First Phase Consultation on the Draft Companies

\textsuperscript{137} Ibid.
Bill, Consultation Conclusions was released on 27 August 2010. Since the release of the draft Bill, the Companies Ordinance Bill was gazetted on the 14 January 2011, and was subsequently introduced to the Hong Kong Legislative Council for its first reading on 26 January 2011. The Legislative Council finally passed this Bill on 12 July 2012. The new CO is expected to commence operation in 2014.

In the press release dated on the same day as the passing of the legislation (12 July 2012), KC Chan, the Secretary for Financial Services and the Treasury said:

> The Companies Ordinance rewrite exercise is a challenging and highly complex project which could not have come to fruition without the concerted efforts of the Governance and the relevant sectors of the community over the years … The Companies Bill was introduced into LegCo in January 2011. The objectives are to enhance corporate governance, improve regulation, facilitate business and modernise the law with a view to strengthen Hong Kong’s status as an international commercial and financial centre and its competitiveness.

Whilst the contents of the press release sounded like a record, especially the reference to an international financial centre, there was no mention or even consideration during the debates of this recent reform on whether the proposals were appropriate for family companies. Thus, the law as it stands, and the new ordinance that will come into effect in 2014 does little to address the governance of family companies.

Evidently, from the discussions in this chapter of the thesis, the passage of the codification of directors’ duties in Hong Kong has experienced many setbacks. Thus, reforming directors’ duties has been a long and difficult road. If we take the 1994 Pascutto Report as the first major attempt to codify directors’ duty of care, the journey took about 21 years for the proposed change to be accepted by the stakeholders. Clearly, for change to occur there must be support from big business,

143 Ibid.
business associations and professional bodies. Their sphere of influence can also be found in the unsuccessful attempts to enact a statutory directors’ duty to avoid insolvent trading.\textsuperscript{145}

There are two other observations. Firstly the reform journey demonstrates that the local policy community is capable of asserting their own views on reform and secondly, there is a reliance and continual use of British laws as a model for reform in Hong Kong. Apart from historical reasons, the Hong Kong government is no longer constitutionally or legally bound to use British laws\textsuperscript{146} and so the rationale for this, as noted in Chapters 1.1, 1.2, and 1.3 is because the British model is considered to be an international benchmark. Even though, the policy community in Hong Kong rejected the codification of directors’ fiduciary duties, the general law obligations are derived from British case laws. Concerning the duty of care, s174 of CA has received some support, and thus a new section 465 of the new CO is a word for word transplant of the British provisions.\textsuperscript{147} Furthermore, a new s466 of the new CO, which spells out the civil consequences for a breach of this statutory duty of care, is almost identical to the British s178 of CA. Therefore, Hong Kong’s directors’ duties are a mix of the old and new British directors’ duties. It is fair to conclude that the law and its development in the Britain have continued to have a strong influence upon Hong Kong.

\textbf{2.4 Summary and Commentaries}

This chapter has discussed the Hong Kong Government’s preoccupation with adopting international standards in corporate governance regulation. Apart from historical reasons and the need for consistency, the choice of adopting British laws as


\textsuperscript{146} A recent the decision of the Hong Kong’s Court of Final of Appeal has ruled that any decisions of the British courts and Privy Council are no longer binding to the courts in Hong Kong, but remained influential. See \textit{A Solicitor v The Law Society of Hong Kong} [2008] HKCFA 15; FACV000024/2007.

\textsuperscript{147} For a copy of the new CO see Companies Registry, ‘New Companies Ordinance’ <http://www.cr.gov.hk/en/companies_ordinance/docs/full-e.pdf>. Note for more discussions on this new statutory provisions in the Companies Ordinance see Chapter 3.3.2.
model laws for Hong Kong, British corporate laws are deemed to be an international benchmark. This in turn is expected to offer confidence to international investors, particularly institutional investors from developed Western economies, to invest in Hong Kong’s equity markets.

Concerning reforming directors’ duties, early attempts by the government in the 1980s to codify those duties had failed. Given the close relationships between big business and the professional elites, the failure of the government to secure consensus from this group can help explain why the Bills were withdrawn from the Legislative Council twice. Again, despite a report drafted by a consultant commissioned by the government in favour of codifying directors’ duties in 1994, the key government advisory body on corporate law reform, the SCCLR was not convinced by the merits. Instead, they opted for guidelines for directors. Given the guidelines were non-legal and merely guides, it is doubtful that such a document would have much impact on directors’ awareness and compliance to the law

In the most recent reforms, the Hong Kong Government drew on British statutory provisions in the 2006 act as a model law to codify directors’ duties. Despite a lack of support for the codification of directors’ general law fiduciary duties, there has been some success with codifying the directors’ duty of care. There has been a growing consensus amongst the stakeholders (again, big businesses, business associations and professional bodies), with slightly more than half of the submissions in favour. What this experience has shown is that there are substantial influences by big business, business associations and professional bodies to corporate law reform in Hong Kong. Notwithstanding the failure to codify directors’ fiduciary duties, the ‘word for word’ adoption of s174 of CA in Hong Kong’s new s465 of CO demonstrates that the British legal influence is still apparent. Therefore, the directors’ duties in Hong Kong are a mix of old British case laws (fiduciary duties), and new British statutory provisions (duty of care), and they apply to directors of all types and size of companies.
However, the discourse, debate and reform efforts have focused on non-family and publicly listed companies where there is separation between control and ownership. As noted in Chapters 1.1.2 and 1.1.3, the needs of Chinese family companies, where the values are derived from Confucian influences, was missing from the reform agenda. This gap in corporate governance should not be overlooked. Without proper regulation, governance problems for over half a million family companies in Hong Kong would hang in the balance. However, before discussing a feasible solution for Chinese family companies in Hong Kong, it is essential to examine in detail the objects, values and nature of directors’ duties so as to develop a better understanding of why British laws, as model laws for Hong Kong, do not address the needs of these types of companies.
Chapter 3 : The Core Values Underpinning Directors’ Duties in Hong Kong

3.0 Introduction

Since the board of directors is at the apex of the organisation, it possesses the power to control the company and so is the primary organ of governance. In 1978, Lord Denning said that directors are a self-perpetuating oligarchy; they select themselves to the board, and even though in theory the appointments are subjected to the shareholders’ approval, more often than not this is automatic. Furthermore, his honour went on to articulate the enormous power directors wield, and consequently their ability to exploit these powers for self-interest at the shareholders’ expense. Thus, holding these individuals accountable to shareholders for their decisions and behaviour is central to good governance. Stemming from this is the notion of transparency. Transparency and accountability combined form the central values of the transplanted laws. The question is - are these duties appropriate for all type of companies in Hong Kong? The search for answers begins with an analysis of the principles of corporate governance and developing insights into directors’ duties.

3.1 The Principles of Corporate Governance and Directors’ Duties

This section will outline the core values and issues that are essential to modern corporate governance and directors duties. The aim is to demonstrate that accountability and transparency are the key pillars of good governance and compliance to the spirit of the law.

1 Jean du Plessis, James McConvill, and Mirko Bagaric, Principles of Contemporary Corporate Governance (Cambridge University, Press, 2005) 54.
2 Alfred Denning, ‘Restraining the Misuse of Power’ (Speech delivered at the Holdsworth Club Presidential Address, Birmingham, 3 March 1978) 8.
3 Ibid.
3.1.1 The Fundamentals of Corporate Governance

Understanding directors’ duties begins with corporate governance because it is the underpinning of the legal rules. To begin, it is interesting to note that neither lawyers nor legal academics coined the term corporate governance. Tricker asserted that he was the first to use this term in a book about contemporary issues in management in 1983. Clarke found that corporate governance evolved out of practices inside boardrooms as internal organisational control mechanisms. Cadbury noted the origins and roots date back as early as 1600 with the establishment of the East India Company by Royal Charter, where the concerns about the accountability of directors to the shareholders parallel present day debates. So the birth of corporate governance is not legal, instead it is a product of corporate evolution.

Corporate governance as it is conceptualised in the modern era was prompted by two key factors. The first was with the industrialisation of Europe and the United States in the 18th and 19th century. Rapid economic development gave rise to the need for more capital to be invested in companies to fund corporate expansion. This brought about an increasing separation of control from ownership because companies required professional managers to oversee expansion beyond what a founding entrepreneur could manage. Therefore, shareholders as owners and capital providers needed to hold those managing their company accountable. The second was due to corporate failures and systematic crises. Iskander and Chamlou found that since the

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7 Adrian Cadbury, Corporate Governance and Chairmanship: a Personal View (Oxford University Press, 2002) 2-3. The East India Company started with 218 members, it was governed by a Court of Proprietors made up of all those with voting rights (those who invested over $200 pounds) and Court of Directors, the executive body of the company responsible for running the company. The Courts of Directors consisted of a Governor, a Deputy Governor, and 24 directors, see pages 2-3.
8 See Alfred Chandler, Scale and Scope, The Dynamics of Industrial Capitalism (Belknap Press, 1990), about the emergence of modern corporations.
10 Clarke, above n 6, 4-5.
11 Ibid, 11-8.
17th century bad corporate governance was a contributing factor in corporate failures. Many of the corporate failures were caused by incompetence, fraud, and abuse of power by key decision makers like managers and directors in the United Kingdom and Europe, and in some instances, corporate collapses have triggered economic crises.12 This perpetuated into the present, with a number of spectacular corporate collapses and scandals in many parts of the world in the 1980s, 1990s, as well as 2008-9, where bad corporate governance was a contributing factor.13 Hence, laws regulating corporate governance have evolved from the separation between ownership and control, and out of necessity responding to failures in internal voluntary control mechanisms of companies. More importantly, its origins and evolution have been Western and is in contrast to the Chinese development of commercial ventures where families and clans were intimately involved with the view for profit.14

Farrar argued that, ‘[corporate governance] is a fashionable concept but like most fashionable ideas it is remarkably imprecise.’15 This is not aided by the proliferation of publications by economists, organisational theorists, lawyers, sociologists, criminologists, and political scientists, laying claim to its meaning, interpretation and applications.16 The Cadbury Report in 1992, commissioned by the British government in the aftermath of a number of corporate failures in Britain, defines corporate governance narrowly as, ‘the system by which companies are directed and controlled.’17 However, corporate governance does not just refer to structures and

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13 Clarke, above n 6, 14-22. It is interesting to note that despite decades of legal reform lead by developed Western economies like the United States and United Kingdom, yet corporate collapses in the last three decades has becoming more and more dramatic with financial losses mounting exponentially, at times triggering economic crisis at a global scale. This bring into question whether there should be a rethink of the conventional wisdom in the notion of accountability and transparency. However, it is beyond the scope of this thesis to examine this issue.
14 For details about Chinese commercial entities, see the concept of kongsi in Chapter 6.4.
16 Angus Young, ‘Rethinking the Fundamentals of Corporate Governance: The Relevance of Culture in the Global Age’ (2008) 29 The Company Lawyer 162.
processes of control. Cochran and Wartick argued that it is, ‘an umbrella term that includes specific issues arising from the interactions among senior management, shareholders, boards of directors, and other corporate stakeholders.’\textsuperscript{18} Du Plessis, McConvill and Bagaric took an even broader approach by defining the term as, ‘the process of controlling management and balancing the interest of all stakeholders and other parties who can be affected by the corporation’s conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation.’\textsuperscript{19} Even though, corporate governance is closely intertwined with management, one should not to treat them as interchangeable terms.\textsuperscript{20} In essence, governance has to do with ‘where the company is going’, whereas management is about ‘getting the company there’.\textsuperscript{21}

Despite a growing number of issues affixing to corporate governance as an umbrella term with applications to independence of auditors, risk management, board meetings and committees, at the heart of governance is the board of directors, as they are at the apex of the company and the primary governance organ.\textsuperscript{22} Lord Haldane in \textit{Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd},\textsuperscript{23} made the analogy that directors are ‘the mind and will of a company’.\textsuperscript{24} Solomon and Solomon noted that, ‘For a company to be successful it must be well governed. A well-functioning and effective board of directors is the holy grail sought by every ambitious company. A company’s board is its heart and as a heart it needs to be healthy, fit and carefully nurtured for the company to run effectively.’\textsuperscript{25} Hence, holding directors accountable for their decisions and behaviour is fundamental to corporate governance.\textsuperscript{26}

\textbf{3.1.2 The Importance of Accountability}

Adrian Cadbury was the Chairman of Cadbury Schweppes for 24 years and was a member of the OECD Business Sector Advisory Group on Corporate Governance in the late 1990s.

\textsuperscript{18} Philip Coachran and Steven Wartick, \textit{Corporate Governance, A Review of the Literature} (Financial Executive Research Foundation, 1988) 1.

\textsuperscript{19} Du Plessis, McConvill and Bagaric, above n 1, 6-7.


\textsuperscript{21} Coachran and Wartick, above n 18, 6.

\textsuperscript{22} Du Plessis, McConvill and Bagaric, above n 1, 54.

\textsuperscript{23} [1915] AC 703.

\textsuperscript{24} \textit{Lennard’s Carrying Co Ltd v Asiatic Petroleum Co Ltd} [1915] AC 703 at 713.

\textsuperscript{25} Solomon and Solomon, above n 4, 65.

\textsuperscript{26} Ibid, 14.
The term ‘accountable’ according to the *Hong Kong Legal Dictionary* is characterised as, ‘responsible; liable.’

Vincent-Jones described accountability, ‘as a process whereby individuals are required to explain or justify their decisions or acts to another person or body in accordance with certain criteria, and then to make amends for any fault or error.’

Du Plessis, McConvill and Bagaric explained that, ‘individuals or groups in a company who make decisions and take actions on specific issues need to be accountable for their decisions and actions. Mechanisms must exist and be effective to allow for accountability. These provide investors with the means to query and assess the actions of the board and its committees.’

Therefore, accountability is one’s obligation towards a definite group of persons with whom one is associated with, and as a member representing this group, or delegated by this group with responsibilities. One is thus answerable to them because there is an element of trust involved.

Joannides was critical about the concept of accountability by arguing that, ‘the accountable self is opaque and is not always capable of reflecting on its deeds and their rationale. It is not always capable of relating its actions to a purpose: sometimes no intelligible reason can be given, limiting the production of verbal or numerical accounts.’

Even if accountability could be at times difficult because the task of allocating responsibility or culpability for collective decisions maybe difficult to identify with great certainty, it is central to what corporate governance is about. Since directors are charged with governing a company, the law confers protection to shareholders by imposing legal liability as a measure to enforce the lack of accountability or to be accountable for failures.

Furthermore, an integral part of being accountable is transparency. Solomon and Solomon noted that, ‘Transparency is an essential element of a well-functioning

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29 Du Plessis, McConvill and Bagaric, above n 1, 8.
33 Solomon and Solomon, above n 4, 14-5.
34 Jenkins, above n 30, 171. See subsequent sections.
35 Solomon and Solomon, above n 4, 60.
system of corporate governance.\textsuperscript{36} This is especially important for publicly listed companies where information is required for a proper functioning market as investors make investment decisions on publicly available information.\textsuperscript{37} Furthermore, investors are increasingly seeking out companies with greater transparency in light of the series of corporate scandals and collapses in the 1990s.\textsuperscript{38} Shareholders as owners need knowledge in order to exert more influence on the board’s decisions. As such transparency facilitates greater accountability of directors.\textsuperscript{39} Transparency includes more than financial information and the disclosure of risk.\textsuperscript{40} It includes directors disclosing any material personal interest in a transaction or contract because this would affect the motive of their decisions.\textsuperscript{41} Again, Joannides was critical, arguing that to be accountable and transparent could create competing tensions for individuals as the former is concerned with justification, whereas the latter is about compliance with procedures. Therefore concerns about transparency might result in dismissing certain performances in favour of conformance because it is easier to conform than to justify.\textsuperscript{42} Conceptually transparency is expected to complement the appeal of directors to be accountable to shareholders. Then, how directors decide what is best for the company is a matter of individual judgements. How these individuals differentiate between right and wrong is shaped by the shared attitudes, values and beliefs.\textsuperscript{43} The underlying assumptions of directors’ duties are to regulate how they behave,\textsuperscript{44} and thus laws are expected to nurture the core values of accountability and transparency amongst all company directors.\textsuperscript{45}

\textsuperscript{36} Ibid, 119.
\textsuperscript{37} Kevin Keasey, Steve Thompson and Mike Wright, ‘Introduction’ in Kevin Keasey, Steve Thompson and Mike Wright (eds), Corporate Governance: Accountability, Enterprise and International Comparisons (John Wiley & Sons, 2005) 1, 5-7.
\textsuperscript{38} Christine Mallin, Corporate Governance (Oxford University Press, 3rd ed, 2010) 16.
\textsuperscript{39} Ibid.
\textsuperscript{40} Tricker, above n 9, 132-3.
\textsuperscript{41} John Farrar, Corporate Governance in Australia and New Zealand (Oxford University Press, 3rd ed, 2008) 119-21.
\textsuperscript{42} Joannides, above n 31, 247.
\textsuperscript{44} Ibid.
\textsuperscript{45} The focus on directors as individuals rather than a collective can be traced to arguments that individual’s contribute to organisational action consists of interactions between individual acts and decisions and the organisation as an entity impacts on organisational acts as well as the ethos of individuals as members of the organisation. Thus, the allocation of responsibilities onto individuals upholds the principles of accountability. See Christopher Harding, Criminal Enterprise: Individuals,
3.1.3 Directors’ Role from a Legal Perspective

As noted in the above, Lord Denning said that directors have wide and extensive powers to manage a company. The delegation of powers by the shareholders onto the directors is usually spelt out in the company’s articles. Apart from the company’s articles, the courts have developed a set of general law duties to rein in directors who have acted against the interest of the company. The legal rules that apply in Hong Kong have evolved from those developed in the United Kingdom since 1795. Davies wrote, ‘rules for directors were developed by the courts at an early stage, analogy with the rules applying to trustees, and the substantial corpus of learning on the nature and scope of these fiduciary duties of skill and care . . . ’ These duties are core regulatory mechanisms to monitor and discipline directors. However, directors are not trustees per say, rather ‘in some respects similar to those of a trustee’. Another description of directors is in terms of agency. Smith and Keenan noted that ‘the relationship between a company and its directors is that of principal and agent and as agents the directors stand in a fiduciary relationship with their principal, the company.’ Yet the analogy of directors as agents is less than perfect. There are elements of both trustee and agent in directorships.

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46 See Art 82 of Table A, Companies Ordinance (Hong Kong) cap 32.
47 Paul Davies, Gower and Davies’ Principles of Modern Company Law (Sweet & Maxwell, 7th ed, 2003) 371.
48 York Buildings Co v Mackenize (1795) 8 Bro Cas 42 (HL). For discussions on legal transplantation see Chapter 7.2.1.
49 Davies, above n 47, 371.
51 Smith v Anderson (1880) 15 Ch. D. 275.
53 Note agency theory is about motivating directors (agents) to act in the interest of shareholders (principals) on the one hand, on the other hand limiting directors’ self-interest in situations that the and have conflicting goals. There are other theories to explain directors’ function and role in a company, there are stakeholder theory, stewardship theory, resource dependency theory, institutional theory, and managerial hegemony. However, it is beyond the scope of thesis to explore these alternative theories about directors. For more on theories of the roles of the board of directors see, Humphry Hung, ‘A Typology of the Theories of the Roles of Governing Boards’ (1998) 6 Corporate Governance: An International Review 101.
54 K Smith and D Keenan, Company Law (Pitman Publishing, 2nd ed., 1970) 141. Note that there is a difference between legal and economic perspectives on agency matters. The law sees it as a question of loyalty, honestly and accountability, whereas economists view it as a question of appropriate incentives, where self-interest not trust, is central. Since companies are economic vehicles or entities, the can pose considerable challenges for directors, torn between self-interest over interest of the
Conceptually if directors are agents, the imperative is to ensure agents act in the interests of the principal (shareholders). Under this model, directors take on a monitoring role to ensure professional managers act in the interest of shareholders. Shareholders are ‘supreme’ in the company because they have the power to appoint or remove directors, whereas as trustees shareholders cede control over the company to directors. Under this model directors have wide discretion powers as long as they act exclusively in the interests of the beneficiaries (shareholders as a collective). The differences between the two roles are not enormous, in the former shareholders are more involved with key decisions of the company (even though it is at arm’s length through the annual general meeting), and the latter, greater power to the board and the relative impotence of shareholders. Besides, contractual obligations reinforce the relationship between directors and a company similar to those of agents and trustees, because shareholders have the power to authorise, or consent to depart from, exclusive benefit principle, thereby treating owners and controllers as separate parties. This structural and functional separation denotes directors as being in fiduciary positions in relation to the company.

company. See Angus Young, ‘The Notion of Regulating Conflicts of Interest: Segregation, Dilemma or Superficial Exercise’ (Paper Presented at the CLTA Annual Conference 2005 on Regulating Conflicts of Interest in Contemporary Corporate Law, University of Sydney, Sydney, 6–8 February 2005) 2-5, 12-4, 17.


Ibid, 298-300.


Ibid, 179-81.


Lan and Heracleous, above n 57, 298.

The Latin word *fiducia*, in the confines of the principle of equity, relates to a number of English words like confidence, trust, or reliance. Thus fiduciary obligations arise when certain categories of relationships are deemed fiduciary in nature and where there is reliance, trust, confidence and even loyalty of one or more parties to the other which transpires whether such obligations arise voluntarily or otherwise. Whilst the legal doctrines of fiduciary obligations have been criticised as a ‘concept in search of a principle’, the elements of ‘trust and confidence’, ‘entrusting elements between parties’, ‘a reasonable or justifiable expectation of loyalty’, ‘unjust enrichment’ and ‘vulnerability or disadvantage’ are key features and attributes. The key theme of this duty assumes that the relationship is unidirectional, where one or more parties entrusts or relies on the other to act in their interests or at least safeguard them.

### 3.1.4 The Underlying Principles and Values of Directors’ Duties

In *Bristol & West Building Society v Mothew*[^69] Millet LJ said ‘a fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence.’[^70]

However, a person is not subjected to fiduciary obligations just because he or she is in a position of power. Flannigan argued that, ‘They only have application once triggered by a prior finding of fiduciary status.’[^71] As noted, fiduciary relationships are those of trust and confidence or confidential relations. As well they involve the exercise of a power or discretion affecting the interests of another person in a legal capacity or practical sense. Thus, Redmond stated that a good director is a person who, ‘brings to the office an ethic of self-denial or disinterested service.’[^73]

[^67]: Nosworthy, above n 65, 288.
[^70]: *Bristol & West Building Society v Mothew* [1998] 1 Ch 1 at 18.
practicability of these assumptions, they lay the foundation of how the law sees and treats directors – as separate individuals appointed to office to perform a service to an organisation and thus have to be accountable for their actions and decisions.  

It is also important to note that fiduciary duties and a duty of care that apply to directors in Hong Kong are presumptive rules because shareholders may opt-out of taking legal action against directors for breaching their duties by ratifying their acts.  

Presumptive rules are products of contractual relations and fiduciary duties between principal and agents, when there is an absence of perfect information. The nature of presumptive rules means that the principal can elect to opt-out of enforcing any legal rules against the agent. The idea is it gives the principal (in this case the shareholders) substantive control over the agents’ (the directors) behaviour and performance. As well, presumptive rules offer flexibility for principals to elect to opt out or waive the rules against the agents. In company law, shareholders may opt-out of taking legal action against directors for breaches of directors’ duties through ratification. These rules are meant to cover a range of foreseen and unforeseen circumstances. They will apply unless parties opt out. Nosworthy noted that, ‘As fiduciary obligation has been developed as a prophylactic mechanism, it can be modified by the consent of the beneficiary.’

More importantly, this opt out provision also recognises that there might be situations where shareholders think it is appropriate to relax the rules over directors. In effect, the nature of fiduciary duties is to reaffirm principles in agency theory by ensuring that the shareholders retain control over the directors’ decisions and behaviour. This gives the principal (shareholders) substantive and discretionary

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74 Davies, above n 47, 381; Flannigan, above n 71, 35.
76 Paul Kwan, Hong Kong Corporate Law (LexisNexis, 2006) 1024-8.
77 Cheffins, above n 75, 257.
78 Ibid, 257.
79 Ibid, 259.
80 Ibid, 226; Kwan, above n 76, 1024-8.
81 Cheffins, above n 75, 257.
82 Nosworthy, above n 65, 283.
83 Cheffins, above n 75, 258.
control over the agents’ behaviour and performance. So there appears to be an inherent assumption that all companies have a separation between ownership and control, otherwise these rules are not likely to serve its purpose.

Another facet of one of the core functions of directors’ duties is to ensure that they are loyal to the company. They are bound to exercise their powers in good faith for the benefit of the company, and not to benefit themselves unless with full disclosure (transparency) and assent of the company (accountability). These duties are deemed to be inflexible and fundamental. They determine what directors should do as well as what they cannot do. These obligations might continue even if he or she has ceased to be a director. It is not dependent on whether the former director refrains from doing a particular act; the issue is whether a positive act or desisting from a particular act was undertaken when this director was in office. Such a conception of loyalty is made under the premise that the directors are trustees and agents (see comments above).

Another duty stemming from the fiduciary relationship is the law concerning care. The logic is that if directors act within their powers then they shall act with such care as is reasonably to be expected of them, having regard to their knowledge and

84 Ibid, 257. This does not mean shareholders’ are able to give direct instructions or alter directors’ decisions and actions, see Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame [1906] 2 Ch 34. Rather shareholders’ key power is to appoint and remove directors, as well as take legal action against them for breaching their duties, see John Armour, Henry Hansmann and Reinier Kraakman, ‘Agency Problems and Legal Strategies’ in Reiner Kraakman et al (eds), The Anatomy of Corporate Law: A Comparative and Functional Approach (Oxford University Press, 2nd ed, 2009) 35, 39-42. Also it is important to note that in Hong Kong directors’ duties cannot be adjusted downwards, see s165(1) of CO – for more detailed discussions see Chapter 4.3.3.
85 Austin, Ford and Ramsay, above n 52, 212. Also see Bristol & West Building Society v Mothew [1998] 1 Ch 1 at 18. Note the directors owe a duty to the ‘company’. This means to the shareholders as a whole, a collective, the assumption is they have common interests. See Davies, above n 47, 371, 372. For more on duties owed specifically to individual shareholders, creditors, and employees in Hong Kong, see Kwan, above n 76, 948-55.
86 Yorston and Brown, above n 64, 173. This is to recognise the fact that interests between directors and shareholders may diverge, if so, it must be done with full disclosure and assent of the company, and divergence when director act with insufficient care and diligence. See Austin, Ford and Ramsay, above n 52, 212.
87 Boardman v Phipps [1967] 2 AC 46.
90 Kwan, above n 76, 948; Shanghai Finance Holding Ltd v Sun Tai Cheung Credits Ltd [2004] HKEC 664.
91 Kwan, above n 76, 1031.
experience and in good faith for the benefit of the company. \(^92\) The duty of care also arises out of contracts and torts. \(^93\) However, Davies argued that:

It is important to recognise that a person who is a fiduciary and who commits a negligent act does not, without more, commit a breach of fiduciary duty. A negligent act does not necessarily involve a breach of the duties of loyalty and good faith, and where it does not, the plaintiff’s remedy will be found normally in damages and he or she will not have access to the other remedies made available for breaches of fiduciary duty. \(^94\)

From a functional analytical lens, according to Frankel, the growth of the use and the acceptance of fiduciary duties by society in general are due to the increase in the specialisation of labour and the pooling of resources as a natural progress in modernisation. \(^95\) Berle and Means suggested that the importance of fiduciary duties is bolstered with the growth of disperse shareholdings in companies in the United States, \(^96\) resulting in the control evolving out of the hands of shareholders - as there is no one majority controller - into the managers and board. \(^97\) Therefore, regulating and monitoring directors has evolved with economic modernisation and public participation in capital pooling. \(^98\) These observations of modernisation tend to be based on models of the development of individualism drawn from western societies, and thus fiduciary duties are seen as a uniform, universal and unified legal instrument to regulate modern commercial life. \(^99\)

Another issue Frankel puts forward is the moral theme in fiduciary duties. \(^100\) She wrote, ‘This moral theme is an important part of fiduciary law. Loyalty, fidelity, faith, and honor its basic vocabulary.’ \(^101\) She claimed that moral expectations

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\(^92\) Lagunas Nitrate Co v Lagunas Syndicate [1892] 2 Ch 392 at 435.
\(^93\) Austin, Ford and Ramsay, above n 52, 243.
\(^94\) Davies, above n 47, 432. Note that the Australian courts have held the duty of care to arise from common law tortious duty of care. See Permanent Building Society (in lkg) v Wheeler (1994) 14 ACSR 109; 12 ACLA 674. Also see Austin, Ford and Ramsay, above n 52, 211, 243.
\(^95\) Frankel, above n 66, 767-84, 829-32.
\(^97\) Ibid, 66-85, 108-111.
\(^100\) Frankel, above n 66, 829-32.
\(^101\) Ibid, 830.
championed in fiduciary duties are altruistic and voluntary.\textsuperscript{102} Frankel added that, ‘once a person becomes a fiduciary, the law places him in role of a moral person and pressures him to behave in a selfless fashion, to think and act for others.’\textsuperscript{103} She also offered moral justifications such as, ‘the moral theme of the law exerts pressure on the fiduciary to fulfil his obligations once he has agreed to enter into the relation. Morality is useful as an adjunct law, because a sense of moral obligations will help bring about the desired behaviour.’\textsuperscript{104} This inferred that these moral values are universal norms.\textsuperscript{105} However, they are not, the moral values espoused in fiduciary duties can be traced to Judeo-Christian doctrines.\textsuperscript{106} Young found both references to, and expectation of, a fiduciary clearly marked in certain passages in both the Old and New Testaments.\textsuperscript{107} He added that, ‘every fiduciary owes specific duties of loyalty and due care to those dependent upon his or her use of fiduciary office … As with any good shepherd, failure to sustain the flock will bring certain chastisement and perhaps loss of benefits.’\textsuperscript{108}

Nevertheless, the above discussion on fiduciary duties draws out the fact that laws are value laden regulatory instruments. Laws make certain value laden beliefs (moral or otherwise) about what is right or wrong, and how those value judgements are rationalised into prescriptive rules. McCormick argued that values are embodied in laws, as they make up the core principles espoused in laws promulgated.\textsuperscript{109} Values as a word have many dimensions; they can include social, ethical, and cultural facets.\textsuperscript{110} Whilst each of these elements is in itself a thesis on its own, this research wishes to

\textsuperscript{102} Ibid, 830.  
\textsuperscript{103} Ibid.  
\textsuperscript{104} Ibid, 831.  
\textsuperscript{105} Norman Bowie, ‘Why Conflicts of Interest and Abuse of Information Asymmetry are Keys to Lack of Integrity and What Should be Done about It’, George Brenkert (ed), \textit{Corporate Integrity and Accountability} (Sage, 2004) 59, 65-70.  
\textsuperscript{107} Young, above n 106, 2.  
\textsuperscript{108} Ibid, 4. Note that Young adopts this term ‘good shepherd’ in a biblical sense see Young, above n 106, 2.  
draw attention to the fact that they are interrelated, and play an important role in shaping norms and laws.\textsuperscript{111} Since Hong Kong’s directors’ duties originated from Britain, the values embedded in these laws are Western. Again, this poses the question - are these Western values compatible with those held by directors of Chinese family companies? If not, it becomes doubtful whether these laws are able to serve their purpose - that is to regulate directors’ behaviour against a set of normative standards.

Directors’ duties, as a set of regulatory standards, are broad and endeavour to be all-embracing obligations,\textsuperscript{112} Kershaw observed that, ‘these duties, therefore, operate both as statements of behavioural expectation – how we expect directors to behave – and as sticks or deterrents to ensure that, or at least to encourage, directors to meet such expectations.’\textsuperscript{113} Thus far, there are four discernible principles and values drawn from the development of directors’ fiduciary obligations (originated in Britain and transplanted to Hong Kong):

- The courts in the United Kingdom have overtime developed a set of legal rules that bring to bear on directors, agency and trustees and their duties towards the company. The growth of separation between ownership and control, as well as corporate failures, propelled the need to hold directors accountable for their decisions and actions.\textsuperscript{114}

- Directors are under fiduciary obligations and as such expected to serve the best interests of the company, unless full disclosure is made and the assent of the company is conferred.\textsuperscript{115} Disclosure conveys that directors’ actions and decisions should be transparent. This infers that the power ultimately lies with the shareholders and not directors.

\textsuperscript{111} Alastair MacAdam and John Pyke, \textit{Judicial Reasoning and the Doctrine of Precedent in Australia} (Butterworths, 1998) 319-35.
\textsuperscript{112} Kelli Ales, ‘Debunking the Corporate Fiduciary Myth’ (Public Law Research Paper No. 358, FSU College of Law, 2009) 4.
\textsuperscript{114} See Adolf Berle and Gardiner Means, \textit{The Modern Corporation and Private Property} (Harcourt, 1932) about the hypothesis of separation of ownership and control in the above. Also, see Charles Rickett and Ross Grantham (eds), \textit{Corporate Personality in the 20th Century} (Hart Publishing, 1998) about the doctrine of separate entity.
\textsuperscript{115} See subsequent sections on detailed discussions on conflicts of interest.
In addition, these presumptive rules confer the shareholders powers to relax the rules over directors when they deem appropriate. In effect, this discretionary power reaffirms the principles in agency theory by ensuring that the shareholders retain control over the directors’ decisions and behaviour. However, the effectiveness of these rules is made on the premise that there is separation between ownership and control, otherwise ratifications of directors’ breach of duties by shareholders could be reduced to procedural matters if the shareholders and directors are the same individuals as can be the case for Hong Kong Chinese family companies.

It also presumes these values (accountability and transparency) are universal, and that the duties will refrain directors from being disloyal (that is against the principals) and/or untrustworthy (abusing the trust of the principals) in dealing with the affairs of the company.\(^\text{116}\) Furthermore, the morality embedded in these duties could be traced to Judeo-Christian teachings, suggest that in Chinese societies like Hong Kong where Confucianism is entwined with the Chinese culture, it might not be appreciated or well received.

Whilst the above section extricates the core principles and values of Western corporate governance and British directors’ duties, it would be premature to make a comparison with the way Chinese family companies are governed without exploring in more depth each of these legal obligations and how Hong Kong’s case law measures up against the territory’s model laws – British legal obligations.

### 3.2 General Law Fiduciary Duties and Obligations in Hong Kong

The general powers and obligations of directors in Hong Kong are made up of statutory obligations found in CO, in the company’s Articles and Memorandum of Association,\(^\text{117}\) and in general law duties. This thesis focuses only on the directors’ fiduciary obligations and duty of care as they form the core legal obligations for

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\(^{117}\) Susan Kwan (ed), *Company Law in Hong Kong: Practice and Procedure* (Sweet & Maxwell, 2007) 7027; Kwan, above n 76, 942-5.
directors. These duties can be divided into two: first, is the duty to act in good faith, for a proper purpose in the interest of the company with no conflict of interest, and second is to exercise care and diligence. In general, directors’ general law fiduciary duties are a closely connected set of obligations. These duties are both broad and all encompassing, in terms of the scope, and specificity of those obligations. Each facet of these duties will be examined closely below. The purpose of this exercise is to examine in detail the obligations these legal rules impose onto directors beyond philosophical objectives. More importantly, the following sections will also illustrate that the interpretations of directors’ duties by the Hong Kong’s courts closely follow British judicial precedents.

3.2.1 Duty to Act in Bona Fide for the Benefit of the Company

In a Hong Kong case on appeal to the Privy Council *Lee Tak, Samuel v Chou Wen Hsien*, the Privy Council affirmed the findings by the Court of Appeal in Hong Kong. Briefly, this case was about the plaintiff, Mr Lee, a director of a company Ocean Land Development Ltd. The plaintiff was suspicious over the sale of the company’s assets and sought more financial information. Mr Lee received a letter from his fellow co-directors requesting his resignation three days after a board meeting where he was frustrated by the lack of information given to him. The Court of Appeal in Hong Kong held the co-directors were within their power to seek Mr Lee’s resignation under Article 73(d), and there was no evidence to back the allegations about breaches in the directors’ duty to act in bona fide in the best interests of the company by the co-directors. In reaching this decision the Hong Kong’s Court of Appeal applied two British leading cases, *Gaiman and others v*

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118 SH Goo and Anne Carver, *Corporate Governance: The Hong Kong Debate* (Sweet & Maxwell, 2003) 259.
120 [1984] 1 BCC 99291.
121 *Lee Tak, Samuel v Chou Wen Hsien* [1984] 1 BCC 99291 at 99294.
122 Ibid.
123 Ibid.
National Association for Mental Health\textsuperscript{125} and Bamford v Bamford\textsuperscript{126} in reading the law.\textsuperscript{127}

The duty to act in bona fide requires a director to act honestly and in good faith.\textsuperscript{128} This applies to every decision directors take about the affairs of the company.\textsuperscript{129} In considering acts in bona fide, the courts will take a common sense approach to consider whether directors have not done what they believe was right, and accepting that, unless they have not behaved as honest people would be expected to act then they would have acted in bona fide.\textsuperscript{130} The test is a subjective one.\textsuperscript{131} However, it is not the courts’ place to make any judgement on the merits of commercial decisions, only legally defined impropriety.\textsuperscript{132} Another important matter to note is that the test of bona fide is considered as Evershed MR observed, ‘within the ordinary scope of the company’s business, and whether it is reasonably incidental to the carrying on of the company’s business for the company’s benefit.’\textsuperscript{133} This means the shareholders (members) as a general body,\textsuperscript{134} which includes present and future shareholders as a

\textsuperscript{125} (1970) 3 WLR 42.

\textsuperscript{126} (1970) 1 Ch 212.

\textsuperscript{127} Samuel Tak Lee v Chou Wen Hsien and Others [1982] HKCA 245; CACV000064/1982, [12]. Note that even though this appeal decision by the Court of Appeal in Hong Kong was made prior to the handover where the Territory was still under colonial administration, this decision stands in post handover Hong Kong unless the Court of Final Appeal, or Court of Appeal overrule this decision. For more on the laws previously in force in Hong Kong prior to the handover in 1997 see Yash Ghai, Hong Kong’s New Constitutional Order: The Resumption of Chinese Sovereignty and the Basic Law (Hong Kong University Press, 1997).

\textsuperscript{128} Stott, above n 119, 230.

\textsuperscript{129} Davies, above n 47, 387.

\textsuperscript{130} Ibid, 387-8; Re Smith & Fawcett Ltd [1942] Ch. 304 at 306.

\textsuperscript{131} Re Smith & Fawcett Ltd [1942] Ch. 304.

\textsuperscript{132} Kwan, above n 76, 956. In Lee Tak, Samuel v Chou Wen Hsien [1984] 1 WLR 1202, Lord Brightman (at 1206) took a two-tier approach with the first limb, that of bona fide, and the second limb, that of proper purpose to determined the directors acted in good faith. For more on ‘proper purpose’ see subsequent sections. Also note bona fide is considered by the courts as a element of motive, whether directors have abused their powers. See Hindle v John Cotton Ltd (1919) 56 SLR 625 at 631.

\textsuperscript{133} Hutton v West Cork Railway Company (1883) 23 Ch. D. 654 at 672. This duty also covers the failure to act. See British Midland Tools v Midland International Tooling [2003] 2 BCLC 523.

\textsuperscript{134} Greenhalgh v Arderne Cinemas Ltd and Others [1951] Ch 286. It is also argued that the test of shareholders can be misleading because directors may make decisions that are contrary to the majority shareholders. See J. Heydon, ‘Directors’ Duties and the Company’s Interests’ in P Finn (ed), Equity and Commercial Relationships (Lawbook Company, 1987) 120, 125. Note shareholders do not mean sectional interest of some, or a majority of members, but it includes the long-term interests of present and future members. See J Heydon, ‘Directors’ Duties and the Company’s Interests’ in P Finn (ed), Equity and Commercial Relationships (Lawbook Company, 1987) 120, 123.
whole.\textsuperscript{135} Flannigan argues that this duty is trustee like, ‘In particular, a director was to give to the corporation ‘the full benefit of all the knowledge and skill which he could bring to bear on the subject.’\textsuperscript{136}

\subsection*{3.2.2 Duty to Exercise Powers for a Proper Purpose}

Another facet of the directors’ duty to act in the best interest of the company is the duty to exercise their powers for a proper purpose.\textsuperscript{137} In a leading case in Hong Kong, \textit{Wong Kam San v Yeung Wing Keung}\textsuperscript{138}, an extra ordinary general meeting resolution was passed to authorise the board to allot 9900 new shares at $1 per share to the third defendant, Kan, which in effect diluted the shareholdings of the first plaintiff, Wong. Justice Lam followed a Privy Council decision in \textit{Howard Smith Ltd v Ampol Petroleum Ltd},\textsuperscript{139} where his honour found the purpose of allotting the shares would result in the dilution of an existing majority, or create a new majority, which did not previously exist, even if it was not for the self-interest of the directors the act was unconstitutional and unlawful.\textsuperscript{140} Furthermore, his honour did not find any commercial justification for the allotment of the new shares.\textsuperscript{141}

This duty states that even if the directors acted honestly, for what they believe to be in the best interest of the company, they may still be liable if the powers are

\textsuperscript{135} \textit{Gaiman v National Association for Mental Health} [1971] Ch. D. 317 at 330 per Megarry J. For group of companies, see \textit{Charterbridge Corp. Ltd v Lloyds Bank Ltd} [1970] Ch 62 – was held directors should regard the group’s interest over the interest of separate entities. This position contrasted with an Australian case, \textit{Walker v Wimborne} (1976) 137 CLR 1. As for interests of creditors - only when the company is trading while insolvent – see \textit{Liquidator of West Mercia Safetywear Ltd v Dodd} [1988] BCLC 250. Note Davis argued that, ‘it is up to directors, not the court, to identify the period over which of promoting the shareholders’ interests can most appropriately be achieved; and it is up to the directors to decide how far the promotion of shareholders’ interests requires corporate largess to be expended upon others (including, of course themselves).’ See Davies, above n 47, 389.
\textsuperscript{136} Flannigan, above n 66, 299.
\textsuperscript{137} \textit{Hogg v Cramphorn Ltd} [1967] Ch 254; Kwan, above n 76, 962. The first limb is the duty to act bona fide in the interest of the company. See \textit{Lee Tak, Samuel v Chou Wen Hsien} [1984] 1 WLR 1202.
\textsuperscript{138} [2007] HKCFI 336; HCA002036/2005
\textsuperscript{139} [1974] AC 821.
\textsuperscript{140} \textit{Wong Kam San v Yeung Wing Keung} [2007] HKCFI 336; HCA002036/2005, [76].
\textsuperscript{141} Ibid, [82].
exercised for a different purpose to that they had been conferred upon. Furthermore, Davis observed that, ‘often the improper purpose will be to feather the directors’ own nests or to preserve their own control, in which event it will also be a breach of duty...’ Even if they honestly believe it is in the best interest of the company, but acted for an improper purpose, it constitutes a breach of this duty.

### 3.2.3 Unfettered Discretion

On the matter of a director’s discretion, there is the positive duty for directors not to fetter their discretion. There are at present no cases in Hong Kong on this matter. According to Kwan, a practitioner in Hong Kong, the authority in Hong Kong is an English appeal case *Boulting v Association of Cinematograph, Television and Allied Technicians*. The nature of this duty is to ensure directors’ judgement is independent and retains their individual discretion. The test for this duty is an objective test, notwithstanding the fact that the discretion was exercised in good faith, or even if there was no personal gain and improper purpose, directors cannot contract with an outsider to vote in a board meeting in a particular way. This does not mean that directors cannot make a contract by which they bind themselves to the future exercise of their powers in a particular manner, or that they are prepared to make recommendations to shareholders on certain transaction, as long as the contract taken as a whole is for the benefit of the company. Exceptions to breaching this rule include directors agreeing in advance to convene a board meeting for the following reasons: to appoint a person as director; allot shares to a specific person;

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142 Davies, above n 47, 385.
143 Ibid, 385, *Hogg v Cramphorn Ltd* [1967] Ch 254. Note that the duty not to act in conflict and no secret profits will be considered in the section below.
144 *Hogg v Cramphorn Ltd* [1967] Ch 254.
145 Kwan, above n 76, 969.
146 [1963] 2 QB 606; Kwan, above n 76, 969.
147 Austin, Ford and Ramsay, above n 52, 260; Davies, above n 47, 391.
148 Davies, above n 47, 389-90, *Cabra Estates Plc v Fulham Football Club* [1994] 1 BCLC 363. Note this does not mean that directors cannot make a contract by which they bind themselves to future exercise of their powers in a particular manner, as long as the contract taken as a whole is for the benefit of the company. See Kwan, above n 76, 972.
to vote in support of the registration of a member of the company; to register a share transfer at a subsequent meeting.\footnote{Andrew Keay, ‘The Duty to Exercise Independent Judgement’ (2008) 29, \textit{Company Lawyer}, 290, 292. For nominee directors who are appointed by a particular class of shareholders or creditors, this present a clear challenge when they are expected to vote in the interest of those who appoint them rather than the company. The court held even though there is nothing wrong about being appointed to be a nominee director, so long as the director is free to exercise his or her judgement in the best interest of the company and not the nominee’s. See \textit{Boulting v Association of Cinematograph, Television and Allied Technicians} [1963] 2 QB 606, at 626, per Lord Denning MR.}{150}

### 3.2.4 No Conflict of Interests and No Secret Profits Duties

In a leading case in Hong Kong, \textit{Kishimoto Sangyo Co. Ltd and Another v Akihiro Oba and Others}\textsuperscript{151}, the managing director of the Hong Kong subsidiary of Kishimoto Sangyo Co. Ltd, Mr. Oba was negotiating, on behalf of the company, contracts with a Taiwanese company (Prime View) on the production of LCD screens. Mr Oba left the company because he was dissatisfied with how headquarters had handled the matter. About a year later he set up a new company BOIS. Along with three other former employees of the Hong Kong subsidiary Oba negotiated with Prime View to produce LCD screens. The former employer sued Mr Oba for breach of fiduciary duties. In reaching his decision, Justice Barnett applied the law from one British and one Canadian case, \textit{Regal (Hastings) Ltd. v. Gulliver}\textsuperscript{152} and \textit{Canadian Aero Services v. O'Malley}\textsuperscript{153} respectively about the no conflict rule. His honour held that, ‘while individual matters are susceptible of innocent explanation, taken together they require no great penetration to reveal an interest and purpose on the part of Mr. Oba to place himself in the pole position when it came to bidding for the project.’\textsuperscript{154} On appeal, even though the Court of Appeal reversed the decision in the first instance on the grounds of not meeting the ‘maturing business opportunity’ test (subdivision of no profit rule), the rulings were made on the question of fact and not law.\textsuperscript{155} Insofar as the breach of fiduciary duties, British law was followed as Vitton VP held, ‘in my judgment, the scope of the so-called principle in \textit{Canadian Aero Service v. O'Malley}’

\textsuperscript{150} Andrew Keay, ‘The Duty to Exercise Independent Judgement’ (2008) 29, \textit{Company Lawyer}, 290, 292. For nominee directors who are appointed by a particular class of shareholders or creditors, this present a clear challenge when they are expected to vote in the interest of those who appoint them rather than the company. The court held even though there is nothing wrong about being appointed to be a nominee director, so long as the director is free to exercise his or her judgement in the best interest of the company and not the nominee’s. See \textit{Boulting v Association of Cinematograph, Television and Allied Technicians} [1963] 2 QB 606, at 626, per Lord Denning MR.
\textsuperscript{152} [1967] 2 AC 134.
\textsuperscript{153} [1973] 40 DLR (3d) 371.
\textsuperscript{154} \textit{Kishimoto Sangyo Co. Ltd and Another v Akihiro Oba and Others} [1995] HKCFI 382; HCA000396/1995, [74].
\textsuperscript{155} Ibid, [14].
is clear enough. As the judge stated in the court below, it is founded upon the well-known [British] case of Regal (Hastings) Ltd. v. Gulliver [1967] 2 AC 134.¹⁵⁶

In another authoritative decision in Hong Kong, Kao Lee & Yip v Donald Koo Hoi Yan and Others¹⁵⁷ the issue of no conflict rule was tried. Mr Koo, the first defendant was a partner of a law firm, Kao Lee & Yip. Whilst a partner at this firm, Mr Koo was in discussion with The Bank of China to set up a law centre in the bank, and intended to join the law centre after it was set up. Even though the idea for the law centre was abandoned, Mr Koo left the firm and set up Koo & partners. The court held Mr Koo had breached the no conflict rule in setting up a new firm.¹⁵⁸ Also note that the other solicitors who left Kao Lee & Yip to join Koo’s firm were co-defendants and were also found in breach of their fiduciary duties owed to their previous employer.¹⁵⁹ His honour, Justice Ma followed the law in Boardman v Phipps¹⁶⁰ a leading British decision, and Canadian Aero Service Ltd. v O’Malley¹⁶¹, a Canadian authority, as well as Kishimoto Sangyo Co. Ltd and Another v Akihiro Oba and Others¹⁶² regarding the maturing business opportunity rule.¹⁶³

On contracts made by the director for the company, where he or she has an interest, full disclosure shall be made; this emanates from the rule of no self-dealing. This is a partial codification of the no conflict rule. It is stipulated in Table A, article 86 of CO, where disclosure shall be made in accordance with s162 of CO.¹⁶⁴ This rule is to protect the company from disloyal directors.¹⁶⁵ Even if disclosure is made, it does not

¹⁵⁶ Ibid.
¹⁵⁷ Kao Lee & Yip v Donald Koo Hoi Yan and Others [2003] HKCFI 850; HCA008847B/1993,[50].
¹⁵⁸ Ibid, [117].
¹⁵⁹ [1967] 2 AC 46.
¹⁶⁰ (1973) 40 DLR 371.
¹⁶² Kao Lee & Yip v Donald Koo Hoi Yan and Others [2003] HKCFI 850; HCA008847B/1993, [75]
¹⁶³ See Table A, art 86 in Companies Ordinance – provides that if a director who is directly or indirectly interested in any contract with the company must declare in accordance with s162 of the CO. Also, note that s162 mirrors s199 in the British Companies Act 1948 and s317 of the 1985 CA.
¹⁶⁴ Boulting v Association of Cinematograph, Television and Allied Technicians [1963] 2 QB 606 at 636, per Upjohn LJ.
necessarily validate the contract, it remains voidable. However, the wording in s162(1) states that only if the interest is material, thus is not absolute. Further, s162(5) does not restrict directors from having any interest in contracts. In a Hong Kong case, *Man Luen Corp v Sun King Electronic Printed Circuit Board Factory*, the judge found that there are strict liability obligations, but the statutory duty does not go as far as general law obligations capable of being waived in the company articles. His honour held, ‘s.162 of the Ordinance merely supplements the duties imposed by general law upon directors in relation to their contracts. The statutory duties do not go so far as those insisted upon by the general law and, unlike the latter obligations, they cannot be waived by the articles.’ Furthermore, he said, ‘equitable rules relating to the duties of directors developed in the cases are extremely strict. Their foundation is that directors must not place themselves in a position where a conflict with their private interest might arise, and to a certain degree their position is not far different from that of trustees.’ This is affirmed in another Hong Kong case, *Pleasure International Ltd and Others v Kao Wai Ho Francis and Others*.

As noted in the above, a director is in a fiduciary position in relation to the company. This means he or she cannot conduct any business where his or her interests will conflict with the company’s interests. This is a strict duty. Any contract found

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166 Stott, above n 119, 246.
167 Note that directors who failed to comply with this section are liable for a fine, s 162(3) of CO.
168 Section 162 of the CO merely supplement general law duties in relation to contracts.
169 [1981] HKC 407. It is interesting to note that the court held, ‘equitable rules relating to the duties of directors developed in the cases are extremely strict. Their foundation is that directors must not place themselves in a position where a conflict with their private interest might arise and to a certain degree their position is not far different from that of trustees. As the passages quoted above indicate, the rule is so strict that the Court is prohibited from going into questions of the fairness or unfairness of a relevant contract.’ See para. 19.
171 Ibid, per Fuad J.
174 Stott, above n 119, 232.
175 *Ching Tung Futures Ltd (in liq) v Cheuk Kwan, Arthur* [1992] HKCFI 205; HCA005081/1989 (unreported); Kwan, above n 117, 7031, *Bray v Ford* [1896] AC 44. However, a simple majority vote by the shareholders at the general meeting can waive a breach of this duty, after full disclosure of all
in conflict would as such be voidable, and any profits made shall be recoverable by
the company unless disclosed to shareholders and sanctioned by them.\textsuperscript{176} The ‘no
conflict rule’ is the first strand and the ‘no profit rule’ is the second strand of this
duty.\textsuperscript{177} Both are interrelated duties, and at times they overlap.\textsuperscript{178} One also has to be
mindful that a breach of duties in the first strand does not necessarily involve profits,
whereas a breach in the second strand usually means there is a breach of the first
limb.\textsuperscript{179} Davies argued that, ‘at common law, the “no conflict” rule is probably the
most important of the directors’ fiduciary duties.’\textsuperscript{180} For the reason that it is a
fundamental rule of equity that a person in such capacity must not make profit out of
his or her trust as part of the wider rule about placing himself or herself where his or
her duty may conflict.\textsuperscript{181} Thus such a director shall not enter into any engagements
in which his or her personal interests conflict, or possibly may conflict with those of
the company’s.\textsuperscript{182} Consideration will be given to the extent, or the value of, the
director’s personal interest.\textsuperscript{183} The test is an objective one.\textsuperscript{184}

about a further consideration is the no profit rule. In a Hong Kong case, \textit{Chinese
United Establishment Ltd v Cheung Siu Ki & Another},\textsuperscript{185} the court followed the
principles laid down in a UK authority, \textit{Regal (Hastings) Ltd. v. Gulliver}.\textsuperscript{186} \textit{Briefly, the plaintiff, a company, applied for relief under s 168A of the CO in the alternative for winding up on just and equitable grounds.}\textsuperscript{187} Rogers J held that the defendant, as

\begin{itemize}
\item \textsuperscript{176} Stott, above n 119, 232.
\item \textsuperscript{177} Jenny Payne, ‘Case Comment: Directors’ Fiduciary Duties’ (2006) 122 \textit{Law Quarterly Review}, 558, 559.
\item \textsuperscript{178} Robert Austin, ‘Fiduciary Accountability for Business Opportunities’ in P Finn (ed) \textit{Equity and Commercial Relationships} (Lawbook Company, 1987) 141, 147.
\item \textsuperscript{179} Ibid.
\item \textsuperscript{180} Davies, above n 47, 392.
\item \textsuperscript{181} \textit{Boardman v Phipps} [1967] 2 AC 46 at 123; \textit{Aberdeen Rail Co v Blaikie Brothers} [1854] 1 Macq 461 at 471.
\item \textsuperscript{182} \textit{Aberdeen Rail Co v Blaikie Brothers} [1854] 1 Macq 461 at 471.
\item \textsuperscript{183} \textit{Transvaal Lands Co v New Belgium (Transvaal) Land Development Co} [1914] 2 Ch 488 at 503.
\item \textsuperscript{184} An Australian case, \textit{Walker v Nicolay} (1991) 4 ACSR 309, conflict includes non-pecuniary and indirect interests if there is a real risk of influencing the director in discharging their duties.
\item \textsuperscript{185} \textit{Boardman v Phipps} [1967] 2 AC 46 at 124.
\item \textsuperscript{186} [1997] HKCFI 61; HCA008004/1995.
\item \textsuperscript{187} [1967] 2 AC 134.
\item \textsuperscript{188} \textit{Chinese United Establishment Ltd v Cheung Siu Ki & Another} [1997] HKCFI 61; HCA008004/1995, [8].
\end{itemize}
a director of the plaintiff’s company, breached the no profit rule arising from the defendant’s position as director when he breached his duty by failing to present the plaintiff’s company the opportunity of acquiring complete control over the management and operation of the business venture.\footnote{188}

This rule maintains that unless a director makes the profit with the full consent and knowledge of the shareholders, he/she is liable to account for any profits made in this conflict of duty.\footnote{189} This includes benefiting any other persons without the company’s consent.\footnote{190} Directors are thus not entitled to misappropriate business or corporate property for their own benefit.\footnote{191} Also profits made out of the information derived from the position have to be accounted for.\footnote{192} This refers to the communication of confidential information giving rise to the obligation of confidentially.\footnote{193}

In conclusion the decisions in the Hong Kong cases on the ‘no conflict, no profit’ rule abide by the prescriptions stipulated in the UK’s general law principles where the directors bear agent and trustee like responsibilities. As such this reinforces the assumptions made where ownership and control are separate parties, and directors’ functions are narrowly defined as serving the shareholders’ interests. This reaffirms earlier arguments that if the shareholders and directors are the same individuals, like in family companies, then the notion of accountability under fiduciary duties might be reduced to mere procedural ratification. Another interesting fact from the examination of the Hong Kong cases concerning fiduciary duties is that none of them involved family companies.

\footnote{188} Ibid, [96]-[104]; Kwan, above n 76, 982-3.  
\footnote{189} Kwan, above n 117, 7033; \textit{Regal (Hasting) Ltd v Gulliver} [1967] 2 AC 134. Note it is irrelevant whether the profit made by the director was one that the company could not, or the profit was made not at the expense of the company. See Kwan, above n 76, 1012; \textit{Keech v Sandford} (1726) Sel Cas Ch 61.  
\footnote{190} Austin, Ford and Ramsay, above n 52, 360.  
\footnote{191} \textit{Cook v Deeks} [1916] 1 AC 554.  
\footnote{192} Kwan, above n 76, 1011; \textit{Regal (Hasting) Ltd v Gulliver} [1967] 2 AC 134.  
\footnote{193} Austin, Ford and Ramsay, above n 52, 364. Also see \textit{Salman Engineer Co Ltd v Campbell Engineer Co Ltd} [1963] 3 All ER 413 at 415; \textit{Thomas Marshall (Exporters) Ltd v Guinle} [1978] 3 WLR 116 at 136.
3.3 General Law and Statutory Duty of Care in Hong Kong

According to the law, directors’ duties of care can arise from contract, equitable obligation, or statute. Concerning contractual obligation, it can arise by expressed or implied terms of the contract. A negligent act does not necessarily mean there is a breach of duties of loyalty and good faith. The duty of care stems primarily from common law negligence. This duty consists of three interconnected elements. They are: care, skill and diligence. In addition, this section shall examine the new statutory provision on directors’ duty of care, skill and diligence in s465 of the newly enacted CO of July 2012.

3.3.1 The General Law Duty of Care

Under general law obligations, in the course of discharging their duties as directors, a director can be held liable for possible losses and damages to the company, if he or she fails to exercise reasonable care and skill. Whilst the liability of directors does not necessarily involve breaches of duty of good faith and loyalty, the duty of care focuses on director’s behaviour rather than the results he or she achieves. This, however, does not mean just because a decision that carries an element of risk that he or she has breached his or her duty of care. The issue is whether the director

194 Austin, Ford and Ramsay, above n 52, 243.
195 Lister v Romford Ice and Cold Storage Co Ltd [1957] 1 All ER 125. Note in Hong Kong, s165 of the CO - no contract could indemnify a director against any liability to the company or a related company, by virtue of any rule of law would otherwise attached to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company or related company shall be void. However, in s358 of the CO, the court may grant relief.
196 Davies, above n 47, 432.
197 Austin, Ford and Ramsay, above n 52, 244. Also refer to the Australian case, Permanent Building Society (in liq) v McGee (1993) 11 ACSR 260; 11 ACLC 761.
198 Kwan, above n 76, 1031.
199 Ibid.
in weighting up the risk and rewards of a commercial decision, took reasonable steps to avoid putting the company in jeopardy.\textsuperscript{201}

In the leading case in Hong Kong, \textit{Law Wai Duen v B. F. Construction Co Ltd and Others}\textsuperscript{202} a director's right to inspect a company's accounts under general law and section 121 of CO was tried. Mr Yip claims that he was appointed director of a family company (the other board members are the husband, wife and daughter) because of his technical expertise in building construction. He considered himself to be an employee whose only responsibility was for the construction aspects of the business. As such he felt he had nothing to do with the accounting or the keeping of those records. Amidst this corporate action against Mr. Chan, who was the major shareholder and director, Mr. Chan commenced divorce proceeding against this wife, Madam Law, the other major shareholder and director of this family company (Mr Yip’s employers). Mr. Chan claimed that his wife was undermining his position and interests in the company out of spite because she suspected he was having an extramarital affair. The wife instead asserted that she thought there were irregularities in the company accounts, and claimed that Mr Yip and her husband denied her the right to inspect the accounts.

In the court of first instance, Chu J held, ‘I agree with senior counsel for the Husband that the court should not overlook the fact that the parties, save Mr Yip, are family members and also the family dimension of the matter.’\textsuperscript{203} Chu J held that Mr Yip in these proceedings was unnecessary and unjustified. The company books were not in Mr. Yip’s possession, even though he was a board member but had no controlling or beneficial interest in the company and was a mere employee.\textsuperscript{204} Her honour held:

\textsuperscript{201} Redmond, above n 73, 361-2.
\textsuperscript{203} Law Wai Duen v B. F. Construction Co Ltd and Others [2001] HKCFI 926; HCMP000703/2001, [37].
\textsuperscript{204} Ibid, [50].
It cannot be realistically suggested that he can on his own volition and decision, make the documents available to the Wife and/or the Daughter without regard to the views of the Husband. It is therefore immaterial that he is on the board of directors.\textsuperscript{205}

And added that:

The Wife [Madam Law] is herself a registered person for Boldwin and has been in that position since 1977. On her case, she has been intimately involved in the business and activities of Boldwin. She would, if her contention is right, also have the opportunity to come across these company documents. Yet she has to apply to the court for an order for inspection … after all, it must be plain that the dispute or disagreement over inspection of corporate books and records is very much a dispute between the Husband and the Wife. There is little purpose to be served by joining Mr Yip, who evidently has no role to play in resolving the dispute.\textsuperscript{206}

In dismissing claims against the defendant, undoubtedly her honour held the view that Mr Yip was caught up in a family dispute. On appeal Madam Justice Chu’s judgement was overturned.\textsuperscript{207} Rogers VP did not take into consideration the family dimensions raised by Chu J. Instead, he held that the law does not have any regard to whether a director is an executive or non-executive.\textsuperscript{208} And his honour followed the British decision by Romer J in \textit{Re City Equitable Fire Insurance Co Ltd}\textsuperscript{209} and held that:

Mr Yip’s attitude in relation both to his duties and position as a director and to the plaintiffs' request for access to company documents is, I regret, flawed. Whereas Mr Yip may regard himself as performing a purely technical role he was, nevertheless, a director of a company. When it came to the exercise by directors of the undoubted right of access to company documents, he could not take a neutral role. His deference to Mr Chan was misplaced. He could not simply act as a messenger and do nothing. His duties as a director obliged him to use such power as he had as a director to enable other directors to exercise their right and

\textsuperscript{205} Ibid, [50].
\textsuperscript{206} Ibid, [50], [51].
\textsuperscript{207} Ibid, [1], [28].
\textsuperscript{208} Ibid, [9]. Note Rogers VP cited the decision of Foster J in a UK case, \textit{Dorchester Finance Co. Ltd v Stebbing} [1989] BCLC 498 on the distinction between executive and non-executive directors, curiously his honour did not adopt the objective standard of care for director. This was probably because the higher standard is stipulated in the British \textit{Insolvency Act} 1986.
\textsuperscript{209} [1925] Ch 407.
Even though from a legal perspective, Roger VP was correct in reaching his decision because he was reading the law as it stood, on a practical level Chu J was also right to draw attention Mr Yip being caught up in a family dispute.

As noted in the above, the British case *Re City Equitable Fire Insurance Co Ltd*[^211^] is the leading general law authority in Hong Kong. Romer J in this legal authority formulated three criteria to determine whether a director has breached the duty of care and skill.^[212^] First, he or she need not exhibit the standard of care and skill reasonably expected of a person of his or her knowledge and experience.^[213^] Second, they are not bound to give continuous attention to the affairs of the company. His or her duties are of an intermittent nature.^[214^] Third, having regard to the exigencies of the business, a director may delegate the running of the company to another, and rely on this person to perform such duties.^[215^] The standard of care and skill of a director from this formulation is low and subjective.^[216^] With regards to the issue of skill, Romer J held that ‘a director need not exhibit in the performance of his duties a greater skill than may reasonably expected from a person of his knowledge and experience.’^[217^] It is also a subjective test. Diligence is another important facet of the duty of care. In *Tesco Supermarket Ltd v Nattrass*[^218^] Lord Diplock held, ‘due diligence is in law the converse of negligence which connotes a reprehensible state of mind – a lack of care for the consequences of his physical acts on the part of a person doing them.’^[219^] A director is said to have breached the duty of care by not

[^210^]: Law Wai Duen v B. F. Construction Co Ltd and Others [2001] HKCA 284; CACV001835/2001, [27], per Rogers VP.
[^211^]: [1925] Ch 407.
[^212^]: Kwan, above n 76, 1032.
[^213^]: Stott, above n 119, 235.
[^214^]: Ibid.
[^215^]: Ibid.
[^216^]: Kwan, above n 76, 1033. Also see *Re Brazilian Rubber Plantations & Estates Ltd* [1911] 1 Ch 425, where the court found a director is not bound to bring any special qualifications to his or her office.
demonstrating an appropriate level of diligence in the execution of his or her duty.220 This includes the duty to inform themselves about the affairs of the company and monitoring of those affairs.221

In sum, the director's duty of care as it stands sees a director as an independent party who is expected to take reasonable care for his or her actions and omissions, not as a member of a family, where the notion of care in the family context might not be the same as the law. Whilst it might be a legitimate and serious matter tried in the Hong Kong case Law Wai Duen v B. F. Construction Co Ltd and Others222, it appears somewhat odd that the plaintiff (the wife) was enthused to take legal action as a director and that she only sued Mr. Yip and left out the other director (her husband) in this action. One might think that the plaintiff wanted justice from Mr Yip for breaching his duty, yet, Madam Law’s husband Mr Chan testified the she wanted to get back at him for his infidelity.223 Since the appeal decision ruled in favour of the plaintiff Madam Law, she petitioned the courts again, as a shareholder and creditor of the company to have the company wound up.224 So the legal action of Mr Yip's failure to execute his duties as a director did not necessarily provide satisfaction for Madam Law. Evidently it would appear that the case by the plaintiff was not about the directors’ duty per se, instead it was a family dispute that spilled into the governance of a family company. However, the Hong Kong legal community's criticisms of this case were that the subjective standard of care for a director was too low.225 Spink and Chan argued that if the territory wants to remain internationally competitive as a financial centre, the standard of care needs to be an objective one.226 This view was taken up by the Hong Kong government in the recent round of Companies Ordinance reform.

221 Redmond, above n 73, 362.
223 Refer to earlier paragraphs in the above.
224 Re Baldwin Construction Co Ltd & Ors [2003] 4 HKC 156.
225 In Law Wai Duen v B. F. Construction Co Ltd and Others, Rogers VP, in his dictum wrote, ‘the standard which he [Romer J] described as being required of a director is, if anything, open to review in present day circumstances as, perhaps, being too low.’ See Law Wai Duen v B. F. Construction Co Ltd and Others [2001] HKCA 284; CACV001835/2001, [10].
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3.3.2 The Newly Enacted Statutory Duty of Care

As noted in Chapter 2.3.2, in mid-2006, the Hong Kong Government launched a major review of the CO. The objectives were to modernise and update the law with the aim, ‘to make it [CO] more user-friendly, and facilitate the conduct of business to enhance Hong Kong's competitiveness and attractiveness as a major international business and financial centre.’\(^{227}\) This rewrite exercise drew substantially on the Standing Committee Company Law Reform (SCCLR) reports from 2000 to 2004.\(^{228}\) Amongst a number of recommendations of SCCLR was to codify. As noted in Chapter 2.3.3, there was some consensus on this matter so the government went ahead with this proposal, ‘with a view to clarifying the duty under the law and providing guidance to directors.’\(^{229}\)

In December 2009, the Financial Services and Treasury Bureau released The Companies Bill: Consultation Draft of Parts 1, 2, 10-12 and 14-18. Under Division 2, Part 10, titled Directors and Secretaries, with respects to the statutory duty to exercise reasonable care, skill and diligence – section 10.13 proposes the following:

1. A director of a company must exercise reasonable care, skill and diligence.

2. Reasonable care, skill and diligence mean the care, skill and diligence that would be exercised by a reasonably diligent person with –

   a. 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

   b. the general knowledge, skill and experience that the director has.

3. The duty specified in subsection (1) is owed by a director of a company to the company.


\(^{229}\) Ibid. For more detailed discussions refer to Chapters 2.3.2 and 2.3.3.
(4) The duty specified in subsection (1) has effect in place of the common law rules and equitable principles as regards the duty to exercise reasonable care, skill and diligence, owed by a director of a company to the company.

(5) This section applies to a shadow director as it applies to a director.230

Therefore from the plain reading of section 10.13(d), this provision replaces in the ensuing section, 10.14, the civil consequences of breach of duty to exercise reasonable care, skill and diligence, it states that:

Without affecting other provisions of this Ordinance, the consequences of breach (or threatened breach) of the duty specified in section 10.13(1) are the same as would apply if the common law rules or equitable principles that section 10.13(1) replaces applied.231

Then in sections 10.16 and 10.18, the draft Bill provides that any provisions in a company’s articles to relieve directors from liability, negligence, or breach of trust are void, as well as to limit the indemnity of directors. This provision along with others in the Companies Bill was passed by the Legislative Council on the 12 July 2012.232 It was enacted word for word from the Bill unamended in a new statutory provision s465 of the CO, coming into effect in 2014.233

Since this new statutory provision in Hong Kong is a word for word transplantation of the British s174 of CA, it will be helpful to examine the implications of Hong Kong’s legal obligations for directors from provisions in Britain. Davies argued that the new British statutory provisions on directors’ duty of care mean several things for the directors:

First, although directors, executive and non-executive, are subject to a uniform and objective standard duty of care, what the discharge of that duty requires in particular cases will not be uniform. As the statutory formulation itself recognises, what is required of the director will depend on the functions carried out by the director, … Secondly, the imposition of an objective duty of care does not necessarily require a directorship to be regarded as a profession … On the other hand, … the days of the wholly inactively or passive director

230 Ibid, 58.
231 Ibid.
would seem to be numbered … Thirdly, directors are permitted to engage in substantial
degression of management functions to non-board employees. … Fourthly, an objective
standard of care is not inconsistent with extensive delegation nor, however, does it permit the
directors to escape from the second requirement of always being in the position to “guide and
monitor” the management … Fifthly, the principles relating to delegation to sub-board
managers apply also to the division of functions among the directors themselves. Inevitably,
executive directors will carry a greater load of management responsibilities than the non-
execs … Sixthly, however, it follows from the inevitable acceptance of extensive
delegation, at least in large companies, that directors cannot be guarantors that everything is
going well … [whether a director is negligent] will depend on the facts of the situation,
including the quality of internal controls.\textsuperscript{234}

Sealy and Worthington had different views. They noted that the difficulty of this new
statutory standard probably explains why the law is not expounded in the general law
breach of duty cases, but primarily in cases concerning directors’ disqualification in
Britain because the standard applied is an objective one.\textsuperscript{235} Furthermore, they noted
that there have been similar developments in Australia about directors’ duty of
care.\textsuperscript{236} Therefore it will be interesting to compare Australia’s statutory provisions.

Briefly, Australia’s statutory directors’ duty of care is found in s180 of The

\textit{Corporations Act 2001} (Cth). Section 180(1) states that:

A director or other officer of a corporation must exercise their powers and discharge their
duties with the degree of care and diligence that a reasonable person would exercise if they:
(a) were a director or officer of a corporation in the corporation’s circumstances; and (b)
occupied the office held by, and had the same responsibilities within the corporation as, the
director or officer.

The statutory standards have modified the general law standards that the Australian
courts have adopted. Prior to the enactment of this statutory provision, Harris,
Hargovan and Adams commented that, ‘The common law duty of care, skill and
diligence that is expected by the courts has traditionally been set at a low

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\footnotesize\textsuperscript{234} Paul Davies, Gower and Davies Principles of Modern Company Law (Thomson, 8th ed, 2008) 491-3.
\footnotesize\textsuperscript{235} Len Sealy and Sarah Worthington, \textit{Cases and Materials in Company Law} (Oxford University

\footnotesize\textsuperscript{236} Ibid.
standard.  They continued with the following statement, ‘It should be noted that the nature of corporate governance, and indeed public perceptions and expectations concerning corporate governance standards, now have dramatically since 1925 when Justice Romer made these famous statements …', noting that the times and the demands of office had changed. Farrar noted that, ‘the reference to ‘reasonable man’ [in the statutory provision] was intended to confirm that the required standard of care and diligence was to be determined objectively.’ In determining whether the director has breached the statutory standards of care, the Explanatory Memorandum, Corporate Law Economic Reform Act 1992 (Cth) stated that:

[w]hat constitute the proper performance of the duties of a director of a particular corporation will be influenced by matters such as the state of the corporation’s financial affairs, the size and nature of the corporation, the urgency and magnitude of any problem, the provisions of the corporation’s constitution, and its composition of its Board. With respects to skill of a director, Harris, Hargovan and Adams noted that in the statutory provision the word ‘skill’ was not used. They added that, ‘Each officer will owe of duty of care and diligence at an objective level based on their purported skills and expertise in the context of the corporation’s circumstances.’

Even though it is beyond the scope of examine the Australian statutory provision in detail, the brief analysis of the Australian s180(1) of the Corporations Act 2001 (Cth) has showed that it has clear ramifications for the interpretation of the new Hong Kong statutory duties for directors as the wordings of the new s465(2) of the CO have similar intrinsic meanings with the Australian provision. There is however a

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237 Jason Harris, Anil Hargovan and Michael Adams, Australian Corporate Law (LexisNexis, 2nd ed, 2009) 494.
238 Ibid, 495. See Justice Romer’s judgement in Re City Equitable Fire Insurance Co Ltd [1925] Ch 407 in Chapter 3.3.1.
239 Farrar, above n 41, 142. Also see Daniels (former t/a Deloitte Haskins & Sells) v Anderson (1995) 16 ACSR 607; 37 NSWLR 438.
240 Explanatory Memorandum, Corporate Law Economic Reform Act 1992 (Cth) [85]-[86].
241 Harris, Hargovan and Adams, above n 237, 511.
243 The wording of the new s465(2) of the CO was stated in the above discussion about the Companies Bill: Consultation Draft of Parts 1, 2, 10-12 and 14-18. Under Division 2, Part 10, titled Directors and Secretaries, with respects to the statutory duty to exercise reasonable care, skill and diligence – section 10.13 (b).
clear distinction between the new Hong Kong statutory provisions and the Australian Act because s180(2) of the *Corporations Act 2001* (Cth) includes a business judgement rule.²⁴⁴ Similarities and differences aside, this discussion has reiterated Hong Kong’s directors’ duties failed to take into consideration the needs of family companies and the influence of Chinese cultural values noted in Chapter 1.1.3.

3.4 Summary and Commentaries

This chapter observed that the law regards directors as fiduciaries of the company because, as controllers, they have wide discretionary powers conferred on them by the company, and thus have to be accountable for their decisions (indecisions) and actions (inactions). Therefore, the primary objective of regulating directors is to reinforce the notion of accountability and transparency as core values underpinning the principles of good corporate governance. This is because the law has deemed directors to be fiduciaries. Since fiduciary obligations arise where there is trust, reliance, confidence as well as loyalty to one or more parties, the relationship between a company and its directors is one of principal and agent. These values are embedded in the British general law duties which apply to all directors in Hong Kong. So a good director is a person who, ‘brings to the office an ethic of self-denial or disinterested service.’²⁴⁵ Concerning the duty of care, this duty focuses on a director’s behaviour including failure to act rather than the results he or she achieves.

As discussed, the court decisions on directors’ duties in Hong Kong followed British precedence without any thought to the appropriateness of those standards for a Chinese society, or the way these Chinese family companies are governed. A possible explanation for this regulatory oversight is that to date cases in directors’

²⁴⁴ Note that s180(2) of the *Corporations Act 2001* (Cth) states: ‘A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they: (a) make the judgment in good faith for a proper purpose; and (b) do not have a material personal interest in the subject matter of the judgment; and (c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and (d) rationally believe that the judgment is in the best interests of the corporation.’
²⁴⁵ Redmond, above n 73, 343.
duties involving family companies in Hong Kong are rare. One case that stood out that involved a family company was the *Law Wai Duen* case. The third defendant (Mr Yip) was found on appeal to have breached his duty of care as a director. Although the judge in the first instance erred in law, her honour noted that the case was primarily about a family dispute spilling over into the governance of a family company. So Mr Yip, a non-family member of the board was a bystander caught up in a family row. However, the appeal judges thought otherwise. They took a strictly legal interpretation of a director’s duty of care. As noted in the above, the legal community’s response to this judgement was that the standard of care applied was too low, and this matter was subsequently taken up by the Hong Kong Government leading to the enactment of a new statutory duty of care for Hong Kong. The new provision on directors’ duty of care, s465 of CO is a word for word transplant from the British statutory obligation.

Putting things into perspective, there is little evidence to suggest that there is widespread use, or even much judicial intervention in family companies as case law on directors’ duties in Britain demonstrates it rarely involves family companies. Alternatives to resolving disputes in family companies in Western societies include the use of shareholders’ agreements, mediation, and arbitration. Even so this thesis argues that the values espoused in the British provisions transplanted into Hong Kong are inapt to regulate Chinese family companies. This is due to the cultural differences that creates incongruence between what the law seeks to regulate and the practices of evolved from indigenous Chinese value system. However such matters

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248 For more on the cultural differences see Chapters 5 and 6.
had eluded the Hong Kong government’s law reforms in the last few decades. Even after the handover of the territory’s sovereignty back to China, much of the reforms in Hong Kong have continued to be influenced by the British laws and legal reforms in Britain.

Such influence could be seen in the most recent round of company law reforms in Hong Kong. As discussed in Chapter 2, even if there was strong opposition in Hong Kong about the enactment of an equivalent of the British s172 of the CA due to disagreement about the notion of the ‘Enlightened Shareholders’ Value’, the territory still retained the British general law definitions of fiduciary duties. Furthermore, the adoption of the British s174 of the CA as the new statutory duty of care for Hong Kong under s465 of the CO, is in line with the Hong Kong Government’s policy objective of maintaining the territory as an international financial centre by transplanting international best practices and governance standards.

This policy position was the product of both its economic development and regulatory capture of big businesses and professional bodies. Therefore, it is not surprising that Chinese family companies had never featured on the agenda of the reform. Part of the reason for this might be that they are self-sufficient in terms of funding, or that these companies are governed so differently from Western norms and ideals that the law as it stands seemed like a social order that existed in a parallel universe for the directors of Chinese family companies. This suggests the law is perceived as irrelevant to the governance of these types of companies.

More importantly, if more than a century of colonial government had little impact on the way the directors of Chinese family companies think and behave it is sensible to

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249 Refer to Chapter 2.3.2.
250 Refer to Chapter 2.4.
251 Refer to Chapter 2.1.1.
252 Refer to Chapter 2.1.2.
conclude that Western legal values and norms would not likely change the way Chinese family companies are governed. Logically, it is important to understand how these companies operate and are governed. This entails an appreciation of the Chinese values and norms as they form the building blocks of the governance of Chinese family companies in Hong Kong. This will be examined in the next part of the thesis.
Part Two: Why Western Laws are Not Suitable for Chinese Family Companies in Hong Kong: Culture, Values, and Norms Matter

Part two consists of three chapters. The aim of this part is to discuss the key reasons, and offer some explanations, as to why the British transplanted laws are not suited for Chinese family companies in Hong Kong. Chapter 4 will examine some experiences of common law in countries’ with separate legislations for family companies and why these laws are not suitable for Hong Kong’s Chinese family companies. Following on from this Chapter 5 will discuss the Chinese business culture and its influence over the way these companies are governed. To conclude part two, chapter 6 will delve into Confucian notions about governance and regulation as Confucianism is a cornerstone of Chinese philosophy and culture.
Chapter 4: The Intricacies of Regulating Family Companies in Hong Kong

4.0 Introduction

Even though family companies are common corporate structures around the world, the objective of this chapter is to substantiate the particular challenges of regulating family companies in Hong Kong and differentiate them from their counterparts in the West. A four pronged approach will be adopted to elucidate this exploration. The first is to demonstrate the importance of family companies in Hong Kong, second a brief survey of other common law countries will be conducted to see how those countries deal with this matter, third civil litigation matters related to the governance of Chinese family companies in Hong Kong will be offered – as an indicator about why Western laws are ill suited for these types of companies and fourth to be examined will be the failed early experiments of the colonial government in legislating for Chinese enterprises in Hong Kong. The significance of this major issue begins with the justification of why family companies are important to the territory’s economy and corporate landscape.

4.1 The Importance of ‘The Family’ and Family Companies in Hong Kong

This section explores the role of the family and its links to the importance of family companies in Hong Kong, as well as how the family share ownership structure in these companies affects its governance.

4.1.1 Families and Family Companies in Hong Kong

As briefly noted in Chapter 1.1.3, whilst Hong Kong is a modern global city with an international outlook, when it comes to the family and family matters traditional Chinese culture and values still hold. Wong and Levin found this to be apparent, and in spite of the families becoming smaller, due to the declining birth rate, those core Chinese values had withstood the test of time in Hong Kong. Furthermore, they argued that for the people of Hong Kong, the family and family ties had contributed to the territory’s prosperity and stability in two ways:

First, as a resource-pooling locus, it has undergirded the enterprising spirit of the Hong Kong Chinese and has proved to be an effective means for survival and social mobility in a society whose government for many years provided only a modicum of public social welfare … Second, this self-help ideology has also served to accommodate needs and assuage discontent within the confines of society. Demands and grievances are met or handled within these family-centric networks, thus contributing to the depoliticization of society … the society, with its myriad of family groups each pursuing its family wage economy, is the economically dynamic force asking little except personal freedom and a modicum of law and order from the polity. The latter, in turn, commanded compliance and consent once it met, to a greater or lesser degree, these expectations.

Therefore, ‘the family’ in Hong Kong takes on a clear economic role in society. This view was also held by Leung where he endorsed the thesis that:

[i]ntra-familial relationships tended to be predicated on mutual exchange of material assistance rather than on status hierarchy. The boundary of the family could also be pragmatically extended to include distant relatives and even friends if they were important in advancing the family’s interests. It was this ‘familial network’, rather than social welfare organizations and government departments, which the individual turned to for material support in times of need … In addition, the prevalence of family-owned and operated business firms in Hong Kong was evidence of the proclivity of family members to cooperate as an economic unit to advance their collective material interests.

Thus, it is this economic role that perpetuates the prevalence of family companies in Hong Kong. Leung went on to make a distinction about Hong Kong’s uniqueness from other modern capitalistic societies by noting that:

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3 Ibid.
4 Benjamin Leung, Perspectives on Hong Kong Society (Oxford University Press, 1996) 80.
Economic sociologists generally subscribe to the view that the modern capitalistic economy operates on principles antipathetic to those of the family. The former seeks to maximize efficiency through following the impersonal principle of meritocracy. The latter treats its members as equally deserving of its care and benevolence irrespective of their individual capabilities. From this perspective, the development towards modern capitalism is impeded in societies where family values and practices spill over into the economy. The Hong Kong experience, however, tells a different story. A salient feature of Hong Kong’s economy is the prevalence within it of family-owned and operated business enterprises … It is evident that familism in the forms of family ownership, paternalistic management, and nepotism has been a widespread practice among the territory business enterprises. Yet Hong Kong’s capitalist economy has been phenomenally successful.5

Thus, this notion of a family centred form of capitalism flies in the face of conventional neo-classical economic theories espousing prudent government economic policies and export strategies as the foundation of Hong Kong’s economic growth.6 Whilst it is beyond the scope of this work to prove or disprove the above hypothesis, the standing of family companies in Hong Kong’s corporate landscape is hard to deny.

Historically, local Chinese entrepreneurs have been a key feature and contributor to Hong Kong’s economic development.7 In Hong Kong, many family companies and factories were established with family members involved in almost every aspect of the business.8 Hong Kong’s manufacturing industry, for example, grew with the help of a network of subcontractors that consisted of many small to medium sized family companies.9 The family involvement in business, the phrase ‘entrepreneurial

5 Ibid, 86-7.
7 Steve Tsang, A Modern History of Hong Kong (Hong Kong University Press, 2004) 168-9; Frank Tipton, Asian Firms: History, Institutions and Management (Edward Elgar, 2007) 147-8.
8 Tony Yu, Entrepreneurship and Economic Development in Hong Kong (Routledge, 1997) 62. For more on the contributions of family companies see Chapters 4.2.
9 Ibid, 64.
familism’ was used to describe the dynamic economy of Hong Kong. This led Wong to conclude that the Jia (family) is a basic unit of economic competition. Whilst this is not a unique form of business structure, the contributions of family companies to Hong Kong’s economy should not be underestimated. Even though there are no statistics available on the number of family companies in Hong Kong, as noted in Chapter 1.1.3, it is estimated that there are about 570,000 family companies. Such share ownership as a corporate structure affects how these companies are governed.

4.1.2 Family Share Ownership and its Impact on Governance

Since shareholders are the ultimate owners and controllers of a company, the scope and extent of their powers and influence vary according to the pattern of ownership structure. If the shareholding in a company is diffuse, with no single person or a group of individuals in a dominant position, the control of the company is left in the hands of the board and managers, therefore agency issues would arise. Without a large and controlling or substantial block of shareholders, managers and boards do not have to answer to a unified or cohesive group of owners, hence the answerability of managers and directors’ are less lucid. In such circumstance, a set of rules or standards are deemed necessary tools to rein in their powers and decisions. At the other end of the spectrum, there are companies with no separation between those who govern and own the company, or are controlled by a small number of major shareholders. In these companies, owners, managers and directors hold close relationships. As a result, agency problems are considerably less or even

10 See Chapter 4.2 for more about ‘entrepreneurial familism’.
14 Ibid.
16 See directors’ duties in Chapters 3.2 and 3.3.
17 Tricker, above 13, 102.
Then, the concern in these types of companies is for minority shareholder protection as the interests of majority or block shareholders might dominate at the expense of minority interests; this is based on the assumption that the minorities are made up of third parties or ‘non-insiders’. If the companies are owned and operated by family members (including extended family members), the concern is different from those of diffused ownership. One of the key issues of these companies is the relationship between members of the family. If tensions manifest into divisions amongst them and should these tensions escalate into conflict it could harm the business by possibly creating deadlocks in the management of the company.

There are predominantly two major types of ownership structures of companies referred to in the literature. They are pigeon-holed as ‘outsiders’ and ‘insiders’ systems. Some characteristics of the outsider system are: dispersed ownership with large institutional holdings, strong protection of minority shareholders’ interest and relatively good disclosure obligations. In an outsider system, since there is no one controlling shareholder, investor protection (via legal prescription on boards to be accountable to diverse shareholders) is critical. Furthermore, companies often rely on markets to shape their governance; the British and American companies have been characterised traditionally to fit into this mould. The expectation is that with strong investor protection the shares of these companies would be higher in value because it offers confidence to investors to ensure the board would align their interests with shareholders.

19 Ibid.
20 Ibid.
22 Mallin, above n 12, 85.
23 SH Goo and Anne Carver, Corporate Governance: The Hong Kong Debate (Sweet & Maxwell, 2003) 85-6.
24 Ibid, 85.
26 Solomon and Solomon, above n 18, 150.
shareholders are an identifiable cohesive group with a close and stable relationship with the board and managers.\textsuperscript{28} These shareholders are usually governments, banks, employees or interlocking shareholdings within a group of companies. Often German and Japanese companies fall into this categorisation.\textsuperscript{29} With low levels of separation of ownership and control, there can be abuses of power, especially against the interests of minority shareholders, because there is usually little transparency. Therefore legal safeguards are necessary.\textsuperscript{30} Also, in countries with weak legal protection for shareholders, an insider system tends to manifest because it presents opportunities for majority shareholders to expropriate from minority shareholders.\textsuperscript{31}

There is however another type of ownership in which Tricker labelled them as ‘Asian family based model’.\textsuperscript{32} This type of corporate structure is common amongst overseas Chinese living in South East Asia (including Singapore), Hong Kong, and Taiwan.\textsuperscript{33} Such companies are family centric, where the control of the company are kept within the family, with emphasize placed upon trust and close personal relationships between people inside and outside the organisation, the governance tends to be paternalistic in style, and strategically drawn from personal intuition rather than market analysis.\textsuperscript{34} Whilst Hong Kong shareholder ownership structures entail both Asian family based model and the outsider system, as noted in Chapter 1.1.3, there is an estimated half million companies in Hong Kong that is structured along the lines of the Asian family based model.\textsuperscript{35}

\textsuperscript{28} Goo and Carver, above n 23, 86. Note that Tam wrote that ‘insider based system’ should not be confused with ‘insider control system’. The latter refers to State-owned enterprises in Eastern European countries of former Soviet Union held by former managers and workers of these companies. See On Kit Tam, \textit{The Development of Corporate Governance in China} (Edward Elgar, 1999) 25, 29-32.
\textsuperscript{29} Ibid.
\textsuperscript{30} Solomon and Solomon, above n 18, 149;
\textsuperscript{31} Ibid.
\textsuperscript{32} Tricker, above 13, 189-91.
\textsuperscript{33} Ibid, 190-1.
\textsuperscript{34} Ibid, 190. For more details see Chapter 5.1.
\textsuperscript{35} Goo and Carver, above n 23, 87; Yeung and Huang, above n 27, 17-8.
Typically in Hong Kong family-owned and controlled companies the line between family and company matters is often blurred because both shareholders and directors are the same people.\textsuperscript{36} Ho argued that there is a general perception that family companies in Hong Kong are old fashioned and grows slowly. Instead these companies place considerable emphasis on the ‘front-line’ operations of their businesses and are more efficient in decision-making which makes them successful enterprises.\textsuperscript{37} Tsui and Stott added that the active involvement of family members in family companies is a plus because the board is more likely to pursue long term maximisation objectives given their stable tenure of office.\textsuperscript{38} Yeung and Huang remarked that the behaviour of family companies in Hong Kong is such that it is incompatible with an international financial centre if one subscribes to the nexus between shareholder protection and market growth.\textsuperscript{39} Therefore a separate set of regulations for these types of companies would seem like a logical solution.

Albeit there is an absence of public or governmental discussions on governance of family companies in Hong Kong, the Hong Kong Institute of Directors (HKID) did attempt to address this in a publication (now in its second edition), called \textit{Guidelines on Corporation for SMEs in Hong Kong} (HKID Guidelines).\textsuperscript{40} The chapter titled, ‘special issues of family companies’, notes that there is no agency cost in these companies and as such the key governance problem is the inability of family companies to differentiate between the family and the company’s interest. As a consequence, those left in charge are likely to put the financial concerns of members of the family ahead of the company.\textsuperscript{41} Furthermore, Chinese family companies often provide employment for members of the family; this obligation extends to even less competent members due to the belief that the business should generate income for

\begin{references}
\textsuperscript{36} Tricker, above 13, 102.
\textsuperscript{37} Simon Ho, ‘Corporate Governance and Disclosure’ in Simon Ho, Robert Scott and Kie Ann Wong (eds), \textit{The Hong Kong Financial System: A New Age} (Oxford University Press, 2004) 361, 386.
\textsuperscript{38} Judy Tsui and Vanessa Stott, ‘Governance in Family-Owned Hong Kong Corporations’ in Ferdinand Gul and Judy Tsui (eds), \textit{The Governance of East Asian Corporations: Post Asian Financial Crisis} (Palgrave Macmillan, 2004) 54, 66.
\textsuperscript{39} Yeung and Huang, above n 27, 18.
\textsuperscript{40} The Hong Kong Institute of Directors, \textit{Guidelines on Corporate Governance for SMEs in Hong Kong} (The Hong Kong Institute of Directors, 2\textsuperscript{nd} ed, 2009).
\textsuperscript{41} Ibid, 57.
\end{references}
the whole family.\textsuperscript{42} Therefore, accommodating the interests of family members usually takes priority, even if it is not aligned to the company’s best interests.\textsuperscript{43} For example, family disputes that have little or nothing to do with the company can lead to deadlock in the management of the company.\textsuperscript{44} However, the solutions offered by the HKID Guidelines seem to be void of Chinese cultural considerations.\textsuperscript{45} For example, the HKID Guidelines recommends that:

Since the needs of the company and the circumstances, or interests, of family members may change, it is important to establish a system by which shareholders can sell their shares, and others buy in. It is important that all concerned understand this system and consider it to be objective and fair. The system will need to be more open if it is intended that control of the company will be passed to outsiders.\textsuperscript{46}

Another is the recommendation concerning the separation between family and company’s interests in the following:

It is important that a formal written agreement, which may take the form of a Memorandum and Articles of Association, or a Constitution, be prepared, that it be understood by all members of the family, and that it be accepted as fair to all. If confidentiality is considered to be of paramount importance then the arrangements can be put into the founder’s will, but if younger family members do not feel secure about the way in which they will be treated they may decide not to join the family company. It can be prepared by the founder and a copy given to all family members before they enter the company, or it can be negotiated and agreed between them.\textsuperscript{47}

There is an inherent assumption in the above statement that written agreements, with intentions be legally binding, are widely practiced or even customary in the Chinese cultural context.\textsuperscript{48} Nevertheless, aside from the Chinese cultural considerations, the HKID Guidelines are an attempt to address issues in the governance of family companies in Hong Kong. It would appear that the HKID is well aware of the limitations of their guidelines by stating in the conclusions, ‘Whatever the pattern of shareholdings, family companies encounter special governance problems that require careful consideration and precise understandings among the parties involved.’\textsuperscript{49}

\begin{thebibliography}{1}
\bibitem{42} Ibid, 58.
\bibitem{43} Ibid.
\bibitem{44} Ibid, 56.
\bibitem{45} Ibid, 18-9, 51-61.
\bibitem{46} Ibid, 54.
\bibitem{47} Ibid, 57.
\bibitem{48} For more detailed discussions on this, see Chapters 3 and 5.
\bibitem{49} Ibid, 61.
\end{thebibliography}
However, one can read into the subtext of this statement that this problem requires greater policy and regulatory attention.

4.2 Statutory Provisions for Family Companies in Other Jurisdictions

The following section shall examine some of the experiences of other common law countries in their regulatory solutions to family companies. This exercise is to determine if the experiences of other jurisdictions could be a model for Hong Kong to adopt.

4.2.1 United States

In the United States, many states have separate legislation on small and family companies called close corporations.\(^{50}\) According to an American authority, *Elmaleh v Barlow*\(^ {51}\) a close corporation has three features: (1) a small number of shareholders; (2) no ready market for the corporate shares; (3) substantial majority shareholder participation in the management, direction, and operations of the corporation.\(^ {52}\) In addition, the statutes also acknowledge the desire of the owners of these companies to remain ‘close’ to a few selected individuals.\(^ {53}\) The operation and control of many close corporations resembles a partnership rather than a corporation because of the close relationship between the shareholders (who are often directors), and also that they behave like partners.\(^ {54}\) Thus, shareholders of close corporations also owe a fiduciary duty to each other.\(^ {55}\) Rock and Wachter argued that close corporations in the United States are also ideal legal structures for Silicon Valley start-ups with new products that need time to develop. This is because of the limitation to the exiting of shareholders, and the provision for non-pro rata distribution of profits prevents

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\(^{53}\) Ibid, 313.

\(^{54}\) Ibid, 344-5.

\(^{55}\) *Donahue v Rodd Electrotype Co* 328 N.E. 2d 505 (Mass. 1975).
opportunistic behaviour by the major shareholder towards the minority shareholders.  

4.2.2 South Africa

In South Africa, the Close Corporations Act 1984 (South Africa) (CCA) is devoted to the regulation of small businesses. One of the key drivers in enacting such legislation was the realisation by the South African Government of the economic and social contributions small businesses had made to the country. A policy document by the South African Department of Trade and Industry states that, ‘the purpose of the Close Corporations Act was to provide a simple, inexpensive business entity offering limited liability for a single person enterprise to one involving a small amount of persons.’

In terms of governance unlike the American close corporations, s42 of CCA stipulates that each member of the close corporation stands in a fiduciary relationship to the close corporation. Section 43 of CCA reinforces this by stating members also owe a duty of care to the close corporation. Du Plessis noted that, ‘partnership principles underlie the internal governance model of a close corporation and keeping the membership limited to natural persons fitted in better with partnership principles where there is a close relationship of utmost good faith among the partners / members of close corporations.’

This contrasts with the American approach where members owe a fiduciary duty to each other rather than to the close corporation.

4.2.3 Australia

Australia also had legislation dedicated solely to small business in the Close Corporation Act 1989 (Cth) (CCAA). In August 1984, the Companies and Securities Law Review Committee from the Ministerial Council first raised the need for the CCAA. They released a discussion paper, raising the possibility of a separate

59 Du Plessis, above n 54, 255.
legislation for incorporated partnership corporations. In September 1985, a report recommended that a new corporate form should be enacted that led to the enactment of the CCAA. At the heart of the recommendation was to simplify the legal obligations for small business, the formal director-shareholder distinction to be eliminated and where the powers to manage the close corporation were vested in members. Thus, the governance of a close corporation was to be regulated by a partnership-like set of legal rules, where members owed fiduciary duties to each other and the corporation. On the 17 December 1992, the Australian Joint Parliamentary Committee on Corporations and Securities tabled a report to parliament recommending that the CCAA be repealed. Amongst other reasons, the Joint Committee pointed out that the merger of the concept of an incorporate entity and partnerships into a single legislation may increase the confusion for members and directors with respect to their duties. However, it was due to constitutional difficulties with the corporation’s legislation that led to the CCAA being repealed in 1995.

In conclusion, what the above examples have shown is that the law recognises how family companies operate in the form of close corporations. These businesses work more like partnerships because the relations between the participants are akin to partners rather than corporations. That is why the close corporations in the United States and the former Australian Close Corporation Act 1989 (Cth) make no distinction between directors and shareholders; the behaviour of these shareholders/members are governed by the same fiduciary duties as directors, where accountability and transparency is central. This may have been to ensure that each shareholder’s interest would be taken into account as in partnerships, and where shareholders have a fiduciary obligation to each other. Whilst this conferred equal

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60 Philip Lipton and Abel Herzberg, Understanding Company Law (Lawbook, 3rd ed, 1988) 58.
61 Ibid.
63 Roman Tomasic, Stephen Bottomley and Rob McQueen, Corporations Law in Australia (Federation Press, 2nd ed, 2002) 288.
64 See ss78, 79, and 85, of the Close Corporations Act 1989 (Cth).
66 Roman Tomasic, Stephen Bottomley and Rob McQueen, Corporations Law in Australia (Federation Press, 2nd ed, 2002) 287.
protection to each shareholder, in terms of accountability, this model of governance is based on the assumption that there is an agency and trustee like relationship in a company between the owners (shareholders) and controllers (directors). However, the notion of the fiduciary relationship in this partnership-like law is no different from those in company law except for the fact that the duties are owed to each shareholder/director (in the US) or in this case the CCA or company laws to the company (shareholders as a whole). This is based on the concept of trustee and agency-like duties developed in Western societies.

4.3 Indications that the Legal Rules are not suited for Family Companies in Hong Kong

To add to the argument that Western laws are ill suited for family companies in Hong Kong, the following analysis will examine the awareness of directors’ duties, review civil litigations concerning the governance of family companies, and explore other legal possibilities within the framework of company law in an attempt to demonstrate that the law as it stands has failed to address the concerns and problems in the governance of these companies.

4.3.1 Awareness amongst Directors Concerning their Legal Obligations

Since directors’ duties have been transplanted from Britain more than half a century ago, one assumes that Hong Kong directors would be reasonably aware of their legal obligations. Yet there is anecdotal evidence from research done by Hong Kong academics to show that this is not the case. The first is an article published in 1998 about directors’ awareness of their legal obligations under general law and CO in Hong Kong. Respondents to the questionnaires were asked whether they agreed or disagreed with the statements concerning directors’ conduct and decisions in

hypothetical situations on a scale of one to five.\textsuperscript{69} The surveys found that, ‘the results disclosed an overwhelmingly low degree of awareness concerning legal obligations and duties.’\textsuperscript{70} In the conclusion of the article, the authors qualified their findings by noting that the response rate was low,\textsuperscript{71} but the research was the first empirical study of its kind about directors’ legal obligations in Hong Kong.\textsuperscript{72} The second article on the same subject matter targeted lawyers in Hong Kong to seek their views about directors’ familiarity with company laws and corporate governance principles.\textsuperscript{73} The authors, Lau and Chan noted that, ‘HK has been selected for this study because there is a lack of academic studies examining the identified characteristics of a board of directors. These neglected characteristics may be a cause of ineffective corporate governance in HK companies.’\textsuperscript{74} They found that the results suggest directors do not appear to be competent in discharging their legal obligations.\textsuperscript{75} According to the lawyers surveyed, the need for continuous education and training would not have a material impact on board effectiveness.\textsuperscript{76} Whilst noting the survey responses in this study are also low,\textsuperscript{77} it adds to the impression that in Hong Kong directors are not too concerned with their legal duties. Even though the reason why is beyond the scope of this thesis, and those surveys did not distinguish between family and non-family companies, the lack of legal awareness, as shown in the above two studies, appears to be unimportant amongst directors in Hong Kong. Spink and Chan offered some clues by noting:

\begin{quote}
[m]ost Hong Kong directors are also major shareholders and board meetings are likely to resemble family gatherings. A lack of proficiency in English, certainly pre-1997, and a general lack of knowledge of company law, especially the nuances of case law, are other factors. Moreover, traditional Chinese Confucian philosophy, which is considerably more
\end{quote}

\begin{flushleft}
\textsuperscript{69} Ibid, 71. The object of those statements was to assess the level of awareness amongst directors about their duties.
\textsuperscript{70} Ibid.
\textsuperscript{71} Ibid, 67. The responses of the survey were 16.84 percent or 62 responses. In addition, the authors did try to find out why many directors failed to respond to the questionnaire - a lack of time was the commonly cited reason.
\textsuperscript{72} Ibid, 89.
\textsuperscript{73} Siu Chan and Alex Lau, ‘Directors’ Attitudes and Corporate Governance Effectiveness in Hong Kong’ (2003) 9 \textit{Asia Pacific Business Review}, 85.
\textsuperscript{74} Ibid, 86.
\textsuperscript{75} Ibid.
\textsuperscript{76} Ibid, 103.
\textsuperscript{77} Ibid, 94. The responses of the survey were only 8.6 percent.
\end{flushleft}
influential in Hong Kong than its international reputation might at first suggest, encourages dispute resolution through mediation. In this context, litigation is usually a remote prospect.”

Clearly, this statement highlights the family and cultural dimensions in Hong Kong’s corporate governance, and so the law as it stands appears to be not much of a concern for Chinese family companies. Kwan a solicitor in Hong Kong wrote, ‘most of the companies in Hong Kong are private and family controlled, and the directors are appointed by the controllers who may themselves be members of the board (if not shadow directors), and as such any breach of duty of care will be ‘tolerated’.”

Even though, a comparative study of managers in Canada and Hong Kong did reveal that executives in both jurisdictions are equally unaware of their legal obligations, the lack of awareness amongst executives and directors in Western countries does not imply they reject, or are unable to identify with the values espoused in the legal duties stipulated. Interestingly, an empirical study in Australia conducted in the early 1990s did find that directors in Australia are broadly aware of their legal duties, but such awareness decreases as the sampled company size decreased. More importantly, as noted in Chapter 2.3.1 a large survey sample of appropriately 3000 directors in Britain was conducted by the government in the late 1990s that revealed an overwhelming support for the enactment of general law fiduciary duties in 2006. Besides, in the past decade corporate scandals and collapses in the US had heightened the American public’s awareness of the importance of directors’ legal obligations. Furthermore, fiduciary obligations are found in many professional occupational codes, as such a lack of awareness amongst directors in the West does not mean they are opposed to the ideals and principles embedded in such legal duties.

79 Paul Kwan, Hong Kong Corporate Law (LexisNexis, 2006) 1031.
83 For example such obligations are found in the work of insolvency practitioners in Australia. See Justice R P Austin, ‘The Legal Standard of Loyalty and Professional Guidelines’ (Speech delivered at Insolvency Practitioners Association of Australia National Conference – ‘Without Fear or Favour’, Brisbane, 12-13 October 2006).
Whilst, the lack of awareness amongst directors of their legal obligation is not the focus of this thesis, it does however raise the question of whether the lack of awareness in Hong Kong is due to ignorance of cultural factors. Should the answer be the latter, cultural factors could influence a person’s judgment, to the extent that what is deemed to be appropriate or even ideal behavior in the West maybe viewed as unacceptable or irrelevant to the Chinese.\textsuperscript{84} This in turn affects how the Chinese approach the issue of governance.

Lau, Nowland, and Young argued that in Hong Kong, family-owned companies operate under a different model of corporate governance so the imposition of Anglo-Saxon laws on family-owned companies will not lead to the desired outcomes in governance.\textsuperscript{85} Such differences can create mismatch between what the law endeavors to regulate and how it is being applied or misapplied by the directors and the shareholders. Thus, notwithstanding the statement in Chapter 3.4 suggesting that the role of litigation might not be representative of how family companies are governed, an analysis of Hong Kong cases would help explain why the law as it stands does not address the governance concerns of Chinese family companies. Also reviewing the case laws offer better insights into the governance concerns of Chinese family companies in Hong Kong because much of how these companies are governed is largely an enigma for the policy and law makers because this subject matter appear to have eluded them in the last few decades of corporate governance law reform.

\textit{4.3.2 Litigations Concerning Disputes in Family Companies}

An article by Lawton examined 275 minority shareholder petitions from 1980-1995 to the court of first instance in Hong Kong, out of which only 26.9 per cent involved Chinese family companies. The small percentage of the total number of cases suggested that these companies do not rely on the court and the law to resolve their disputes.\textsuperscript{86} The nature of the dispute in involved Chinese family companies implied that Hong Kong’s Chinese business community did not see minority shareholder

\textsuperscript{84} Also see Chapter 5.1 for more on the differences between Western and Chinese family companies.

\textsuperscript{85} Alex Lau, John Nowland, and Angus Young, ‘In Search of Good Governance for Asian Family Listed Companies: A Case Study on Hong Kong’ (2007) 28 The Company Lawyer 306, 308. For more on the differences see Chapter 5.1.

protection in the same way as companies in Western countries because, according to Lawton, for these litigants it had more to do with, ‘face saving and harmonious relationships’.  

In Re Shiu Fook Company Ltd a petition was presented before the court to wind up the company under s180(1A) of CO and unfair prejudice under s168A of CO. The petitioner was the concubine of the founder of the company. She alleged that a deadlock with the other family members (who were also directors and shareholders), arose following an extraordinary general meeting about the assets of the company. Madam Wong (the petition) contended that there was a long history of family disputes between her side of the family and the family members of the first wife. However, the court held that many of her allegations concerning the family dispute had no relevance to the winding up action. Clearly, the petitioner was seeking a resolution to a family matter and misused the winding up action in her quest for justice.

87 Ibid, 254-68. See explanations for these Chinese concepts in Chapters 5 and 6 of the thesis.
89 This provision stipulates that – ‘Where the petition is presented by members of the company as contributories on the ground that it is just and equitable that the company should be wound up, the court shall not refuse to make a winding-up order on the ground only that some other remedy is available to the petitioners unless it is also of opinion that they are acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy.’
90 This provision is about an alternative remedy to winding up in cases of unfair prejudice. It stipulates that – ‘Any member of a specified corporation who complains that the affairs of the specified corporation are being or have been conducted in a manner unfairly prejudicial to the interests of the members generally or of some part of the members (including himself) or, in a case falling within section 147(2)(b), the Financial Secretary, may make an application to the court by petition for an order under this section.’ On the definition of conduct deemed unfairly prejudicial to the interests of members generally or some part of the members (including himself) see Re Taiwa Land Investment Co Ltd [1981] HKLR 297. Examples of conduct considered to be unfairly prejudicial includes: exercise of powers for improper purpose; self-interested transaction by controllers generally; misapplication and misappropriation of company’s assets; mismanagement, negligence and inefficiency; exclusion from management (for quasi-partnership companies) – for further discussions see Roman Tomasic and Ted Tyler (annotators) Butterworths Hong Kong Company Law Handbook (LexisNexis, 8th ed, 2006) 680-706.
91 In Hong Kong if a concubine was wedded to a married man before 1971, the courts will recognise the union under Chinese customary marriages, see Marriage Reform Ordinance (Cap 178). For the definition of concubine see Suen Toi Lee v Yau Yee Ping [2001] HKCFA 21; [2001] 4 HKCFAR 474; [2002] 1 HKLRD 197; [2001] HKEC 1548; FACV000022/2000; Leung Lai Fong v Ho Sin Ying [2006] HKCFI 1366; HCAP000008/2004.
In *Re HY & HT Lee Brothers & Co Ltd*, the case involved Mr Samuel Tak Lee, a shareholder and director of a Chinese family company (HY & HT Lee Brothers & Company Limited). Samuel Lee petitioned the court to wind up the family company on just and equitable grounds in pursuant to s177(1)(f) of the CO. His petition was based on two complaints. The first was a board meeting held on the 7 March 1998 which triggered a loss of trust and confidence between the petitioner and the respondents (his elder brother and uncle). The second was seven transfers made between March 1995 and February 1997 of dividends attributable to 2,750 shares of the Company registered in the name of Lee Cheong Yee to MW Lee & Sons Enterprises Limited (another family company). Those shares were appointed to the Petitioner under the will of his late mother Ng Chun Wah exercising a special power of appointment conferred on her by the will of her deceased husband MW Lee. The dividends comprised those accumulated between the death of Madam Ng in May 1991 and February 1997. The action failed as Le Picton J held that, ‘there is no merit in any of the Petitioner's complaints, it is unnecessary for me to reach any final conclusion as to abuse of process and equitable relief or to consider the case law cited.’ However, her honour noted that there are Chinese cultural and family dimensions in this dispute by stating that:

The Respondents come from a traditional Chinese family whose values and code of behaviour permeate through to the way a Chinese family company is run … it emerged that for years his elder brother had counselled and entreated him [the petitioner] "to reduce conflict rather than blow it up in a big fight", to avoid "hard confrontation", "not to press people too much or to corner them to a dead end" and "to let sleeping dogs lie" when dealing with members of the extended family.

Lawton comments that this case offers a glimpse into the complex and subtle forces at play in Chinese family companies.

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94 He is party to some 16 legal actions regarding a string of family companies a result of family between himself, his elder brother and relatives, see Lawton, above n 78, 257.
96 Ibid.
97 Ibid, [109].
98 Ibid, [6], [8].
99 Lawton, above n 86, 268.
In *Wong Tin Chee Tiny & Ors v Wong To Yick & Ors*\(^{100}\) the legal action followed a series of family disputes spilling over into the operation of the family company. The father (first respondent) founded the family company in 1988 with the objective to produce and market a Chinese medicated ointment. The product was made and sold, as early as the 1960s. The incorporation of the company was the result of the children (the first, second and third petitioners) of the first respondent (the father) getting involved in the business. In the judgement Judge Yuen noted that the petitioners (3 out of the eight children of the first respondent) had alleged that following a domestic dispute, the father asked three other children to return to Hong Kong, and disclosed to them, and the spouse of one of them, the production line and formula for the ointment. This was against a longstanding policy and agreement that the production line and formula should not be disclosed to persons who were not members of the family. Furthermore, the petitioners (3 children) alleged that a general meeting was held without their knowledge in December 1999, where the children who had newly returned to Hong Kong replaced them all as directors. They also claimed that as directors and shareholders, they did not have access to various documents and that information was withheld from them so they were unable to assess the value of the family company. They also claimed that the father and the new directors had conducted the affairs of the family company in such a way that it was unjust and inequitable to require the petitioners either to continue as members or to leave on unjust terms.\(^{101}\) The question before the court was – were there grounds for winding up under unjust and equitable grounds? Her honour rejected the Petitioners’ application on the grounds that:

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\text{[It is plain and obvious that a court would not make a winding-up order but would grant the alternative relief sought, and that the court would hold the Petitioners to be unreasonable should they insist on the winding-up order. ... It would be unlikely in the extreme for such a successful company to be ordered to be wound-up by the Court when there was an available alternative remedy being sought at the same time by the Petitioners. ... a winding-up of a solvent company is not in the interests of any of its members. It may result in the sale of the assets at break-up value, without regard to goodwill and the "know-how" of the company. ... There are also innocent shareholders who would be adversely affected by a winding-up order.}
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\(^{101}\) *Wong Tin Chee Tiny & Ors v Wong To Yick & Ors* [2001] HKCFI 1290; [2001] 2 HKRLD 683; HCCW668/2000, [14]-[17].
In the present case, shareholders who are neither Petitioners nor Respondents together hold 35% of the Company.\textsuperscript{102}

Whilst the judge read the law diligently, the petitioners were not satisfied with the judgement and took another legal action. This time the litigation was about the goodwill of the family company, and its related trademarks and businesses.

In this subsequent case, Judge Lam said in his opening remarks, ‘This is a sad case.’\textsuperscript{103} Then, his honour went on to say:

Before I go into the background leading to the dispute, it must be emphasized that in a court of law, the judge must resolve the issues according to the law and the evidence. … There is no scope for coming up with any other solution even though the answer provided by the law may not deal with all the problems. It is not possible for a court of law to mend the relationship between the parties. Only the parties can achieve that by their own willingness to do so. A lot of parents would gladly pass the family business to their children hoping that they could carry on the same trade after the parents’ retirement. But there are exceptions. In the present case, the 2nd Plaintiff is almost 90 years old. He claims that the children had misappropriated his (or the 1st Plaintiff’s) rights in the goodwill of the Ointment and seeks relief from this court against them. The evidence shows that at one stage, the Ointment business was run by the children and the family had had happier days. It is therefore quite distressing for this court to observe that when they gave evidence, both the father and the son harboured bitterness towards each other. The father was particularly vocal in expressing his animosity.\textsuperscript{104}

From the facts of this case there were two key issues that led to the demise of the family company, the first was the alleged reneging of the father about letting his son take over the business,\textsuperscript{105} and the second was the father’s extra marital affair that led the children to side with their mother against the father.\textsuperscript{106} The father’s affair also had implication on the governance of the family company as his honour noted that, ‘the mother and the children were concerned about the possibility of Kwan’s

\textsuperscript{102} Ibid, [28], [31]-[32], [34].
\textsuperscript{103} \textit{Wong To Yick Wood Lock Ointment Ltd and Another v Wong Tin Chee Tinly and Others} [2007] 221; HCA7984/2000, [1].
\textsuperscript{104} Ibid, [4]-[5].
\textsuperscript{105} Ibid, [28]-[49].
\textsuperscript{106} Ibid, [81]-[93], [180]-[181].
[father’s mistress] intervention into the Ointment business through the shareholding of the father in the Company.\(^\text{107}\) Whilst the judge found in favour of the father’s petition, he stated in his concluding remarks that:

> Based on my key findings, no matter how the other issues raised in these actions are to be decided, there would not be a final resolution of the disputes between the parties. The fortune of the parties is locked into the business of the Company. … No judgment in these actions can change the reality that unless they agree on the way ahead for the Company, there will be no end to their fighting. That would not be good for business and I do not see how it could be in the interest of any one of them. It is high time that the family members should sincerely attempt to make peace with each other. Even though previous attempts have failed, I think it is worthwhile for them to try again in the light of this judgment. There are alternative ways of resolving conflicts and litigation may not always produce the most satisfactory outcome.\(^\text{108}\)

Again, from this remark it is evident that his honour understood that for the Chinese, ‘relationships’ are key, but the judge was not in the position to provide justice under the court of law.

Another recent case, *Kam Kwan Sing v Kwam Kwan Lai & Ors*,\(^\text{109}\) was about one of Hong Kong’s popular Chinese restaurants and tourist eateries which Yung Kee established 68 years ago.\(^\text{110}\) The dispute involved the second-generation leadership, between the two brothers, which arose after their father’s death. In a media report, the older brother had said in a previous interview that his younger brother had tried to gain control of the business by appointing his nephew to the board.\(^\text{111}\) In that interview, it was alleged that his nephew had only worked a few days a week but was paid HKD$45,000 a month.\(^\text{112}\) The report also stated that the older brother had offered to sell his stake in the company to his brother but had been rejected, and said that he was no longer able to cooperate with his younger brother.\(^\text{113}\) He petitioned the

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\(^\text{107}\) Ibid, [93].
\(^\text{108}\) Ibid, [237]-[238].
\(^\text{111}\) Ibid.
\(^\text{112}\) Ibid.
\(^\text{113}\) Ibid.
court to wind up the company under s327(3)(c) and unfair prejudice under s168A of CO. The judge held, ‘I do not find the respondents [including Kam Kwan-lai, the younger brother] have been able to establish any grounds put forth in support of this application [to strike out the winding up move].’\textsuperscript{114} It was also reported in the newspapers that the liquidator would not be able to wind up the restaurant because the holding company (the two brothers control) owns only 80 per cent of the shares in the restaurant group, so the sale of the holding company would be the most likely outcome.\textsuperscript{115} In a post litigation interview the older brother said, ‘I hope for harmony. The best thing for us is to discuss the matter as brothers and resolve [the dispute] peacefully.’\textsuperscript{116} Harmony according to Confucius is important in maintaining good relationships and in the meeting of relational obligations.\textsuperscript{117}

However, two years after the first attempt had failed another legal action was launched in January 2012, and again for winding up of the company under s327(3)(c) and unfair prejudice under s168A of CO.\textsuperscript{118} Presumably the two parties had failed to come to an agreement on the respondent buying the shares of the petitioner. This time the petition failed again, but it was on different grounds. The verdict was handed down on the 31 October, about 3 weeks after the petitioner died.\textsuperscript{119} In essence, the application failed because the company in question (holding all the business assets and ownership of the restaurant), was incorporated outside of Hong Kong. His honour, Harris J held that:

In my view there is insufficient connection between the Company and Hong Kong to justify the Hong Kong Companies Court exercising its discretion and accepting jurisdiction over a dispute between Company’s shareholders. They are shareholders in a BVI [British Virgin Islands] company, which is a separate legal and corporate entity.

\textsuperscript{114} Kam Kwan Sing v Kwam Kwan Lai & Ors [2010] HKCFI 629; HCCW000154/2010, [29].
\textsuperscript{116} Ibid.
\textsuperscript{117} Chau-kiu Cheung and Andrew Chan, ‘Philosophical Foundations of Eminent Hong Kong Chinese’ (2005) 60 Journal of Business Ethics, 47, 55. See chapter 6.2.2 for more on harmony.
\textsuperscript{118} Austin Chiu, ‘Yung Kee brother ‘not a partner in eatery’’, South China Morning Post (Hong Kong) 2 February 2012, C2.
Islands] company and they can take their dispute to the courts of the jurisdiction in which the Company is incorporated which provides remedies…

According to a media report on the 1 December 2012, the wife of the late petitioner has lodged an appeal to the first instance’s decision. Clearly, the family feud had not been resolved by the death of the petitioner or losing two court battles. This begs the question - is the court the best venue to resolve disputes about the governance of Chinese family companies? Then again, apart from the courts, there are no alternatives for these cases to be heard or resolved.

In sum, there are two key observations from the above cases. First, instead of petitioning the courts on breaches of directors’ duties, legal action concerning the governance and related matters of Chinese family companies in Hong Kong were about winding up of the company on just and equitable grounds under s177(1)(f) and unfair prejudice under s168A of CO. This adds to the argument that the notion of fiduciary duties does not resonate with the directors of these companies. This disregard for directors’ duties was also echoed in the two cited empirical studies in Chapter 4.3.1. Another observation from the above cases is that most of those companies were profitable or asset rich. For those members of the families, justice was not about holding directors accountable in the fiduciary sense. Perhaps, this is due to the fact that the term fiduciary duty according to the English-Chinese Glossary of Legal Terms by the Hong Kong’s department of Justice literally means ‘trusted person’s responsibility’ or ‘trustee responsibility’. As noted in the above, the cases had more to do with, ‘face saving and harmonious relationships’. In addition, the above litigations revealed that tensions within a family might trigger a breakdown in relationships leading to a deadlock in the management of the family company or crisis in governance. This leads to the second point, the argument that the prevailing

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122 Note that the HKSAR Department of Justice’s The English-Chinese Glossary of Legal Term provided the Chinese translation for fiduciary duty as ‘受信責任’. See <http://www.legislation.gov.hk/eng/glossary/homeglos.htm>. This was translated from s52(2) of the Securities and Future Ordinance (Hong Kong) cap 571. The section is referring to the application of market collateral not affected by certain other interests.
123 Lawton, above n 86, 254-68.
laws and courts in Hong Kong are not designed or apt to regulate directors in Chinese family companies because there are cultural dimensions in these disputes. However, without an alternative forum to redress their grievances, the courts are the only institution or body presently available in Hong Kong.

Another example demonstrating Chinese cultural values matters related to corporate governance is corporate insolvency. Empirical research by Tomasic and Little concluded with the following observations:

In Hong Kong, insolvency law is used mainly by foreign creditors and corporations, and rarely by Chinese businesses ... Chinese businesses, however, use the legislation as it is perceived to be based on foreign laws, rather than on Chinese social tradition ... An expatriate accountant said, of the solvency law, that “we have an English system imposed on Hong Kong, which does not necessarily reflect how Hong Kong works. The Chinese system is one of self-reliance, where people aim to solve their problems themselves you keep it within the family”.124

Interestingly, in the recent company law reforms in Hong Kong, the government has failed to consider these issues. Yet, ‘once upon a time’ the colonial administration of the territory did enact a law to regulate Chinese enterprises, but it was subsequently abolished. The question is – why?

4.3.3 Discounting Other Legal Possibilities

Before delving into the colonial administration’s failed attempt to regulate Chinese businesses in Hong Kong in the proceeding section, it is important to exhaust other legal options before dispelling the use of Western laws to regulate the governance of Chinese family companies in Hong Kong. Hence, the aim of this sub-section is to examine the possibilities of incorporating Chinese values and practices into the current company law framework, as well as other legal instruments like the use of shareholders’ agreement as a substitute governance mechanism.

Historical discourse suggests that company law was heavily influenced by values drawn from partnership ideas. This denotes that the root of the company laws could be linked to agreements between incorporators. From an economic perspective a company is understood to be a nexus or bundle of contracts. This meant that the internal governance of a company is set out to be flexible and changeable, where the relationships are, to a certain extent guided by contractual principles. These concepts are encapsulated in the articles of association of a company, as Davis and Worthington wrote,

A remarkable feature of the British company law is the extent to which it leaves regulation of the internal affairs of a company to the company itself through rules laid down its constitution, in particular in its articles of association (which prescribe the regulations for the company).

Furthermore, Kwan noted that,

In construing a company’s articles, the court will regard them as a business document and will construe them as to give them business efficacy where the result ‘is admissible on the language of the articles, in preference to a result which would or might prove unworkable’: per Jenkins LJ in Holmes v Keyes [1959] Ch 199 at 215. In Rayfield v Hands [1960] Ch 1 ‘it has again been emphasised that the proper way to construe the document is as a commercial or business document to which the maxim “validate if possible” applies.’

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129 Davis and Worthington, above n 122, 64.

130 Kwan, above n 76, 213.
Evidently, the articles of association (articles) of a company has contractual effect between the company and its members as Lord Selborne LC held in *Oakbank Oil Co v Crum*, 131

Each party must be taken to have made himself acquainted with the terms of the written contract contained in the articles of association … He must also in law be taken … to have understood the terms of the contract according to their proper meaning; and that being so he must take the consequences whatever they may be, of the contract which he has made. 132

Goulding noted that articles typically contain basic regulations for the management of the company,

[c]overing such matters as the issue and allotment of shares, the calls on shares, the rules relating to the transfer of shares, the procedures to be followed at general meetings and the regulations relating to members voting, the appointment, removal and powers of directors, the payment of dividends and the capitalisation of profits. 133

In Hong Kong a model articles can be found in Table A of Sch. 1 of the CO. 134 For companies limited by shares, which includes both family and non-family companies, the articles covers many aspects of a company and can broadly be divided into four categories. 135 They are (under Table A of CO) capital (arts 2-48), members (arts 49-76 and 132-135), officers (arts 77-114), and distributions and disclosures (arts 115-

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131 (1882) 8 App Cas 65.
132 Ibid, 70. Also note that is not like a normal contract. Kwan wrote, ‘For example, the court has the power to rectify the document to give effect to the true agreement of the parties even if the same does not reflect exactly what the contracting parties have agreed upon … [i]n some cases, court had indicated that notwithstanding that rectification could not be ordered, they are willing to make an order for specific performance requiring the shareholders to vote in a particular manner to remedy any defect which was brought about by any articles not reflecting the parties’ intention … [v]itiating factors which may invalidate a contract, such as duress, undue influence and misrepresentation, do not apply…’, see Kwan, above n 76, 214.
133 Goulding, above n 123, 94.
134 Note that the UK’s CA has a similar table A in the 1985 act. However the earlier version of this table was first prescribed by the UK’s *Joint Stock Companies Act* 1856, which was called Table B. Since 1 October 2009 table A has been replace CA 2006 model articles. See Companies House, *Companies Act 2006 – Model Articles* <http://www.companieshouse.gov.uk/about/tableA/>.
In particular, the articles that relates to the duties of a director that are relevant to this thesis is found in art 86, Table A of Sch. 1 in CO.

Given that the articles is a contractual document between the company and its members, the provisions could be altered by members’ special resolution under s13(1) of CO. The court held in *Lee Tak Samuel v Chou Wen-hsein* a company is entitled to include in its articles it considers desirable in the internal management of the company. The legal issue in question was an added provision in the article about directors vacating from office. The article in question was 73(d) which stated, ‘[i]f he [director] is requested in writing by all his co-directors to resign;…’ This points to the fact that members could affix additional duties or limit the powers of directors by stipulating such provisions in the company’s articles.

In *Kwok Ping Sheung Walter v Sun Hung Kai Properties Ltd and Others* the plaintiff seek an injunction from the court to prevent the board from removing him as chairman and CEO by claiming there was an agreement allowing him to remain in his position. Her honour Kwan J held that,

> [T]he alleged agreement does not provide that the Company shall not use its constitutional powers to remove Walter as chairman or executive director. If the agreement were to this effect, it would be unenforceable against the Company as this is seeking to circumvent the statutory requirement for any alteration of the Articles of Association to be by special resolution. I am not satisfied there is a serious issue to be tried on the case of breach of contract.

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136 Ibid.
137 Note that under s13(1A) the alteration must not be inconsistent with any special rights attached to the class of shares. Such class of rights is governed by ss 63A-64 of CO.
139 Also see indoor management rule in *Royal British Bank v Turquand* (1856) 6 E & B 327.
142 Ibid, [13], [23], [24].
The company of the above case in question is Sun Hung Kai Properties Limited. This company was listed in Hong Kong in 1972 and is currently one of the largest property developers in Hong Kong. The father (deceased) of the plaintiff was the founder. The family retained majority shareholders and the Kwok brothers are the second-generation board members of this publicly listed company. Walter Kwok, the eldest brother was chairperson and CEO, he was suddenly relieved of his position by the board and re-designated as non-executive director in May 2010. This saga began as a family dispute spilling over into the boardroom. According to newspapers reports in Hong Kong, the family dispute between the brothers was due to Walter’s extra-marital affair. This affair had caused friction between the brothers and the matriarch of the family (Walter’s mother, Kwong Siu-hing). Media reports alleged she intervened personally and told the other two sons to relief Walter from his duties in the company. Walter’s mother recently moved to cut off her eldest son out of the family fortunes. The media reported rumours that the family matriarch is willing to pay Walter HKD20 billion as payment for one third of the shares in the family trust to leave the company. The solicitor representing Walter said that he might challenge the matriarch’s decision to reorganise the family trust. In spite of the fact that this company is not a Chinese family company per se, it shows that articles might not be the most effective governance mechanism when it concerns family disputes. Besides Kwan J noted this in her judgement,

Whatever might be the disputes and ill feelings between Walter and his brothers, what happened at the adjourned meeting on 8 May 2008 called by Walter is insufficient for this
court to infer that the other 14 directors would not vote in accordance with their honest beliefs as to what is in the best interest of the Company.147

Notwithstanding her honour’s acknowledgement of the family dimensions in this case, unsurprisingly it did not weigh into her judgement.

More importantly, the key question in this section of this thesis is – can articles be altered to such an extent that replaces directors’ fiduciary duty and duty of care with Chinese principles or rules for Chinese family companies in Hong Kong? The short answer is no. There are two reasons for this. Firstly, articles is an enforceable statutory contract by a company against the member, a member against the company, by members themselves against each other, and the enforcement of an extrinsic contract by reference to a statutory contract,148 this document however cannot void or extinguish a director’s fiduciary duties and duty of care. As noted in Chapter 3.1.4 these duties arose out of certain categories of relationships that are deemed fiduciary in nature and where there is reliance, trust, confidence and even loyalty of one or more parties to the other which transpires whether such obligations arise voluntarily or otherwise. Extinguishing such legal duties could only be achieve by explicit amendments to the CO. Secondly, even though s165 of the CO is about the avoidance of provisions in articles or contracts relieving officers from liability,149 this provision implies that directors’ duties cannot be adjusted ‘downwards’ simply by amending the company’s articles. As s 165(1) of the CO states that,

Any provision, whether contained in the articles of a company or in any contract with a company or otherwise, for exempting any officer of the company or any person employed by the company as auditor from, or indemnifying him against, any liability to the company or a related company that by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company or related company shall, subject to subsections (2) to (4), be void.

147 Kwok Ping Sheung Walter v Sun Hung Kai Properties Ltd and Others [2008] HKCFI 429; HCA000857/2008, [29].
148 Kwan, above n 76, 216-36.
149 This provision is similar to the provisions in s 232 of the UK’s CA 2006.
Therefore, substituting directors’ duties in the company’s articles with Chinese principles or rules could be interpreted as lessening a director’s general law and statutory obligations, which could be void by this statutory provision. Therefore certain provisions in the CO and general law duties could not be overridden by the inclusion of Chinese regulatory benchmarks in the articles.150

Alternatively, a shareholder’s agreement is another possible remedy. It is a private document that could bring about an agreement between shareholders without some of the restraints in a company’s articles.151 In Lee, Ng Louise v Silver Bell Uniform Ltd and Another152 the judge held that an agreement to buy out the shares of the plaintiff made commercial sense and it would be an equitable course of action for the plaintiff.153 Thus by extension of a private arrangement shareholders could make an agreement on how a company would be governed.

Brewer listed a few principal uses of a shareholder agreement, including two that are pertinent to this thesis, the ‘[p]articular division of managerial and operational responsibilities, particularly among members who are (a) prepared to assume executive directorship, and (b) members who prefer to remain non-executive and passive investors;…[c]onfering personal rights that cannot be enforced merely by inclusion as articles, eg appointment as a lifetime director;…’154 In Tse Wing Yin,

151 Ibid, 326. For discussions about the advantages and disadvantages of shareholders’ agreements see Sean FitzGerald and Graham Muth, Shareholders’ Agreements (Sweet & Maxwell, 6th ed, 2012) 7-10.
153 Ibid, [14]-[44].
154 Ibid, 326-327. The other uses are: ‘[e]ntrenching share transfer restrictions, principally detailed pre-emption rights and providing for their extension to restrict sale of beneficial interests in shares as well as transfer of the legal interest; regulating special relationships between members unconnected with the company’s administration, eg the particular business purposes to which the proceeds of share subscriptions will be put, dividend policy, covenants not to compete with the company or solicit business from its customers, or entice its employees; settling obligations incurred and agreements made prior to incorporation; entrenching minority protection provisions which would only be effective in the articles if the minority membership were largely enough to frustrate a special resolution: a shareholder agreement can effectively give minority interests a veto power over any future alterations to the articles without the need to create separate classes of shares.

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Irene v Chan Wai Keung and Another, the court affirmed ‘[t]he shareholders’ agreement envisaged an arrangement between the parties whereby the plaintiff would be the “executive” director. Also in Wong Man Yin v Ricacorp Properties Ltd and Others the court upheld a clause in the shareholders’ agreement was valid and found that the plaintiff did not breach his obligations stipulated in the clause.

So from the brief analysis in the above, it demonstrated that shareholder’s agreements could confer personal rights of shareholders that would otherwise be difficult if they were to be included in the company’s articles. However the courts in Hong Kong are very unlikely to enforce any contractual provision that extinguishes directors’ legal obligations. This is because in Re Beijing Greater Region Expressways Ltd the court held that any contracts that fetter the exercise of statutory power in CO or override a corporate statutory power was invalid as being contrary to public policy. Cheung and Suen argued that,

If Greater Beijing [the above case] is intended to strike at commercial uncertainty engendered by the use of private agreements and devices to evade mandatory statutory powers, such reflections as these might suggest that the cure is worse than the disease, for the [Hong Kong] Court of Appeal left vital questions of the law and judicial policy unanswered…

By extension, it is thus unlike for the courts to allow shareholder agreement to fetter or evade other general duties like directors’ fiduciary duties and duty of care obligations, which do not relate to shareholders enforcing their private rights.

Evidently, amending the company articles or the use of shareholder agreement for the purpose of substituting directors’ duties with Chinese principles or codes for

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156 Ibid, [3].
158 [1999] 3 HKLRD 862. Note that this case purports to follow the principles laid down in the UK case, Russell v Northern Bank Development Corp [1992] 1 WLR 588.
159 Ibid, 870.
directors of Chinese family companies in Hong Kong would not likely be a viable option. Consequently a different approach would be required. Interestingly during the early years of the colonial administration of Hong Kong, the colonial administrators recognised such regulatory needs and enacted the *Chinese Partnership Ordinance* (Hong Kong) cap 53 (CPO) in 1911.  

### 4.4 Early Attempt to Regulate Chinese Enterprises and Judicial Review in Hong Kong

Prior to the enactment of the CPO, a court had criticised the partnership laws operating in Hong Kong for failing to consider local Chinese customs. His honour in *Li Po Kam v Li Ling Shi* said that:

> But this is an ordinance passed in 1897 [Partnership Ordinance] by the local Legislature, and I can only hold, there being no reference from end to end to Chinese customs, that it was the deliberate intention to ignore the Chinese customs of partnership. Whether this was wise or unwise is not for me to say. But I must point out to the Government the extreme danger of reproducing English legislation bodily in the colonial statute book, without at least considering the body of Chinese who are legislated for. It is a question on which I have had considerable experience, and in my opinion, whenever Chinese customs are likely to be interfered with by a law introduced, as this was, bodily from Imperial legislation, there ought to be an express statement whether these customs are affected, or are not affected, by the law.

Then in 1901, the Colonial Secretary advocated for a Chinese partnership law because leading Chinese merchants were unanimous in their desire for legal recognition of their business ventures. The intentions of Colonial administrators in

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161 LexisNexis, *Halsbury’s Laws of Hong Kong* (at 18 November 2010) [95.005].
162 *Li Po Kam v Li Ling Shi* (1908) 3 HKLR 170 at 174.
163 Ibid.
164 Ibid, 174-5.
165 David Faure and Pui-tak Lee, ‘The Legal Framework’ in David Faure and Pui-tak Lee (eds), *Economy: A Documentary History of Hong Kong* (Hong Kong University Press, 2004) 27; Also see *Chan Kong v Chan Li Chai Medical Factory (Hong Kong) Ltd & Others* [2007] HKEC 1719 CA, [17].
enacting this ordinance were to allow family *tongs* (Chinese ancestral trust),\(^\text{166}\) to be recognised as legal arrangements.\(^\text{167}\) The obligations between partners in the CPO were fiduciary in nature, and silent partners who contributed part of the capital in the partnerships were treated as limited partners.\(^\text{168}\) However, this law was short lived, and was repealed in 1971. The Attorney General (then) said in a statement to the Legislative Council that over a 35-year period while the act was in force only one such partnership was registered,\(^\text{169}\) and that the *Limited Partnership Ordinance* (Hong Kong) cap 37 was more than adequate for those who wanted to form a business body of that nature.\(^\text{170}\) Even though no explanation was provided as to why there was only one such partnership registered, one possible reason is that the administering of justice during the early years of the colonial administration was anything but just. This was because the laws were said to be better understood by the Europeans and the courts seemed to have prejudices against the Chinese populous by labelling them thieves and criminals.\(^\text{171}\) Therefore, it was understandable that the Chinese merchants did not hold the laws with much regard let alone the registration of their business ventures.

At present, Hong Kong’s courts do recognise traditional Chinese customary practices of *tongs* under the auspices of customary law.\(^\text{172}\) These *tongs* are divided into two major categories, those that engage in business enterprises,\(^\text{173}\) and those that are non-

\(^{166}\) Note that the definition of *Tong* under s 15 of the New Territories Ordinance means family lineage trust – *Tang Man Kit and Foo Tak Ching (suing as Managers of Wah Yan Mo Fan Heung) v Hip Hing Timber Company Ltd* [2001] HKCU 759 at para 26 as per Yuen J.

\(^{167}\) LexisNexis, *Halsbury’s Laws of Hong Kong* (at 18 November 2010) [95.005].

\(^{168}\) Ibid.

\(^{169}\) No reason or explanation as to why only one such partnerships was registered

\(^{170}\) The Attorney General’s statement to the Legislative Council in 1971 to repeal CPO was quoted in *Chan Kong v Chan Li Chai Medical Factory (Hong Kong) Ltd and Ors* [2007] HKCU 1603 at para 24.

\(^{171}\) John Carroll, *A Concise History of Hong Kong* (Hong Kong University Press, 2007) 48; Tsang, above n 7, 49.

\(^{172}\) The definition of tong under s 15 of the *New Territories Ordinance* means family lineage trust – see *Tang Man Kit and Foo Tak Ching (suing as Managers of Wah Yan Mo Fan Heung) v Hip Hing Timber Company Ltd* [2001] HKCU 759 at para 26 as per Yuen J. Also note that Tong has been written as *T’ong* or known as *Tso*, see Belinda Wong, ‘Chinese Customary Law -- an Examination of *Tsos* and Family *Tongs*’ (1990) 20 *Hong Kong Law Journal* 13; Stephen Selby, ‘Everything You Wanted to Know About Chinese Customary Law (But Were Afraid to Ask)’ (1991) 21 *Hong Kong Law Journal* 45. For more about customary law under Hong Kong’s legal system see Chapter 7.2.4.

\(^{173}\) *Chan Luen Yan & Ors v Chan Tin Chai & Ors* [2010] HKCU 1054.
Wong found that. ‘Tongs were formed for many purposes. Some family tongs were set up by men who wanted to be honoured after their deaths and could afford to ensure this result. Others were formed by descendants of a common ancestor whom they wished to commemorate. ’

However, the management of these entities was simple because the creation of a tong, in most cases was for the preservation of Chinese traditions and customs like a place of ancestral worship or clan meeting halls. Wong observed that, ‘The manager is usually responsible for collecting rents, keeping accounts, and paying for rituals. If the government resumes tso or tong land, the manager is responsible for signing the relevant documents and dealing with the money.’ Moreover, the application of Chinese customary laws is very limited. For example, in the termination of the manager of a tong, s15 of the New Territories Ordinance (Hong Kong) cap 97 (NTO) is interpreted in accordance with common law principles, and as Wong has noted that, ‘for both the rules of natural justice and the burden of proof are English law concepts. Chinese customary law plays no part here for this is a matter concerning the District Officer's jurisdiction and not the internal management of the tso or tong.’

Such restrictive interpretations apply to commercial tongs too. In Chan Luen Yan & Ors v Chan Tin Chai & Ors, the petitioners and respondents were all members of an extended family, and they ran a business selling traditional Chinese medicine with another family, initially as a tong, later involved as a partnership, and then as a

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174 Chinese customary trust in Hong Kong under customary law can be further divided in a Chinese family trust to hold land and assets, or for ancestral worship. For the former is recognised under legislation in section 13(1) of the New Territories Ordinance (Hong Kong) cap 97 that governs the inheritance of new territories land, and the latter refers to ancestral land set aside for ancestral worship often used a village hall to worship ancestors, hold village meetings and celebrations of Chinese festivals. Any rents from this land go to the maintenance of the ancestral temple, to fund education of members of the clan, and financial assistance to clan members in need. Land is held in the name of the ancestor and cannot be transferred or conveyed without the consent of the representatives of the clan. – see Lau Leung Shi v Lau Po Tsun (1911) 6 HKLR 149.


176 Ibid, 19.

177 Ibid 20.

company. Over time, disagreements between the two families became irreconcilable, but the judge could only decide on the petition to seek relief for unfair prejudice under s168A and winding up on just and equitable grounds under s177(1)(f) of CO, which failed because the plaintiffs could not prove their case. This is an example showing that the courts are not apt or the appropriate venue to resolve disputes that involve the interpretation and application of Chinese customs and values. Thus, Selby suggested that traditional clans ought to be the forum to settle family or tong related disputes.

Another case, Tang Man Kit and Foo Tak Ching (suing as Managers of Wah Yan Mo Fan Heung) v Hip Hing Timber Company Ltd, involved what was alleged to be a family tong. However, the plaintiffs failed to prove their case. The judge held it was instead, ‘an unincorporated association whose members were motivated by purpose of gain, sought to hold lands…’. An appeal was lodged against the ruling of the judge of first instance about the meaning of tong under s15 of the NTO. In spite of the substantial vigour shown by the judges in the court of appeal ascertaining what were the nature and the activities of a tong from case laws, expert witness statements, and academic research, they had enormous difficulty in coming to terms with traditional Chinese values, customs and practices, because they were so vastly different from Western values and norms for which the common law was founded upon. Furthermore, the recognition of tongs was confined to the geographic boundary of the New Territories, north of Hong Kong under s15 of the NTO.

180 Ibid.
181 Ibid.
184 Tang Man Kit and Foo Tak Ching (suing as Managers of Wah Yan Mo Fan Heung) v Hip Hing Timber Company Ltd [2001] HKCU 759, [54].
The above cases demonstrated that there are clear limitations in the adjudication of disputes involving traditional Chinese commercial and non-profit trusts under customary laws. Another implication is that customary laws and the courts might not be equipped to regulate the governance of Chinese family companies for the following reasons. First, the courts found the unravelling of the history, and ascertaining the operations of *tongs*, somewhat arduous largely because the courts had the difficult of piecing together the fragmented information from various sources, and deciphering the Chinese way of thinking and values. Second, customary practices might be incompatible with the Western notions of natural justice and English legal concepts. Furthermore, as noted, the colonial administrators did experiment with the enactment of the CPO. Though it was well intended, the law failed to serve its purpose - create a legal framework for Chinese enterprises that took into account Chinese customs. The reason for this could be due to the lack of appreciation for Chinese values and culture.

4.5 Summary and Commentaries

This chapter raised the issue that the law as it stands is not apt for the needs of family companies in Hong Kong. Even though family companies are common around the world, in Hong Kong, the family has an economic role. As noted in 4.1.1, this runs against conventional economic sociological views that modern capitalistic economy operates on principles antipathetic to those of the family. This familial economic functionality helped explain why family companies are so prevalent in the territory. Furthermore, in spite of Western influences and the modern attitudes of the Hong Kong Chinese, when it comes to the family, traditional Chinese values remain embedded. Thus, this Chinese value orientation would inexorably have an effect on the governance of these family companies.

Whilst a survey of family company laws in the US, South Africa, and Australia have shown that legislators acknowledged the fact there is often no separation between control and ownership, the remedy in the US was to impose fiduciary duties between shareholders. However, a series of cases in Hong Kong regarding the disputes between members of Chinese family companies in Hong Kong revealed that instead
of taking action under directors’ duties they have chosen to seek remedy for unfair prejudice and winding up on just and equitable grounds. It revealed an important facet of the governance in Chinese family companies not explored in depth from the literature reviewed. Family members felt that they were either being wronged or dismayed in the way members of the family behaved and acted. The above mentioned cases also suggested that governance for the Chinese family companies in Hong Kong have to do more with preserving goodwill, as well as maintaining order within the family rather than the assertion of their legal rights or accountability. Therefore, when relationships between family members soured and personal disagreements escalated to the point of conflict as the deadlocks would cripple its management and the operations of the family company would be disrupted. These matters are clearly beyond the scope and sphere of directors’ duties.\textsuperscript{187}

One other point worth mentioning is in Chapter 3.1.4 the presumptive nature of directors’ duties were discussed. Since shareholders could ratify breaches of directors’ duties, this meant that shareholders in Chinese family companies could use this power to opt-out the enforcement of these legal obligations against directors. However, the cases discussed in Chapter 4.3.2 suggest that chances of ratifying breaches of directors’ duties is remote since maintaining harmonious relationships and preserving paternalistic order in Chinese family companies appear to take precedence. Besides, if the shareholders of these companies, who are also members of the family were distraught, or having strong disagreements amongst themselves, chances of ratification is highly unlikely.

Furthermore, the discussions in Chapter 4.3.3 about amending the articles and the use of shareholder agreements to regulate directors of Chinese family companies had failed to deliver solutions as the courts are unlikely to validate any attempt to bypass general law duties and CO provisions. Altogether adds to the argument that the laws as it stands are ill suited to regulate directors in Chinese family companies. From a Chinese cultural perspective, if harmonious relationships between members of the family have broken down in the worst-case scenario - as briefly mentioned in Chapter 1.4 - \textit{fen jia} (division of assets leading to liquidation) occurs. And in the

\textsuperscript{187} Refer to Chapter 3 for more on directors’ duties.
cases highlighted in Chapter 4.3.2, many if not all the plaintiffs, seek a court order to wind up their family company because the absence of harmonious relationship or a loss of order is a recipe for governance failure in these companies.

Furthermore, two empirical studies discussed in this chapter revealed that directors in Hong Kong had very low awareness of their legal duties. Whilst some might think an education campaign could assist in increasing legal awareness, survey results from the Hong Kong respondents gathered in 2009-11 by Ho et al. found that the awareness campaign about directors’ duties by Hong Kong Companies Registry via the distribution and promotion of the ‘Guidelines’ had failed to achieve much. The most likely reason to explain directors’ legal ignorance is that family and cultural dimensions in Hong Kong dominated concerns about governance. Even if critics point to the fact that many directors in the West are not aware of their duties, in Hong Kong it is different. Ignorance of the law amongst directors in Hong Kong’s Chinese family companies is not focal point of this debate, rather it is to contend that Chinese value system has more influence over their thoughts and behaviour.

Moreover, despite the legal actions discussed in the above the grievances between family members were not resolved, and more importantly it highlighted that what the law had intended to regulate did not address the underlying causes of the disputes. As noted in the above, a few judges remarked in their obiter dicta that the importance of relationship amongst the family members was a key factor in the continuation of their business operations. This suggests that the courts are not appropriate forums to mend relationships and create harmony (in the Chinese sense of the word) amongst litigants.

The brief discussions on the use of other legal instruments to govern Chinese family companies in Chapter 4.3.3 were less than fruitful. Apart from the fact that the articles and shareholder’s agreements are not likely to be binding if the crux of such attempts were to circumnavigate general law and statutory obligations. Furthermore, the cases discussed in Chapter 4.3.2 suggests that the relationships in Chinese family

188 Ho, above n 78, 95. Note that the ‘guidelines’ in the above refers to the non-statutory guidelines on directors’ duties published in 2004. For more discussions on this see Chapter 2.2.4.
companies are not contractual in nature, and thus shareholder’s agreements are not be appropriate mechanisms to regulate the governance of Chinese family companies in Hong Kong. Therefore, without an alternative, the directors of these companies have nowhere to seek redress for their grievances. Ideally, an alternative body or venue applying Chinese values might be a more appropriate dispute resolution forum for directors of Chinese family companies.

Furthermore, this chapter has also highlighted that the former colonial government attempted to regulate Chinese enterprises under the CPO and courts adjudicated on disputes concerning or in relation to *tongs*. However, the CPO was a complete failure because over a 35-year period only one such partnership was registered. As for the cases, the courts found it difficult to understand how the *tongs* operated and apply the law - possibly due to the fact that it is difficult to apply common law principles onto Chinese customs and practices. In conclusion the discussion so far has pointed to fact the Chinese culture does matter, especially in Chinese family companies. As to how and why culture affects the governance of these companies, this shall be considered in the next chapter.
Chapter 5 : Relation-centred Cultural Norms and Paternalistic Governance in Hong Kong’s Chinese Family Companies

5.0 Introduction

The conclusion in the previous chapter carried over is that ‘culture does matter’ in the governance of Chinese family companies. This line of enquiry is not without controversy, as Porter remarked that:

Attitudes, values, and beliefs that are sometimes collectively referred to as “culture” play an unquestioned role in human behaviour and progress … The question is not whether culture has a role but how to understand this role in the context of the broader determinants of prosperity.¹

However, Harrison noted that:

Scepticism about the link between cultural values and human progress is found particularly in two disciplines: economics and anthropology. For many economists, it is axiomatic that appropriate economic policy effectively implemented will produce the same results without reference to culture … The chief problem for many anthropologists, and other social scientists influenced by them, is the tradition of cultural relativism that has dominated the discipline in this century and rejects the evaluation of another society’s values and practices.²

Apprehensions aside Licht argued that:

Cultural orientations represent general societal emphases that are deeply ingrained in the functioning of major societal institutions, in widespread practices, in symbols and traditions, and, through adaptation and socialization, in the values of individuals. This process of value acquisition is sensitive to actual circumstances more than to formal reform and indoctrination.

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As a result, cultural values’ emphases may preserve and perpetuate the imprint of ancient intellectual legacies and historical initial conditions.³

Since culture shapes human behaviour and viewpoints, the aim of this chapter is to examine the cultural influence in the governance of Chinese family companies in Hong Kong. Such influences could be found in practices and customs as a form of shared norms.⁴ Both culture and norms are powerful social constructions fashioned by values and beliefs.⁵ Licht articulated that:

“When values are used to characterize cultures, what is sought are the socially shared, abstract ideas about what is good, right, and desirable in society or other bounded cultural group.” Cultural values are the bases for the specific norms that communicate to people what is appropriate in various situations.⁶

In this chapter the two key issues are Chinese business culture and the governance of Chinese family companies in Hong Kong. This is because Chinese business culture has a profound effect on the governance of the family companies, and vice versa. Like any social system, although the Chinese business culture and governance practices are far from perfect, the primary object of this chapter is to understand its workings and logic. As such, insights will help explain why Western laws are ill suited for Chinese family companies in Hong Kong. Further, this chapter endeavours to develop greater insights into Hong Kong’s business culture and appreciate the way Chinese family companies are governed from both emic and etic perspectives.⁷

5.1 Value Differences between Hong Kong and Britain

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⁷ See Chapter 1.2.2.3 on explanation about emic and etic approaches to cultural studies.
Hofstede showed how national culture affects the values of individuals in the workplace. He found that there are many differences between cultures around the world. His research findings were based on surveys from many countries over a 20-year period, from over 116,000 employees in IBM branches spanning across 50 countries. From the data generated, he came up with four (and later added a fifth) value dimensions to profile the cultural and behavioural differences between countries. Critics like McSweeney and Baskerville pointed out that there are certain weaknesses in Hofstede’s thesis. In spite of this, Chapman argued that Hofstede’s research findings still remain authoritative in the field of cross-cultural management. Mead concurred and asserted that, ‘No other study compares so many other national cultures in so much detail. Simply, this is the best there is’.

Leaving aside the critiques and endorsements of Hofstede’s cultural dimensions, his research demonstrated that there are cultural value differences between individuals from a number of countries and that when those left in charge of the company apply culturally inappropriate corporate decisions they are likely to generate negative outcomes. Given the laws regulating directors in Hong Kong are essentially Britain’s general law obligations and selective statutory provisions, the value differences between Hong Kong and Britain might help explain the differences in the

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11 Ibid.
12 Brendan McSweeney, ‘Hofstede’s Model of National Cultural Differences and their Consequences: A Triumph of Faith – A Failure of Analysis’ (2002) 55 Human Relations 89; Rachel Baskerville, ‘Hofstede Never Studied Culture’ (2003) 28 Accounting, Organizations and Society 1. Note that those criticisms are an assumption that the culture within a national territory is uniform, data is drawn from a single company and industry; the question of bias because the administration of survey as well as the ownership of the results are by IBM; and some of the surveys were completed in groups affecting the independence of the data source. See Mead, above n 8, 48-9; McSweeney, above n 12, 95-112.
14 Mead, above n 8, 51.
15 Ibid, 18-9, 52.
16 Refer to Chapters 3.2 and 3.3 about directors’ duties in Hong Kong.
governance practices between the two jurisdictions.\textsuperscript{17} From the results of Hofstede’s five value dimensions, Hong Kong has noticeable differences in three of the value dimensions (power distance, individualism versus collectivism, and long versus short-term orientation).\textsuperscript{18}

Power distance is the extent to which the less powerful within an organisation accept that power is distributed unequally.\textsuperscript{19} In some cultures, the relatively large differences in power distance are acceptable and tolerated.\textsuperscript{20} At the work place, in countries with high power distance, ‘employees are seen as frequently afraid of disagreeing with their bosses and bosses as autocratic or paternalistic. Employees in similar jobs are less likely to prefer a consultative boss.’\textsuperscript{21} Also in countries with high power distance, power tends to be concentrated in the hands a few and they exhibit large differences in authority and privileges.\textsuperscript{22} In addition, the CEO in these countries tends to minimise formal participation of subordinates.\textsuperscript{23} Moreover, the CEO in high power distance countries is usually also the chairperson of the board. Li and Harrison asserted that in Hong Kong, ‘A consolidated chair and CEO position exemplifies high power distance as this structure represents a steeper hierarchy, a more dominant CEO role, and a higher concentration of power, and it gives the CEO greater stature and political influence over the board.’\textsuperscript{24} CEOs are also more powerful because the ideal boss is a benevolent autocratic and subordinates are expected to be told what to do.\textsuperscript{25} Comparatively, amongst 50 countries, Hong Kong is ranked 15\textsuperscript{th}, whereas Britain is ranked 35\textsuperscript{th} on Hofstede’s a power distance index.\textsuperscript{26} This helps to explain why Hong Kong’s corporate board structure is hierarchical and

\textsuperscript{17} For more about the differences in the model of corporate governance between Chinese family companies and Anglo-US see Chapter 5.3.1.\textsuperscript{18} Hofstede, above n 10, 23-171.\textsuperscript{19} Ibid, 26, 53, 166.\textsuperscript{20} Jiatao Li and J. Richard Harrison, ‘National Culture and the Composition and Leadership Structure of Boards of Directors’ (2008) 16 Corporate Governance: An International Review 375, 378.\textsuperscript{21} Hofstede, above n 10, 31.\textsuperscript{22} Li and Harrison, above n 20, 378.\textsuperscript{23} Ibid, 379.\textsuperscript{24} Ibid.\textsuperscript{25} Hofstede, above n 10, 37.\textsuperscript{26} Ibid, 26. For full list, refer to table 2.1 in page 26 of the book.
power is centralised in the hands of ‘the boss’.\textsuperscript{27} Hence, it is not unusual for bosses in Hong Kong to rule over the affairs of the company with almost absolute discretion. This contrasts with the structured, process-oriented, and ruled based governance in the West.\textsuperscript{28}

In societies with collectivist values, interpersonal relationships and group affiliations are highly valued.\textsuperscript{29} Hong Kong is a relatively more collective society compared with Britain;\textsuperscript{30} on Hofstede’s individualism index, Hong Kong ranks 37\textsuperscript{th} compared to 3\textsuperscript{rd} place for Britain. Hofstede also added that in societies like Hong Kong, the maintenance of harmony amongst people, having an acute sense of shame, the importance of face, and voluntary compliance with social norms are all key social attributes.\textsuperscript{31}

Concerning long versus short-term orientation, this value dimension is a later addition to Hofstede’s original set of four value dimensions. A group of researchers in Hong Kong, led by Bond, identified certain Chinese values that were not addressed in Hofstede’s earlier work.\textsuperscript{32} Bond and his team came up with a list of 40 values drawing from the works of Chinese philosophers and social scientists.\textsuperscript{33} They then grouped them into four clusters labelling them: integration; Confucian work dynamism; human heartedness; and moral discipline.\textsuperscript{34} They found that only Confucian work dynamism did not correlate with Hofstede’s four value dimensions.\textsuperscript{35} Hofstede later developed this fifth dimension with the assistance of

\begin{itemize}
\item \textsuperscript{27} See subsequent sections below on paternalistic governance.
\item \textsuperscript{29} Li and Harrison, above n 20, 378.
\item \textsuperscript{30} Hofstede, above n 10, 53.
\item \textsuperscript{31} Ibid, 60-1.
\item \textsuperscript{33} Ibid, 146.
\item \textsuperscript{34} Ibid, 150.
\item \textsuperscript{35} Ibid, 152-8.
\end{itemize}
Bond. Confucian work dynamism consist of eight values: ordering of relationship; thrift; persistence; having a sense of shame; reciprocation; personal steadiness; protecting your ‘face’; and respect for tradition. This fifth dimension was subsequently re-labelled as 'long-term orientation', because it needed to be able to index the values of non-Asian countries, but most of the elements of this measurement remained unchanged. Long-term orientation is used to describe the following attributes, ‘values of persistency; ordering relationships by status and observing this order; thrift; and having a sense of shame.’ Hong Kong ranks 2\textsuperscript{nd} on the list whereas Britain ranks 18\textsuperscript{th} out of 23 countries surveyed. Thus, the differences in the above three value dimensions indicate that Confucius’s teachings are entrenched in the minds of the people in Hong Kong.

Regarding the other two value dimensions, the differences between Hong Kong and Britain are relatively less significant. These are masculinity versus femininity and uncertainty avoidance. Masculine people are competitive, assertive, ambitious, and have a lack of concern for others. In contrasts the emphases on caring, relationships, and concern for others are feminine. Hong Kong scores 18\textsuperscript{th} and Britain took the 9\textsuperscript{th} place out of 50 countries in Hofstede’s masculinity index. This suggests that in both societies managers are expected to be decisive and assertive. In a more feminine culture like Hong Kong (compared to Britain), resolution of conflicts is through compromise and negotiation. The concept of uncertainty avoidance, concerns the response of people to unstructured and ambiguous contexts, so in low uncertainty avoidance cultures, there is a greater tolerance for unfamiliar situations, and in these countries there is less reliance on rules because of the high

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37 Ibid, 150.
38 Hofstede, above n 10, 165, 168.
39 Mead, above n 8, 47.
40 Hofstede, above n 10, 166.
41 Ibid.
43 Ibid; Li and Harrison, above n 20, 378.
44 Hofstede, above n 10, 84.
46 Ibid.
level of tolerance for an uncertain environment.\textsuperscript{47} Hong Kong ranks 49\textsuperscript{th} and Britain took the 47\textsuperscript{th} spot out of 50 countries in the uncertainty avoidance index.\textsuperscript{48} Whilst this favours the argument that Hong Kong’s society prefers informal rules, it also shows that Britain shares the same cultural tendency when it comes to rules.

Hofstede’s research pointed out that values are not universal. When it comes to Hong Kong and Britain, there are considerable differences in three out of the five value dimensions. Since laws are value laden, the assumption that directors’ duties from Britain will work in all types of companies in Hong Kong is a highly doubtful proposition. Furthermore, Hofstede and Bond stated that, ‘It then appeared that the country scores on Confucian Dynamism derived from this exercise are strongly associated with those countries’ economic growth. Thus we found a cultural link to an economic phenomenon.’\textsuperscript{49} Since Hong Kong ranked 2\textsuperscript{nd} out of 23 countries for Confucian dynamism, then this shows that Confucian doctrines have considerable influence on the population of Hong Kong.\textsuperscript{50} Miles asserted that cultural value disparity leads to different mindsets, thus the measurement of what is appropriate or ideal in the West may be viewed as unacceptable in jurisdictions where culture of Confucian traditions dominate.\textsuperscript{51} The next question is: how does this Chinese cultural influence translate into its business culture and economic structure?

5.2 Chinese Entrepreneurialism and Relation-centred Culture in Hong Kong

This section endeavours to examine the Chinese cultural contributions to Hong Kong’s economic development. The discussion will focus on Hong Kong’s Chinese

\begin{itemize}
\item\textsuperscript{47} Li and Harrison, above n 20, 376-7.
\item\textsuperscript{48} Hofstede, above n 10, 113.
\item\textsuperscript{49} Hofstede and Bond, above n 36, 17.
\item\textsuperscript{50} Ibid, 12-3. Note that an economic historian, Yu made the remark that Hong Kong is not place of great traditions so Confucianism has never found its root in Hong Kong, but he also observed Hong Kong’s brand entrepreneurship is family centred and Chinese culture notably familism is the building blocks of its success. See Tony Yu, \textit{Entrepreneurship and Economic Development in Hong Kong} (Routledge, 1997) 61-3.
\item\textsuperscript{51} Lilian Miles, ‘The Cultural Aspects of Corporate Governance Reform in South Korea’ (2007) 51 \textit{Journal of Business Law} 851, 858-60.
\end{itemize}
spirit of entrepreneurialism and business network structure as well as its relational traits.

5.2.1 Hong Kong’s Chinese Spirit of Entrepreneurialism

Hamilton argues that, ‘Hong Kong, as a place, was and continues to be at the organizing centre of Chinese-led capitalism. Hong Kong assumed this role shortly after its founding in the nineteenth century and continued it until World War Two’. In the preceding years to World War Two, Hong Kong also served as a capitalist funnel for Chinese working or migrating overseas. The influx of funds from China to Hong Kong created unexpected demands for goods and services locally. This spurred Chinese entrepreneurs residing in Hong Kong and provided the opportunity to benefit from this surge in economic activities. When China fell into the hands of the Chinese communists, Chinese family enterprises bloomed in Hong Kong with the surge in arrivals of Chinese migrants with capital and business skills fleeing the Chinese communist regime. During the early colonial administration, as there was no formal education system, many did physical work like labour, and those with skills became tradesmen, while others with capital either started small family shops, or became merchants.

This family centred form of entrepreneurialism and its traditional Chinese value driven practices predates the British colonial administration. Chen noted that, ‘for the Chinese, business has always been connected to family. In fact, in traditional Chinese culture, the family serves as the basis for and prototypical unit of all

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53 George Hicks, Overseas Chinese Remittances from Southeast Asia: 1910-1940 (Select Books, 1993) 18-20.
54 Ibid.
55 Hamilton, above n 52, 141.
56 Steve Tsang, A Modern History of Hong Kong (Hong Kong University Press, 2004) 58-61; John Carroll, A Concise History of Hong Kong (Hong Kong University Press, 2007) 36-37. Also see Chapter 4.1.1 for socio-economic explanation for prevalence of family companies in Hong Kong.
57 Tony Yu, Entrepreneurship and Economic Development in Hong Kong (Routledge, 1997) 62. Also see Chapter 4.1.1.
Yu labelled this unique entrepreneurial characteristic as ‘entrepreneurial familism’ or family-centre entrepreneurialism. According to Yu, Hong Kong’s ‘entrepreneurial familism’ exhibited the following characteristics; firstly the father figure is central, with filial piety, honour, ‘rengqing’ (relational obligations), pressure to live up to family expectations and family training paramount to ensure the members conform to the goals of the family business. Secondly, a Chinese family firm in Hong Kong is governed by paternalism. The head of these companies takes the position that ‘my staff is my family’, and thirdly, a Chinese family firm in Hong Kong engages extensively in business networks and nepotism, and this is an extension of family culture.

Redding coined this phenomenon as ‘the Spirit of Chinese Capitalism’. Furthermore, he argued that it was the combination of Confucian teachings, ‘entrepreneurial familism’, and close-knitted business network structures that were the driving force behind Hong Kong’s economic rapid development. This stands in contrast with Western countries, like the US and Britain, as the industrialisation of these countries was spurred by the rise of managerial capitalism, where family companies could no longer effectively run the company and professional managers were hired to take over operational control. Furthermore, companies in the US and Britain developed and expanded in a competitive environment, where opening up competition brought about greater efficiency and innovation.

59 Yu, above n 57, 62-3.
60 Tony Yu, ‘From a ‘Barren Rock’ to the Financial Hub of East Asia: Hong Kong’s Economic Transformation in the Coordinating Perspective’ (2004) 10 Asia Pacific Business Review 360, 368. For more on filial piety and relational obligations see subsequent sections.
61 Ibid.
65 Boyce and Ville, above n 64, 232-46; Chandler, above n 64, 47-392.
5.2.2 Hong Kong’s Chinese Business Network Structure and Relational Traits

Furthermore, in the late 18th century segregation between the expatriate Europeans and the local Chinese in this British colony led the Chinese community to organise their own affairs; this included voluntary businesses associations and informal groupings. This history of intimate relationships amongst local Chinese businesses in Hong Kong had overtime nurtured the formation of an informal business network structure. Apart from self-regulatory roles, these networks also have strategic functions, namely, to share resources to overcome the limited capacity within smaller companies and so spur growth. This business network structure facilitates the pooling of resources and reduces uncertainties associated with economic and political risk. The links between ‘entrepreneurial familism’ and Hong Kong’s network economic structure is a direct one. It enables these businesses to pool resources and collaborate on large business projects through a system of exchanges and cooperation that allow flexible organic growth. This is one of the key factors in helping Chinese family companies in Hong Kong, Taiwan, as well as overseas Chinese businesses in South East Asia to be successful. Commentators labelled this network of Chinese family companies in Asia as the ‘bamboo network’.

This formation of interlocking and loosely connected companies had been a permanent feature in the territory’s business environment. Historically, these networks centred on elite Chinese families or large British trading houses known as ‘the hongs’. The influences of these ‘hongs’ (in particular, Chinese Hongs) on the

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66 Tsang, above n 56, 65-72; Hamilton, above n 52, 113-20, 134-9, 142; Carroll, above n 56, 37-9.
67 For more on the self-regulatory role of Chinese business associations see Chapter 6.4.
68 Redding, above n 28, 275
71 Mead, above n 8, 188-204.
73 Wong, above n 69, 87-111.
74 Tsang, above n 56, 56-72. Note, ‘The Hongs’ were major business houses in Hong Kong with significant influence on patterns of consumerism, trade, manufacturing and other key areas of the economy. They were led by honourable leaders. See Wikipedia, ‘The Hongs’ <http://en.wikipedia.org/wiki/The_Hongs#1990s>.
75 Note, prior to the handover in 1997, large British trading houses in Hong Kong began their slow and gradual retreat due to the political uncertainties associated with post-handover political-economic
territory’s economy and government policies continued to be considerable even into the present. At present, Hong Kong has a small number of very large conglomerate groups dominating key sectors of the economy like real estate, telecommunications, food, energy, automotive, commodity, transport, and retailing subsidiaries. Williams argued that in Hong Kong, there is a common corporate structure made up of interconnected subsidiaries through pyramid ownership structures and cross ownership held by families. He added that this concentration of interlinking economic power in the hands of a few oligarchic families has enabled them to persuade the government to delay the introduction of competition laws in Hong Kong for decades. Another important matter to note is that this network builds on interpersonal relationships between heads of Chinese family companies to forge trust between parties and for them this is more important than formal contracts. Li, Park, and Li observed that this relation-based norm forged through the development and nurturing of personal relations between heads of Chinese family companies cannot be reassigned to another person. Thus, the ‘bamboo network’ in Hong Kong, reinforced this relational based informal connection to form close knit business communities.

Chinese cultural values and norms also played a key role in the formation of this bamboo network, one of which is the notion of ‘xingyong’ (trust) held between heads of Chinese family companies. It is the foundation of Hong Kong’s business community. Having xingyong also facilitates quicker decisions because there is no landscape. As early as the 1970s some British establishments started to move their headquarters out of Hong Kong. See Tsang, above n 56.

77 Mark Williams, Competition Policy and Law in China, Hong Kong and Taiwan (Cambridge University Press, 2005) 237.
78 Ibid.
79 Ibid. Note that on the 14th June 2012 the Hong Kong Competition Bill was passed and the ordinance was gazette on 23rd November 2012. See Hong Kong Special Administrative Region, Commerce and Economic Development Bureau, ‘What’s new - Competition Ordinance (Commencement) Notice 2012 gazetted’ (23 November 2012) <http://www.cedb.gov.hk/speech/2012/pr23112012.htm>.
80 Redding, above n 28, 272.
formal process or due diligence required.\textsuperscript{84} Although this system of \textit{xingyong} is not a substitute for legal agreement, often ‘the word’ of the head of a company is enough to strike a business deal.\textsuperscript{85} Hamilton noted that in a network-based society like Hong Kong, this trust has relation-specific and is situationally applied.\textsuperscript{86} He added unlike in the West where trust relates to abstract standards, such as justice and honesty, equally applying to all participants regardless of their situation, the Asian notion of trust is defined as, ‘what is inappropriate moral behaviour by reading the situation and by knowing the social categories of, and sets of relationships between, the actors involved’.\textsuperscript{87} Such notions of trust and behavioural norms stem from the Confucian notion of reciprocity and propriety.\textsuperscript{88} \textit{Xingyong} also places emphasis on personal relations and the maximisation of long-term mutual benefits between parties.\textsuperscript{89} In addition, the Chinese notion of trust is not a matter of faith; rather it is demonstrated through continual exchanges between parties to build mutual confidence.\textsuperscript{90} For family members, \textit{xingyong} is a given,\textsuperscript{91} but for non-family members, it builds on reciprocity and one’s reputation.\textsuperscript{92}

\textit{Xingyong} also has a commercial value in terms of reputational gains.\textsuperscript{93} Reputation in Chinese slang is known as \textit{mianzi} or ‘face’.\textsuperscript{94} There is no equivalent of this concept in the West.\textsuperscript{95} Chen observed that, ‘it [\textit{mianzi}] denotes a social standing based on one’s character and reputation within a given social group.’\textsuperscript{96} Having \textit{mianzi} has advantages; it is like having a good credit history - a form of social currency in business and social circles.\textsuperscript{97} Yao noted that, ‘Indeed words of reputable Chinese

\textsuperscript{84} Redding, above n 62, 66-7.
\textsuperscript{85} Wong, above n 83, 16-22. See Hofstede’s value dimensions in Chapter 4.3 below.
\textsuperscript{86} Hamilton, above n 82, 289.
\textsuperscript{87} Ibid. This contrast strongly with Western notions of trust in fiduciary duties, see Chapter 3.
\textsuperscript{88} Wong, above n 83, 24. For discussions about Confucian doctrines on reciprocity and propriety see Chapter 5.2.
\textsuperscript{89} Souchou Yao, Confucian Capitalism: Discourse, Practice and the Myth of Chinese Enterprise (RoutledgeCurzon, 2002) 121.
\textsuperscript{90} Ibid, 122-3.
\textsuperscript{91} Tong Chee Kiong, ‘Centripetal Authority, Differentiate Networks: The Social Organization of Chinese Firms in Singapore’ in Gary Hamilton (ed), \textit{Asian Business Networks} (Walter de Gruyter, 1996) 133, 138.
\textsuperscript{92} Chen, above n 58, 74-5.
\textsuperscript{93} Wong, above n 83, 13; Redding, above n 62, 99-100.
\textsuperscript{94} Chen, above n 58, 72.
\textsuperscript{95} Redding, above n 62, 65.
\textsuperscript{96} Chen, above n 58, 72.
\textsuperscript{97} Ibid, 72-3.
entrepreneurs – those with face or mianzi – are binding as, or even more so than paper drawn up in the solicitor’s office or before creditable witnesses.98 This concept exists in relation to others, thus it has to be reciprocated - if others give you mianzi, you would have to do likewise – thereby strengthening the business relationship and dealings.99 In another sense, mianzi is a key component of guanxi (connections).100 Chen wrote, ‘The relationship between guanxi and face (mianzi) is intertwined and complicated.’101 The more mianzi one has, the easier one can develop more guanxi and the combination builds one’s xingyong and standing in society.102

The concept of guanxi is universal across all Chinese communities including Hong Kong, China, Taiwan, and South East Asian countries. However, the term guanxi has no direct English translation creating much confusion over its precise meaning.103 It is the existence of connections with reciprocal and mutual obligations, often misunderstood by Westerners as cronyism and influence peddling associated with bribery and corruption. Rather guanxi is grounded in xingyong, renqing (mutual obligations), and shared experiences with roots dating back to ancient Chinese social customs.104 Chen, Chen and Huang added that the notion of guanxi might conflict with Western, ‘public ethics of the community and the rule of law, impartiality and fairness.’105 Li argued that, ‘the nature of guanxi-practices as a privatization process, has significant damaging impacts upon the distributonal justice…’.106 Ambler and Witzel also noted that, ‘Westeners have difficulty with concept of obligations unmatched by rights.’107 This is because Chinese society is structured primarily in

98 Yao, above n 89, 112.
99 Chen, above n 58, 75-6.
101 Ibid, 52.
102 Ibid, 53-4; Yao, above n 89, 122-3.
103 Chen, above n 58, 46.
104 Ibid, 46.
Thus, for them trust is built progressively through social interactions, which are indispensable in business dealings.\(^{109}\)

Chung and Hamilton added that, ‘Guanxi cannot make things work; it only makes things work better.’\(^{110}\) They also noted that the success of a great many Chinese entrepreneurs in Hong Kong rests on networks, and guanxi is an essential part of becoming a member of a business network.\(^{111}\) It is a ‘door’ to gain access to business opportunities.\(^{112}\) Guanxi could be understood as a means to develop xingyong and forms the foundations of business networks.\(^{113}\) Furthermore, guanxi is also rooted in Confucian doctrines where relational obligations and bonds are paramount in all aspects of social life in Chinese societies.\(^{114}\)

‘Renqing’ (mutual obligations) is also linked to guanxi. This is crucial in terms of the understanding and nurturing of guanxi. Chen explained the term renqing is used to express favours that accrue through guanxi relationships, and added that, ‘As this range of meanings suggests, renqing obligations weave networks of relationships through reciprocal offerings of gifts and favors, creating mutual indebtedness that continues indefinitely and becomes a basis for guanxi’.\(^{115}\) The term renqing is made up of two Chinese characters ren literally means human and qing that has no equivalent in English, but loosely translated, means ‘appeal to the other’s feeling’, ‘human emotions’, or ‘sense of humanity’.\(^{116}\) Renqing applies to non-family

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\(^{109}\) Ambler and Witzel, above n 107, 99.

\(^{110}\) Chung and Hamilton, above n 108, 336.

\(^{111}\) Ibid, 342.

\(^{112}\) Ambler and Witzel, above n 107, 98.

\(^{113}\) Chung and Hamilton, above n 108, 339, 342.

\(^{114}\) Ambler and Witzel, above n 107, 84; Yuan Wang, Xin Sheng Zhang and Rob Goodfellow, *China Business Culture: Strategies for Success* (Talisman, 2003) 22-3, 29-30. For detailed discussions about Confucian doctrines on relational obligations see Chapter 6.2.

\(^{115}\) Chen, above n 58, 49.

members and the relationship is horizontal in nature, creating a set of binding obligations between people. Renqing is also closely link to ren (benevolence) in Confucianism, where humanity and humanness is a very important moral value.

Therefore renqing, guanxi, and mianzi are interlinking concepts that reinforce and strengthen the bamboo network to such an extent that it becomes ‘a club’. The concepts and practices of renqing, guanxi, and mianzi in Chinese societies, like Hong Kong, also indicate that relationships and relational obligations that arise out of interactions between people create binding reciprocal and mutual obligations.

Aside from the merits mentioned in the above, the cooperative nature of this network in turn allowed economics of scale and scope to be built between Chinese family companies across Asia, thereby facilitating the rapid expansion of business operations domestically and regionally, reaching into markets across borders with relative ease. Another way of understanding this phenomenon is a form of social capital. However, there has been criticism, especially in the aftermath of the AFC where the closely knit business relationships in Asian countries had allowed excessively risky bank loans and corruption to be a norm. Pye is more circumspect as he remarked that the advocates of Asian values might have overstated its contributions to Asia’s economic growth. And he added that, ‘Cultural differences [Asia and the West] will endure, and in most cases there is little point in trying to say

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117 Hamilton, above n 52, 227.
118 For detailed discussions about Confucian doctrine of ren see Chapter 6.2.
119 Mead, above 8, 199.
122 Note that according to Fukuyama, ‘Social capital can be defined simply as an instantiated set of informal values or norms shared among members of a group that permits them to cooperate with one another. If members of the group come to expect that others will behave reliably and honestly, then they will come to trust one another. Trust acts like a lubricant that makes any group or organization run more efficiently. See Francis Fukuyama, ‘Social Capital’ in Lawrence Harrison and Samuel Huntington (eds) Culture Matters: How Values Shape Human Progress (Basic Books, 2000) 98, 98.
124 Lucian Pye, ‘“Asian Values”: From Dynamos to Dominoes?’ in Lawrence Harrison and Samuel Huntington (eds), Culture Matters: How Values Shape Human Progress (Basic Books, 2000) 244, 255.
which cultures are superior and which ones inferior. Their strengths and weaknesses will be in different areas and will involve different practices.125

Nevertheless, this informal network system has a binding effect on those who are inside this network, even though they are personality centred and value driven.126 For Hong Kong, the informal business networks and Chinese ‘entrepreneurial familism’ are interdependent and mutually supporting phenomenon sustained by their shared beliefs in Confucian doctrines.127 This means the values they hold affect the way they govern and run the company. So much so that Chen made the following remarks, ‘The Chinese family business is the product of the Chinese culture and tradition. Many features of the CFBs’ [Chinese family business] organization and management must be understood in the cultural and traditional context, without which wrong conclusions will be reached.’128

5.3 Paternalism in Hong Kong’s Chinese Family Companies

As noted in the above the values in Hong Kong are essentially drawn from traditional Chinese culture and practices. To appreciate this issue in greater depth, this section will examine the following. First a brief comparison of Chinese family and Anglo-American governance models, second a more in depth analysis of paternalism and harmonious relations as the core elements of the governance of Chinese family companies in Hong Kong, and third, issues incidental to paternalistic governance.

5.3.1 Comparing Chinese Family and Anglo-American Governance Models

To compare Chinese family and Anglo-American governance models table 1 below summaries the key differences between these two types of companies. This has been collated from the literature of various business and related disciplines. The table is a summary from the literature review to identify the key values, norms, and practices that shape the governance between the two cultures.

125 Ibid.
126 Mead, above 8, 201.
127 Hamilton, above n 52, 141-2, 231-6.
128 Chen, above n 100, 78.
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<th></th>
<th>Anglo American Model</th>
<th>Chinese Family Centred Model</th>
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<tr>
<td>Separation between ownership and control</td>
<td>Owners are in control of the company.</td>
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<tr>
<td>Outsider system (where large firms are controlled by their managers but owned by outside shareholders)</td>
<td>Insider system (owned predominantly by insider shareholders who also wield control over management)</td>
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<td>Company managed by professional managers</td>
<td>Company managed by family members or relatives</td>
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<td>Rule rather than relationship based governance system</td>
<td>Relationships and trusts are more important than formal legal safeguards</td>
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<tr>
<td>Disperse shareholdings</td>
<td>100 per cent or block shareholdings held by family members</td>
<td></td>
</tr>
<tr>
<td>Emphasis on independent non-executive directors to bring independent judgement to the board - transparency</td>
<td>Paternalistic governance and decision making with the head of the family dominating and no clear separation between the interests of the family and the company</td>
<td></td>
</tr>
</tbody>
</table>

129 Note this term does not denote that corporate governance practices and laws are universal in the US and Britain. This term describes the “outsider” systems of corporate governance adopted by US and Britain, where shareholders interest is held to be paramount. See Thomas Clark, *International Corporate Governance: A Comparative Approach* (Routledge, 2007) 129.


133 Solomon and Solomon, above n 131, 150.

134 Ibid, 151.

135 Chen, above n 58, 35.

136 Ibid.

137 Shaomin Li, Seung Ho Park and Shuhe Li, ‘The Great Leap Forward: The Transition from Relation-Based Governance to Rule-Based Governance’ (2004) 33 *Organizational Dynamics* 63, 64-5.

138 Chen, above n 58, 77.

139 Tricker, above n 130, 183-4.

140 Ibid, 189.


142 Redding, above n 62, 153-5.
Power is linked to the appointment and responsibilities conferred by the board. Power is conferred by status within the family hierarchy – legitimacy.

Interests of the shareholders as a whole is paramount. Interests of the family is often not separated from the interest of the company.

Sense of duty and legal obligations is important – therefore the focus is accountability. Sense of loyalty and family obligations comes first – the focus here is on harmonious relationship.

Clearly, the table above has revealed startling contrasts that are embedded in the two models of governance.

The term ‘Anglo American Model’ is a label commonly used to identify systems of corporate governance in the US and Britain. Apart from Britain and the US, many other Western countries including Australia and New Zealand are said to embrace the Anglo-American model of governance. This system of governance has certain discernible characteristics like dispersed shareholdings; shareholder interest is held to be paramount; strong disclosure requirement; and strong emphasis on minority shareholder protection. The boards of an outsider system are entrusted with the responsibility of monitoring the affairs of the company on behalf of shareholders. Even though researchers have found that family companies in the West do not always fit the Anglo-American model (instead arguing that the stewardship model is more suited), Miller and Le Breton-Miller argued that overtime as a family

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143 Tricker, above n 130, 241.
144 Fock, above n 132, 32.
145 Tricker, above n 130, 181-4.
146 Redding, above n 62, 153, 173.
147 Chen, above n 100, 21-30.
150 Ibid, 169.
151 SH Goo and Anne Carver, *Corporate Governance: The Hong Kong Debate* (Sweet & Maxwell, 2003) 845.
152 Clarke, above n 149, 131.
company grows and the founder of the company is succeeded by the next generation, there is a tendency to develop an agency type model of governance. Even if family companies in Western countries are said to adopt the stewardship model of corporate governance (implying the directors are stewards rather than agents), Tricker contended that this theory better reflects the ideals encompassed in directors’ fiduciary duties.

In contrast, the Chinese family centred model discussed is Asian family based model because of a general lack of non-family members as shareholders. As such, this system is relationship orientated because of the close personal relationships prevalent between the board and the shareholders. Clarke noted that the boards of an insider system have the tendency to rubber-stamp the decisions of the CEO/Chair, and act to further the family’s interest. This Asian family based model is atypical in companies found in Hong Kong and Taiwan, as well as companies of overseas Chinese in Indonesia, Malaysia, Singapore, Thailand, and the Philippines. Even though, Chinese family companies share some superficial similarities with Western family companies like the use of company resources to further the family’s interests.


Tricker, above n 130, 224.

154 Solomon and Solomon, above n 131, 149. Also refer Chapter 4.2.1 about Asian family based model.

155 Ibid.

156 Clarke, above n 149, 203.

157 Chen, above n 100, 58-79.
and parental altruism by the founder / CEO," they are quite different. Redding found from the interviews with a number of Chairs/CEOs of Chinese family companies in Hong Kong that the family patriarch or matriarch governs these companies with total control and discretion. This approach to governance is characterised by Redding as ‘paternalistic’. Albeit altruistic behavioural tendencies by parents who are heads of family companies in Western countries are not unusual, there is no equivalent to paternalistic governance in the West. Furthermore, family companies in the West have greater acceptance of independent board members being beneficial for the company, but this is not the case for Chinese family companies in Hong Kong.

Translating all the above into the context of corporate governance in Chinese family companies - though in modern Chinese societies references to morally or moral principles might have not be as common as in the heydays of Confucianism during the Han dynasty- paternalism is amongst the Chinese family values to persevere into the present. Leung found that in Hong Kong there is ample evidence to suggest that ‘patriarchal values and practices linger on, both within the family and in society at large.’

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161 Redding, above n 62, 156-69. Interviews include public listed companies, which started as family companies, after listing family members retained substantial shareholdings, and continues to be headed by the family patriarch.

162 Ibid, 156. See Chapter 5 for explanation of paternalistic governance.


165 Benjamin Leung, Perspective on Hong Kong Society (Oxford University Press, 1996) 85.
Westwood remarked that paternalistic governance is an admixture of clearly delineated and legitimised patriarchal authority, together with reciprocal obligations. This governance structure is grounded particularly in the centrality of the family unit. Erben and Guneser noted that, ‘When paternalism is analyzed from the perspective of interpersonal relations, we can talk about superior and subordinate relationships. This type of leadership is fairly similar to autocratic leadership, except that in paternalism, the leader is like a father and takes care of the followers like a parent would.’ Paternalistic leaders are looked upon positively in Chinese societies like in Singapore, Hong Kong, and Taiwan because of their fatherly concern for the followers (from the moral principle of ren), and their attempt to create a family-like atmosphere in the company. The negative side of this governance regime is the risk of nepotism in the family company, where privileges and resources are given to those deemed by the head of the company as favourites.

Empirical research by Westwood found that Chinese family companies across Singapore, Hong Kong, and Taiwan are paternalistic and that these companies have two common features: the first is order and compliance, and the second is harmony. Under this governance regime, the following attributes will manifest: patriarchy, large power distance (Hofstede’s value dimension), hierarchical structure, and ‘filial piety’. He commented that this orientation is sustained through deep-seated values and traditions, much of which is a family-centred value system based on Confucius’s teachings. The second requirement for

168 See Chapter 6 for more on the concept of ren.
169 Ibid.
170 Ibid, above 166, 453.
171 Westwood, above n 166, 453.
172 See Chapter 4.2.
173 Ibid, above n 166, 453.
174 Ibid, 455.
harmony is a distinctive attribute in collectivism.\textsuperscript{176} reciprocity, moral leadership, propriety and virtue, and face sensitivity (\textit{mianzi}).\textsuperscript{177} This second requirement is a relationship centred concept, where harmony is the end goal.\textsuperscript{178} Again, much can be linked to Confucius’s teachings, especially propriety and virtue, as well as reciprocity.\textsuperscript{179} These are in short two key elements: hierarchical order and relational obligations. Another description of this mode of governance is ‘patrimonialism’, which means a combination of paternalism, hierarchical order, mutual obligation, familialism, and personalism.\textsuperscript{180}

5.3.2 An Analysis of Paternalism and Harmonious Relations

Paternalistic governance has roots in Confucian ideals about how households should be governed.\textsuperscript{181} The head of the company is expected to be benevolent (\textit{ren}) and fatherly like.\textsuperscript{182} Cheung and Chan observed that:

Hence while leaders take care of their subordinates’ welfare, their subordinates should obey and behave loyally to their leaders. As such, subordinates should not form cliques or faction within the organization. Hierarchical order is clear-cut and people have their own clear roles, like parents and children.\textsuperscript{183}

This parental-like approach to leadership has a built in sense of legitimacy towards the superior-subordinate relationship. For the Chinese, it is an extension of the Confucian natural order of things.\textsuperscript{184} Furthermore, if children are on the board of directors, the family patriarch or matriarch is the one in control and wields the power. The hierarchical order in the boardroom and organisational structure in these companies is top down, as shown in diagram 1. It also demonstrates that paternalistic governance is personality centred. Thus, by implication the board of directors is not

\textsuperscript{176} See collectivism in Hofstede’s value dimensions in Chapter 5.1.
\textsuperscript{177} Westwood, above n 166, 453. Also see Chapter 5.2.2 about \textit{mianzi} and reciprocity.
\textsuperscript{178} Ibid, 458. Also refer to discussions about the Chinese concept of harmony in Chapter 5.2.
\textsuperscript{179} Ibid, 459. For more on Confucius’s teachings see Chapter 6.
\textsuperscript{180} Mead, above 8, 70.
\textsuperscript{181} Redding, above n 28, 285.
\textsuperscript{182} Chau-kiu Cheung and Andrew Chan, ‘Philosophical Foundations of Eminent Hong Kong Chinese’ (2005) 60 \textit{Journal of Business Ethics} 47, 49.
\textsuperscript{183} Ibid.
\textsuperscript{184} Redding, above n 62, 61. See Chapters 5.1 and 5.2 for discussions about Confucian natural order of things.
the source of power; instead it is held by the family patriarch – usually, the father
who could also be the founder of the family company.

Diagram 1

Compared with companies in Britain or the US the contrasts are quite startling where
the CEO/Chair is a member of the board and the board governs the company as a
collective.\textsuperscript{185} Further, in Britain and the US boards across many companies consist of
professional managers and independent outsiders. The positions of chairperson and
CEO, especially in Britain, are often separated, and the combination of legal rules
and principled-based instruments regulate the conduct of directors.\textsuperscript{186} As mentioned
in Chapter 3, even though, the transplanted British general law fiduciary duties and
the newly enacted statutory duty of care regulate all directors in Hong Kong, for
Chinese family companies, as noted in the above table, Chinese cultural values
dominate. In addition, directors of Chinese family companies do not separate
between the family’s and company’s interests.\textsuperscript{187}

\begin{itemize}
\item \textsuperscript{185} Cally Jordon, ‘Family Resemblances: The Family Controlled Company in Asia and its Implications
\item \textsuperscript{186} Tricker, above n 130, 183-6; Colin Carter, \textit{Back to the Drawing Board: Designing Corporate
Taylor, \textit{Boards at Work: How Directors View Their Roles and Responsibilities} (Oxford University
\item \textsuperscript{187} Wai-Kei Wong, \textit{A Study of Corporate Governance Amongst Listed Chinese Family Enterprise in
Hong Kong} (PhD Thesis, University of Hong Kong, 2001) 60-1.
\end{itemize}
Therefore the Chinese family company’s model of governance is personality oriented with the head of the company having hands on control; this means all major decisions have to be personally approved by the leader. This head is either the patriarch or a matriarch of the family - usually the one who founded the business - with other family members holding key positions. Even when the family company expands into other businesses, the parent company is linked to a web of subsidiaries and allied companies, typically owned by various members of the immediate and extended family creating a complex network of companies, with ownership distributed throughout the extended family. Chen added that the head of the company retains his power by maintaining of a large power distance. The subordinates are supposed to think what the boss is thinking and tailor responses to his or her demands, with dissenting opinions only being conveyed to the boss in private and with a respectful tone.

As discussed above, the other side of the equation, according to Confucius, is that the father is expected to be benevolent to the child. In an organisational context, this means that a leader (fatherly-like boss) should be benevolent towards his or her subordinates. Farh, Liang, Chou, and Cheng articulatd that a benevolent leader, ‘refers to behaviour that demonstrates individualized, holistic concerns for a subordinate’s well being.’ In another article, Farh and Cheng wrote:

> [t]he cultural roots of benevolent leadership originate from the Confucian ideal of the kind, gentle superior, and they are further cemented by practical concern for exchanging superior favours for subordinate indebtedness, personal loyalty and obedience. All come under the umbrella of the powerful norm of reciprocity.

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188 Westwood, above n 166, 466.
189 Chen, above n 58, 26.
189 Ibid, 26. Also see pyramid corporate ownership structure in Chapter 4.1.
189 Chen, above n 100, 73.
189 For more on filial son and benevolent father see Chapter 6.2 for details.
Whilst this is an ideal, in practice, this is most likely to give the impression that the leader is an authoritarian. At the extreme, a paternalistic leader might appear to be on the verge of being despotic because the decisions made are not up for discussion or scrutiny similar to an Emperor issuing a decree. Those who wish to oppose should resign from the company.

Another Confucian value that is linked to paternalism is harmonious relationships. For example, renqing is born from obligations arising from a sense of being obliged, mixed with affection, or moral principles, but this is horizontal in nature and draws from the relationship between relatives. Empirical research by Zhang and Bond found that the respondents in Hong Kong and China strongly endorsed the Chinese concepts such as harmony, renqing, and mianzi born out of xiao. As highlighted in the above, guanxi is an indispensable element of Chinese business dealings. Chen and Chen maintained that for Confucius individuals do not exist by themselves only in relations to others, social order is achieved through hierarchical differentiation, and each relationship operates under moral principles, which altogether give rise to the evolution of guanxi in modern Chinese societies. However, guanxi only applies to non-family members. It draws from obligations preordained in the family. Hence, guanxi attempts to mimic obligations like those in the family. In an interview conducted by Redding, a head of a Chinese family company said, ‘My staff is my family’. Redding went on to explain that, ‘Perhaps because Chinese morality is based in relationships rather than on more abstract ideals, one might anticipate the enhancing of a sense of responsibility towards workers.’ Employees of these companies could also relate to this mindset as Chai and Rhee argued that:

196 Redding, above n 62, 130.
197 Ibid, 131.
198 See Chapter 6 for more on harmony.
199 Redding, above n 62, 227. Also see above about renqing.
204 Redding, above n 62, 156.
205 Ibid.
These norms are derived originally from popular popularized understandings of Confucian ethics, but employees of the firms do not have to personally subscribe to the ideal justness or rightness of the norms in order to follow them or for the norms to be effective. Rather, the employees simply need to be aware that these norms are part of a shared background of salient cultural material that is common knowledge.\(^{206}\) This is because employees who have served Chinese family companies over a long period are treated as if they are extended members of the family.\(^{207}\)

The cohesiveness of a family for the Chinese means the relationship between every member is maintained through a strong sense of responsibility and obligation towards one another.\(^{208}\) This implies that potential or actual differences between individuals are subordinated in favour of achieving harmony.\(^{209}\) Harmony is maintained when each party performs according to their roles dutifully.\(^{210}\) If not, the contrary behaviour is counterproductive or might even be destructive to a family company. Buckley noted that, ‘Family quarrels (particularly given the tortuous nature of many complex family interrelations in these companies) tend to limit the lifecycle and development of companies.’ \(^{211}\) Therefore, a key concern of a paternalistic leader is to foster harmony and stability amongst family members.\(^{212}\) Furthermore, the strong sense of responsibility amongst family members and even staffers creates an obligation for them to mediate any differences between themselves or with the guidance of the head of the company for the sake of harmony.\(^{213}\) Thus, harmonious relations in this context are extensions of paternalism.


\(^{207}\) Chen, above n 58, 77-8.


\(^{212}\) Westwood, above n 166, 454.

\(^{213}\) Redding, above n 62, 144-5, 156-67.
There are several advantages to this paternalistic regime. Since power is vested with one person, decisions can be made relatively quickly.\textsuperscript{214} Internal organisational efficiency is achieved through vertical control.\textsuperscript{215} There are also cost savings in these types of companies, as family members are usually not paid. They work in the family company out of a sense of loyalty and personal obligation.\textsuperscript{216} In addition, loans are usually from family members and relatives, with little to no interest charged.\textsuperscript{217} Finally, there is an expectation of benevolent leadership, which stems from Confucian ethics, where relational obligations are more important. Thus, the emphasis on cooperation and avoidance of conflict is embedded into the organisational culture of the family company.\textsuperscript{218} These cornerstones lend support for the argument that paternalistic governance is part of the reason why Chinese family companies have been relatively successful.\textsuperscript{219} In summary, paternalism and harmonious relationships are key attributes of corporate governance of Chinese family companies. More importantly, as noted in the above, the justification is for paternalistic control of the family company is a moral one.

There are however disadvantages. The heads of these Chinese family companies might not distinguish between company and personal assets.\textsuperscript{220} As noted in the above, the line between family and company could be blurred. Another problem is that the decisions of a paternalistic leader are not to be questioned. This means the rationale for decisions is not always justifiable from an analytical viewpoint.\textsuperscript{221} Instead, the individual’s principles and personal experiences form the basis of many decisions.\textsuperscript{222} This leadership style also tends to repress professional talent,\textsuperscript{223} so growth is limited due to the lack of new blood and ideas.\textsuperscript{224} Sometimes, non-family employees are often left out of promotional opportunities, and have a low degree of loyalty and

\begin{flushright}
\textsuperscript{214} Ibid, 207. \\
\textsuperscript{215} Ibid, 208-12. \\
\textsuperscript{216} Mead, above 8, 281. \\
\textsuperscript{217} Ibid, 282-3. \\
\textsuperscript{218} Sonia El Kahal, \textit{Business in Asia Pacific: Text and Cases} (Oxford University Press, 2001) 134. \\
\textsuperscript{219} Redding, above n 62, 156; Yeung, above n 63, 80. \\
\textsuperscript{220} Wong, above n 187, 60-1. \\
\textsuperscript{221} Angus Young, Grace Li, and Alex Lau, ‘Corporate Governance in China: The Role of the State and Ideology in Shaping Reforms’ (2007) 28 \textit{The Company Lawyer} 204. \\
\textsuperscript{222} Ibid. \\
\textsuperscript{223} Chen, above n 100, 76. \\
\textsuperscript{224} Redding, above n 62, 132-3.
\end{flushright}
responsibility towards the company.\textsuperscript{225} Next, nepotism appears to be common in Chinese family companies. This is because for the Chinese, members of the family are most trusted, and hence important or sensitive commercial matters are best to be left in the hands of family members.\textsuperscript{226} Another barrier Chinese family companies confront is limited access to finances, because they tend to use personal savings or loans from family members and extended relatives to fund their enterprise. In part, this is due to their reluctance to let outsiders examine their company’s accounts.\textsuperscript{227} Hence, this can limit the long-term growth potential, and also helps to explain why many of these companies remain undercapitalised.

\textbf{5.3.3 Issues Incidental to Paternalistic Governance}

Whilst paternalistic leadership unites family members within the company through centralised control, what becomes of the company upon the death of the leader is an open question.\textsuperscript{228} The lack of institutionalised succession plans also undermines the longevity of family companies.\textsuperscript{229} Besides, succession could be a prickly issue because of the possible infighting between members of the family.\textsuperscript{230} Since there are no agency issues the incumbent usually chooses his or her successor. Often the choice is not based on capability but by seniority.\textsuperscript{231} However, the choice of successor can meet resistance from other resentful family members.\textsuperscript{232} Moreover, second generation leaders can find governing and managing the company challenging because of a lack of personal loyalty and trust from family members.\textsuperscript{233} For example as discussed in Chapter 4.3.2, in \textit{Kam Kwan Sing v Kwam Kwan Lai \& Ors}\textsuperscript{234} his honour at first instance decided that the plaintiff had not established

\textsuperscript{225} Chen, above n 100, 76.
\textsuperscript{226} Mead, above 8, 280. Note that members of the family here include extended family members as well.
\textsuperscript{227} Ibid, 282-3.
\textsuperscript{229} Chen, above n 100, 76.
\textsuperscript{231} Tan, above n 229, 31.
\textsuperscript{234} [2010] HKCFI 629; HCCW000154/2010. For details about the facts of this case, see Chapter 4.4.2.
sufficient grounds in support of his application for the unfair prejudice and winding up on equity grounds.\textsuperscript{235} This dispute was essentially about second-generation leadership between the two brothers.\textsuperscript{236} The details of this case illustrated that good or harmonious relations are critical to Chinese governance.

Another element that feeds into the issue of legitimacy of the new leadership post succession is the question of personal trust.\textsuperscript{237} The issue of xin (trust) as a moral virtue for Confucius,\textsuperscript{238} or xingyong (trust) in the form of relational obligations is in the hands of the successor. The successor must establish his or her trustworthiness in order to command the confidence of other members of the family.\textsuperscript{239} Redding noted that, ‘the Chinese find it very difficult to come to terms with neutral, objective relationships, where they cannot “read” trustworthiness, and tend instead to work on creating trust beforehand.’\textsuperscript{240} Such is the importance of trust, the failure to build or maintain trust has consequences. The leader is likely to be ostracised by the rest of the family, therefore his or her hold onto power as head of the company would come into question or be challenged by others in the family.\textsuperscript{241} However, being a trusted family member to head the company is not enough. The successor must also have the skills to lead the company. This would include the ability to resolve disagreements or conflicts relatively quickly. Therefore, the heir apparent must be able to wield the trust of the rest of the family members. This form of trust is also expected to bring about harmonious relationships in the family.

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\textsuperscript{235} Kam Kwan Sing v Kwam Kwan Lai & Ors [2010] HKCFI 629; HCCW000154/2010, [29].
\textsuperscript{237} Cheng-shu Kao, “‘Personal Trust’ in the Large Businesses in Taiwan’ in Gary Hamilton (ed) Asian Business Networks (Walter de Gruyter, 1996) 61, 62.
\textsuperscript{238} For more see Chapter 6.
\textsuperscript{239} Redding, above n 62, 68.
\textsuperscript{240} Ibid, 67-8.
\textsuperscript{241} Redding, above n 70, 38.
\end{flushleft}
At the board level, harmony manifests itself as solidarity amongst directors behind the scenes of the family company.\textsuperscript{242} Therefore, a key role of paternalistic leadership, according to Westwood, is to maintain harmony in the family.\textsuperscript{243} As illustrated in the cases discussed in Chapter 4.3.2, failure to secure reconciliation in family disputes led to the breakup of a family company and splitting up of assets; in Chinese this is known as \textit{fen jia}.\textsuperscript{244} The term literally means ‘split home or separate house’. \textit{Fen jia} is a complicated and emotionally charged affair, especially when it comes to - who gets what.\textsuperscript{245} The outcomes of \textit{fen jia} is not an optimal return as the breakup value of the family company into small entities entails diseconomies of scale and the loss of goodwill from existing business operations accrued over the years.\textsuperscript{246} Therefore, the smooth transition into the second or even third generation of leadership with the family company left intact is better value than \textit{fen jia}.\textsuperscript{247}

A recent example of the above was Mr Stanley Ho’s plight. Mr Ho owns and controls one of Hong Kong and Macau’s biggest business empires. Even though it involved a publicly listed company, the shares of the public company were held in family companies and trusts. A bitter family feud about the division of his assets made media headlines. According to a media report, Mr Ho, the head of the business empire who has 17 children from four women (whom he refers to as wives), was struck down by an illness and had brain surgery in August 2009. A family feud about \textit{fen jia} (dividing the family assets which includes ownership of several proprietary companies having holding controlling interest of a flagship public company listed in Hong Kong), went public on 25 January 2011.\textsuperscript{248} Two of Ho’s four wives and some of their children waged a battle over the business empire. At stake was the control of

\begin{thebibliography}{99}
\bibitem{243} Westwood, above n 166, 453. See discussions about Westwood’s research about paternalistic governance in the above.
\bibitem{245} Ibid, 65.
\bibitem{246} Ibid, 65-8.
\end{thebibliography}
Ho's 31.7 per cent holdings in privately held shares of Sociedade de Turismo e Diversões de Macau (STDM) that had stakes in casinos, construction, luxury hotels, and Macau's airline.²⁴⁹ Mr Ho alleged his third and second wives had gone against his wishes that his fortune be shared among his four families.²⁵⁰ He instructed his lawyer, Mr Oldham, to file a lawsuit against his third and second wives, and five of his children alleging they forced him to sign a document about dividing his assets on the 24 January 2011.²⁵¹ The battle took a twist when Mr Ho called a press conference appearing on television with his third wife and one of their daughters to say he was dropping the suit and firing his lawyer, Mr Oldham, on the 27 January 2011.²⁵² In another bizarre twist, on the 28 January 2011, Oldham acting on behalf of Mr Ho filed a suit with the High Court to seek an injunction to stop his relatives from claiming ownership of some of his assets, which included proprietary companies holding controlling interest in STDM.²⁵³ Oldham said Mr Ho was coerced into reconciling with family members on live television.²⁵⁴ Then on the 11 March 2011 an email was sent to the media to say the family feud was settled, the media report said:

[a] Deed of Settlement was executed on March 8 between all branches of the family. The agreement was reached with "mutual understanding and mutual accommodation" and the families will work together and continue to develop the gambling business with a view to achieving greater contribution to the prosperity and stability of Macau, Hong Kong and China.²⁵⁵

²⁴⁹ Fredrik Balfour, ‘For Macau’s Stanley Ho, a Family Feud’, Bloomberg Businessweek (online) 3 February 2011 <http://www.businessweek.com/magazine/content/11_07/b4215026347701.htm>.
²⁵⁰ Fredrik Balfour, ‘For Macau’s Stanley Ho, a Family Feud’, Bloomberg Businessweek (online) 3 February 2011 <http://www.businessweek.com/magazine/content/11_07/b4215026347701.htm>.
²⁵⁵ Bonnie Chen and Dennis Chong, ‘One Big Happy Family Again’, The Standard (online), 11 March 2011
This example demonstrates that the family patriarch, Mr Ho who was unable to manage the day to day affairs of his companies due to illness, was coerced against his will to relinquish control over his companies in favour of some and at the detriment of others. Subsequently, a lawsuit was used as a threat to reassert his control over his family business and assets, but it was through negotiation that his paternalistic control was restored.

Paternalism does not necessarily mean oppressive behaviour, rather disputes are often resolved through dialogue where parties find a compromised solution. There are two cultural reasons for this. First, in a collectivist culture open dispute is avoided, instead a policy of working out behind closed doors to resolve the conflict by building on common grounds between the parties is adopted. Second, is the preference for mediated outcomes rather than litigated resolutions because Confucius pointed out litigation is detrimental to relationships between people and disrupts harmonious order. As noted in Chapter 4.3.2 in *Wong To Yick Wood Lock Ointment Ltd and Another v Wong Tin Chee Tinly and Others* which involved a long standing dispute between members of a family that spilled over to the Chinese family company, his honour said in his judgement, ‘Before I go into the background leading to the dispute, it must be emphasized that in a court of law, the judge must resolve the issues according to the law and the evidence.’ His honour made this statement because the dispute was essentially the result of a family squabble, so it is not his role to make peace between the parties. This is evident in the judgement as the judge said in obiter dictum that:

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256 Mead, above 8, 150-63. Also, see discussions about value dimensions from Hofstede in the above about collectivist culture.
259 For details about the facts of this case, see Chapter 4.4.2.
260 *Wong To Yick Wood Lock Ointment Ltd and Another v Wong Tin Chee Tinly and Others* [2007] 221; HCA7984/2000, [4].
It is high time that the family members should sincerely attempt to make peace with each other. Even though previous attempts have failed, I think it is worthwhile for them to try again in the light of this judgment. There are alternative ways of resolving conflicts and litigation may not always produce the most satisfactory outcome.\textsuperscript{261}

This emphasis on harmony is consistent with the arguments put forth in above, therefore establishing and preserving family unity and harmony is the key to holding on to power in Chinese family companies.\textsuperscript{262} Failure to do so has serious consequences and in the worst-case scenario is \textit{fen jia}.\textsuperscript{263}

Even though, there are signs that some family companies in Hong Kong are changing. Chen remarked that, ‘The Chinese business will undergo organizational transformation and strategic redirection over the next twenty years, as internal and external pressure challenge the traditional Confucian principles that have informed Chinese families and businesses throughout their history.’\textsuperscript{264} These companies are taking on board Western governance practises like recruiting professionals to the board of directors as well as appointing independent board members.\textsuperscript{265} There are in two main reasons for this. Firstly, second or third generation leaders are increasingly educated in the West, and they bring to the board new ideas from Western companies.\textsuperscript{266} Secondly, the pressure from globalisation and the need for foreign equity have also made boards change their ways.\textsuperscript{267}

Yet, the ‘bamboo network’, as discussed in the above, enables Chinese family companies to prosper. Thus, paternalistic governance is not likely to die out in the short term.\textsuperscript{268} Pressures from globalisation are not likely to change the ways these companies are governed, in part because they do not need to raise capital through

\textsuperscript{261} Ibid, [238].
\textsuperscript{262} Fock, above n 132, 175-8.
\textsuperscript{264} Chen, above n 58, 43.
\textsuperscript{265} Ibid, 40-3; Goo and Carver, above n 151, 228. Note that having independent non-executive directors in publicly listed company is a mandatory requirement under the HKEx listing rules chp 3.09.
\textsuperscript{266} Chen, above n 58, 36.
\textsuperscript{267} Goo and Carver, above n 151, 12-6.
\textsuperscript{268} Wong, above n 244, 58.
public listing, and hence are not obliged to be concerned about accountability and transparency. And since the governance of these companies is quite distinct from the assumptions of prevailing director’s duties in Hong Kong, those legal duties are unlikely to affect or regulate the behaviour of directors of Chinese family companies in Hong Kong. As noted in Chapter 4.3.2, those cases have shown that when relationships amongst family members had broken down as a result of disputes related to or even unrelated to the governance of the family companies, they resorted to petitioning the courts for relief for unfairly prejudice and equitable grounds for winding up the company – in effect, this is fen jia. Therefore an alternative regulatory solution to the prevailing laws and courts are needed to address this problem.

5.4 Summary and Commentaries

On a broader conceptual level, Barney and Zhang and later Jia, You and Du argued that Chinese management and business research from an emic perspective is difficult to achieve, because the prevailing analytical lenses are all virtually formulated in the West. As such they are conceptualised based on Western value judgements.269 Therefore, most work in Chinese management and business culture is descriptive encompassing identifiable traits, practices, and philosophical ideals.270 This has also been the approach undertaken in this chapter.

In sum, this chapter has delved into the Chinese business cultural norms and the way Chinese family companies in Hong Kong are governed. Empirical research from Hofstede demonstrated that there were significant value orientation differences between individuals in the workplace in Hong Kong and Britain. This, in turn, affects the way the people in these two jurisdictions think and behave. Furthermore, the

270 Barney and Zhang, above n 269, 15.
literature sourced from various disciplines has shown that the influence of Chinese values in Hong Kong’s Chinese family companies is considerable— in particular the existence of an informal business network of Chinese family companies. Unlike the West where companies’ dealings are stipulated under contractual commitments, the Chinese network is sustained through personal relationships and not formal agreements. This is where xingyong, bolstered by guanxi and mianzi, a derivative of Confucianism, is developed via close personal interactions and bonds. These personal connections in turn perpetuate this family-centred entrepreneurialism in Hong Kong. The combination of value orientations and relation-centred business networks, suggests that relationships and ‘familism’ are central to Chinese business cultural norms.

Then, table 1 drawn primarily from organisational studies literature, listed many differences between Anglo-American and Chinese family centred models of governance. The contrast between the two models of governance raises doubts about the practicality of super imposing Britain’s corporate governance regulation onto Chinese family companies in Hong Kong. Further analysis showed that paternalism and harmonious relations are core values of governance in Chinese family companies in Hong Kong. Even though there are pros and cons in the governance of these companies, it is beyond the scope of this thesis to offer critical analysis. The prime objective of this chapter has been to develop insights on the subject matter so as to provide alternative solutions to this regulatory gap. What this chapter has also uncovered is that if the governance of these companies is left unregulated and without an alternative dispute resolution forum, tensions within a family company might trigger a breakdown leading to deadlocks in management,\(^\text{271}\) and so in the worst-case scenario fen jia might materialise.\(^\text{272}\) Therefore, there is cause for regulation to be put in place. Yet, prevailing laws treat were directors as fiduciary, and this chapter have argued that they are not appropriate for directors of Chinese family companies. Yet, left to its own devices

\(^{272}\) Wong, above n 244, 64; Fock, above n 132, 37.
Another important feature that has emerged from the discussions of the governance of Chinese family companies is the centrality of control held in the hands of the head of the family. Witt and Redding’s recent publication coined China’s governance as authoritarian capitalism because of the state and Chinese communist party domination; and the same could also be said about the governance of Chinese family companies held in the hands of the family patriarch. This also implies that focus on form in terms of authority and power in either a moral or opportunistic sense. Viewed from this perspective it allowed corrupt practices and cronyism to develop. In contrast, this chapter also highlighted the Confucian influence in Chinese business culture and governance. This has led Chai and Rhee to label this form of capitalism as Confucian capitalism, because Confucius’s teachings are adopted as guiding principles for its governance. Therefore, it is important to explore in greater detail in the next chapter, these principles, and what they mean so as to have a sense of why for many centuries Chinese business people have conformed to these Confucian ideals. Furthermore, insights into Confucius’s influence on Chinese jurisprudence is expected to shed some light on why the imperial courts in ancient China did not enact laws comparable to the West to regulate businesses.

Chapter 6 : Making Sense of Confucian Notions of Governance and Regulation

6.0  Introduction

As noted in the conclusion of the previous chapter, Confucianism has influenced the way Chinese family companies in Hong Kong are governed. Even though Chang commented that it would be a mistake to equate Confucianism with Chinese culture and value system, Bell and Hahm noted that one should not underestimate its contributions to Chinese values and the unique attributes of modernity in Chinese societies. Whilst Chang argued that many portraits of Confucianism neglected the negative aspects of his ideals with respect to discouraging people from taking on professionals, its hierarchical social structure, and its favouring farming and scholarly pursuits over entrepreneurship, it is beyond the scope of this thesis to examine these criticisms in-depth. Instead the aim of this chapter is to develop some insight into the teachings of Confucius so as to appreciate the philosophical roots behind relational obligations, paternalism and other characteristics of the Chinese business culture and governance practices amongst Chinese family companies in Hong Kong.

On a broader social level, McDonogh and Wong noted that Hong Kong residents, ‘can never be divorced from the conflicts among traditional Confucian patriarchy, Chinese modernism, and the West, whether they were manifested in politics, economics, or everyday culture and practices.’ Furthermore, the Hon. Kam-lam Chan, a Hong Kong Legislative Council member put forward a motion during a Council meeting on the 13th January 2010 to propose that Confucius’s birthday be made a public holiday in Hong Kong. Mr Chan argued that:

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3 Chang, above n 1, 190-1. For more criticisms about Confucianism see Chapter 6.1.
4 Gary McDonogh and Cindy Wong, Global Hong Kong (Routledge, 2005) xi, 88.
[t]here is indeed a need for the Government to revive the philosophy of Confucianism in the community, with a view to building social order and harmony, strengthening business ethics, and enhancing personal virtues and qualities; … designate the birthday of Confucius as the Confucius Day to establish the esteemed position of Confucian thinking in the Hong Kong community.⁵

Although the motion was defeated,⁶ it highlights the fact that Confucius and his ideals are still relevant in Hong Kong today.

Since the focus of this chapter is to examine Confucian notions about governance and regulation, the task is to examine the rationalities of Confucianism. Though the core arguments of this chapter will primarily be descriptive, drawn primarily from Chinese philosophy, there are normative elements that would contribute to the search for a culturally apt regulatory framework for directors of Chinese family companies in Hong Kong.

### 6.1 A Foreword on Confucianism

At the outset, it is important appreciate that the logic of Confucian thinking is quite different from Western rationality. For example, in the preface of one of the books by a French philosopher Foucault, where he tried to make sense of passages in a Chinese encyclopaedia describing the Chinese Emperor at the apex of all animals in his kingdom including those that were embalmed, tame, and strayed.⁷ He remarked that:

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⁶ Hong Kong Special Administrative Region, *Legislative Council Meeting Voting Result*, 13 January 2010, <http://www.legco.gov.hk/yr09-10/english/counmtg/voting/v201001131.htm>. Note the motion was defeated due to the double majority it required from both the functional and geographical constituencies to be passed were not achieved. There were also a high number of abstentions in voting for it to be carried. As well, there was only one no vote against this motion shows there are some consensus in this matter. For more about the political and legislative system in Hong Kong’s Legislative Council, see Ma Ngok, *Political Development in Hong Kong: State, Political Society, and Civil Society* (Hong Kong University Press, 2007); Lam Wai-man, Percy Luen-tim Lui, Wilson Wong and Ian Holliday, *Contemporary Hong Kong Politics: Governance in the Post-1997 Era* (Hong Kong University Press, 2007).

In the wonderment of this taxonomy, the thing we apprehend in one great leap, the thing that, by means of the fable, is demonstrated as the exotic charm of another system of thought, is the limitation of our own, the stark impossibility of thinking that. But what is it impossible to think, and what kind of impossibility are we faced with here? Each of these strange categories can be assigned a precise meaning and a demonstrated content; some of them do certainly involve fantastic entities – fabulous animals or sirens – but, precisely because it puts them into categories of their own, …  

The above exemplifies how certain aspects of Chinese values like Confucian doctrines could be difficult to decipher from Western perspectives. The order of things in Chinese thinking, as the above quote from Foucault has shown could be perplexing from Western mindsets. This can fuel misconceptions about Chinese philosophy, for example, Max Weber has been quite critical of Chinese traditions and thinking, in particular the influence of Confucianism, even claiming that the Chinese are incapable of logical thinking. This does not however mean Chinese philosophy is irrational, rather its reasoning and logic is simply different from the West.

Furthermore, Confucianism is not without controversy. In ancient China, Confucius had his critics, including Mozi and Han Fei-zei, who were reputable Chinese philosophers in their own right. Chan and Young noted that pro-modernisation Chinese writers in the 1910s-30s, like Lu Xun, Liu Xiaobo and Bao Zunxin were very critical of Confucius’s teachings and ideals. These Chinese critics characterised Confucianism as being an evil and systematic form of oppression used to prop up the imperial rule of China, and a system of governance employed to enslave the Chinese people and rid them of any individual rights. Goldin noted

8 Ibid.
12 For more on Mozi and Han Fei-zei see Philip Ivanhoe and Bryan van Norden, Readings in Classical Chinese Philosophy (Hackett Publishing, 2001).
13 Alex Chan and Angus Young, ‘Reinterpreting the Chinese Legal Doctrine of “Li” (禮): Beyond Rites, Ritual and Ceremonies’ (Paper presentation at the Ceremonies of Law Conference 2011, University of Wollongong, 7-9 December, 2011) 1-2.
14 Ibid, 2.
Max Weber’s criticism regarding Confucianism holding back China’s economic development by ‘a relentless canonization of tradition … impedes creativity and progress by glorifying those who have come before us and those who are placed in a position of authority over us’.\(^{15}\) Ames referred to other critics of Confucianism such as English philosopher Bertrand Russell, who asserted that filial piety and traditional Chinese family is an ‘obstacle’ to be surmounted in the struggle for social progress.\(^{16}\) Even in modern Hong Kong gender inequality was attributed to the influence of Confucianism.\(^{17}\) Controversies aside, Cao noted that the Chinese people do not need to read Confucius’s work to be under his influence, as his ideas are in the Chinese grammar and vocabulary, and so are literally and metaphorically, transmitted through living as a Chinese and being a Chinese.\(^{18}\) Furthermore, as noted in Chapter 1.4, the approach of this thesis is to understand Confucianism rather than to critique it, because the aim of this research is to develop a culturally apt regulatory framework from a Chinese perspective.

To understand Confucianism, it is also important to note that the terminologies and concepts used in Confucian texts are interlinked and entwined with humanism, role ethics, a natural order of things, and dialectic rationality with a strong hermeneutical tradition.\(^{19}\) This is atypical of Chinese traditional philosophy.\(^{20}\) Besides, the meanings of the same Chinese character could vary considerably when applied across different contexts,\(^{21}\) making translation and more importantly, interpretation of Chinese text in English difficult.\(^{22}\) However, it is important to note that in different contexts or applied differently the meanings of the Chinese character are not logically inconsistent or confusing. To Westerners, apart from the language

\(^{17}\) Benjamin Leung, *Perspectives on Hong Kong Society* (Oxford University Press, 1996) 82-3.
\(^{19}\) Chung-ying Cheng, ‘Inquiring into the Primary Model: Yi-Jing and Chinese Ontological Hermeneutics’ in Bo Mou (ed) *Comparative Approaches to Chinese Philosophy* (Ashgate Publishing, 2003) 33, 56-7; Robert Allinson, ‘Hegelian, Yi-Jing, and Buddhist Transformational Models of Comparative Philosophy’ in Bo Mou (ed), *Comparative Approaches to Chinese Philosophy* (Ashgate, 2003) 60, 62-5. For more explanation of these terms see subsequent paragraphs and Chapter 7 for details.
\(^{20}\) Cheng, above n 19, 34-5.
\(^{21}\) Goldin, above n 15, 25.
\(^{22}\) Roger Ames and David Hall, *Focusing the Familiar: A Translation and Philosophical Interpretation of the Zhongyong* (University Hawai’i Press, 2001) 3-8.
barrier, Chinese philosophical rationalities and messages might appear disconnected and suggestive in nature.\textsuperscript{23} This is because the Chinese language is a highly coded language with pseudo-historical anecdotes.\textsuperscript{24} Further, Hall described the Chinese culture as a high context culture.\textsuperscript{25} Communications in high context cultures are dependent on their shared experiences, and words are interpreted and decoded by situational factors.\textsuperscript{26} Mead noted that in high context cultures, people learn from birth to interpret signs and develop common understandings when they communicate as much of the meaning is conveyed indirectly.\textsuperscript{27} For those who are not familiar with Chinese language and culture Confucianism might be a challenge because the English translation of Confucian concepts is never quite exact.\textsuperscript{28} Thus to understand the arguments of Confucius’s teachings it would be prudent to put aside Western notions of ‘right or wrong’ or value judgments, otherwise his message could be easily misconstrued or misinterpreted.\textsuperscript{29}

Another matter worth noting is that in spite of the difficulty associated with deciphering Confucius’s work in English, and the fact that he lived over 2000 years ago, his teachings have been explored across many disciplines including political science, philosophy, economics, Asian business studies, jurisprudence, legal history, Chinese literature, and ethics.\textsuperscript{30} In particular, the ethical elements of his teachings have received much attention as they have been seen as the pinnacle of Confucius’s

\textsuperscript{23} Fung, above n 10, 11, 14.
\textsuperscript{24} Cheng, above n 19, 33; Cao, above n 18, 3.
\textsuperscript{26} Ibid, 33.
\textsuperscript{27} Ibid.
\textsuperscript{29} Also see Alex Chan and Angus Young, ‘Confucius’s Principles of Governance: Paternalistic Order and Relational Obligations’ (Paper presentation at the Corporate Law Teachers Association Annual Conference 2012, Bond University, Gold Coast, 5-7 February 2012); Roger Ames and Henry Rosemont, ‘Were the Early Confucians Virtuous?’ in Chris Fraser, Dan Robbins and Timothy O’Leary (eds), \textit{Ethics in Early China} (Hong Kong University Press, 2011) 17.
teachings.\textsuperscript{31} Even though moral principles are a major part of his doctrines,\textsuperscript{32} reducing his work to merely ethical issues oversimplifies the profundity and versatility of his teachings.\textsuperscript{33} More importantly, elements of governance in his writings have been largely unexplored. Perhaps, this is because on the surface the text reads more like moral teachings of an ancient society, political ideology or a combination of both rather than a set of governance principles.

6.2 Confucius’s Notion of Governance

Governance for Confucius is a combination of a socially structured order and a relational centred morality known as san gang wu chang. The Confucian concept of harmony, which is a key goal of this system of governance will also be discussed in this section.

6.2.1 Confucius’s Notion of San Gang Wu Chang

In order to decipher Confucian notions about governance, it is important to appreciate the constitution of Chinese society from two basic elements: its hierarchical social structures and its relation-centred senses of obligation.\textsuperscript{34} To make sense of this, it is important to understand the role-bearing responsibilities of a person.\textsuperscript{35} For Confucius each person in society has multiple roles and they are interdependent.\textsuperscript{36} Mencius, an ardent Confucian and well known neo-Confucian, captures this role and relational centred constitution of society by identifying five

\textsuperscript{32} Ibid, 145.
\textsuperscript{33} Even so, it is worth noting that there are considerable differences between Western and Confucian notions of ethics. The former is individualist and the latter is family-centred and with the focus social cohesion. See Ames and Rosemont, above n 29, 17, 25.
\textsuperscript{34} This contrasts with Gidden’s depiction of the West where social systems, structures and rules are key elements of the constitution of society. See Antony Giddens, \textit{The Constitution of Society} (University of California Press, 1984) 17-24, 162-80.
\textsuperscript{35} Ames, above n 16, xiv.
\textsuperscript{36} Ames and Rosemont, above n 29, 21.
key relationships, known as *wu lun* as the building blocks of civil society.\(^ {37}\) The five relationships are those between: 1) father and son; 2) ruler and subject; 3) husband and wife; 4) elder and younger siblings; and 5) between friends.\(^ {38}\)

*Wu lun* highlights the importance of these relation-centred senses of obligation because the concept of individualism is incompatible with the Confucian conception of a person.\(^ {39}\) Ames and Rosemont noted that, ‘Nothing is more defining of humanity for Confucius than the genuine concern of one human being for another, …’\(^ {40}\) For the Chinese, the concept of *qing* is important. Sin and Chu observed that, ‘*Qing* is a concept particular to the Chinese, which has no equivalent in the English language. It can be loosely translated as ‘appeal to other’s feeling’, ‘emotions’, ‘sense of humanity’ or ‘common decency’.’\(^ {41}\) Ames and Hall noted that:

[qing] is important in understanding the radically contextualized and perspectival nature of creativity itself. Because persons are constituted by their relationships, and because these relationships are valorized in the process of bringing their fields of experience into focus, the creative interactions among persons discloses their feelings for one another, and for their environs.\(^ {42}\)

Furthermore, *qing* appears in the Confucian text in tandem with human nature.\(^ {43}\) This helps explain the emphasis on relationships in Chinese societies. Liu noted that for Confucius, ‘Individuals cannot be defined in their solitude but in their relations with others. Everyone in society bears particular identities; there can be a multiplicity of overlapping roles…’\(^ {44}\) Thus, everyone in society has a set of reciprocal obligations, but they are differentiated in accordance to the role and status in relation to the other,

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\(^ {38}\) Albert Chen, ‘Confucian Legal Culture and Its Modern Fate’ in Raymond Wacks (ed), *The New Legal Order in Hong Kong* (Hong Kong University Press, 1999) 505, 515.


\(^ {40}\) Ames and Rosemont, above n 29, 21.


\(^ {42}\) Ames and Hall, above n 22, 74.

\(^ {43}\) Ibid, 73.

\(^ {44}\) Liu, above n 39, 58.
or in the social context. These obligations are espoused archetypes, where the ideal ruler is benevolent; the ideal subordinate is loyal; the ideal father is benevolent; the ideal son is filial; the ideal older sibling is thoughtful; the ideal younger brother is respectful; the ideal husband is righteous; the ideal wife is compliant; and the ideal friend is truthful. Furthermore, each role has inherent obligations attached, this is where authority and responsibilities become affixed to each of those roles as functionalities, which in turn creates differentiated and hierarchical status. Although, Nuyen rationalised *wu lun* as a, ‘mechanism of symbolic control for the primary purpose of social stability’, this social pecking order and discriminatory treatment of people is expected to produce a sort of Confucian notion of social cohesion and harmonious society (*da tong*). Hence, relation centred obligations and hierarchical social conventions are central to building a harmonious society.

Out of the five relationships, the three, also known as *san gang* (three bonds) – between ruler and subject, father and son, husband and wife – have been singled out by neo-Confucians as possessing greater significance. The Chinese character *san* is the number three, and *gang* literally means, ‘a major chord in a net, to which all the other strings are attached.’ This implies interdependency between the parties at each level of *san gang*. Chen notes that, ‘the ‘three bonds’ [*san gang*] made a major...

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45 Chen, above n 37, 49; Chen, above n 38, 515.
46 John Head and Yanping Wang, *Law Codes in Dynastic China: A Synopsis of Chinese Legal History in the Thirty Centuries from Zhou to Qing* (Carolina Academic Press, 2005) 49. Note that the issue of *xiao* (filial piety) stemming from the father and child relation is central to the governance of small family companies and shall be discussed in greater details in the subsequent paragraphs.
47 Fung, above n 10, 33.
50 Ibid, 175; Albert Chen, ‘The Concept of ‘Datong’ in Chinese Philosophy as an Expression of the Idea of the Common Good’ (Research Paper No 2011/020, University of Hong Kong, November 2011) 10. Also see arguments in Chapter 4.1.4 about the notion of harmony as an end of the Chinese conception of *zhong* (loyalty), which quite different from notions of loyalty in the Western fiduciary sense.
51 Geoffrey MacCormack, *The Spirit of Traditional Chinese Law* (University of Georgia Press, 1996) 73. Note that Tung Chung-Shu (179-104B.C.) synthesized the works of Confucius and Mencius to come up with a blueprint for the creation of civil society based on hierarchical order and moral cultivation, he coined this term *sangang*. For Chinese references *san gang* see Chan and Young, above n 29.
52 Fung, above n 10, 197.
contribution to Chinese civilisation by ensuring the maintenance of relatively stable social and political order most of the time during the two millennia. The ultimate goal of san gang like wu lun is to create harmonious relationships between people and an orderly society.

The first two bonds give rise to the cardinal duties of zhong (loyalty) and xiao (filial piety). Such are their importance that without zhong and xiao, Confucius believes that without them there will be social unrest and chaos. The Chinese character zhong is more than loyalty as it embodies doing one’s utmost, being respectful, and faithful. Thus being zhong and being faithful are interrelated. Zhong is the core duty subjects and ministers owe to their ruler. Yet being zhong does not mean unquestionable obedience. Ministers are duty bound to offer their advice to the king respectfully, but expected to stand firm on what is righteous. Further, the relationship between the king and his subjects is thus not immutable. If the king acted immorally, his subjects are not obliged to be loyal. For Confucius, the ruler must possess the ability to be introspective and self-critical (also refer to junzi in below). The king must also be able to relate to his subject and understand his concerns, as well as being benevolent (ren) and morally righteous in order to gain his loyalty. Liu argued that, ‘Loyalty is thus being loyal to one’s moral obligations and fulfilling the duty one’s role dictates.’ For Confucius the relationship between the

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53 Chen, above n 38, 515.
54 Sonia El Kahal, Business in Asia Pacific: Text and Cases (Oxford University Press, 2001) 134; Kim-chong Chong, Early Confucian Ethics (Open Court, 2007) 11-12. For more on harmony see subsequence sections.
56 Goldin, above n 15, 15-9; Ames, above n 16, 200-1.
58 Derk Bodde and Clarence Morris, Law in Imperial China: Exemplified by 190 Ch’ing Dynasty Cases with Historical, Social and Juridical Commentaries (Harvard University Press, 1967) 39.
60 Ibid, 501.
61 MacCormack, above n 51, 108.
62 Legge, above n 31, 394.
63 Andrew Plaks, Ta Hsueh and Ching Yung (Penguin Books, 2003) 13-5. Mencius implied that rebellion by the masses is justified if the ruler is immoral and cruel.
64 Liu, above n 57, 50.
king and his minister is also depicted as one between a father and his children because the king is expected to take on a fatherly role to care for his ministers and subjects.⁶⁵

Conceptually, zhong is closely linked with xiao. They both share a common thread; the relationships are vertical and strict (subjects have to be loyal to their ruler; son has be filial towards his father). More importantly, zhong and xiao stem from the actualisation of these obligations unpinning this hierarchical order.⁶⁶ So a person who is xiao is inclined to be respectful and unlikely to defy his superiors or seniors, so this person is also said to be zhong to his seniors and ruler.⁶⁷ Choi noted that, ‘The reason why filial piety [xiao] was so critical to the Confucian monarchy was that it formed the vital link between the Confucian system of family ethics and the question of loyalty to the state.’⁶⁸ According to Lee, zhong is like xiao, ‘meant to teach people to put the interests of their superior, whether father or ruler, before their own.’⁶⁹ Therefore, logically a xiao person is also a zhong subject. However, this value was not institutionalised through organisations rather it was actualised in every household.

Ames remarked that for Confucius, ‘The family is conceived as the centre of all order, social and comic, … all meaning ripples out in concentric circles from personal cultivation within family…’⁷⁰ For Confucius the family is, ‘the primary locus within which one’s first relationship is formed.’⁷¹ Shin also argued that for Confucians, ‘family life was seen as a training ground for children to learn not only how to be successful in their own lives but also how to be good subjects or good

⁶⁵ Goldin, above n 15, 26.
⁶⁷ Ivanhoe and Van Norden, above n 12, 3.
⁶⁸ Choi, above n 30, 302.
⁶⁹ Lee, above n 11, 30.
⁷⁰ Ames, above n 16, 97.
rulers.’ Confucius even proclaimed that in order for a king to rule the state well, it was necessary for him to first regulate his own family. The logic of this thinking according to de Bary, Chan and Watson is, ‘One can never teach outsiders if one cannot teach one’s own family.’ The king is therefore a model or ideal son, a good father, and a dependable brother. That is why Plaks argued that:

Only when one’s behaviour as father, as son and as elder or younger brother is worthy of emulation will people take one as a moral exemplar. This is what meant by the statement: ‘the establishment of orderly rule in one’s kingdom is predicated upon putting one’s family into proper balance.’

Whilst these words seem plain and simple, the actualisation is more intricate as there is also a spiritual dimension which involves the sage kings from Chinese antiquity bestowing this model of governance onto humankind. Moreover, the morals of those sage kings spelled out a natural cosmic order of things. This order begins at home. This is also where personal development begins and where the notion of xiao takes root, in childhood.

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73 Legge, above n 31, 357-8.
74 Ibid, 370.
76 Plaks, above n 63, 13.
77 Ibid, 15.
78 Julia Ching, ‘Who Were the Ancient Sages?’ in Julia Ching and RWL Guisso (eds), *Sages and Filial Sons: Mythology and Archaeology in Ancient China* (Chinese University Press, 1991) 1, 2-5. Note Confucius often refer to the ancient Sage Kings (the three Sage Kings are Yao, Shun, and Yu) as ideal exemplars in his teachings and writings, especially when comes to leadership and moral values.
79 Ibid, 10-8. Note that the cosmic order or natural order predates Confucius and it is deemed to a law of nature established by heaven or supernatural forces so it controls all things living and non-living on earth. Natural calamities or misfortunes will be bestowed upon anyone who goes against this order. See Wing-tsit Chan, *A Source Book in Chinese Philosophy* (Princeton University Press, 1963) 6-13; Ames and Hall, above n 22, 26-30.
80 Ames, above n 16, 97-8; Goldin, above n 15, 33-4.
184
Xiao lies at the heart of Confucianism. It is not only the bedrock of a family and state’s governance;\textsuperscript{81} it is the noblest quality in a person.\textsuperscript{82} Whilst the mandate to rule from ancient Chinese beliefs is conferred by heaven, a king could in theory be replaced by the next in line if he is guilty of not performing filial duties towards his mother.\textsuperscript{83} Xiao is not blind obedience of a child towards his or her parents, nor providing for them financially when parents become old and frail. It embodies the gratitude for the parents’ hardship in one’s upbringing,\textsuperscript{84} respect, love, and reverence, not only while they are alive, but also after their passing.\textsuperscript{85} For Confucius, if one’s parents fall into error, one should reprove and lead them back to what is right.\textsuperscript{86} Liu took this further by stating that, ‘If parents act improperly, then children should be relieved from their duty of filial piety.’\textsuperscript{87} Whichever leanings one takes, the element of reciprocity (shu) in Confucius’s conceptualisation of relationships is a key fundamental in his doctrines.\textsuperscript{88} Then again, this does not undermine the importance of xiao, Fung noted that, ‘It [xiao] commences with the service to the parents; it proceeds to the service of the ruler; it is completed by the establishment of one’s personality. … Yes, filial piety is the way of Heaven, the principle of Earth, and the practical duty of man.’\textsuperscript{89}

There is however no equivalents to xiao in the West. Liu remarked that children in the West, ‘have duties of gratitude but not duties of indebtedness to their parents.’\textsuperscript{90} And, ‘The dominant Western view is that adult children have no moral obligation towards their aged parents.’\textsuperscript{91} Therefore, xiao in the Confucian sense does not seem to manifest itself in the West. Conversely, the importance of xiao is foremost for the

\textsuperscript{81} Goldin, above n 15, 33-8.
\textsuperscript{82} De Bary, Chan and Watson, above n 75, 97-8.
\textsuperscript{84} Goldin, above n 15, 35.
\textsuperscript{86} Liu, above n 39, 64.
\textsuperscript{87} Liu, above n 57, 52.
\textsuperscript{88} Ames, above n 16, 97-8; Goldin, above n 15, 195-200.
\textsuperscript{90} Liu, above n 39, 55.
\textsuperscript{91} Ibid, 43.
Chinese. Chen noted that, ‘As it is said in the “Chronicle of Literature and Art,” contained in the History of the Han Dynasty: “Filial Piety” [xiao] is the rule of Heaven, the (sense of) righteousness of Earth and the (basis of the) people’s conduct.’\(^92\) Clearly, \textit{xiao} is the cornerstone of Chinese family life and the foundation of social and political order in China.\(^93\) It is also equally important to note that for centuries imperial governments impose harsh penalties for children guilty of being unfilial. At the extreme, the magistrate could impose the death penalty against an unfilial child.\(^94\) This meant that the imperial legal codes recognised the authority of the grandfather, or the father over all the members of the family, and decision pertaining to all matters in the household.\(^95\) However, nowhere in Confucius’s writings does he indicate that he wanted \textit{xiao} to become legalised in any form or manner. For him \textit{xiao} should be performed out of a natural sense of probity and not on legal obligations.

Even though the concept of \textit{xiao} originated over three thousand years ago, it is still relevant in Hong Kong and other Chinese societies. Empirical research by Lee finds that Singaporeans ranked \textit{xiao} first on a drawn up list of traditional Chinese values.\(^96\) Furthermore, the author finds that Singaporeans are like Hong Kong Chinese residents when it comes to preserving the basic tenets of individual moral conduct and interpersonal relations from Confucian doctrines. These values are fostered from within the family from a young age.\(^97\) Despite influences from the West, both Singaporeans and Hong Kong Chinese have remained rooted in Chinese cultural values, especially when it comes to \textit{xiao}.\(^98\) In other research, Zhang and Bond find that there is no gender or regional differences between Hong Kong Chinese and

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\(^92\) Chen, above n 59, 3.
\(^93\) Huang, above n 85, 29.
\(^94\) Geoffrey MacCormack, \textit{Traditional Chinese Penal Law} (Edinburgh University Press, 1990) 180. This is a good example of the Confucianisation of the law, see paragraphs in the above.
\(^96\) Lee Cheuk Yin, ‘Do Traditional Values Still Exist in Modern Chinese Societies? The Case of Singapore and China’ (2003) 1 \textit{Asia Europe Journal} 43, 54.
\(^97\) Ibid, 58.
\(^98\) Ibid, 57; Michael Bond and Ambrose King, ‘Coping with the Threat of Westernization in Hong Kong’ (1985) 9 \textit{International Journal of Intercultural Relations} 351, 360.
Mainland (China) Chinese in the endorsement of *xiao* as a social norm.\(^{99}\) Furthermore, respondents who strongly subscribed to *xiao* tended to also rate harmony and good relations highly.\(^{100}\)

Hamilton found that Chinese entrepreneurs in Hong Kong and Taiwan use the principle of *xiao* to organize their business and retain control because they manage the long-term fate of those businesses on an authoritative basis.\(^{101}\) Even if the family business were to grow larger, Chinese entrepreneurs often would subdivide their company where the children would manage those new companies whilst the parent maintained effective control.\(^{102}\) But if the opposite develops, or that *xiao* is forsaken due to family disputes, as Chapter 5.3 has noted, then *fen jia* might be an unfortunate fate that confronts the family company.\(^{103}\)

Ho, Lau and Young, in an article on corporate governance surveyed respondents in Hong Kong on whether they thought that culture mattered when it came to directors’ duties.\(^{104}\) Their research showed that the most important Chinese value for these respondents was *xiao*.\(^{105}\) Therefore, *xiao* has contributed to the perpetuation of paternalism and paternalistic governance in Chinese societies like Hong Kong, Taiwan and Singapore.\(^{106}\) However, this does mean the father can act irresponsibly, abusively, or in tyrannical manner. As a father, he is the leader of his household. As a leader, he is thus obliged to nurture his moral qualities. This is clearly articulated in *The Great Learning* where it stated that, ‘the regulation of one’s family depends on the cultivation of his person … if the person be not cultivated, a man cannot regulate his family.’\(^{107}\)

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100 Ibid.
102 Ibid. Refer to pyramid share ownership structure in Chapter 3.1.1 of the thesis.
103 Also, see subsequent section about *fen jia*.
104 Daniel Ho, Alex Lau and Angus Young, ‘Do Chinese traditional values matter in regulating China’s company directors? Preliminary findings from surveys in Hong Kong’ (2010) 31 *The Company Lawyer* 339. The authors of this article note that the reason why surveys were collected in both China and Hong Kong is to make certain that the cultural gap is apparent in China, and not just based on subjective impressions from one side of the boarder.
105 Ibid.
106 For more on this see subsequent section.
107 Legge, above n 31, 369.
Since family feeling is the ground of Confucian role ethics, and since polity in this tradition is a direct extension of the family as quite literally ‘country-family’... If we ask after the relative importance of the state and the family in effecting cosmic harmony, we must allow that family is the ultimate source and ground of political order, and in the absence of the flourishing family and the thriving community it enables, political order is a sham or worse.\textsuperscript{108}

Therefore, those who lead must be strive towards moral excellence.\textsuperscript{109} A Confucian leader has to be trustworthy; to be trusted he or she has to nurture character using moral precepts as benchmarks.\textsuperscript{110} Thus, the Confucian leader has to ‘rule by virtue’ and not through laws.\textsuperscript{111}

\textit{San gang} refers to a structured social order underlined by moral principles to regulate the behaviour and attitudes between people depending on their role or status in relation to other persons. This is the Confucian principle of governance. Individual qualities and the values in which a person should nurture are grounded in moral precepts known as \textit{wu chang} (five constant virtues), or five key moral precepts.\textsuperscript{112} Chan and Young commented that \textit{wu chang} likens it to the flesh that clothes the dry bones of the hierarchical system of controls stipulated in \textit{san gang}.\textsuperscript{113} Another way of looking at the relationship between \textit{san gang} and \textit{wu chang} is that the former creates social order by means of hierarchical structure and the latter moderates individual behaviour through morality to create a harmonious society (\textit{da tong}).\textsuperscript{114} This for Confucius is in keeping with a cosmic or natural order, where society is organised in accordance with the greater power known as ‘the way of heaven’.\textsuperscript{115}

\textsuperscript{108} Ames, above n 16, 167-8.
\textsuperscript{109} Legge, above n 31, 369-70.
\textsuperscript{111} Ibid.
\textsuperscript{112} Fung, above n 10, 197.
\textsuperscript{113} Chan and Young, above n 29, 8.
\textsuperscript{114} Fung, above n 10, 197. See subsequent sections on discussions about harmony.
\textsuperscript{115} Yao, above n 49, 149-60.
Wu chang (the five constant virtues) consists of the following moral precepts: ren (benevolence), yi (righteousness), li (propriety), zhi (wisdom), and xin (trust). Tung, a Han Dynasty minister articulated that it is through wu chang people will develop a higher sense of morality. He drew these five virtues from the writings of Mencius and Confucius. Individuals are expected to strive towards perfecting their morality by reflecting on their conduct in everyday social interaction using these five virtues are benchmarks. Even though wu chang identifies each virtue separately, they are not stand-alone concepts, instead are interlinked and interrelated.

Out of these five virtues, ren is the most important (or even supreme), because it is both the foundation of these five virtues, as well as the most fundamental of all the moral principles for Confucius. Ren is the essence of perfecting one’s virtues or perfection of human character. The Chinese character ren is often translated as benevolence, other descriptions of the Chinese character are; ‘altruism’, ‘humanity’, ‘humanness’, ‘love’, ‘kindness’, ‘perfect virtues’, ‘goodness’, and ‘human-heartedness’. It is deemed by Confucius to be a naturally inherent quality that merely needs to be nurtured because according to Mencius (the most ardent Confucian) all humans are born good but become tainted with hate and envy from the desire for personal gain, therefore they need to be reminded of this inborn goodness. Its external manifestation is often associated with acts of caring and loving others. Lai noted that ren has the role of upholding a commitment to humanity. There is also a spiritual side to this virtue, because there are references of this virtue with ‘sageliness from within’, as part of human nature that when

117 Fung, above n 10, 197.  
118 Chan and Young, above n 29, 9.  
119 Antonio Cua, ‘Emergence of Chinese Philosophy’ Bo Mou (ed), Comparative Approaches to Chinese Philosophy (Ashgate, 2003) 3, 26; Chen, above n 59, 277-80.  
119 Chan and Young, above n 29, 9.  
120 Ames, above n 16, 177-8; Chong, above n 54, 23-30. Such is the importance of ren, Chan and Young find in The Analects this was cited 105 times, far more than the other virtuous principles, see Chan and Young, above n 29, 9.  
121 Ivanhoe and Van Norden, above n 12, 359.  
122 Liu, above n 83, 91.  
123 Chong, above n 54, 19; Ames, above n 16, 123-4.  
124 De Bary, Chan and Watson, above n 75, 104.  
125 Dawson, above n 66, 82; Fung, above n 10, 42.  
perfected one is able to know the will of heaven. In Confucius’s worldview, all people and things are related extrinsically, thus everything and every person is correlated and interlinked with one another. It is in this tradition that ren cannot be read in isolation; being ren one could not do without the ability to know what is proper and right. This is where with ren comes yi.

The Chinese character yi is usually translated as ‘righteousness’ or ‘propriety’, Ames gave it a more elaborate translation where yi is, ‘achieving an optimal appropriateness in one’s relations.’ The function of yi is to determine what is appropriate or inappropriate in social relations and human intercourse. It is the basis of making good judgement leading one to be just and have a sense of propriety. Hence, Liu argued that this Chinese character also embodies the Confucian conception of justice. Justice for Confucius according to Liu is a dialectical interaction between the self and the contextual as well as communal environments, and it, ‘is an aesthetic judgement of quality rather than a deduction from first principles. Justice as a harmonisation of the disparate interests and potentialities in the creation of maximally humane state is a matter of degree.’ So Western notions of fairness and equality do not seem to be present in the Confucian way of thinking, Rather yi has to be understood in the communal sense, within a larger social and relational context where mutual obligations between relations comes before self-interest. Yi also has a crucial role in balancing any excesses of emotions emanating from ren.

Fung explained that the relationship between the two virtues as:

The idea of yi is rather formal, but that of jen (ren) (human-heartedness) is much more concrete. The formal essence of the duties of man in society is their “oughtness,” because all these duties

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128 Fung, above n 10, 76-7.
130 Chan and Young, above n 29, 10.
131 Ames, above n 16, 201.
132 Ibid, 201-203; Chong, above n 54, 9.
133 Liu, above n 39, 60. For more discussions of this from a regulatory perspective and context, see Chapter 6.3.
134 Ibid, 61.
are what he ought to do. But the material essence of these duties is “loving others,” i.e. jen or human-heartedness.  

Apart from the links between yi and ren, this virtue is also linked to another - li. Li is a virtue born from yi, this virtue concerns the behavioural aspects of social conduct and interactions.  

Li can be translated as ‘rites’, ‘rituals’, ‘etiquette’, and ‘ceremony’. Goldin argued that, ‘Western interpretations of Confucius’s writings have frequently mischaracterized li as something like a code of conduct, ...’ Code, for him, is the wrong word to associate with li. This virtue has readily observable qualities with spiritual, educative and governing functions. The origins of li are born from sacred ritual ceremonies that pre-date Confucius’s time in the Shang dynasty (1600-1100B.C.). Confucius’s contribution to li was to develop it beyond the externalities found in ceremonies void of moral substance. The role of li is to steer people towards a moral life. In the scheme of things, law and punishment are considered as secondary instruments or as a last resort to maintain social order. Li is a versatile and dynamic concept capable of mapping out different standards of appropriate behaviour in accordance with one’s place in a particular relationship. It serves as guides for correct behaviour in a range of relational contexts like those between children and parents, subject and ruler. Shun wrote:

A person with li is not skilled in and disposed to follow the rules of li but is also prepared to depart from such rules when appropriate. This preparedness involves the operation of yi, a commitment to propriety. Even when a rule of li should be followed, yi still plays in that one should ideally follow the rule with an awareness of its appropriateness to the situation and, in

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137 Fung, above n 10, 42.
138 Chan and Young, above n 29, 11.
139 Ames and Rosemont, above n 129, 51.
140 Goldin, above n 15, 20.
141 Lai, above n 127, 29.
142 Chan and Young, above n 13, 5-14.
143 Chan and Young, above n 29, 11.
144 Phillip Chen, Law and Justice: The Legal System in China 2400 B.C. to 1960 A.D. (Danellen Publishing, 1973) 27. For more discussions of this from a regulatory perspective and context see Chapter 6.3.
146 Ibid, 27. For more elaborate explanation of li see chapter 6.2.
that sense, make the observance of the rule not a mechanical action but a display of one’s own assessment of the situation.\textsuperscript{147}

Chan and Young noted that, ‘The practice of \textit{Li} is to restore a person to original goodness. This goodness is natural, and in born, bestowed by heaven. This is where he linked \textit{Li} to \textit{Ren}.’\textsuperscript{148} Then by combining the moral virtues of \textit{ren}, \textit{yi} and \textit{li}, the virtue of \textit{zhi} (wisdom) is spawn because one will possess the ability to distinguish between what is right from wrong from one’s understanding or and commitment to virtuous behaviour.\textsuperscript{149} It is a virtue because one needs to know one’s own faults in order to rectify them, and the ability to take precaution against repeating the same faults, this is where \textit{zhi} is defined as wisdom.\textsuperscript{150} Other translations of the Chinese character \textit{zhi} include know-how, good judgments, about consequences of actions, to realize, and moral intelligence.\textsuperscript{151} \textit{Zhi} is also linked to courage, as those who are courageous would do what is righteous, reasonable, or what one ought to do.\textsuperscript{152} Shun inferred that this virtue requires one to have proper aims and sufficient motivation to carry out those aims.\textsuperscript{153} It entails appropriateness to context and realisation of one’s situation.\textsuperscript{154} Thus, this virtue enables a leader to make good judgements and have the foresight to be aware of the consequences of each decision.\textsuperscript{155} Apart from this virtue being a product of the other mentioned virtues, it translates into one having cognitive ability, wisdom and courage to do what is morally right.\textsuperscript{156}

The fifth virtue, \textit{xin}, consists of the following qualities: trust, good faith, faithfulness, honesty, integrity, and trustworthiness.\textsuperscript{157} The notion of \textit{xin} is different from Western notions of trust and fiduciary relations.\textsuperscript{158} In the Confucian sense, this Chinese

\begin{itemize}
  \item \textsuperscript{147} Shun, above n 136, 65.
  \item \textsuperscript{148} Chan and Young, above n 29, 11-2.
  \item \textsuperscript{149} Van Norden, above n 28, 108; Chan and Young, above n 39, 12.
  \item \textsuperscript{150} Chen, above n 59, 277-83.
  \item \textsuperscript{151} Ames and Rosemont, above n 129, 55; Ames and Hall, above n 22, 85.
  \item \textsuperscript{152} Huang, above n 85, 20-1.
  \item \textsuperscript{153} Shun, above n 136, 66.
  \item \textsuperscript{154} Ames and Hall, above n 22, 85.
  \item \textsuperscript{155} Ivanhoe and Van Norden, above 12, 111, 137-8.
  \item \textsuperscript{156} Chan and Young, above n 29, 12.
  \item \textsuperscript{157} Ames and Rosemont, above n 129, 53; Lai, above n 127, 50; Huang, above n 85, 47-8, 106, 128.
  \item \textsuperscript{158} See more about fiduciary duties in Chapter 3.
\end{itemize} 

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character is associated with zhong (sincerity).\textsuperscript{159} \textit{Xin} is often referred to by Confucius as, ‘making good of one’s word,’\textsuperscript{160} implying the importance of one’s creditability as part of a person’s morality. For Confucius having \textit{xin} between friends is essential.\textsuperscript{161} Although this is similar to \textit{xingyong} found in the business context for the Chinese,\textsuperscript{162} the added emphasis for Confucius is the moral dimension.\textsuperscript{163} Wee noted that:

\[ \textit{Xin} \text{ is an expression of the care that one needs to take in one’s transactions with others, and the responsibility that one must fulfil towards others. It is clear, then, why having } \textit{xin} \text{ might be seen as being close to being moral. The person of } \textit{xin} \text{ possesses the underlying capacities and orientation toward others that are needed in moral cultivation. The capacity for reflection, the concern for what is appropriate, and the sense of responsibility and care that one has in one’s interactions with others…} \textsuperscript{164} \]

As with the other moral precepts (discussed in the above), there are close links to each other. Apart from \textit{zhong}, \textit{xin} is also linked to \textit{li} and \textit{yi}.\textsuperscript{165} Confucius describes \textit{xin} as the pin of a yoke that enables a carriage to be drawn as it coagulates all the four virtues into a set of moral benchmarks so that humans faithfully follow the principles of nature (Heaven) which is the source of all morality as well as the life force.\textsuperscript{166} Chan and Young remarked that, ‘Confucius attached great importance to \textit{Xin}. Confucius asserts that a state can have no arms or even no food, but its politicians must have \textit{Xin}, otherwise they could not get the people’s support.’\textsuperscript{167}

Such are the importance of \textit{wu chang}, that they are portrayed by a Han dynasty Confucian as the vital organs of the body,\textsuperscript{168} working hand in hand to complete and complement each other. Confucius has equated those individuals who cultivate these virtues, as ‘superior’ or ‘noble’ men (\textit{junzi}), who are held in high esteem.\textsuperscript{169} \textit{Junzi} is not a person born into a noble family, or one with royal titles. In essence, \textit{wu chang}

\begin{footnotes}
\footnotetext[159]{Huang, above n 85, 22.}
\footnotetext[160]{Ames, above n 16, 205.}
\footnotetext[161]{Ibid, 206.}
\footnotetext[162]{See Chapter 5.2 about \textit{xingyong} (trust).}
\footnotetext[163]{Cecilia Wee, ‘\textit{Xin}, Trust, and Confucius’ Ethics’ (2011) 61 \textit{Philosophy East and West} 516, 520.}
\footnotetext[164]{Ibid, 523.}
\footnotetext[165]{Chan and Young, above n 29, 10-3.}
\footnotetext[166]{Yao, above n 49, 84-6.}
\footnotetext[167]{Chan and Young, above n 29, 13.}
\footnotetext[168]{Dawson, above n 66, 90.}
\footnotetext[169]{Huang, above n 85, 33-4.}
\end{footnotes}
are moral ideals, which have to be internalised through self-cultivation of the five virtues. Self-cultivation implies self-reflective understanding of the self with reference to those moral benchmarks.\textsuperscript{170} If after self-reflection and self-examination the \textit{junzi} finds his / her own faults, he or she should censure himself or herself, and then rectify them, as well as guard against future mistakes.\textsuperscript{171} Thus, he / she is not perfect in everything or every situation, but does his / her utmost and seeks to self-improve.\textsuperscript{172} Yet this is not to say Confucian moral leadership is not pragmatic.\textsuperscript{173} Fernandez argued that, ‘Confucius sculpted a model of leadership that was the zenith of human relations – the perfect person in society, a person who is not divorced from daily activities, a leader who is both idealistic and realistic’,\textsuperscript{174} much like the head of a Chinese family company.

In sum, \textit{san gang} and \textit{wu chang} according to Yao are more than moral precepts and a structured social order, as:

There are principles and regulations are taken as the essence of life and bonds of society. In this way, Confucianism extended the boundaries of moral codes from individual matters to social and political areas, not only providing the state with an ideological format, but also equipping the authority with the standards to judge behaviour and thoughts.\textsuperscript{175}

This has meant that this Confucian notion of governance builds on a set of moral precepts and principles that vary according to one’s social status and the duties that come with those roles.\textsuperscript{176} It is important to note that \textit{san gang} outlined the roles of individuals in vertical relationships, and yet it was not meant to be oppressive, instead it creates differentiated obligations according to one’s role or status in relation to another. \textit{Wu chang} seemed to be directed at individuals in the nurturing of morality and regulation of one’s behaviour and attitudes. Even if times have

\textsuperscript{171} Chen, above n 59, 280-1.
\textsuperscript{172} Lee, above n 11, 44.
\textsuperscript{173} Lai, above n 127, 50.
\textsuperscript{175} Yao, above n 49, 34.
\textsuperscript{176} Ibid 35.
changed and modernisation has transformed Chinese societies around the world, Confucian values espoused from *san gang* and *wu chang* like paternalism and relation-centred governance continues to influence Chinese societies like Hong Kong.  

6.2.2  **Confucian Harmonious Order of Things**

Another important feature of Confucianism is the emphasis on the duties imposed by these relationships, as such relational bonds and obligations are crucial to social cohesion and harmony.  

Cohen wrote:

> [i]deas of order, responsibility, hierarchy and harmony” were enshrined in the prevailing social norms, the *li*, which were approved patterns of behaviour prescribed in accordance with one’s status and particular social context. Harmony was pre-eminent among these ideas. Once it had been disturbed it could best be restored through compromise.  

Therefore, for Confucius all moral principles and social constructs including political orthodoxy are to bring about a harmonious social order.

The notion of harmony has both quasi-religious and social dimensions for Confucius and the latter is the subset of the former. Yao wrote, ‘harmony is the culmination of the Confucian way and marks the point where the Way of Heaven and the Way of Humans converge.’ Also the way of heaven is akin to the natural order of things, and heaven is where all Confucius’s beliefs converge, taken as the ultimate authority in deciding the fate of humans. However, the influence is not one way or top down, it is interdependent, and as such when there is harmony on earth, there will be

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178 Dawson, above n 66, 89.  
181 Yao, above n 49, 169.  
182 Ibid, 170.  
183 Ibid, 149-51.
Harmony in heaven.\textsuperscript{184} This in turn helps to explain why Confucians place considerable emphasis on fostering a harmonious society because it is the basis of peace, serenity, and a natural order.\textsuperscript{185}

Harmony in a social context according to Confucius consists of two essential elements \textit{he} and \textit{tong}. \textit{He} is the art of blending two or more different or even opposing people so that they come together congenially, most likely through compromise without losing their separate and particular identities.\textsuperscript{186} \textit{He} also includes finding balance, equilibrium, and mutual adjustments, ‘the creative and productive outcome when such differences are coordinated to optimum effect.’\textsuperscript{187} \textit{Tong} simply means uniformity or as Fung puts it, ‘identity, which is incompatible with differences.’\textsuperscript{188} Fung also used the analogy of combing salty and sour to produce a contrast of favours and balancing of one over another to describe the Confucian sense of harmony.\textsuperscript{189} Ames and Hall argued that for Confucius:

Harmony so considered entails both the integrity of the particular ingredient and its ease of integration into some large whole. Signatory of this harmony is the endurance of the particular ingredients and the aesthetic nature of harmony. Such harmony is an elegant order that emerges out of the collaboration of intrinsically related details to embellish the contribution of each one.\textsuperscript{190}

In essence, social cohesion involves people of different status, personalities and views being able to be blend into a unified and blissful congregation.

Ivanhoe identified two characteristics of what he coined as the early Confucian meaning of harmony.\textsuperscript{191} The first element is a collection of individuals, each

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{184} Ibid, 174-5.
\item \textsuperscript{185} Ibid, 175-6.
\item \textsuperscript{186} Ames and Rosemont, above n 129, 56.
\item \textsuperscript{187} Ames, above n 16, 169.
\item \textsuperscript{188} Fung, above n 10, 174.
\item \textsuperscript{189} Fung, above n 89, 34-6.
\item \textsuperscript{190} Ames and Hall, above n 22, 66.
\item \textsuperscript{191} Philip Ivanhoe, ‘The ‘Corporate’ Nature of Confucianism and Its Implications for Business Ethics’ in Eugene Heath and Byron Kaldis (eds), \textit{Wealth, Commerce and Philosophy: Foundation Thinkers and Business Ethics} (University of Chicago Press, 2013) forthcoming.
\end{itemize}
\end{footnotesize}
performing their roles with moral sensibilities and thereby further being able to
develop oneself as one participates in and serves the greater community, and the
second element is directed at leaders to prompt them to include diverse points of
views, and make clear that cooperation is essential and that no single point of view
can dominate.\(^1\) Chong separated this concept into three key categories: ‘organic
harmony’, ‘emotional harmony’, and ‘role harmony’.\(^2\) Organic harmony refers to a
sense of interconnectedness and empathy towards differences; emotional, is the
balancing of one’s feelings and not being excessive, and role makes clear that people
with different responsibilities or functionalities complement and enhance one another
at the communal level and in society as a whole.\(^3\) Therefore, for Confucius, a
harmonious society is a well-organized society where people of differing talents
occupy their proper places, perform their proper functions, and are not in conflict
with one another in a harmonious unity.\(^4\) Harmony is found in diversity held
together by relational obligations anchored in moral precepts and a sense of
communal, spirited collaboration for the greater good. This harmonious society is
thus not a product of state policy or polity; instead, it comes from a utopian like
vision.\(^5\)

Ultimately a harmonious society according to Confucius is known as da tong. One
translation of this term is ‘Grand Unity’ and it has been interpreted as an expression
of a society where the common good is paramount.\(^6\) This utopian vision is one
where wu chang are widely practiced.\(^7\) Furthermore, Confucius stipulates that when
da tong prevails, society will be ‘crime free’ because every person’s moral aptitude
would be equivalent to a junzi.\(^8\) Then again, if the object of the Confucian system
of governance (as discussed in the above) is harmony, and this notion of harmony is
one that is morally driven and structured, thus such a regime is held together by

\(^1\) Ibid.
121, 125-8.
\(^3\) Ibid.
\(^4\) Ibid, 202-3.
\(^5\) Chen, above n 50, 2-4.
\(^6\) Ibid, 3.
\(^7\) Fung, above n 89, 377-8.
values promoting an ideal of ‘ought to’ instead of ‘must’, logically speaking. So what is the incentive for individuals to comply? The answer is - it is observed out of a sense of obligation to society, or out of a sense of shame or guilt or from fear of social sanctions for non-compliance. This sense of shame, *chi* as Ames wrote, ‘is such a powerful expression of moral awareness that, when properly nurtured, can become a pervasive value that enables the community to be both inclusive and self-regulating.’ Therefore, harmony in the Confucian sense is the heart of civil society and social order.

Westwood found that the notion of harmony is fundamentally embedded in the Chinese cultural traditions and value system, ‘Such harmony is not based on equalitarian or egalitarian presumptions, nor upon merely exchange values, rather it flourishes even in an environment of clear and acknowledged power distances and inequalities.’ This helps explains Hofstede’s research rating Hong Kong as very high in power distance, collectivism, and long term orientation. Westwood also explained the need for harmony helps legitimise the leader’s position of authority, as it fosters solidarity and consolidates the bonds of mutual obligations and reciprocity. In addition, it is equally important to note that this Confucian family-centred moral order is not rule based it is relationally centred and paternalistic in nature. This could help explain why for centuries the Imperial Chinese government did not legislate on business enterprises. This led Chinese law commentators like Bath to argue from a historical perspective that Confucianism has retarded the development of modern commercial laws in China. This is because for centuries China had adapted the moral principle of *li* into a regulatory doctrine.

Ames, above n 16, 172.
See Chapter 5.1 for more on Hofstede’s research on cross cultural studies in organisational studies.
Westwood, above n 202, 459.
6.3 Confucian Doctrine of Li as a Regulatory Norm

This section examines how a Confucian moral principle had been adapted into a regulatory doctrine. Also this section will explore how this doctrine entrenched itself as a non-legal regulatory norm that has regulated Chinese enterprises and businesses for centuries.

6.3.1 Traditional Chinese Characterisation of the Law and Jurisprudence

At the fundamental level, the difference between the West and Chinese notions of law stems from notions about the law as a word. The Chinese word for the law is made up of two characters – the first is fa, which can be literally translated into English as ‘method or means’ and the second is lu which means ‘discipline or order’. Hence, the term and characterisation of law in Chinese is flexible, contextual and not necessarily from prescribed or written rules. For centuries, notions of social controls and moral values are embedded in the Chinese characterisation of the law. Furthermore, Chinese reading of what constitute law could be so broad that Western commentators often misconceived it as excessive general, vague, and inconsistent. Long noted that:

Legal anthropologists have long struggled with the problem of choosing a proper vocabulary to describe Chinese laws. The interaction of different social elements, especially the ideological character in law, creates formidable difficulties in making cross-cultural comparative law study … the difficulty in linguistic translation is only one aspect of the problem with legal comparative study. The deeper disagreement concerns the uniqueness of each individual culture … in the legal comparative study, it would be insufficient to merely map Chinese legal practices and ideologies onto familiar Western conceptual territory. If we impose the Western legal terminology on Chinese legal practices, we risk misunderstanding Chinese legal sensibility.

207 Cao, above n 18, 94.
208 Ibid, 21-2.
But for the purpose of elucidating traditional Chinese regulatory philosophy and methods, the closest and plausible definition of law in the Chinese sense and meaning in English is ‘regulation’. This is because for the Chinese the difference between values, norms, non-legal codes of conduct, criminal codes and imperial decrees are at times blurred, and used either in combination or in part depending on the context, purpose and nature of the act or actions in question.

This broad characterisation of the traditional Chinese notion of ‘the law’ also affects how Chinese theorize what is the law. Cao argued that jurisprudence in the Western sense of the word hardly existed in China. Choi noted that one can think of Chinese jurisprudence in terms of legal traditions in China influenced considerably by Confucianism. Lau and Young argued that for the Chinese the law, ‘[c]ould be understood in four related themes. They are order, rites, human-made laws and a system of control.’ To appreciate this, it is important to understand the development of Chinese laws from historical and philosophical perspectives.

211 The word regulation by itself is broad and at times abstract. Besides, they are not necessarily rule based and the state usually takes on some role in this sense. A very broad definition of this word regards regulation, ‘as comprising all mechanisms of social control or influence affecting the behaviour, from whatever source, whether intentional or not’. See Arie Freiberg, The Tools of Regulation (Federation Press, 2010) 3.
212 Ch’u, above n 95, 284.
213 Cao, above n 18, 3. In terms of jurisprudence Cao mean by meant the inquiry into fundamental questions about the law, the nature of the law, and the legitimacy of the law.
214 Choi, above n 30, 7-33. Note that Chinese legal traditions possess three key attributes. First, China had a bureaucratic state ruled by feudal/imperial system under the command of an Emperor. This gave rise to a top down relationship between the state and its subjects, thus administrative laws were well developed and articulated. Second, the origin of laws was predominantly secular (fa) on the one hand, on the other hand, was quasi-religious with emphasis on moral rules and social obligations (li). Third, formal legal system was relatively insignificant in civil matters, customary practises and social norms were regularly adopted and enforced by clan elders, village elders, and merchant guilds. See Chen, above n 144, 7; MacCormack, above n 51, xiv; Patrick Glenn, Legal Traditions of the World: Sustainable Diversity in Law (Oxford University Press, 2nd ed, 2004) 309; Hyung Kim, Fundamental Legal Concepts of China and the West: A Comparative Study (Kennikat Press, 1981) 33; James Brady, Justice and Politics in People’s China: Legal Order or Continuing Revolution? (Academic Press, 1982) 31-40.
In ancient China the Emperor or the King was the source of all political, legal and moral authority, as he possessed the ‘mandate from heaven’ to rule. The earliest form of a legal text in ancient China was a piece of proclamation on the ‘five corporal punishments’ by King Yao (2357-2255 B.C.), but it was not until the Zhou dynasty (1027-221 B.C.) that a set of rule-like decrees from the King to his subjects were recorded as imperial edicts. It was during the reign of King Wu (1122-1116 B.C.) of the Zhou dynasty that li evolved beyond rituals used to worship the heavens and ancestors to governing the conduct between nobles and officials. Whilst Confucius promoted the concept of li as a benchmark and behavioural standard not only for the nobles but also for the commoners, it was not until later during the Han dynasty (206 B.C.-220 A.D.) that this goal was achieved.

A rival to legal doctrine known as fa (legalism) emerged during the Warring States period (475-221 B.C.). Men like Shang Yang (361-338 B.C.) and Han Feizi (280-233 B.C.) completely rejected the Confucian notion of li as a moral and regulatory

217 Kim, above n 214, 34.
218 Chen, above n 216, 8.
219 Bodde and Morris, above n 58, 15.
220 MacCormack, above n 51, 2; Chan and Young, above n 13, 12.
221 Patricia Blazey and Gisele Kapterian, ‘Traditional Chinese Law’ in Patricia Blazey and Kay-Wah Chan (eds), The Chinese Commercial Legal System (Thomson, 2008) 19, 23. Note that even though, li is a moral principle, it was treated as law-like norms because it had binding effects on the masses. Even the Kings and Emperors were all mighty and powerful, they were obliged to comply with li, because the source of cosmic order of things – ‘heavenly li’ (tien li). Therefore, for Confucius the source of li is not social or political, its from heaven. This notion of heaven is a supreme force that governs over in the universe. Thus, li is believed be abide by the cosmic order of things, in short, it is liken to Western notion of natural law because of references to heaven and spirituality, but also serves as a form of social ordering. See Lau and Young, above n 215, 155, 162-3; Choi, above n 30, 53-8; Yao, above n 49, 142, 147-153; Kim, above n 217, 33; Yu-Lan Fung, A History of Chinese Philosophy, Volume II: The Period of Classical Learning (Princeton University Press, 1953) 36, Benjamin Schwartz, ‘Some Polarities in Confucian Thought’ in Arthur Wright (ed), Confucianism and Chinese Civilization (Stanford University Press, 1959) 3, 6.
222 Head and Wang, above n 46, 46; WM Theodore de Bary, and Irene Bloom, ‘Legalism and Militarists’ in WM Theodore de Bary, and Irene Bloom (eds), Sources of Chinese Tradition: From the Earliest Times to 1600, Volume One (Columbia University Press, 2nd ed, 1999) 190, 191. Note that the core ideas of fa was not entirely original, in fact it manifested before Confucius’s time in antiquity (2800-2000 B.C.) known as xing (system of punishment inflicted for disobeying the King or nobles) and widely used during the reign of the Shang dynasty (1600-1027 B.C.). See Liu, above n 83, 111-40; Chan and Young, above n 13, 7-8.
These men viewed altruistic ideals espoused from *li* as not practical because of the social changes that occur with the growth of population, and so *li* would no longer be capable of regulating the behaviour of the masses. They argue that Imperial codes and decrees are superior to *li* because they are clear-cut and not easily changed. The system of *fa* was based on imperial codes or decrees to administer punishments to subjects who disobeyed the King or Emperor. Thus, the core idea of this doctrine was to use severe punishment to compel obedience to the Emperor and the laws he proclaimed. However, the domination of *fa* as the official legal and political ideology was short lived. It emerged during the reign of the Qin dynasty and ended when the dynasty was replaced by Han rule.

From the Han dynasty until the Tang dynasty (618-907 A.D.), Confucian doctrines were gradually codified (known as ‘Confucianisation of the law’). Even though this firmly institutionalised Confucian ideals via imperial codes, the process distorted the doctrines because they were fundamentally contradictory. Ch’u asserts that the conflict between ruling by *li* and *fa* is very different. The enforcement of *li* through *fa* amounted to defacing the ideas that *li* espouses. Justice Ma, a former Grand Justice of the Judicial Yuan of Taiwan was critical of the ‘Confucianisation of the law’ and wrote:

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224 Blazey and Kapterian, above n 221, 32-4.
225 Chen, above n 216, 33.
226 MacCormack, above n 51, 5-6.
227 Goh, above n 177, 34; Kim, above n 217, 6.
228 Bodde and Morris, above n 58, 23-5. Note that this was because the brutality and severity of punishments the Qin Emperors had inflicted onto their subjects led to its downfall, much like the factors that had also led to the demise of the Shang dynasty. However, many elements of the *fa* lingered on in some form or another for centuries. See Head and Wang, above n 46, 72-6; MacCormack, above n 51, 4-5; Blazey and Kapterian, above n 221, 36; WM Theodore de Bary, and Irene Bloom, ‘The Han Reaction to Qin Absolutism’ in WM Theodore de Bary, and Irene Bloom (eds), *Sources of Chinese Tradition: From the Earliest Times to 1600, Volume One* (Columbia University Press, 2nd ed, 1999) 227, 228; Chan and Young, above n 13, 5-8; Blazey and Kapterian, above n 221, 36.
229 MacCormack, above n 51, 4-5.
230 Blazey and Kapterian, above n 221, 37-40; MacCormack, above n 51, 53.
231 Blazey and Kapterian, above n 221, 40.
232 Ch’u, above n 95, 268.
[t]he “Confucianization of the law” has unfortunately brought disrespect and even damage to both the law and Confucianism. In the first place, Confucian ethical doctrines are founded on the belief that man is good by nature and therefore capable of realizing benevolence and righteousness by himself … “Compulsory” morality would be inconceivable to Confucius and Mencius. They would be the last persons to approve of coating their teachings with legal language. Even in advocating LI or rules of rites, they focused their attention on the principles underlying then, which are derived from human nature, not on the formalities and the letter of the rules themselves. Because of the severity of the legal sanctions designed to uphold Confucian ethics, not only was traditional Chinese law made largely inhuman, but also Confucianism was bereft of much of its inherent humanity.233

Yet the justification for this by successive Imperial rulers was necessary to reverse moral decline in all levels of Chinese society.234 However, anecdotal evidence suggested that it was motivated by political reasons.235

Interestingly, the law and the courts during China’s imperial rule did not regulate many aspects of social life. Ch’u found that:

[t]he law played a limited role in society, mainly because the law, essentially a penal code, included only a few provisions on family, marriage, adoption, inheritance, property and debts. Many of these matters, which would be considered civil laws in modern concepts, were very much neglected and largely left to custom or li.236

Brady also concurred by stating that the laws and imperial governments did not have the capacity to introduce and monitor social and related controls at the micro-level, besides formal litigation was infrequent and strongly disapproved of from a Confucian perspective.237 Even if disputes were brought before the magistracy, the solutions were not drawn from the law. This is because the magistrates’ were not legally qualified (meaning they did not need to have studied the imperial codes); instead, they were examined on their knowledge of Confucius’s teachings,238 as the

234 Goh, above n 177, 37.
235 MacCormack, above n 51, 53-9; Head and Wang, above n 46, 237; Chen, above n 216, 84.
236 Ch’u, above n 95, 284.
237 Brady, above n 214, 13.
adjudicatory function of the magistrate in private disputes was to mediate between parties and repair relationships. This is because the magistrate was expected to be father-mother official (fumu guan), charged with a range of legal, administrative, and fiscal responsibilities.

Moreover, the bad reputation of the magistracy in traditional China—due to the brutality in sentencing and extraction of confessions, rampant corruption, and explicit privileges conveyed to the rich and nobles—encouraged recourse to the informal private judicial system based on kinship (clan) or occupational (guild) and to business associations to resolve disputes and bring about justice. Another recourse option was to the family because, for the Chinese, the family was more than a home. The father or most senior (by age) member of the family was expected to ensure no members of the family violated social norms, customs or family rules, therefore disputes were often resolved within the immediate or extended family. What the imperial governments did not provide in terms of regulation, the merchant and trade associations (tongxiang or huiguan) did. Furthermore, these business associations, guilds and clan systems of justice reinforce the family-centred approach to resolving disputes, where senior members or elders in the clan would mediate. The aim of this system of justice was not to try the matter as a court would but rather used conciliatory tones to find compromises without dictating terms. Such was the sway of clans and guilds, members or parties accepted the deliberations voluntarily. The reason was that even if the disputes were brought before the

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240 Note that even though magistrates must comply with the instructions or codes from the imperial courts, in practice there are many gaps in those codes so the underlying basis of decision-making for the magistrate is to think like a parent, for the betterment of the King’s subjects, as if they were his children, this ideal comes from Confucian teachings. See Alford, above n 238, 953-954.
241 Alford, above n 238, 953-954.
242 Brady, above n 214, 13; Ch’u, above n 95 284.
243 Goh, above n 177, 44-51, 69.
244 Hamilton, above n 101, 58-9.
245 Goh, above n 177, 72-9.
246 Cohen, above n 179, 1222. Note that if mediation fails some clans have the power to impose punishments, ranging from reprimands and fines to corporal punishments and in the worst case expulsion. The reason for the dominance of clan over the lives of their members is because they are collective society and has high levels of solidarity and strong sense of group cohesiveness and
magistracy, it was common practice for the magistrate to consult the clans and guilds’ rules in making his rulings. More importantly, the clan and guild rules, tongxiang and huiguan rules, and their system of justice was based on the Confucian notion of li. Another reason, is that cooperation within the clan was sustained mainly by moral obligations and reputational incentives. Liu observed that, ‘The clan rules appear to have been effective in helping people to live in accordance with Confucian ideals and to place a high value upon the Confucian virtues.’ This helps to explain the significance Confucianism plays in the regulation of Chinese society, in particular in the family and the business context. Therefore, it is essential to understand li in greater depth, especially as it is a Confucian moral principle.

### 6.3.2 The Genesis of Li as a Moral Principle with Regulative Properties

Confucius had a disdain for laws and legal codes. He believed that a state led by laws is condemned because perpetrators can find ways to avoid punishments. Even if compliance was achieved through the threat of penalties, conformance is insincere, and the law is powerless to transform the inner character of these individuals. Goldin interpreted a passage from the Analects in the following statement:

> Legislation and punishments are not ineffective; on the contrary, they are highly effective, because they make people do whatever is necessary to avoid being punished. But what laws and punishments cannot do is effect any moral transformation in the populace, and this is (as will soon become clear) the only legitimate purpose of government.

Yet this does not mean Confucius thought the law did not have a place in society. Hucker argued that Confucians do see the law as a necessity, ‘but a necessarily

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247 Hamilton, above n 101, 64.
248 Goh, above n 177, 44.
251 Huang, above n 85, 52.
252 Peerenboom, above n 209, 28.
253 Goldin, above n 15, 20.
fallible handmaiden of the natural moral order and must be enforced flexibly. Lee felt Confucius believed that, ‘Laws may be necessary for those who, no matter what kind of government is in place, will never behave.’ Thus, Confucians are not opposed to the law per se, or the use of punishment, rather these are to them, secondary instruments. To Confucians only morals could restore the goodness in people while laws only compel physical obedience. Moreover, Confucius did not believe that having robust systems and institutions to enforce legal rules would necessarily lead to justice served because these are fallible mechanisms, and instruments created by men. If the architects of these instruments were not morally righteous, then the systems that they created would be flawed, and thus unable to provide natural justice (tienli) to the aggrieved parties.

Even though, as discussed in Chapter 6.2.1, li is one of the five moral principles (wu chang), over the centuries, li had gradually evolved into a legal doctrine. Choi argued that this phenomenon gained momentum around the Sung dynasty in the 12th Century. In the narrowest sense, the Chinese character li refers to religious rituals like paying respect to ancestors and revering the heavens in ancient China. Thus, it is often translated in English as ritual and rites. Huang noted that li has encompassed all phases and aspects of human life for centuries in China ranging from rituals governing state visits, marriage, banqueting, drinking parties, archery tournaments, learning, music, and mourning to etiquettes governing family and social relations and matters of dress, and more, all designed in accordance with rank and status. This demonstrates the multi-dimensional conception, depiction and application of li.
Confucius had always maintained that he did not formulate the concept of *li*. He merely revived it from ancient sages to teach human beings about the ways of the heaven.\(^{264}\) He felt it was his duty to collate and interpret *li* handed down from antiquity during the reign of the sage Kings of Yao, Shun, and Duke of Zhou (210-771 BC).\(^{265}\) The Duke of Zhou (before Confucius’s time) proclaimed that *li* came from the notion of *tienming* (a mandate from heaven).\(^{266}\) The ruler, King or Emperor, is expected to rule his Kingdom in accordance with *li* as it is the will of heaven.\(^{267}\) Otherwise, their reign will end abruptly because those who defy *tienming* and *tienli* (natural justice) go against the natural order of things, and shall be punished by the heavens.\(^{268}\) For the masses, those who followed *li* are said to be in harmony with heaven;\(^{269}\) this is known as ‘harmonious oneness of heaven and humanity’ (*tienren heyi*).\(^{270}\) This concept of *tienming* in Confucianism denotes a moral and social code bestowed by heaven and thus ‘man’ must abide by this order of nature.\(^{271}\) Therefore, as noted earlier, *li* as a concept and doctrine is akin to Western medieval natural law.\(^{272}\) However, unlike the Christian traditions where Aquinas proclaims that the law of man is connected with the law of God,\(^{273}\) Confucius’s view on Chinese antiquity is

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\(^{264}\) Kim, above n 217, 29-33. Note *tienming* (Mandate of Heaven) and *tienxing* (Heavenly Virtue) are religious concepts Confucius used to explain the connections between moral rules from heaven bestowed upon humanity - See pages 25-60.

\(^{265}\) Bodde and Morris, above n 58, 19; Head and Wang, above n 46, 5-9, 24-9; Liu, above n 83, 89.

\(^{266}\) Head and Wang, above n 46, 28. *Tienming* is defined as decree from heaven, which determines one’s life or the rise of fall of the political order. Heaven is believed to be the creator and mother of all things. See Kim, above n 214, 39-40.

\(^{267}\) Head and Wang, above n 46, 28. Note that the ruler, Emperor, or King is called the ‘son of heaven’ as he is given the divine right to rule from heaven. See Kim, above n 214, 40.

\(^{268}\) Kim, above n 214, 39-40.

\(^{269}\) Head and Wang, above n 46, 28-30; Kim, above 214, 53.

\(^{270}\) Yao, above n 49, 140.

\(^{271}\) Kim, above n 214, 34.

\(^{272}\) Bodde and Morris, above n 58, 20. Note that unlike Western notions of natural law, the Confucius’s moral rules are not subject to change. However, how they are applied could be adapted. See MacCormack, above n 51, 12-3.

that heaven and humanity share a symbiotic relationship. This in turn would establish a natural social order as Kim writes, ‘Natural law [tienli] becomes a social norm in the form of moral rules [li] by which to regulate one’s conduct in his relations to others in social life.’

From a regulatory sense, li refers to a normative code of conduct or propriety dictating proper behaviour. This is achieved through the mapping out of different standards of appropriate behaviour in accordance with one’s place in a particular relationship. Thus, li would vary according to one’s social status, so ‘when a person’s title and position are different, the li used is different.’ Hence, li dictated how one should behave at home and in public. They are socially learnt non-legal rules of behaviour and codes of conduct controlling one’s actions, words used, and attitudes towards people, beyond what legal rules can achieve – social discipline and order without legal rules- and through these rules comes the nurturing and cultivation of moral values.

6.3.3 Establishing Social Order through the Doctrine of Li

Confucian regulatory doctrines can be described as self-regulatory and non-penal forms of social order, because the state and notions of criminality are not part of this system of beliefs. Instead, it is a family-centred social modus operandi based on moral values. The way li works, as a regulatory concept, is that the society as a

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275 Kim, above n 214, 53.

276 Goh, above n 177, 32-4; Liu, above n 83, 61-109.

277 Ch’u, above n 95, 231; Choi, above n 30, 13.

278 Note that according to Confucius human are born good (distinct from the Christian concept of ‘original sin’), so li has restorative functions in bringing out the goodness in people. See Bodde and Morris, above n 58, 20.
whole plays a critical role in its operation. As noted in the above, \( li \) is the ‘Way of Heaven’ and thus translates into a social context the ‘Way of Man’, and it is applied as codes or rules for human conduct. The connection between heaven and humanity is \( li \).

As discussed in Chapter 6.2.1, the two moral precepts of \( ren \) and \( yi \) are closely linked to \( li \). Chong noted that, ‘Ren is absent when li is performed without proper spirit, and the rituals of li, seen in this light, have an educative function in bringing about the attitudes and values incorporating ren.’ In short, \( li \) is the form and \( ren \) is the substance of what constitute proper conduct. The rigidity of \( li \) is moderated by the affection of \( ren \) to bring about harmony in society or as Lai noted that \( ren \) has the role of upholding a commitment to humanity. The other moderator of \( li \) is \( yi \). \( Yi \) is a moral quality that ensures \( li \) is not applied incorrectly, or followed blindly. Confucius felt that the moral principle of \( yi \) is second only to \( ren \). Ames argued that, ‘\( Yi \) is “achieving an optimal appropriateness in one’s relations” – that is, the satisfaction of moral certainty through an acquired sense of what is most fitting in the situation.’ In fact, \( yi \) is a Confucian notion of justice. Liu went further:

While Western philosophies emphasise the deontological ethics of universal law and principles for rational agents, Confucianism, in its axiological ethics calls for aesthetic judgments of Yi. A further distinction between the Western concept of justice and Yi is that Yi is generally used in connection with other Chinese characters like Ren-Yi (benevolent righteousness or benevolent justice) or Qing-Yi (affective righteousness or affective justice). Therefore, Yi can be said to be a code of conduct which conforms to morality. It is a standard of moral evaluation and is a moral code at a higher level.

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279 Kim, above n 214, 53.
280 Ibid.
281 Yao, above n 49, 148.
282 Chong, above n 54, 19.
284 Lai, above n 127, 29.
285 Huang, above n 85, 18.
286 Ames, above n 16, 201.
287 Liu, above n 39, 61; Fung, above 89, 284.
288 Liu, above n 39, 60-61.
Clearly, such a notion of justice from *li*, in the Confucian sense, has a combination of relational obligations created by social status in relation to another person and a juxtaposition of moral principles to establish appropriate behaviour depending on the context and situation.

Furthermore, as noted in Chapter 6.2.1, for Confucius moral principles are interrelated; in *the Analects*, the concepts of *ren, yi* and *li* were portrayed as the interconnected limbs of a body.\(^{289}\) Goldin captured this link in the following observations, ‘Li is best understood, then, as embodied virtue, the thoughtful somatic expression of basic moral principles, without which the ceremonies are void.’\(^ {290}\) Yet, it will be a mistake to think that *li* is merely a set of moral principles\(^ {291}\) because these moral expectations have a self-disciplinary effect on individuals.\(^ {292}\) Thus, the regulatory function of *li* is to ensure humanity preserve this goodness in people through moral based regulative norms.\(^ {293}\)

As mentioned, the application of *li* creates social stratification, differentiation, and hierarchical order because *li* differs according to social status, and so involves discriminatory treatments and privileges.\(^ {294}\) Confucius did not believe that people were born equal, consequently society was characterised by relationships of subordination and superordination.\(^ {295}\) The differentiation by social status (royal titles and ranks) establishes a hierarchical order wherein people are discriminated in line with their status and roles,\(^ {296}\) thus creating different levels of responsibilities. The Confucian morality expects those higher up in the hierarchy to live by a higher moral standard and should set an example of moral excellence for those lower in the social pecking order.\(^ {297}\) As such, the aim is not to create mechanisms of social control,

\(^{289}\) Huang, above n 85, 19.
\(^{290}\) Goldin, above n 15, 22.
\(^{291}\) Cao, above n 18, 23.
\(^{292}\) Chen, above n 59, 278-85.
\(^{293}\) Bodde and Morris, above n 58, 20.
\(^{294}\) Head and Wang, above n 46, 42-4.
\(^{295}\) Ibid, 42.
\(^{296}\) Bodde and Morris, above n 58, 33-4; De Bary, Chan, and Watson, above n 274, 18.
\(^{297}\) Bodde and Morris, above n 58, 35.
rather to maintain social order. Order is about preserving stability and preventing discord to achieve social cohesion. This cohesion is achieved when the responsibilities associated with the duties of each party are fulfilled.\(^{298}\) As the state or monarchy is not the only source of social order,\(^ {299}\) conformance with shared values and norms is achieved, according to Bull, ‘out of practice in lineage or locality groups in their relations with one another, these become embodied in ‘custom’ and are confirmed by moral and religious belief.’\(^{300}\) In addition, compliance with such norms is backed by social sanctions, often sufficient to have a penal like effect on close knit or cultural homogeneous communities.\(^ {301}\)

Confucius was aware of the importance of society to achieve his vision of \textit{da tong}; he understood the fact that ‘men’ are social beings.\(^ {302}\) Since our lives are essentially social, for Confucius we will come to know the ways of heaven from our parents and our fellow ‘men’.\(^ {303}\) Therefore, the learning of \textit{li} is achieved through education and the process of socialisation. This normative ordering system derived from \textit{li} is aimed at promoting a cohesive society through social stratification and relational obligations that are governed by moral principles to create \textit{da tong}.\(^ {304}\) Confucius believed that if every person performed their obligations in accordance to their social status, guided by moral principles, there would be peace and harmony amongst ‘men’.\(^ {305}\) In sum, unlike laws or legal codes, where the threat of punishment by the King, the Emperor, or the imperial government was used to compel obedience to the law, the effectiveness of \textit{li} as a regulatory norm is achieved by norms indoctrinated since childhood in the family, and later amidst interaction with others in the social context.\(^ {306}\)

\(^{299}\) Hedley Bull, \textit{The Anarchical Society: A Study of Order in World Politics} (MacMillan, 2\textsuperscript{nd} ed, 1995) 57.
\(^{300}\) Ibid, 58.
\(^{301}\) Ibid.
\(^{302}\) Chen, above n 59, 54.
\(^{303}\) Chen, above n 59, 55.
\(^{304}\) Huang, above n 85, 20.
\(^{305}\) Head and Wang, above n 46, 49.
This effectiveness of these Confucian value-based norms is also aided by three other moral values. They are *shu* (reciprocity), *lian* (integrity) and *chi* (shame). Whilst *ren* and *yi* are core morality virtues, *shu*, *lian*, and *chi* are supporting moral principles, practiced in daily life, all of which sustain and promote *li*. Ames has explained that *shu* is, ‘putting oneself in the other’s place’.  

If we gauge others’ wishes by checking what we ourselves would not desire, we would have set a reasonable constraint on our action that would affect others ... one can also extend oneself to appreciate what the other person in the opposite role would desire ... The extension of oneself can go beyond the person of an opposite role to reach people of similar roles.  

There is also a clear relational dimension in reciprocity because references to the family relations are used as the basis for individual judgment. The key contribution of *shu* in the observance of *li* is the reciprocation of one’s sense of morality and righteousness towards others. Next, is the moral value *lian*. Apart from integrity, other meanings attached to this term are upright and honourable. A person of integrity (*lian*) is righteous in character and behaviour. Thus, such a moral person practices the virtues of *li*, because he is conscious of the moral imperatives of *ren* and *yi*.  

Perhaps, having a sense of shame (*chi*) is the most noteworthy moral principle that allows *li* to be an effective regulatory mechanism. This moral principle is a powerful expression of moral awareness and a pervasive value. Liu and Ivanhoe explain that, ‘It is the feeling of shame that inclines one to live up to his/her moral standard. It is because one has such a feeling, that one will prefer death to doing something...”

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307 Ames, above n 16, 194.
308 Liu, above n 57, 55.
309 Shun, above n 136, 146-7.
310 Ames, above n 16 196-7; Goldin, above n 15, 17-9.
312 Huang, above n 85, 83.
313 Low and Ang, above n 311, 116.
314 Chen, above n 59, 302-3.
315 Ames, above n 16, 172.
shameful." Mencius even claims, ‘Whoever lacks a heart of shame is not human’ and ‘The heart of shame is the beginning of righteousness.’ He went further by noting that chi involves evaluative judgments about oneself or about what is appropriate and suitable, so those who possesses chi, would naturally adhere to li.

As a regulatory doctrine or jurisprudence, even though the contravention of li may not constitute breaching of the law so no official punishment is imposed by the courts, it is expected to attract social sanctions by way of public shaming and social indignation, which has a penal effect. It is expected that the wrongdoer or perpetrator will feel ashamed by social denunciation and in turn become remorseful. From passages in the Analects, Confucius made it clear that the use of the law to regulate people would only make them find ways to evade it, and have no sense of shame; instead if they are led by li, they would have a sense of shame and be rehabilitated.

Remorse, according to Confucius, will rehabilitate the wrongdoer by appealing to his or her own conscience and sense of righteousness. Rehabilitation is an important component of li as a regulatory doctrine. Unlike laws where penalty or punishment is the consequence for breaching the legal codes, for Confucius li has an educative function. This is because education is a tool to teach moral values and reinforce the intrinsic worth of possessing virtuous qualities. More importantly, peer pressure is imperative in the entrenchment of li as a regulatory doctrine. Thus, this explains how li manifests itself as a norm with regulative properties.

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317 Goldin, above n 15, 46.
318 Liu and Ivanhoe, above n 316, 189.
320 Legge, above n 31, 146.
322 Huang, above n 85, 181.
323 Yao, above n 49, 30.
Whilst there are prescriptive elements in *li*, like what rites to use on various occasions, the application is both broad and flexible in terms of what act or actions constitute breaches.\(^{324}\) For centuries, clan rules in China had been prescribed by respective clans under the broad yardstick of *li*.\(^{325}\) Liu noted that clan rules are basically instructions based on moral principles drawn from Confucian doctrines.\(^{326}\) The principle function of these rules is to control the clan’s individual members and offer normative orientation; often the clans would add a second layer of more specific rules using Confucian teachings as justification.\(^{327}\) Therefore, these clan rules are negotiated outcomes between Confucian doctrines, past practical experiences and local customary practices.\(^{328}\)

These practices were similar in guilds and business associations in ancient China. In addition, these guilds or business associations did invoke harsh punishments for wrongdoings like theft, unfilial acts of children, cheating or serious misconduct.\(^{329}\) In clans, for severe cases, punishments could be in the form of physical stokes using wooden planks, and for guilds, fines and reparations were imposed, or in extreme cases, cessation of membership could be imposed as punishment for breaching guild rules.\(^{330}\) However, social sanctions and pressures were more effective in securing compliance of mediated decisions for civil or less serious disputes.\(^{331}\) These could range from peer pressure to comply and conform to the mediated outcomes, to the most severe, the threat of withdrawal of community support to disputants or social ostracism.\(^{332}\) And since in Chinese societies where collectivism is central to social life and maintenance of business links,\(^{333}\) these sanctions mounted to a loss of face (*mianzi*) and *xinyong* as well as a break down in *guanxi*.\(^{334}\) Such was the sway of

\(^{324}\) Ibid, 191-8.
\(^{325}\) Liu, above n 250, 16-17.
\(^{326}\) Ibid, 17.
\(^{327}\) Ibid, 19.
\(^{328}\) Ibid, 19-20.
\(^{329}\) MacCormack, above n 51, 62-3.
\(^{330}\) Ibid, 62-6.
\(^{331}\) Goh, above n 177, 69, 72-86.
\(^{332}\) Ibid, 51-2.
\(^{333}\) Also, refer to Chapter 5.2 about *mianzi*, *guanxi*, and *xinyong* in relation to conducting business in Hong Kong.
\(^{334}\) Goh, above n 177, 52-8. Also see Chapters 3.2.2 and 3.2.3 for explanation of the terms.
clans, guilds and business associations’ decisions were accepted by members or parties voluntarily.\footnote{Cohen, above 179, 1222.} The reason being even if the disputes were brought before the magistracy, it was common practice for the magistrate to consult the clans and guilds’ rules in making his rulings.\footnote{Hamilton, above n 101, 64.} Whilst both the magistracy and the clan are expected to abide by the Confucian line in terms moral consciousness and virtues, the clan appear to be more effective in helping people to live in accordance with Confucian ideals because of their conciliatory approach in resolving civil disputes.\footnote{Liu, above n 325, 47.} This is because they could persuade delinquents or the disgruntled to agree to mediation.\footnote{Brady, above n 214, 38.}

The preference for mediation over litigation for Confucius is clear from passages in the \emph{Analects}.\footnote{Chen, above n 180, 259.} For the reason being as Chen explained that, ‘Litigation is considered to be a negative social phenomenon because it is a deviation from and a disruption of harmonious social relationships. The construction of a harmonious social order is one of the greatest Confucian ideals.’\footnote{Ibid, 260.} Cohen added that:

\begin{quote}
“[i]deas of order, responsibility, hierarchy and harmony” were enshrined in the prevailing social norms, the \emph{li}, which were approved patterns of behavior prescribed in accordance with one’s status and particular social context. Harmony was pre-eminent among these ideas. Once it had been disturbed it could best be restored through compromise.\footnote{Cohen, above n 179, 1207.}
\end{quote}

Compromises between parties are usually achieved with the aid of Confucian ideals as justification and being told by clan seniors of the limitations of the reality.\footnote{Liu, above n 325, 39.} To compromise is another characteristic of being moral and virtuous as when in conflict with others, self-scrutiny and reflection is integral to this process.\footnote{Chen, above n 180, 261.} This act of contemplation is expected to put the greater good of the community before personal

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\begin{itemize}
  \item \footnote{Cohen, above 179, 1222.}
  \item \footnote{Hamilton, above n 101, 64.}
  \item \footnote{Liu, above n 325, 47.}
  \item \footnote{Brady, above n 214, 38.}
  \item \footnote{Chen, above n 180, 259.}
  \item \footnote{Ibid, 260.}
  \item \footnote{Cohen, above n 179, 1207.}
  \item \footnote{Liu, above n 325, 39.}
  \item \footnote{Chen, above n 180, 261.}
\end{itemize}
views and interests and thus, mutual yielding (rang) or giving concessions. Goh noted that:

In this sense, it is not the pursuit of individual rights or justice, but, rather, the restoration of social harmony that represents the desired result should a conflict arise. The Chinese cultural desire for yielding is the prime motivating factor behind the need for compromises, which, in turn, shape the process of any mediation.

This clan-sponsored mediation is also used to settle family disputes. Whilst the father or grandfather, whose authority is absolute, frequently adjudicates conflicts or disagreements amongst family members, at times, this might not be enough, for example, the division of family property or assets of large families with emotionally charged and complicated facts; this is when the clan or guild gets involved. A clan or guild elder, with seniority by age and status, and often a family friend or associate is the mediator because parties will have personal connections (guanxi) making it easier to work towards a compromise. An important thing to bear in mind is that this process is reconciliatory in tone with harmony as an end, and the reinforcement of moral values like xiao. This system of dispute resolution, apart from the family centred mindset, an individual’s need for social affirmation by way of demonstrating one’s unimpeachable moral qualities is another important part of this Confucian regulatory system.

In sum, the use of li as a regulatory doctrine has been called ‘rule by virtue’. Thus, the function of li is to attain social order by way of relational bliss between people.

344 Ibid.
345 Goh, above n 177, 57.
346 Cohen, above n 179, 1216.
347 Ibid.
348 Ibid.
349 Goh, above n 177, 78-80.
350 Chen, above n 180, 263-5; Yao, above n 49, 181-3.
351 Cohen, above n 179, 1207-8.
Another facet that flows from this is the reconciliatory tone *li* takes on in resolving disputes, where compromise and restoring peaceful co-existence is the object, not coercion or threat of penalty. This means society and the community plays a critical role in the effectiveness of the regulatory doctrine, for without communal support, this system becomes nothing more than empty symbolism. And since the family is central in the governance of Chinese society, according to Ames family or familial reverence, ‘[p]rovides concrete guidelines for moral conduct by acknowledging the practical, situated, interpenetrating, and dispositional nature of all goods, values, and virtues.’ Yet, *li* as a regulatory doctrine is not without shortcomings. The hierarchical order in society gives those with royal titles and vast riches, many privileges, special treatment and leniency if they breached *li*. The temptation to abuse their powers is noted in the teachings of Confucius. As mentioned in the above, from the late Han dynasty onwards, there was a gradual codification of Confucianism obscuring the true spirit of *li*. Furthermore, by accentuating the discriminatory treatment of people without Confucian prescribes, it runs the risk of becoming a system of patronage, cronyism, and in the worst case, corruption. In spite of this, for centuries China’s enterprises were not governed or regulated by legal rules but by Confucianism.

### 6.4 A Glimpse into History about Confucian Influence on Governance and Regulation

The first company law in China was enacted in 1904 just years before the fall of the last imperial government, the Qing Dynasty. The Act was enacted in haste,

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353 Ames and Rosemont, above n 129, 24-5.
354 Chen, above 144, 34-6.
355 Bodde and Morris, above n 58, 34-5.
357 Chan and Young, above n 13, 14.
transplanted from the European civil codes. China enacted company law primarily due to pressure from Western trading partners. For centuries, the underlying reason for successive imperial governments’ reluctance to legislate on companies was because there was no need to do so; this helped explain the low number of Chinese companies registered under this legislation. Rather, Confucian system of governance and regulation was adopted by choice.

As mentioned in Chapter 6.1, besides criticizing Confucianism, Max Weber was also critical of China’s unwillingness to follow the West in economic reforms. He argued that China remains imprisoned in a cultural time warp until the era of colonialism. For Weber the West had transformed from ‘traditional domination’, to a foundation based upon laws and rational modes of reasoning, whereas in China the patriarchal grip was unbroken. Thus, conditions in China were not conducive to the emergence of capitalism like in the West. Yet historical evidence contradicted Weber’s assertions as during the Ming and Qing dynasties, China’s economy was then one of the world’s largest by size. Interestingly, this was not a product of good public administration because the imperial governments had never played a significant role in China’s commerce. The imperial policies concerning commerce were mainly confined to collecting taxes. Richardson observed that in the early years of the Qing dynasty, the rulers adopted Confucian principles of government. The rationale was, if the Confucian inspired policies worked in the past, there was no need for change. And despite the influx of Westerners into China during the Qing dynasty, the Imperial rulers deemed modern ideas from the West to be too radical,

360 Ibid.
361 Bath, above n 206, 69.
363 Ruskola, above n 359, 1679.
365 Hamilton, above n 101, 55.
366 Ibid.
369 Tipton, above n 9, 113.
371 Ibid.
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and the Chinese populous saw Westerners to be opportunist trying to acquire China’s vast resources.\footnote{Ibid, 7-8.}

Even though gradually the imperial legal codes developed some rules for commercial matters like contracts and property, they were relatively insignificant compared to other matters like crime, social order and treason.\footnote{G Jamieson, \textit{Chinese Family and Commercial Law} (Vetch and Lee, 1970) 109-130; Bodde and Morris, above n 58, 76-104, 160-72.} This is because there was no concept of civil law and remedies as noted in the above. The adjudicatory function of the magistrate in private disputes was to mediate between parties and repair relationships.\footnote{Ohnesorge, above n 239, 368.} As noted in the above, what the Chinese imperial governments did not provide, the merchant and trade associations (\textit{tongxiang} or \textit{huiguan}) did. \textit{Tongxiang} were regional associations, which literally means ‘same hometown’ also known as ‘local-system loyalties’. They were networks or guild organisations comprising of members originating from a region in China.\footnote{Ohnesorge, above n 239, 368.} Another type of clannish merchant associations were known as \textit{huiguan}, which literally means ‘native-place associations’, comprising of occupational group or trade specific to an area.\footnote{Hamilton, above n 101, 60.} In Hong Kong, Faure found documents kept by the colonial administration that showed that in the early years of colonisation there were a number of Chinese guilds active in Hong Kong.\footnote{Ibid, 61.} The Chinese guilds were organised along the lines of professions and operated as self-regulated entities. For example, the ‘Kwong Yi T’ong’ was a guild (\textit{huiguan}) for the bricklayers.\footnote{David Faure, \textit{Society: A Documentary History of Hong Kong} (Hong Kong University Press, 1997) 61.} It had its own house codes and rules to determine working conditions, wages, and membership fees.\footnote{Ibid, 61.} The guild also gave parental like authority to the chief member of the guild to reprimand and discipline members for breaches of the guild’s rules.\footnote{Ibid, 73.} There were also a number of business guilds like The Pawnbrokers’ Guild, The Chinese Bankers’ Guild, and The Chinese Insurance Guild. A colonial government report in 1912 noted that the committee members of these guilds have considerable powers over its membership.
and members’ conduct.\textsuperscript{381} Perkins also found that Chinese merchants in Shanxi during the Qing dynasty developed their own systems for sanctioning behaviour that would undermine the security of commerce.\textsuperscript{382} In addition, Chan and Young drew from Chinese sources and found voluntary rules (known as \textit{gui}) regulated a Shanghai soy sauce manufacturers’ association, established in 1894.\textsuperscript{383} They found that:

\textit{[t]he association was established to ensure profits and high ethical conduct was maintained as the swell in new producers led to increasing incidents of disputes from the heightened competition between them. Thus, there was an incentive to foster harmonious relations amongst producers by instituting a self-regulatory body. Apart from the generality, impreciseness, and principle based nature of the Shanghai Soy Business Association rules (\textit{gui}), more interestingly there was a Confucian undertone in the sub text.}

Although how the goals of the voluntary codes were actually achieved remains somewhat illusive with the combination of insignificant mundane matters, broad statements and at times ambiguous prescriptions from a non-member,\textsuperscript{385} it is an indication that Chinese business associations were capable of regulating their own affairs without any form of government intervention or laws.

Topically the voluntary codes of conduct for \textit{tongxiang} or \textit{huiguan} were drawn up by senior members (elders) to establish a kind of internal or in-house order.\textsuperscript{386} These rules had many influences ranging from Confucian doctrines, familism, to trade specific or regional customs.\textsuperscript{387} The contents of these rules also favoured the maintenance of strong networks.\textsuperscript{388} Senior members of these \textit{tongxiang} or \textit{huiguan

\begin{itemize}
\item \textsuperscript{381} Ibid, 78-85.
\item \textsuperscript{383} Alex Chan and Angus Young, ‘Devolution of Governance Regulation in the China: Reviving Traditional Confucian Doctrines for the Modern Era’ (Paper presentation at the 6th Political and International Studies Association Congress 2012: Policy and Politics in Changing Asia, Hong Kong Institute of Education, Hong Kong, 30 November – 1 December 2012) 21.
\item \textsuperscript{384} Ibid, 21-22.
\item \textsuperscript{385} Ibid, 22.
\item \textsuperscript{387} Ruskola, above n 359, 1640, 1650, 1659.
\end{itemize}
would often mediate disputes between members on an informal basis. On occasions if disputes were brought before a court, it was common practice for the magistrate to consult the voluntary codes of the tongxiang or huiguan in making his rulings. These tongxiang or huiguan were collectives similar to professional or representative bodies, with membership consisting of individuals and family owned and managed enterprises. This is also evident in the self-regulation of villages or townships in China during imperial rule. Liu noted that, ‘[t]he clan rules were able to serve as a channel of communication between the Confucian theories and the common people…’ However, the Confucian ideals were adapted and interpreted from the family and the clan standpoint. In sum, the Confucian influence was evident in how tongxiang, huiguan, and clans were regulated and this could have implications for Hong Kong’s Chinese family companies.

With respects to governance, for centuries, kinship enterprises, ancestral trusts and Chinese lineage corporations were common forms of business arrangements. They usually consisted of members of a family, extended family members or descents of several generations. Unlike Western legal doctrine where a corporation is a separate entity, these kinship enterprises were treated as a clan or ancestral commune. They operated like large family enterprises where the governance was in essence Confucian in substance. This meant that often the eldest male or a small group of eldest males occupied the highest position, but operational matters were left to a committee of senior members of the family and extended family.

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389 Brady, above n 214, 38-9.
390 Hamilton, above n 101, 64.
391 Tipton, above n 9, 111.
392 Liu, above n 325, 49.
393 Ibid, 42.
394 Ruskola, above n 359, 1645. Note that some of these ancestor trusts operated profit-oriented enterprise.
396 Ruskola, above n 359, 1672.
397 Ibid, 1640.
398 Ibid, 1649-1650.
The concept of family and kinship enterprises persisted for centuries in China, and was even transplanted by Chinese migrants into Southeast Asian countries. The seeds of modern Chinese companies (kongsi) were sown, according to Wang, around the period of the Ming Dynasty. The literal translation of kongsi is - public department or administration of public affairs. Kongsi were not creatures of legal instruments, but emerged out of informal commercial arrangements used by Chinese migrants in Southeast Asia in the 18th Century initially to operate mining business. They were self-regulated entities drawing on the spirit of cooperation and consideration of mutual welfare for migrant workers, who usually had a stake in these companies. However, these kongsi were operated more like huiguan in China. Overtime these kongsi began to change and the heads known as towkay (means ‘boss’ in Hokkien – a Chinese dialect) who took over the business operations turned them into family enterprises. Nevertheless, the cooperative spirit between towkays survived in the form of business networks. These networks built on personal relations between the heads of each business enterprise. Instead of formal contracts, these entrepreneurs would do ‘deals’ based on their word or a handshake and the operative word for this spirit based on mutual trust was known as xingyong. The notion of xingyong drew from Confucian doctrine about trust and relationships (as noted in Chapter 5.2).

To sum up, Yao wrote:

In fairly loose terms the concept of Confucian capitalism is characterized by two major motifs. First, there is the valorization of the financial success and economic performance of East Asian societies where Confucianism had been a major historical and culture heritage. Second, and on a micro-individual level, it emphasizes the continuing relevance of

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401 Ibid, 1.
402 Ibid, 3.
403 Ibid, 5.
404 Ibid, 6-7, 14-22.
405 Ibid, 10-22.
406 Ibid, 88-94; Yao, above n 399, 21-40.
407 Yao, above n 399, 101-120.
408 Ibid, 121. Also, see Chapters 4.2 and 4.3 about xingyong.
‘Confucius values’ of discipline, collectivism and social humanism in providing the key explanation for Chinese behaviour.410

In addition, he found there was evidence to suggest that Confucianism was one of the unifying forces in the Chinese family enterprises he studied.411 Linking this back to discussions in chapter 5, Hong Kong’s family companies adopting a non-legal regulatory approach like in tongxiang and clans, drawing upon Confucian doctrines might better suit these companies. The laws in Hong Kong as they stand are clearly unhelpful to preserve harmony or in averting fen jia if disputes amongst family members escalate.412

6.5 Summary and Commentaries

This chapter has endeavoured to explain the Confucian principles of governance known as san gang wu chang. Whilst it might be at times difficult to grasp or appreciate, it outlined the obligations of vertical relationships between individuals. This system of governance is underscored by different moral obligations, for example, the son is expected to be xiao, and vice versa the father would be ren to his sons. This helps explain why Ames labelled Confucian social structure as essentially role ethics,413 whereas wu chang is directed at the individual level. The five moral precepts are benchmarks for individual moral excellence. The application of san gang and wu chang in combination are said to bring about harmony because by conforming to these moral obligations and precepts, it is said to be in unison with the natural order of things.

Even though Hong Kong is not a Confucian society per se, or that the residents of Hong Kong identified themselves closely with the teachings of Confucius, the influence of his doctrine seemed to manifest most prominently in the family context and social relations. This in turn, as seen in the discussions of Chapter 5 shaped the

410 Yao, above n 399, 5.
411 Yao, above n 399, 83-8.
412 Refer to case laws in Chapter 4.4.2.
413 Ames, above n 16, 167-8.
governance of Chinese family companies. In addition, it helped to sustain an informal network of Chinese family companies where *guanxi* had encouraged the formation of this social capital aided by Chinese concepts of *mianzi* and *xingyong*. Therefore Confucianism has influenced the values that underpin the governance of Chinese family companies in Hong Kong.

Confucianism also helped shed light on why China never felt the need to enact an indigenous company law until compelled to do so from Western powers attempting to colonize China. What the imperial governments did not provide, in terms of business laws and regulations, the merchant and trade associations (*tongxiang* and *huiguan*) did. Often the voluntary codes of these bodies embodied some of the ideals and values espoused from Confucian doctrines, as demonstrated in the voluntary codes as well as the adoption of family-centred approach to resolving disputes, where senior members or elders in the clan or association would mediate and seek compromises between parties. This would certainly have implications in the disputes concerning Chinese family companies in Hong Kong because as Chapters 4.3 and 4.4 have shown the courts and laws, as they stand, are not apt to deal with such matters. If left unattended, Chapter 5.3.3 had noted that in the worst case scenario, *fen jia* might be the outcome. This reinforces the notion that left to their own devices the disputes in these companies might result in a complete breakdown in governance. Therefore, there is a need for culturally appropriate regulation. All of which shall be discussed in part three of this research.
Part Three: In Search of a Conceptual Framework
Pluralism as a Prospective Solution for Hong Kong

Part three of this thesis consists of one chapter. The object of this chapter is to conceptualise an alternative regulatory framework to regulate directors of Chinese family companies in Hong Kong under a pluralistic regime. Whilst Hong Kong’s legal system provides for pluralism under the auspices of customary laws, it is limited. A possible solution is to institutionalise the practices and norms of Chinese family companies, permitting disputes in Chinese family companies to be resolved in a culturally appropriate manner. Furthermore, by tapping into the informal networks of Chinese family companies and drawing lessons from the business associations, huiguan and tongxiang, a self-regulatory body or arrangement could be established as a forum where disputes concerning the governance of Chinese family companies in Hong Kong could be heard and resolved.
Chapter 7 : Pluralistic Corporate Governance Regime as Solution for Hong Kong

7.0 Introduction

As mentioned in Chapter 1.1.3, the estimated number of Chinese family companies in Hong Kong is approximately 570,000. Part one of this thesis expounded the Hong Kong Government’s reform agenda and motivations to adopt British laws as benchmarks for Hong Kong. This contrasts with the experiences and factors that led to the enactment of company law in Britain. At the heart of corporate governance laws are directors’ duties. Yet, the values espoused in those duties treat directors as agent-likedand trustee-liked, thus are fiduciaries in nature, furthermore control and ownership are assumed to be separate. Part two of this research indicated that family companies are a vital part of the territory’s corporate ownership structure, and in these companies control and ownership are common. In addition, Chinese cultural values are central to the characteristics of these companies. However, a sample of common law countries’ legislations on family companies revealed that the directors’ duties remained fiduciary in nature. A number of litigations concerning disputes in the governance of Chinese family companies in Hong Kong chose unfair prejudice and winding up on equitable grounds as the course of action. Yet those actions failed because the facts revealed that the disputes were about family disagreements. Even though colonial administrators in Hong Kong recognised the need for separate legislation for Chinese enterprises, it failed miserably. Case law involving traditional Chinese ancestral and commercial trusts also revealed that judges had difficulties in applying English legal principles onto Chinese customary practices and norms.

As noted in Chapter 6.4 China never had a company until 1904 due to pressures from the Western powers. It was argued that the new company laws enabled Western and foreign companies to be incorporated in China during the imperial rule, but there

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1 Note that the British company law was arguably a product of the Bubble Act and to a certain extent, shaped by Christian socialist values and partnership laws, see Rob McQueen, A Social History of Company Law: Great Britain and the Australian Colonies 1854-1920 (Ashgate, 2009) 17-274. Also see discussions about the moral dimensions of fiduciary duties in Chapter 3.1.4.

2 Albeit the fact that there is also little judicial intervention in Western family companies the values underscoring Western family companies is still different from the Chinese. See Chapters 3.4, 5.3.1 and table 1 for more discussions.
were no evidence that the local Chinese family businesses had signed up or even took notice of the new laws. In Hong Kong when the British administrators colonized the territory over a century ago, they imposed the English laws onto the local Chinese, as Donald described, ‘[i]n an often discriminatory and exaggeratedly harsh manner.’ He went on the note that whilst English laws applied to all in the colony regardless of European or Chinese decent, the Chinese leaders and merchants took upon themselves, to a certain extent, to govern their affairs and arbitrated disputes, especially commercial and family matters through various Chinese associations because they saw the English laws alien to their norms and values. This cultural divide was not reconciled in Hong Kong. Therefore it is impossible, given the disparities to even contemplate reconciling English legal principles (such as fiduciary ideas) with Confucian ideals embedded in Chinese customary practices and norms for centuries. As such it is unlikely for directors of Chinese family companies influenced by Confucian morals would embrace Western legal obligations and accept the values espoused in those duties. Besides the continued adoption of Western legal principles onto matters where Chinese values distinctly prevail could be construe as a form of ideological repression of the Chinese way of thinking and life.

Literature from business studies and sociology also revealed that Hong Kong’s Chinese family companies bore unique characteristics. They are culturally driven where paternalism and relation-centred factors like mianzi, guanxi, xingyong featured prominently in the way business was, and still is, conducted and much of these practices stem from Confucian doctrines. An analysis of the Confucian notion of

4 David Donald, ‘History’s Marks on Hong Kong Law: From British Colony, to Chinese SAR’ (Working Paper No. 5, Centre for Financial Regulation and Economic Development, Chinese University of Hong Kong, October 2011) 9. For more on the legal history and regulatory instruments the British administrators governed the territory and Chinese customary practices and law see Chapter 7.2.1.
5 Ibid, 20-3. Also see Chapter 6.4 for more about the history of Chinese associations and guilds in China.
6 See Chapter 4.4 on details about the British recognition of this culture divide with the enactment of the (now repealed) Chinese Partnership Ordinance (Hong Kong) cap 53 and see Chapters 3, 4 and 5 about the cultural differences between the transplanted British laws in Hong Kong and the practices of Chinese family companies.
governance has shown that it is role dependent with the emphasis being placed upon
the family as the model. In essence, Confucianism is about moral values moderating
individual behaviour, where the constitution of society is defined by various
relational obligations with the aim of fostering harmonious relationships; all of
which help explain the governance practices of Chinese family companies in Hong
Kong.

The central idea of this chapter is built on parts one and two of this research to
conceptualise an alternative regulatory framework to regulate directors of Chinese
family companies in Hong Kong under a pluralistic regime. This would involve an
analysis of the debates of the corporate governance regime, followed by an
examination of legal pluralism under Hong Kong’s current legal system. This is to
ascertain the challenges of instituting a pluralistic corporate governance regulatory
framework. Combining this with the values and practices of Chinese family
companies from part two of the thesis, the final section will put forward some
suggestions about establishing a culturally appropriate framework to regulate
directors of Chinese family companies in Hong Kong. To begin with, there needs to
be a reconsideration of the conventional thinking of the models of corporate
governance and its regulatory framework.

7.1 Rethinking the Debates about Convergence versus Path Dependence Models
of Corporate Governance Regime

This section looks into the key debates about models of corporate governance and its
regulatory framework, and asks the question – whether there is scope to move
beyond two polarised views into the prospect of a pluralistic regime.

7.1.1 Convergence Theory of Corporate Governance Regulation
From an economic perspective, legal barriers between two or more countries can deter markets from integrating, and thus hinder the globalisation of markets. Hence, legal convergence can aid the process of integrating markets. It is from these premises that a number of legal academics have argued that corporate governance regimes will converge. Those academics have used anecdotal evidence to make their case for the affirmative. Furthermore, they have argued that corporate governance regimes across the global are converging towards a shareholder primacy model because it promotes and safeguards shareholders’ interests. Hansmann and Kraakman made some bold assertions that this model had emerged from a normative consensus and is the standard of choice. They listed three reasons for this phenomenon:

1. By the force of logic as investors’ interests cannot be protected by contracts alone, and if the control rights of equity holders are strong, it is a powerful incentive to maximize the value of the company they invest in.

2. By the force of example, comparing the US economy with those in Germany, France and Japan, they argue that the United States shareholder model promotes better economic outcomes.

3. In the face of mounting competition in the international financial markets, investors, like institutional investors, have tended to favour the shareholder primacy model.

Therefore, they have maintained that, ‘The emerging consensus in favour of the standard model [shareholder primacy model] has, in recent years, been driven with increasing intensity by each of these [the above three] forces.’ They have even

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10 Pinto, above n 9, 11-8, 28-33; Hansmann and Kraakman, above n 9, 439.
12 Ibid, 46.
14 Ibid, 48.
15 Ibid, 45.
claimed that the superiority of the shareholders-oriented model of the corporate governance ‘is now assured’.\(^\text{16}\)

Apart from the three forces driving corporate governance towards a universal standard, they have also asserted that the failure of alternative models is another reason why financial markets across the world are converging towards the shareholder primacy model.\(^\text{17}\) They have cited the corporate collapses in the United States in the 1970s and 1980s have, ‘largely destroyed the normative appeal of the managerial model.’\(^\text{18}\) Using Germany as an example, they argued that the labour oriented model (where corporate governance is co-determined by shareholders and employees) produced inefficient decisions as the interests of employees may differ from those of shareholders.\(^\text{19}\) As for the state oriented model, they used Thatcherism in United Kingdom and Mitterand’s leadership in France as examples of the decline of state socialism to point out that this model is no longer attractive.\(^\text{20}\) Lastly, the stakeholder model was also rejected by Hansmann and Kraakman because they claimed that this was a variant of the labour and the state oriented model, and thus shared the same weaknesses.\(^\text{21}\)

Another proponent of the convergence thesis is Coffee. He argued that convergence is occurring at stock exchanges and in the listing rules around the world, more so than in corporate law because stock exchanges are interested in efficiency and securing international capital.\(^\text{22}\) In addition, he blames local political resistance in many countries across the global to have complicated the process of convergence.\(^\text{23}\) Gordon also found that the directives of the European Commission have been

\(^{16}\) Hansmann and Kraakman, above n 10, 468.

\(^{17}\) Hansmann and Kraakman, above n 11, 36.

\(^{18}\) Hansmann and Kraakman, above n 9, 444.

\(^{19}\) Hansmann and Kraakman, above n 9, 445-6.

\(^{20}\) Hansmann and Kraakman, above n 3, 447.

\(^{21}\) Hansmann and Kraakman, above n 3, 448.


\(^{23}\) Ibid.
gradually converging towards the US model. Dignam and Galanis concurred with this thesis by citing Germany’s securities law reforms as validation of the phenomena. Gilson, in comparison, was more subdued arguing that convergence is occurring at a functional level rather than at the formal level, citing the example of Germany’s institutional inflexibility and political restrictions as reasons for the status quo. He substantiated this with empirical evidence to establish his thesis that functional convergence occurs as a response to competitive pressure. Furthermore, this approach is flexible enough to respond to the demands of changing circumstances without the need for formal changes in law. Gilligan was equally circumspect with the empirical evidence from interviews in Australia which found that Australia did not follow the lead of the US, instead the UK had more influence. He concluded that, ‘Different jurisdictions have different perceptions about what are their respective legitimate interests and appropriate regulatory strategies.’

Theoretically, the shareholder primacy model draws its origins from the agency theory of corporate governance. Other labels of this model include ‘market-centred’ or ‘outsider system’, fermented on the assumption that the overarching role of directors is to promote the interests of shareholders. Agency theory’s key assumption is that ownership and control of a corporation are separate, and thus shareholders (the principal), delegates the responsibility of managing the company to

29 Ibid, 356.
the directors and managers (the agents). This theory postulates that the shareholders need to monitor the directors and managers because there are no incentives for these individuals to maximise the interests of shareholders. This rationalisation of the relationship between the board of directors and shareholders as a whole offers a simple and clear mode of control with emphasis on accountability of directors and managers, building on the assumption that there is a separation between ownership and control. Yet this elegant and simplistic proposition has not materialised in places like Europe. In spite of the European Union’s efforts to harmonise corporate governance standards, the resistance towards change is apparent.

Critics of the agency model of governance and the convergence thesis point to the fact that the lynchpin of the convergence thesis rests on economic propositions of shareholder centred capitalism and the globalisation of financial markets. Branson is one of the critics of the convergence thesis. He made the following comments about Hansmann and Kraakman’s article on the convergence model:

In “End of History for Corporate Law,” the only work cited on labor participation in governance is by one of the co-authors himself. In another recent piece of global convergence scholarship by two elites, in 58 footnotes the co-authors cite their own works 33 times. In two or three instances, they cite publications by other scholars but in works one or the other co-author has edited.

In addition, he found that advocates for convergence ignore other economies in the Pacific Rim or South and Central Americas that do not mimic the United States shareholder’s centred capitalistic system. Besides, Branson believed that

34 See Adolph Berle and Gardiner Means, The Modern Corporation and Private Property (Harcourt, Brace & World, 1932). This is a widely cited book about post WWII ownership structure of publicly listed companies in the United States, where there is a separation between ownership and control because data demonstrated that the shareholdings were dispersed. Also note that the governance of US and UK publicly listed companies is known as ‘outsider system’ due to the dispersed shareholding companies and the reliance on markets to regulated boards.
36 Hansmann and Kraakman, above n 9, 451-3.
38 Ibid, 335.
globalisation is an exaggerated preposition as he found evidence of diversity in national economic structures around the world. Kwek is another critic of the convergence thesis. He noted that the claims in this proposition were overstated. He added that the dominance of America’s economy is questionable, and thus adopting its corporate governance system is open to some doubt. He stated that this model of governance has created a culture of speculative gains, as well it suffers from the danger of underinvestment in long-term intangible assets. Whilst Hansmann and Kraakman tried to explain the problems of convergence by stating in a recent article that, ‘The more difficult part is to work out the details in implementing the SSM [standard shareholder-oriented model] and continually re-adapting it to an ever-changing environment’. Iskander and Chamlou contested the notion that there is a ‘one size fit all’ approach to corporate governance in the aftermath of the Asian economic crisis in 1997. They argued that each corporate governance system must reflect the rich composite of social, cultural, and historical influences. However, the forces of globalisation seemed to be pushing for a consensus. And there is presumption of a, ‘high degree of technological determinism. In the world they posit all firms face the same optimizing problems and seize on the same solutions’. Therefore, the robustness of the convergence thesis is increasingly weakened by its critics.

7.1.2 Path Dependency Theory of Corporate Governance Regulation

39 Ibid, 321.
41 Ibid.
42 Ibid, 315.
45 Ibid.
Path dependency theory is the complete opposite to convergence theory. The central thesis of this model is that corporate structures are different in advanced economies because of historical, cultural, and political factors, which is why convergence in governance will not transpire despite pressures from global market forces. One of the two premises of the path dependency model is ‘structure-driven path dependence’. According to Bebchuk and Roe this is due to two reasons:

First, the original structures affect which structure will be efficient for any given company: sunk adaptive costs, complementarities, network externalities, endowment effects, and multiple optima might all make the identity of the efficient ownership structure depend on earlier structures. Second, initial structures might persist because players that enjoy rents under them might have both incentive and power to impede changes in these structures. These two sources of structure-driven path dependence can help explain some key differences in ownership structures among the advanced economies that have persisted thus far.

The other premise refers to ‘rule-driven path dependence’, where interest group politics affect the choice of legal rules. As well, diversity in corporate ownership structures explains why substantial differences in corporate law systems have persisted.

Bebchuk and Roe also argued that legal rules are a product of culture, ideology, and politics. Morck and Steier also shared this view; they added that the business and political elites prefer status quo, so differences in corporate governance between countries would persist. Roe added that the political differences can make convergence difficult. Milhaupt adopted this line of argument to substantiate his

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49 Ibid, 153.
50 Ibid, 166.
arguments about property rights. By property rights, he meant that the rules in which assets are allocated and enforced. Political elements, he claims, emerge, ‘initial allocations and subsequent changes in control rights are worked out largely through political process, corporate governance cannot be separated from political governance.’ Thus, the politics embedded in the initial allocation of property rights in turn obstruct the feasibility of convergence.

Licht took the cultural factor further by stating that:

A nation's culture can be perceived as the mother of all path dependencies. Figuratively, it means that a nation's culture might be more persistent than other factors believed to induce path dependence. Substantively, a nation's unique set of cultural values might indeed affect — in a chain of causality — the development of that nation's laws in general and its corporate governance system in particular.

In the conclusion of this article, he inferred his preference for a pluralistic corporate governance regime in the following remarks, ‘One may thus imagine a pyramid of social norms in which cultural values constitute the foundations. Corporate governance systems build on these foundations to develop both formal and non-formal rules as well as structures.’ In another article about South Korean corporate governance, Licht found that the current transplanted formal corporate governance regime in South Korea did not fit well in a nation deeply entrenched in Confucian heritage. However, he stated in this article that, ‘Designing a culturally-compatible governance model that would leverage this social capital and put it to modern productive use exceeds the scope of this article and is left to future research.’ In another later article, co-authored by Licht, where a meta-analysis of data from a number of publications on cross-cultural corporate governance was undertaken, they

55 Ibid, 251.
56 Ibid, 251.
58 Ibid, 205.
60 Ibid, 234.
found that, ‘perceived legality in the East Asian cultural region is significantly lower than in English-speaking and West European countries. This finding is prima facie evidence that the law on the books may play only a minor role in determining shareholder protection in practice in East Asian countries.’

In a later article Licht et al added that:

>cultural value emphasis may preserve and perpetuate the imprint of ancient intellectual legacies and historical initial conditions. Cultural differences along the autonomy/embeddedness dimension, at least when North American and Confucian-influenced cultures are compared, are further accompanied by markedly different epistemologies and cognitive styles.

Whilst this article’s contention that there are clear differences between Western and Confucian values and in their impact on corporate governance regimes was confirmed by empirical research, they fell short of offering any regulatory solutions.

Others like Haxhi and Aguilera highlighted the importance of culture by noting that:

>tension between existing national business cultures and practices, and the adoption of new regulatory modes that originate from other business cultures and practices, and the adoption of new regulatory modes that originate from other business contexts, may strengthen the resistance to the convergence of corporate governance best practices.

In the conclusion of this article, the authors added that, ‘a diverging convergence is likely as corporate governance practices continually evolve.’ Even if there is political will to converge, several other authors have reiterated the issue of culture as a major impediment because the transplanted rules, codes, and best practices might be incompatible with existing values and norms that remain entrenched in the minds of local business communities. Then again, Yuka argued that, ‘Perhaps,

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63 Ibid.
65 Ibid, 244.
66 Guler Aras and David Crowther, ‘Exploring Frameworks of Corporate Governance’ in Guler Aras and David Crowther (eds), Culture and Corporate Governance (Social Responsibility Research Network, 2008) 3; Lilian Miles, ‘The Cultural Aspects of Corporate Governance Reform in South
‘Transplantation’ or ‘Convergence’ of the formal law means nothing without any local initiatives to apply them as a living law within the commercial practice.” 67 This implied that there is a possibility for selective or strategic convergence, as long as the local values and norms regulating practices could co-exist in some form or manner.

7.1.3 Prospects of a Pluralistic Corporate Governance Regime

Overall, both convergence and path dependency models put forward arguments in favour of their propositions based on different assumptions. More importantly, those works underestimated the importance of how laws, values, and norms interact with each other. Clearly, both theses sit on opposite ends of the spectrum. Yet, neither proposition is overwhelmingly convincing. In a globalised market place competition for capital is intense, thus some level of convergence is to be expected, especially to facilitate the free flow of capital across borders. This is not a question of whether convergence is good or bad, rather that it is necessary for some companies to raise capital and gain confidence from international investors. This runs counter to the arguments put forward in the path-dependency thesis, where politics, culture, and history made convergence unfeasible. This does not however mean that the path-dependency thesis is invalid, because local or jurisdiction-specific values and norms cannot eclipse the onslaught of globalisation.

Therefore, it is likely that theses of convergence and path dependency models could co-exist in some form, manner, or degree. Take Germany as another example, on the one hand, the German takeover regulations were amended by the European Union’s Thirteenth Company Law, which was modelled upon the United Kingdom’s Takeover Panels’ Principles. On the other hand, the co-determination structure, with the inclusion of employees at the supervisory board that results in a two-tier board,

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remained steadfast. This board structure differed to those in the US and Britain where there are unitary boards. What the German example has demonstrated is that two models can co-exist within one jurisdiction. Another example is cross listing - if a company from a Latin America country listed on NASDAQ, it does not necessarily mean that these Latin American companies listed on the United States stock exchange have adopted the governance measures in Latin America. Thus, pluralistic corporate governance regimes exist within a single jurisdiction. Young added that, ‘Eventually a pluralistic governance framework should accommodate culturally specific norms to deliver a more effective framework without compromising on the objectives of good governance.’ This suggests that two models of a corporate governance regime are not mutually exclusive. The possibility of having two pluralistic governance frameworks in a jurisdiction is not far -fetched or impossible. This would also vary according to the circumstances and needs of each jurisdiction.

In a rejoinder to the debate about Hong Kong’s corporate governance regime in Chapter 2, the territory’s corporate governance regulatory framework is unmistakably a product of the British legacy and the need to maintain Hong Kong as an international financial centre. However, Chapters 4 and 5 point out that this might suit Chinese family companies. Therefore, it is not fanciful to argue that a ‘one size fits all’ regulatory solution is not ideal for Hong Kong. Chapters 1.1.4 and 2.4 mentioned that what is missing in the debate is a corporate governance regulatory framework for Chinese family companies in Hong Kong. Chapter 5.3 argued that directors of Chinese family companies in Hong Kong do not see themselves as fiduciaries, rather their behaviour is shaped by Chinese values and norms. Furthermore, Chapter 5.3 contended that governance in Chinese family companies in Hong Kong is a family centred system which is paternalistic and where the end goal

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is to achieve harmonious relationships. In sum, Chapters 2 and 3 have shown that Hong Kong’s formal governance system is essentially British on the one hand, and on the other hand, Chapter 4 has indicated that this model of governance is ill suited for Chinese family companies. In addition Chapter 5 has revealed that there is another informal system that exists in Chinese family companies where Chinese values and norms prevail. The discussion in Chapter 6 about Confucianism offered some clues as to the rationale of paternalistic governance and harmonious relationships. Therefore, there are two distinctive models of corporate governance in Hong Kong. Therefore, in Hong Kong two governance models co-exist, one formally and the other informally. The next issue is - how should one go about instituting the informal practices into Hong Kong’s regulatory landscape? The search for this answer begins with a review of the territory’s legal system.

7.2 Legal Pluralism and Hong Kong’s Legal System

This section will examine the problems associated with the transplantation of British laws to the territory during the colonial administration and why the legal culture should not be neglected. This section will also explore the recognition of Chinese values and customs under customary law in Hong Kong and whether such a pluralistic legal arrangement allows Chinese tradition and practices to flourish.

7.2.1 Transplantation of British Laws and Their Shortcomings for Hong Kong

One does not need to look too hard to notice the fact that pluralism is entrenched in Hong Kong’s legal system. This legal reality is a product of its colonial legacy. The cession of Hong Kong came about with the Treaty of Nanking in 1842.\(^\text{71}\) This was due to the defeat of the Chinese against the British navy in 1839.\(^\text{72}\) China had to cede the islands known as Hong Kong to the British as a condition for peace. This was followed by the cession of Kowloon in 1860, incorporated in Article VI of the

\(^{71}\) Note the British started occupying the island of Hong Kong in 1841, pursuant to the non-ratified Treaty of Chuenpi. See Peter Wesley-Smith, *The Sources of Hong Kong Law* (Oxford University Press, 1994) 87.

\(^{72}\) John Carroll, *A Concise History of Hong Kong* (Hong Kong University Press, 2007) 16. The war between the Chinese and British broke out in 1839. The British military victory of first opium war gave them the upper hand in forcing China to cede the island of Hong Kong to British control.
However, the failure of the Treaty of Nanking to deliver what the British wanted, namely greater access to Canton in China and greater trade concessions, resulted in a second Anglo-Chinese War. This led to further territorial expansion into the new territories (north of Kowloon), so a second Convention of Peking was signed in 1898. Unlike Hong Kong and Kowloon, the annexation of the New Territories was a 99-year lease.

Prior to the signing of the Treaty of Nanking and The Convention of Peking, Captain Charles Elliot, on behalf of the British Empire proclaimed one of the earliest governance documents about Hong Kong in 1841. The proclamation stated that there were two legal authorities (British and Chinese) in Hong Kong. However, the Supreme Court Ordinance (Hong Kong) cap 4 enacted in 1873 stipulated that English laws would apply to the new colony. The reception of English laws to Hong Kong was an expression of its sovereignty over the new colony. Unless stated otherwise all the islands’ inhabitants were subjected to English law. Historians found that in the early years of the colonial rule, the local Chinese population were victimised by the British administrators in Hong Kong. They were not only heavily policed and regulated, but also Carroll noted that, ‘unfamiliar with British law, the Chinese were less able to appeal unfavourable verdicts.’ Clearly, the transplanted English laws were alien to the native Chinese inhabitants because prior to the colonisation, the islands were under the Qing dynasty rule, where Qing Codes and Chinese customs rooted in Confucian traditions governed the island community.

73 Peter Wesley-Smith, Constitutional and Administrative Law in Hong Kong: Text and Materials, Volume One (China and Hong Kong Law Studies, 1987) 38-9.
74 Steve Tsang, A Modern History of Hong Kong (Hong Kong University Press, 2004) 29-35.
75 Ibid, 36-38.
76 Wesley-Smith, above n 73, 41. For detailed discussions the various treaties between Britain and China see Peter Wesley-Smith, Unequal Treaty 1898-1997: China, Great Britain and Hong Kong’s New Territories (Oxford University Press, 1980).
77 He was the Chief Superintendent of Trade and Plenipotentiary.
78 Peter Wesley-Smith, The Sources of Hong Kong Law (Oxford University Press, 1994) 87-8. To the native Chinese, China’s laws and customs would be applied, for the British subjects and foreigner, British law would be applied.
79 Ibid, 90.
81 John Carroll, A Concise History of Hong Kong (Hong Kong University Press, 2007) 47-49; Steve Tsang, A Modern History of Hong Kong (Hong Kong University Press, 2004) 49.
82 Ibid, 48.
83 De Cruz, above n 80, 128.
The differences between the values and ideals espoused in English laws and Western legal traditions, with those found in the Qing Codes, and Chinese customary laws were clear. Yet, as a British colony, the choice of laws governing the islands was not open to discussion by the local Chinese natives. Thus for the last hundred years imposition of the universality of British laws in Hong Kong has eclipsed the possibility of an alternative non-Western regulatory order. Besides, law reformers in Hong Kong have never questioned whether the values of Western societies are incompatible with local Chinese cultural values. Yet this does not mean the matter has been resolved. The incongruity between legal doctrines, traditions, culture, and values persisted. De Cruz noted that, ‘the continued reception of contemporaneous judicial decisions meant that there was a possibility of Hong Kong being left with a set of ossified legal decisions.’ Even though this has not caused social upheavals or injustices in contemporary Hong Kong, it does not mean that Hong Kong residents have accepted the English legal system as their own, as many still elect not to use the laws and courts to resolve their personal and commercial disputes. Therefore, the territory’s colonial heritage is a source of Hong Kong’s legal peculiarity.

Transplantation of laws refers to the moving of a set of laws or a legal system from one country to another. Legal transplantation has been a rich source of legal development. The borrowing of ideas between different jurisdictions, and transplanting of laws has been increasingly common around the world because of closer economic co-operation and gradual integration under the auspices of globalisation. It is also not unusual for countries to borrow laws from other

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84 For more on sources of Western legal traditions see David Goldman, *Globalisation and the Western Legal Tradition: Recurring Patterns of Law and Authority* (Cambridge University Press, 2008) 6-7.
85 De Cruz, above n 80, 127.
86 For more on traditional Chinese meditation to resolve disputes, see Goh Bee Chen, *Law without Lawyers, Justice without Courts* (Ashgate, 2002).
89 De Cruz, above n 80, 22. Watson came up the term ‘legal transplantation’ in his research on the history of the adoption of Roman laws in European countries. He argues that legal transplantation is common throughout European and has been relatively successful. However, he qualify his statements by noting when people move into different territory where there is a comparable civilisation or accepts a large part of the system of another people or peoples, transplantation of laws will be successful. See
jurisdictions when new circumstances prompt legislators to act. As well, the globalisation of financial markets has prompted legislators to draw upon the experiences of other countries when reforming their own financial markets with the aim of enhancing their competitiveness.

Watson came up with the term ‘legal transplantation’ in his research on the history of the adoption of Roman laws amongst European countries. He argued that legal transplantation is common throughout Europe and has been relatively successful. However, he qualifies his statements by noting that the transplantation of laws will be successful where there is a comparable civilisation or wide acceptance by the recipients of the new laws. This suggests that unless these conditions exist, legal transplantation would not be ideal. Others like Friedman believed that borrowing laws from other jurisdictions as a method of finding solutions to similar problems is accelerated by globalisation. This is also increasingly common around the world because of closer economic co-operation and gradual economic integration under the auspices of globalisation.

However, Berkowitz, Pistor, and Richard found that out of 39 jurisdictions surveyed, those who are receptive to the transplantation of laws are familiar with the imported laws and legal concepts. Whereas the reason for jurisdictions that were unreceptive to the imported laws, was that the transplanted laws were incompatible with existing legal traditions and regime, as well as that the new laws failed to adapt to local conditions. Unsurprisingly, Hong Kong was listed as one of the 28 jurisdictions that were unreceptive to the transplanted English laws in this research. Despite a

94 De Cruz, above n, 80, 22.
96 Ibid.
97 Ibid, 194.
century of British rule, this empirical research is another indication that the transplanted British laws have not been widely accepted in Hong Kong.

Teubner argued that those who believe that laws are readily transferable from one jurisdiction to another in a mechanistic sense neglect the social and institutional aspects of ‘law in action’. Other critics point out that Watson’s notion of legal transplant is very narrow and limited, because its focus was on the transfer of a legal rule from one jurisdiction to another, and nothing about the role of culture of the ‘sending’ or ‘receiving’ society when assessing the fate of any such transfers. The critics pointed to the fact that laws do not exist in a social or cultural vacuum. The law is more than a set of rules, it is an expression or aspect of culture in the sense of shared traditions, values or beliefs, so legal transplant will be successful if both jurisdictions share similar cultures. One of the most ardent critics of legal transplantation is Legrand. He argued that laws could not be void of historical, epistemological, or cultural baggage. He added that:

The “legal transplants” argument is precariously based on analogy, specifically, on mechanical analogy. In the way this reasoning promotes an exacerbated form of positivism, it fails to grasp and express the multi-layered nature of the interaction between the constitutions of a social totality. The refusal or inability to see that law acts as a site of ideological refraction of deeply rooted embedded cultural dispositions does not, however, make reality dissolve…

Whilst these claims maybe dispelled by those who point to globalisation as proof that transplantation of laws could work, the possibility of incongruity between the prescribed legal obligations of the exporting jurisdiction and cultural values of the

100 Cotterrell, above n 88, 71, 79.
101 Ibid.
103 Ibid, 59, 66.
importing countries has clear ramifications for the effectiveness of the law, and the willingness of the recipients to comply with those transplanted obligations.\(^\text{105}\)

### 7.2.2 The Importance of Culture and Legal Culture

Thus far the discussion has noted that culture is central in the effectiveness of the transplanted laws in a recipient jurisdiction. The analysis of culture consists of learnt patterns of behaviour, shared core beliefs, an aspect of actions below conscious levels, and patterns of thought and perception.\(^\text{106}\) Hofstede argued that culture is a form of mental programming and a collective phenomenon because it is a shared and learnt value system.\(^\text{107}\) Furthermore, he asserts that culture sits in between human nature and personality; it is the product of both inherited and learned values.\(^\text{108}\) Furthermore, Freiberg noted that, ‘[culture] can be understood as ‘learned knowledge, belief, art, morals, law and custom’ in society’. It is a powerful force that may determine the development and operation of a regulatory system.\(^\text{109}\) Critics like Chang argued that cultures are defined very loosely and often resort to typecasting people into a hasty categorisation.\(^\text{110}\) As noted in Chapter 5.0 cultural matters, it is deeply ingrained in institutions, embedded in practices, manifests itself in traditions, and through adaptation and socialisation is sown in the values of individuals.\(^\text{111}\) The issue here is how culture affects laws, and society’s attitudes towards laws.

The term ‘legal culture’ according to Friedman consisted of attitudes, values, and opinions held in a particular society, essential ingredients in turning a static collection of norms into a body of laws.\(^\text{112}\) Cotterrell articulated that legal culture is


\(^{107}\) Geert Hofstede, *Cultural and Organizations: Software of the Mind, Intercultural Cooperation and Its Importance for Survival* (Profile Books, 1991) 4-5. Also, see discussions in Chapter 4.3.

\(^{108}\) Ibid, 5-6.


made up of, ‘ideas, attitudes, expectations and opinions about law, held by people in some given society.’  Critics like Glenn pointed out those definitions are flabby, vague and too broad. Watson too is critical about legal culture instead he preferred studying legal history to analyse the relationship between law and society. Further, defining the term legal culture is made more difficult by the fluidity between society, culture, law, and the existence of sub-cultures.

Van Hoecke and Warrington compared and distinguished different legal cultures by categorising them into legal families. This approach enabled them to locate various legal orders within the broader context of the societal culture to which they belong. Through this categorisation the divide between the West and Chinese is clear as each legal family was largely influenced by historical events. In the West Judaeo-Christian beliefs and Romano-Germanic legal rationalism have affected Western social norms and attitudes towards the law and evolution of the law. By comparison, Chinese legal traditions are shaped by its history, political economy, and Confucian ideological imperatives. Regulations and rules often embody normative notions of standards and norms and build upon a consistent moral and cultural foundation, which validates and gives moral meaning and social authority to form a system of controls. Hence, regardless of the controversies, incompleteness, or ambiguities associated with the term legal culture, what the above has highlighted is the fact that cultural concerns are important to assess the effectiveness of the law in regulating a specific or target group of people. For Hong Kong, whether one adopts

113 Cotterrell, above n 88, 83.
120 For more on Confucian influence on Chinese jurisprudence and legal tradition see Chapter 6.3
the approach from legal families or tradition, the startling contrasts between its indigenous Qing legal codes, customary practices, and traditions versus the transplanted English laws cannot be clearer. The label of legal cultures here highlights the deeply entrenched differences between its indigenous Chinese legal and social orders and the laws imposed by the British when they colonised Hong Kong.122

Furthermore, Western legal culture is underpinned by dogmas like individualism and rationalism.123 The Asian legal culture in contrast is collective, and for the Chinese and Japanese in particular, the influence of moral and social order espoused by Confucianism meant that legal rules may be a second order of importance compared to moral and social obligations.124 Countries that are profoundly influenced by Confucianism like South Korea, is testament to the fact that adjusting to the transplanted Western laws remains ideologically challenging. Choi made the following observations:

No doubt, an understanding of the gap between the law and the reality in Korea will not be complete without an appreciation of its dimension of the conflict between Western and Oriental cultures … one difficult problem arising from the conflict, however, is that in Korea there are two sets of social standards for action neither of which is triumphant over the other or diminishing its social relevancy...125

Even though, Hong Kong has a different legal system from South Korea the tensions between the transplanted British laws and the local Chinese value systems have persisted.

122 Note that from a postcolonial perspective, the transplantation of British laws onto their colonies is, ‘[a]n observable process by which law organizes, rationalizes and assimilates that which is, or those who are, initially outside its imperial jurisdiction. It exposes the manner in which the law weaves these historically hitherto unconnected peculiarities into its own theoretically all-encompassing textual order. It exposes a process of subjection and uncovers an interlacing range of mechanisms employed in justifying its universality and grip.’ See Piyel Haldar, Law, Orientalism and Postcolonialism: The Jurisdiction of the Lotus Eaters (Routledge-Canvendish, 2007) 2.
For example, the socio-cultural barrier found in the attempt to provide bilingual law facilities for Hong Kong residents is quite apparent. Unless one reads the law in English, many legal terms are lost in translation.\textsuperscript{126} The biggest challenge for legal translators is the retention of common law meanings in Chinese because common law concepts are culturally laden with no equivalents in the Chinese language and culture.\textsuperscript{127} Whilst the use of explanatory notes and further explanations about the British laws in Hong Kong is a way to bridge the ideological and cultural gaps, certain quirkiness remains, making it difficult for non-English speakers to understand the law in its entirety.\textsuperscript{128} Even if this matter could be resolved through English language training, there is more to it than just the language issue, it is cultural. Jones commented that even though the Diceyan notion of the rule of law had been a feature of Hong Kong’s legal system for a century, what appeals to the local residents, especially values drawn from their Chinese heritage should not be disregarded.\textsuperscript{129} She added that if the people of Hong Kong cannot discard their Chinese value systems, then to what extent the values entrenched in the English rule of law will endure beyond 1997 is an open question.\textsuperscript{130}

At first glance, the residents of Hong Kong lead cosmopolitan lifestyles comparable to any developed Western countries.\textsuperscript{131} Modernisation and rapid economic development since 1960s also saw the growth of the new-middle class who are professionals and highly educated with many receiving their university education in Western countries.\textsuperscript{132} As noted in Chapters 4 and 5, many local Chinese held on to


\textsuperscript{127} Ibid, 236. Note the same could be argued (but to a less extent in comparison to common law) for China’s laws because the Chinese language can be ambiguous and vague, thus making the law imprecise. See Deborah Cao, Chinese Law: A Language Perspective (Ashgate, 2004) 94-121.

\textsuperscript{128} Sin and Roebuck, above n 126, 250-1.

\textsuperscript{129} Carol Jones, ‘Politics Postponed: Law as a Substitute for Politics in Hong Kong and China’ in Kanishka Jayasuriya (ed), Law, Capitalism, and Power in Asia (Routledge, 1999) 45, 66.

\textsuperscript{130} Ibid.

\textsuperscript{131} Gary McDonogh and Cindy Wong, Global Hong Kong (Routledge, 2005) xi, 8.

\textsuperscript{132} Wong Siu-lun, ‘Social Transformation and Cultural Identities’ in Yue-man Yeung (ed), The First Decade: The Hong Kong SAR in Retrospective and Introspective Perspectives (Chinese University of Hong Kong Press, 2007) 235, 242-5; Graham Johnson, ‘Hong Kong from Colony to Territory: Social Implications of Globalization’ in Benjamin Leung and Teresa Wong (eds), Twenty-five Years of Social and Economic Development in Hong Kong (Chinese University of Hong Kong Press, 1994) 660, 674-5.
their traditional values, in particular their views about family. This incongruity between a Western outlook and Chinese traditional values also affects Hong Kong’s legal and business culture. As noted in Chapters 2 and 3, the transplanted British laws in Hong Kong are permanent features of the territory’s laws. Interestingly, the two different legal and normative orders do not seem to conflict rather they operate as if they were in parallel universe. This also suggests that convergence between the two regulatory orders is not likely to occur. As to why they did not conflict with each other, Miles and Goo offered some clues by arguing that,

Hard law regulates directorial conduct by stipulating the penalties for breach of duties by directors. It does not necessarily improve the inner qualities of directors. Business and management in the west in recent years have urged directors to adopt a more inclusive approach to company management and to demonstrate moral values and principles. Confucianism already promotes this, in its advocacy for an upright, integral, and moral way of living. It thus offers a holistic approach to corporate governance, a way of management that appears to have been neglected in recent times.

From a pool of 327 respondents in China and Hong Kong, Chan et al. found that 75 per cent of the respondents did not identify with directors’ duties. This is why having a separate set of regulatory framework for directors of Chinese family companies in Hong Kong might be a feasible solution to fill the gaps in corporate governance regulations.

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135 Such duality in regulatory order and the difficulty of convergence between the two in Hong Kong would logically raise concerns about possible conflicts, yet interestingly whilst this problem manifest in the background it does not seemed to create much legal or constitutional crises and political upheavals, see Peter Wesley-Smith, ‘The Content of the Common Law in Hong Kong’ in Raymond Wacks (ed), *The New Legal Order in Hong Kong* (Hong Kong University Press, 1999) 9-38.
136 It is interesting to note that Tam, Chinese corporate governance expert drew from Mayer’s work to highlight the distinctions between Anglo-American models of outsider-based system and the Japanese insider-based system of governance and as such each system has different sets of governance problems, see On Kit Tam, *The Development of Corporate Governance in China* (Edward Elgar, 1999) 25-30.
139 On a broader socio-history level, Hong Kong’s historian Tsang argued that despite a century of colonial rule the local Hong Kong residents’ identity retains strong identifications with the traditional Confucian moral code, and therefore the convergence of British legal doctrine and Confucian doctrines would unlikely to occur. See Tsang, above n 133, 194-6. Such sentiments were also echoed
Having more than one legal culture or order within a jurisdiction is not uncommon. Ehrlich noted that there are some countries in Europe having more than one legal order within a jurisdiction, one is judge-made law and the other is non-legal customary norms – which he coins ‘living law’. What Ehrlich pointed out is the existence of more than one form of legal order, known as legal pluralism, is common across many European countries. Legal pluralism has manifested in Europe since the medieval period in the form of legal codes and customary/religious laws. Pluralism is not unique to European countries. For centuries imperial China has had more than one form of legal order with the blend of legal rules in the form of imperial codes (fa) and non-legal regulatory norms from a Confucian notion of rites, ritual and ceremonies (li). More interestingly, for Confucius pluralism or a pluralistic order with the aim of achieving harmony is of greater importance than uniformity. Therefore, this concept is not a creature of modernity; rather it is has roots in both Western legal history and Chinese legal traditions.

Banakar and Travers pointed out that legal pluralism is a product of an awareness of the socio-cultural plurality in both primitive and modern societies. Similar to legal culture the concept of legal pluralism is broad and diverse. Generally the term

by Hong Kong novelist Xu Xi in her fictional work written in English about the traditional Chinese cultural influence during the colonial administration as part of her character growing in Hong Kong. See Xu Xi, Hong Kong Rose (Chameleon Press, 2004). Also note that the governance of Western family companies, the awareness of their duties, and comments about the little judicial intervention in the UK on family companies are discussed in Chapters 3.4, 4.5, 5.3.1.


Brian Tamanaha, ‘Understanding Legal Pluralism: Past to Present, Local to Global’ (Legal Studies Research Paper No 07-0080, St John’s University, May 2008) 4-10.

Roger Ames and Henry Rosemont, The Analects of Confucius: A Philosophical Translation (Ballantine Books, 1998) 168-169. Also, see Chapter 5.1.3 for discussions on Confucius’s notion of harmony.


refers to the, ‘incorporation or recognition of customary law norms or institution within state law, or to the independent coexistence of indigenous norms and institutions alongside state law (whether or not officially recognized)’. The first wave of legal pluralism could be located in the writings of legal anthropologists. It emerged from research about colonies in African, Asian and the Pacific, where the coloniser is confronted by indigenous rules and local customs in the newly colonised territories that are based on a distinct regulatory rationality different from the West. According to Malinowski, primitive non-Western societies have a system of mutual obligations and norms like customary laws. Others were critical of Malinowski’s assertions about indigenous laws by arguing the demarcation between norms of proper behaviour and law remained problematic, thus obligations from norms might not be treated the same way as laws.

The second wave of legal pluralism emerged in the late 1970s. The debate shifted to focus on the co-existence of state and non-state laws. This approach distinguishes between anthropological fact and political circumstances. It is understood as a by-product and a consequence of colonisation. To contend with the existence of non-state laws Hertogh argued that there are two sources, the first cluster is from immigrant groups and cultural minorities, and the second source is from social networks and institutions as a form of legal ordering. Others looked beyond customs and customary laws in their conceptualisation of legal pluralism, instead focusing on the inner ordering amongst associations and social groups in which rules

147 Brian Tamanaha, ‘Understanding Legal Pluralism: Past to Present, Local to Global’ (Legal Studies Research Paper No 07-0080, St John’s University, May 2008) 26.
151 Ibid, 205-8.
152 Warwick Tie, Legal Pluralism: Toward a Multicultural Conception Law (Dartmouth, 1999) 50.
154 Ibid, 17.
Griffith’s approach is different whereby there are two forms of legal pluralism, one strong and another weak. Legal pluralism in the weak sense means the state (coloniser) defines the parameters of the operation of indigenous and customary laws. Such arrangement merely subordinates customary laws to those of the state. Whereas legal pluralism in the strong form presents two or more distinct and independent legal orders, one of which maybe that of the state. So far, the discussion has revealed that the tension between dual forms of legal ordering has not been satisfactorily resolved, especially in colonial or postcolonial societies.

The third and most recent wave of legal pluralism puts the attention of this phenomenon under the banner of globalisation and is seen in the diffusion of non-state laws transcending national borders. Teubner claimed that globalisation did not necessarily bring about greater convergence of social orders and laws. Instead, he argued that new differences led to the fragmentation of societies into functionally differentiated global sectors and a multiplicity of global cultures. Berman noted that, ‘only in recent years has pluralism come to be used as a framework for conceptualizing the multiple conflicting jurisdictional assertions (both state and non-state) that characterize the global arena.’ The growth of non-state legal ordering at a global level is a new form of legal pluralism. This third wave also extends to the postmodernist notion of normative ordering. The creation of law evolves beyond

156 Griffiths, above n 155, 8.
157 Anne Griffiths, ‘Legal Pluralism’ in Reza Banakar and Max Travers (eds), An Introduction to Law and Social Theory, 289, 291.
158 Griffiths, above n 155, 8.
162 Ibid.
163 Berman, above n 160, 239.
the exclusive purview of the state into multiple normative orders, shifting lawmaking away from the state into the periphery of transnational actors.\textsuperscript{165} This is a product of rule or norm making transnational institutions, international governmental and non-governmental actors gradually eroding the monopoly of a state’s power.\textsuperscript{166} Furthermore, the influences and drivers of change come from multiple domestic and international sources. The values and norms of these institutions and communities combined have broken down the traditional state’s control over many areas of regulation, especially in business and related laws and codes of conduct.\textsuperscript{167} Another issue is interlegality – Michaels explained that, ‘[interlegality] is the “phenomenological counterpart of legal pluralism,” which describes the complex and ultimately unstable relation between different laws, either as a psychological state of the individual subject to more than one set of norms or as a description of a dynamic state of affairs.’\textsuperscript{168} Svesson defined interlegality as a, ‘ continual flow of legal perceptions, the dynamic force of pluralistic arrangement, that reshapes state law to better accommodate the cultural distinctiveness of indigenous people’.\textsuperscript{169} This decentralised and inter-subjective conception of law looks beyond the superficialities of rules to forms of social controls in terms of governance.\textsuperscript{170} This notion of governance entails power, governments, knowledge, and institutional control,\textsuperscript{171} explicating and converging on the fact that law as a regulatory instrument contains elements of incompleteness found in legal rules and governmental controls of society.\textsuperscript{172} This incompleteness highlights the importance of governance across many forms of social relations and orders.\textsuperscript{173} This view of the law as constructs of a diffused form of normative ordering in which the recognition of social norms and cultural values is part of a new form of regulation. In such a conceptualisation, there

\textsuperscript{166} Ibid, 243-256.
\textsuperscript{167} Berman, above n 160, 225-39.
\textsuperscript{168} Michaels, above n 165, 254.
\textsuperscript{170} Warwick Tie, Legal Pluralism: Toward a Multicultural Conception Law (Dartmouth, 1999) 8.
\textsuperscript{171} Alan Hunt and Gary Wickham, Foucault and Law: Towards a Sociology of Law as Governance (Pluto Press, 1994) 78-97.
\textsuperscript{172} Ibid, 102-3, 116.
\textsuperscript{173} Ibid, 66-67. Note that businesses in particular have managed to minimize the amount direct governmental controls through institutional system of self-regulatory mechanisms and rules, see Christine Parker, ‘The Pluralizatioon of Regulation’ (2008) 9 Theoretical Inquiries in Law, 349, 357-369.
are no contradictions in having multiple normative orderings. This in turn perpetuates the co-existence of multiple ordering within and across a number of jurisdictions drawn from social norms and cultural values.

Re-joining earlier discussions in Chapter 7.2.1 - notwithstanding a century of British rule the incongruity between the reception of English laws and Chinese Qing codes and Confucian norms has not been satisfactorily resolved. Ling cited research by Lau and Kuan found based on surveys conducted in the 1980s tensions between English common law and Chinese societies are inevitable.\textsuperscript{174} This research stated that 77.4 per cent of the respondents found it difficult to understand the law and legal system in Hong Kong.\textsuperscript{175} Sin and Chu also questioned the continued use of British notions of rule of law in Hong Kong’s postcolonial governance.\textsuperscript{176} They argued that Chinese cultural values held by people in Hong Kong are different from those in the West and that even notions of reasonableness in English laws are different from the Chinese characterisation of this term.\textsuperscript{177} Furthermore, they referred to the Chinese sense of qing,\textsuperscript{178} which has no equivalent in the English language, and refers to human sentiments that creates relational obligations.\textsuperscript{179} This is important because Chinese reasoning and sense of reasonableness is closely linked to qing.\textsuperscript{180} For the Chinese qing and reasonableness are entwined to such an extent it is a unity, which is in stark contrast to common law principles where reasonableness is understood in terms of a reasonable person acting rationally.\textsuperscript{181} The article went on to discuss the cultural bias of English case laws applied in Hong Kong’s courts to further their arguments of the cultural divide.\textsuperscript{182} In addition, this paper referenced two popular Chinese films in Hong Kong to infer the resistance of the vox populi to British laws.\textsuperscript{183} Although, the

\textsuperscript{175} Ibid.
\textsuperscript{177} Ibid, 152.
\textsuperscript{178} Also refer to Chapter 6.2.1.
\textsuperscript{179} Ibid, 152-3.
\textsuperscript{180} Ibid, 153.
\textsuperscript{181} Ibid, 153-7.
\textsuperscript{182} Ibid, 154-8.
\textsuperscript{183} Ibid, 160-2.
authors of this article did not offer any recommendations, they highlighted the conundrum that has not been satisfactorily resolved for over a century. This is arguably a product of the territory’s colonial legacy.

### 7.2.4 Customary Laws as a Form of Legal Pluralism in Hong Kong

The recognition of customary laws in Hong Kong under the colonial government can be traced to Captain Charles Elliot’s proclamations on the 2nd February in 1841. In an attempt to reconcile and manage the nexus between Western and Chinese legal order the British colonial administrator pigeonholed the Qing dynasty codes and Chinese customs and practices as customary law found in section 5 of the *Supreme Court Ordinance* (Hong Kong) cap 4. Even if the argument that the body of case laws about Chinese customary laws in the Hong Kong Law Reports is testament to the successful incorporation of Chinese customary laws in the common law system, Chinese customary law is only applicable as long as it is not repugnant to the fundamental principles of English common law and equity. In *Wong Yu Shi and Others v Wong Ying Kuen* the learned judge held, ‘in our view Chinese law and custom prevails only if the corresponding English law is inapplicable in the sense that it cannot be applied without injustice or oppression and if it is not shown to be excluded by Hong Kong legislation.’ Not only do British judicial precedents prevail over Chinese customary law, this is merely a form of tokenism because it is a shadow of the territory’s colonial past where the transplanted laws were superimposed onto the local inhabitants. Even after retrocession to Chinese rule in 1997, this legal doctrine carried on in the post-colonial era with Article 8 of the Basic

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184 Ibid, 163.
186 Wesley-Smith, above n 78, 207.
189 Wesley-Smith, above n 78, 209.
190 [1957] HKLR 420.
191 *Wong Yu Shi and Others v Wong Ying Kuen* [1957] HKLR 420 at 443.
Law (Hong Kong’s mini-constitution) reinforcing the status quo. A further mentioning of customary laws was implied in Article 40 where:

[tr]aditional rights and interests of the indigenous inhabitants of the “New Territories” shall be protected in the Hong Kong Special Administrative Region.

Traditional rights here refer to the court’s power to enforce any Chinese customary rights affecting the lands of New Territories held by indigenous inhabitants dating back to the early years of colonial rule.\(^{193}\)

The text and language of s3 of the \textit{Application of English Law Ordinance} (Hong Kong) cap 88 enacted in 1966 (now repealed), stipulates that Chinese customary laws can be construed as rules ‘applicable to the circumstances of Hong Kong or its inhabitant’.\(^{194}\) Yet it makes no explicit mention of Chinese customary laws or the customs of local Chinese residents of Hong Kong.\(^{195}\) Hence, Chinese customary laws can only be admitted if English rules of equity, British judicial precedence, and Hong Kong’s Ordinances have been proven to be ‘inapplicable’.\(^{196}\) In an ideal world, customary laws would include long established practices that gain widespread acceptance by the community concerned, but this is far from settled in Hong Kong.\(^{197}\) In \textit{Tang Ho-foon v Leung Sek}\(^{198}\) the judge referred to the 1840s as a point of reference to customary practices.\(^{199}\) \textit{In Re Wong Chio-ho and Another}\(^{200}\) the judge held, ‘the correct law to apply is the Ch’ing [Qing] law and custom as it existed in 1843 with such modifications in custom and in the interpretation of the law as have taken place in Hong Kong since that period.’\(^{201}\) Whereas in \textit{Lui Yuk-ping v Chow}\(^{193}\) See \textit{Tang Kai-chung v Tang Chik-shang} [1970] HKLR 176.

\(^{194}\) Wesley-Smith, above n 78, 209.


\(^{196}\) Ibid, 233. The \textit{Application of English Law Ordinance} states; 3(1) The common law and the rules of equity shall be in force in Hong Kong– (a) so far as they are applicable to the circumstances of Hong Kong or its inhabitants; (b) subject to such modifications as such circumstances may require; (c) subject to any amendment thereof (whenever made) by- (i) any Order in Council which applies to Hong Kong; (ii) any Act which applies to Hong Kong; or (iii) any Ordinance. 3(2) The common law and the rules of equity shall be in force in Hong Kong as provided in subsection (1) notwithstanding any amendment thereof as part of the law of England made at any time by an Order in Council or Act which does not apply to Hong Kong.

\(^{197}\) Wesley-Smith, above n 78, 210.

\(^{198}\) [1953-5] DCLR 152.

\(^{199}\) \textit{Tang Ho-foon v Leung Sek} [1953-5] DCLR 152 at 156.

\(^{200}\) [1969] HKLR 391

\(^{201}\) \textit{In Re Wong Chio-ho and Another} [1969] HKLR 391 at 394.
To his honour held, ‘whether this custom (allowing a husband to oust the concubine if she was disrespectful to his mother) is a mere social convention or whether it derives from Chinese law does not seem to be clearly established.’ This decision shows that custom and customary law are not always distinguishable.

To determine what customary law is Hong Kong’s courts relied heavily on the evidence of expert witnesses to ascertain the Qing dynasty’s codes and traditional Chinese customs. Lewis noted that, ‘This practice, however, has suffered from the unfortunate, but seemingly unavoidable, drawback of producing conflicting views on what in fact is the Chinese customary law subsisting in Hong Kong.’ Besides, Chinese customs and traditions vary across different clans, groupings, villagers or region. From a historical viewpoint, traditional Chinese customs and Confucian doctrines played a more important role than imperial codes (during imperial rule). At times, if imperial codes and Confucian doctrines were in conflict, Confucian doctrines of *li* prevailed over *fa*.

In Hong Kong, Confucian doctrines and concepts are recognised in limited circumstances under the broad label of traditional Chinese customs, for example, the changes in the ownership without registration of clan or ancestral held land and properties.

As noted earlier, Hong Kong’s statute recognises Chinese customary laws on matters mainly to do with inhabitants in the New Territories. Section 13 of the NTO states:

> Court of First Instance or the District Court may enforce Chinese customs. (1) Subject to subsection (2), in any proceedings in the Court of First Instance or the District Court in relation to land in the New Territories, the court shall have power to recognize and enforce any Chinese custom or customary right affecting such land. (2) In subsection (1), "proceedings" does not include proceedings in respect of or in relation to the Probate and

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203 *Lui Yuk-ping v Chow To* [1962] HKLR 515 at 533.
206 Ibid.
208 See Chapter 6.3 for more details about Confucian legal doctrine of *li*.
209 Wesley-Smith, above n 78, 214-5. See details about Tongs in subsequent paragraphs and in Chapter 6.2. For more on ancestral trust see Lawrence Ma, *Equity and Trust Law in Hong Kong* (LexisNexis, 2006) 236-237.
Administration Ordinance (Cap 10), the Intestates' Estates Ordinance (Cap 73) or the Inheritance (Provision for Family and Dependents) Ordinance (Cap 481).

Evidently, the use of Chinese customary laws is applicable in certain aspects and areas in Hong Kong. This has much to do with its history. Resistance to the British occupation of Hong Kong in the early decades of colonisation was most prominent in the New Territories because Chinese nationalistic sentiments were strong, and so preservation of its customary practices have been vigorously guarded and passed down for generations. In *Tang Kai-Chung v Tang Chik-Shang* the court noted that under The NTO land disputes should be resolved according to Chinese customary values and norms.

Marriage customs is another area of Chinese customary law. However, since 1971 the enactment of the *Marriage Reform Ordinance* (Hong Kong) cap 181 (MRO) weakened one area of Chinese customary law. Section 5(1) of the MRO stipulates that, ‘on or after the appointed day, no man may take a concubine and no woman may acquire the status of a concubine’. Section 17(1) specifies that, ‘for the purposes of this Ordinance, a marriage shall constitute a customary marriage if it was or is celebrated in Hong Kong before the appointed day in accordance with Chinese law and custom.’ Therefore, concubinage (in traditional China a man is permitted to have concubines under customary law) is not permitted after the enactment of the MRO.

Other legal matters relating to Chinese customary laws are - adoption, succession, and customary trust. Concerning adoption in *Ho Sau Lam v Ho Cheng Shi* recognised the validity of Chinese customary adoptions and its purpose. The courts accepted an adopted child’s right to the estate of the adoptive father upon his death. Legislation again altered the customary rights in s33, *Adoption Ordinance* (Hong Kong) cap 290 stipulating:

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211 Ibid, 171.
214 Note that Chinese customary marriage legal issues are also recognised in Singapore and Malaysia many of the disputes arise are quite similar to those in Hong Kong, see MB Hooker, ‘Chinese Customary Law in Contemporary Malaysia and Singapore’ (1999) 1 *Australian Journal of Asian Law* 34.
215 Lewis, above n 205, 362-3.
217 Lewis, above n 205, 366.
(1) After 31 December 1972, an adoption in Hong Kong may be effected only in accordance with this Ordinance. (2) Subsection (1) shall not affect in any way the status or rights of a person adopted in Hong Kong under Chinese law and custom before 1 January 1973.

On succession, Lewis argued that the judge *In the Estate of Chak Chiu Hang and Others*\(^\text{218}\) effectively overrode the application of Chinese customary laws in favour of English legislative obligations transplanted to Hong Kong.\(^\text{219}\) Chinese ancestral trusts tend to be concentrated in the New Territories (northern part of Hong Kong), where local indigenous Chinese had practiced ancestral worship for centuries even before British colonisation of Hong Kong.\(^\text{220}\)

From the various examples discussed, it is fair to contend that Chinese customary laws in Hong Kong fit the description of Griffith’s notion of weak legal pluralism.\(^\text{221}\) Despite litigants petitioning the courts in Hong Kong about matters on or related to Chinese customary laws,\(^\text{222}\) they are mainly confined to land issues for inhabitants in the New Territories.\(^\text{223}\) This is true even after 1997 retrocession to Chinese rule.\(^\text{224}\) The clear limitation of Chinese customary law’s application in Hong Kong is that it only applies if common law or statutes would create injustice or oppression.\(^\text{225}\) Hsu noted that, ‘the courts procedures have been in English, and the judges would inevitably apply English reasoning and English cultural values in interpreting Chinese law and custom.’\(^\text{226}\) Albeit under the basic law any statutory amendments made by the legislative council cannot abolish the customary rights that existed before 1997, ‘but the problems associated with the courts’ administration of the customary law are not susceptible to legislative solutions and may be too entrenched, too theoretical, and too intractable for the judges to deal with them’\(^\text{227}\)

\(^{218}\) (1925) 20 HKLR 1.
\(^{219}\) Lewis, above n 205, 349.
\(^{220}\) Re *Estate of Lau Wai Chau* [2000] 1 HKC 681.
\(^{221}\) Lewis, above n 205, 379.
\(^{222}\) Denis Chang, ‘Has Hong Kong Anything Special or Unique to Contribute to the Contemporary World of Jurisprudence’ (2000) 30 *Hong Kong Law Journal* 347, 347
\(^{223}\) Wesley-Smith, above 78, 224.
\(^{225}\) Wesley-Smith, above n 78, 223; Lewis, above n 205, 354.
\(^{227}\) Ibid, 224.

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From the discussions in parts one and two of this thesis, there is ample of evidence to show the differences between Western and Chinese values and value systems. Thus far, this section has gone further to affirm the fact that Hong Kong’s brand of legal pluralism is weak and confined to specific issues as well as geographical boundaries. Customary laws in Hong Kong have not, or been able to address any complex issues beyond the views of expert witness and case laws on specific matters like wills and land issues. Furthermore, the discussions in Chapter 4.3.1 about Chinese ancestral trusts - tong demonstrated that the courts in Hong Kong found it difficult to apply common law legal principles onto traditional Chinese customary practices and values. Therefore it is even more unlikely that Chinese family companies in Hong Kong could be aptly regulated, or seek dispute resolution, in the courts under the auspices of Chinese customary law.

Instead, as discussed in the above, legal pluralism as a regulatory framework is no longer a state dominated domain; the fragmentation and interdependence between state and non-state actors, professional bodies, associations, and community groups have emerged as alternatives in a polycentric regulatory and normative order. Such a conceptualisation of normative ordering in place of a strict sense of the term laws would be met with strong resistance from the echelons of power and the state. Nevertheless, Zumbansen pointed out the fact that a good example of non-state based pluralism is in the area of the regulation of corporate governance; this is evident in the number of codes and best practices proliferating globally. The question is how can this be adapted for regulating directors of Chinese family companies in Hong Kong?

7.3 A Proposition for Directors of Chinese Family Companies in Hong Kong

This final section will attempt to conceptualise a regulatory framework for directors of Chinese family companies in a culturally appropriate context with normative

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ordering in line with Chinese traditions and customs. The challenge is enormous because this section will attempt to synthesise complex concepts, broad principles, idealistic values, and rich experiences in a concise manner. The contents will include values and norms as the foundations of regulations and the institutionalisation of the ‘Bamboo Network’ as a self-regulatory body or arrangement.

7.3.1 Values and Norms as Foundations of Regulation

Values, as a term, is wide-ranging and multifaceted because of its various meanings across many disciplines, and because it engages psychological, philosophical, religious, moral, cultural, and social issues. Thus, this thesis will approach this term in the words of Haralambos and Holborn that, ‘a value is a belief that something is good and desirable. It defines what is important, worthwhile and worth striving for’. Thus, values can be described as beliefs held by individuals about what is appropriate behaviour, what is right or wrong, or even desirable or despicable attitudes. Whilst laws can regulate external behaviour, legitimacy of legal rules can be justified by relating to values and morals in some form or manner. Hence, they provide a basis of how individuals and society perceive and react to legal rules or a normative order. This is because values, at their core, grapple with the basics that prompt one to obey or disobey the law or norms and so are often linked to morals and moral justifications. This in turn points to the importance values play

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in one’s willingness or acceptance in complying with a certain set of legal rules or social norms to regulate one’s behaviour and actions.\textsuperscript{236}

Braithwaite described values as, ‘enduring, abstract, and socially shared principles that regulate action’.\textsuperscript{237} Haralambos and Holborn contended that:

Without shared values, members of a society would be unlikely to cooperate and work together. With differing or conflicting values they would often be pulling in different directions and pursuing incompatible goals. Disorder and disruption may well result. Thus an ordered and stable society requires shared norms and values.\textsuperscript{238}

Therefore, values are enablers. Apart from determining what desirable behaviour is, they incorporate standards for how individuals should interact with each other,\textsuperscript{239} and in so doing help to foster social solidarity and an orderly society.\textsuperscript{240} However, Barber argued that:

Values are incommensurable when they cannot – or cannot sometimes – be placed on a common scale. It may then be true that of the two options that neither is better than the other, nor are they equally attractive. Sometimes, all that can be said is that one value requires us to act one way, whilst another value requires us to act in another way.\textsuperscript{241}

Then again, values come from one’s self-consciousness and the development of one’s identity in the social context.\textsuperscript{242} Thus it is in this context one’s sense of belonging is construed from this shared systems of values and beliefs that are closely linked to norms.\textsuperscript{243} Parker contended that, ‘norms begin as values that are ahead of community attitudes and then are embodied in social movements that successfully

\textsuperscript{238} Haralambos and Holborn, above n 231, 6.
\textsuperscript{239} Braithwaite, above n 237, 48.
\textsuperscript{241} NW Barber, ‘Legal Realism, Pluralism and their Challenges’ (Legal Research Paper Series No 76/2012, University of Oxford, December 2012) 21.
\textsuperscript{242} Haralambos and Holborn, above n 231, 45.
\textsuperscript{243} Davis, above n 234, 133-15; Braithwaite, above n 237, 48-54.
implement them into regulatory institutions such as laws. … Thus, values help constitute norms and rules in a given society or community.

Social norms are similar to rules. They are normative modes of social control. Such social controls tend to be in effect in groups where inter-group relations are deemed to be important to that collective. Haralambos and Holborn noted that, ‘Norms tend to ensure that role behaviour is standardized, predictable and therefore orderly.’ This order can also be understood as a cultural phenomenon intertwined in the processes of routinisation and naturalisation of behavioural rectitude, and in terms of power relations, including the indoctrination of certain values held by a collective onto individuals. Often norms manifest as rule-like inhibitors regulating individual behaviour that incorporates the production and reproduction of social practices. As noted in the above, Enrlich observed that customary practices and cultural values have a regulatory effect, and labelled this phenomenon as ‘living law.’ Furthermore, he contended that it is not uncommon for people to follow social norms instead of official laws. For these people the centre of gravity of legal development lies not in legislation, but in society. The state here does not have monopoly over social control and ordering, the example he gave was lex mercatoria. A counter argument to Ehrlich’s thesis is - norms can be ignored without the threat of punitive consequences. Then again, non-compliance with norms can amount to deviant behaviour, such behaviours are stigmatised by others in the community. Enrlich pointed out that those norms, in his opinion, become stronger

244 Parker, above n 244, 98.
246 Vago, above n 233, 195-7.
247 Haralambos and Holborn, above n 231, 774.
249 Giddens, above n 249, 18, 172-4.
251 Hertogh, above n 148, 15.
252 Nelken, above n 250, 447-8.
when they manifest as organisational norms. These organisational norms are an autonomous expression of law-like consciousness, having binding effects on its members and replicated across organisations. Thus, norms have a regulative effect on individuals and society in general.

Eisenberg defined social norms as, ‘rules and regularities concerning human conduct, other than legal rules and organizational rules.’ Whilst Raz made a distinction between mandatory and non-mandatory norms, he equated norms to rules. This is an imperative laid down by groups of individuals guiding human behaviour. In addition, Christie noted that, ‘The terminology of ‘norms’ is very similar in usage to the terminology of ‘rules’. Indeed, the terms ‘rule’ and ‘norm’ are sometimes used interchangeably.’ He was referring to rules in the general sense consisting of both legal and social aspects. Braithwaite emphasized the social dimensions of rules by arguing that they represent, ‘socially defined and enforced standards of behaviour.’ These norms are commonly observed out of a sense of obligation to society, or out of a sense of shame or guilt from fear of social sanctions for non-compliance. In addition, conformance to norms promotes trust and a sense of security as well as belonging amongst individuals in a social context. Therefore, there are both positive and negative motivations to conform to norms.

Another view is that norms are based on moral or practical grounds, assuming the function of the glue that holds society together, having the effect of forcing or obligating an individual to behave accordingly. The regulative function of norms is

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259 Ibid, 9.
260 Ibid, 51.
262 Ibid, 3-4.
263 Braithwaite, above n 237, 48.
265 Braithwaite, above n 237, 53-57.
266 Haralambos and Holborn, above n 231, 5.
267 Alasuutari, above n 248, 37.
a form of endorsement of the shared values and belief system that includes conceptions about what is right or wrong.\footnote{Ibid, 34.} Hence, values, norms, and regulative rules from a sociological perspective, are interrelated and interlinking concepts.\footnote{Davis, above n 238, 139; Cotterrell, above n 88, 77.} This signifies the importance of values and norms as an important element of rulemaking and the society’s support for the legitimacy of rules. But for Kelsen norms are a short hand for what ought to happen within a legal system and institutionalised as laws.\footnote{Marett Leiboff and Mark Thomas, Legal Theories in Principle (Thomson, 2004) 100.} McCormick wrote that, ‘Laws certainly embody values and these values are characteristically expressed in statements of the principles of a given legal system’.\footnote{Neil MacCormick, Legal Reasoning Legal Theory (Clarendon Press, 1978) 232-235.} For instance, notions of order, justice and individual freedom have been regarded in Western society as principle values embedded in the form of laws.\footnote{Peter Stein and John Shand, Legal Values in Western Society (Edinburgh University Press, 1974) 5.} Whilst the precise nature of the relationship between laws or rules, and values are complex, changes in values can prompt law reforms, if those values represent society’s beliefs on a subject matter.\footnote{Twining and Miers, above n 235, 129-131. In particular, for highly differentiated societies, value systems often take the form of legal rules. See Talcott Parsons, ‘An Outline of The Social System’ in C Calhoun, et al (eds) Classical Sociological Theory (Blackwell Publishers, 2002) 366, 376.} 

A brief conclusion from this section is that there are interrelationships and links between values, norms and laws in regulating human behaviour. Another is that norms and legal rules are modes of regulating human behaviour. Therefore, a norm is a mode of social control and should be seen and understood, in the right context, like in the Confucian sense, as discussed in Chapter 6.3 that it is no less effective nor less powerful as the law. This issue then reverts to how is this going to impact on corporate governance.

### 7.3.2 Different Modes of Regulation

In general, a number of conceptual and philosophical perspectives characterises how we understand the law.\footnote{Peter Butt, Butterworths Concise Australian Legal Dictionary (LexisNexis, 3rd ed, 2004) 252.} Setting aside the differences in philosophical groundings
and legal systems or families, legal rules are central to the conception of the law. Legal rules as regulatory instruments have several advantages and disadvantages. On the one hand, they are identifiable in the form of statutes, regulations, and case laws. It offers some certainty to the populace in terms of identifying what is legal or illegal, clarity in terms of the scope, transparency in terms of due process, and stipulation of certain sanctions or consequences if breached. Laws can also serve as a guarantee of certain values being cemented as a fundamental right, or even an absolute.

On the other hand, laws are also imperfect regulatory instruments because they are prescriptive, anticipatory, and generalised rules to regulate human behaviour. This means a law is based on factual predication prone to be either under or over inclusive. As regulatory tools they are generalisations dealing with a range of events and abstractions based on past and futuristic scenarios, therefore tend to oversimplify complex matters, represent missed regulatory targets and factual predicates. Furthermore, there are clear limitations of using laws as instruments of social change, even though laws regulate behaviour. Vago stated that ‘it cannot alter attitudes, values, and morality.’ He added that resistance to change can come about

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276 Even though the notion of rules varies across different fields of social and scientific enquires, in this section the focus is on legal rules - see Twining and Miers, above n 224, 136.
278 Joseph Raz, ‘The Rule of Law and its Virtue’ in Aileen Kavanagh and John Oberdiek (eds), *Arguing about the Law* (Rouledge, 2009) 181-90. Even if, laws are far from being neutral regulatory rules, being instruments exploited for political, economic moral or other ends, they afford a group, community, or society a kind of order or ordering with prescriptive standards of behaviour. See Atiyah, above n 225, 126-33; David Ingram, *Law: Key Concepts in Philosophy* (Continuum, 2006) 2-15; Freiberg, above n 109, 178; Margaret Davis, *Asking the Law Questions: The Dissolution of Legal Theory* (Lawbook Co, 2nd, 2002) 4, 6.
281 Ibid, 7.
282 Schauer, above n 279, 32-33.
283 Vago, above n 233, 329.
if the changes conflict or are inconsistent with traditional values or customs. Other reasons contributing to the resistance could include social, ideological, psychological, and cultural factors. Besides, empirical researches have shown that laws failed to deter or have a deterrent effect on corporate misconduct or white-collar crimes. More importantly, Perry argued that in Asian matters concerning the family or commerce the use of long held practices and norms had been the regulation of choice. This is also seen in Chapters 5 and 6 where non-legal value based norms had been regulating Chinese commerce for centuries as well as Hong Kong’s family companies for about a century.

An alternative to laws is self-regulation. Ayres and Braithwaite recognise the limitations of a law centred regulatory system as being inefficient and at times a cumbersome regulatory system. Whilst self-regulation may take many forms, ranging from pure self-regulation to a certain degree of governmental intervention, Ogus referred to this as, ‘some degree of collective constraint, other than that directly emanating from government, to engender outcomes which would not be reached by individual market behaviour alone’. Frieberg added that self-regulatory industry schemes are considered likely to be the most effective regulatory regime if there is a viable industry association with a cohesive membership of like-minded participants to advance and preserve certain shared norms and values to regulate its industry and

284 Ibid, 330.
288 Ian Ayres and John Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (Oxford University Press, 1992) 4-15, 26-33, 35-40.
members.\textsuperscript{291} The strengths of self-regulation, according to Gunningham and Rees are:

\begin{quote}
[s]peed, flexibility, sensitivity to market circumstances and lower costs. Because standard setting and identification of breaches are the responsibility of practitioners with detailed knowledge of the industry, this will arguably lead to more practicable standards, more effectively policed. There is also the potential for utilizing peer pressure and for successfully internalizing responsibility for compliance. Moreover, because self-regulation contemplates ethical standards of conduct which extend beyond the letter of the law, it may significantly raise standards of behaviour.\textsuperscript{292}
\end{quote}

Therefore, self-regulation has clear advantages, especially in nurturing certain norms and values as well as harnessing the collective interests of the industry or business community.\textsuperscript{293} Critics of self-regulation assume that it would fail because it is self-serving for certain groups of rational actors and thus does not protect the greater interests of the broader community.\textsuperscript{294} Furthermore, knowing the industry and being closer to the targeted regulatees does not necessarily mean that the self-regulator has an incentive to police thoroughly if it runs the risk of adverse publicity or segregating the community or industry.\textsuperscript{295} However, there is no conclusive evidence that self-regulation is ineffective or impotent.\textsuperscript{296} The international trend in regulation is tilting towards the wider use of self-regulation because markets are increasingly globalised, becoming more complex, and change too rapidly for laws and state regulators to deal with.\textsuperscript{297} Then again, whether this applies to the regulation of corporate governance is a separate question.

\subsection*{7.3.3 Self-Regulation as a Framework to Regulate Corporate Governance}

Since self-regulation builds on norms, Boytsun, Deloof, and Matthyssens argued that social norms and social cohesion had more influence on peoples’ attitudes towards
More importantly, their empirical research finds that, ‘strong social norms offer better informal protection of property rights and regulation of corporate governance in that the community provides efficient informal incentives for open governance and punishment for deviant behaviour.’

This finding is more pertinent in communities that share deep-seated norms, and this in turn may foster a greater sense of social cohesion, as in Hong Kong where there is network of Chinese family companies. This suggests that the degree of acceptance by a community on laws regulating corporate governance is dependent on how strong the norms are, and the level of unity is influenced by those norms.

Eisenberg found that social norms are relevant to corporate governance, in particular directors’ behaviour in the boardroom, because they shape a director’s belief-system. Redmond remarks that the members of the board are obliged to self-consciously adopt and respect a norm out of a sense of obligation. He labelled these norms moderators of director’s conduct. In the United States, studies have found that social norms influence the behaviour of directors more so than legal rules. For this reason norms have the potential risk of allowing bad norms to fester in boardrooms as at Enron and Worldcom that led to their speculative corporate collapses. Hence, there ought to be a regulatory system to ensure both desirable and appropriate norms and values are instituted amongst directors. Nicholson, Kiel and Kiel-Chisholm added that markets need a norm-based social framework to

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299 Ibid, 55.
300 Ibid, 56.
302 Ibid, 1291.
304 Ibid.
305 Ibid, 347.
operate. As such, they postulated that social norms matter to market behaviour, and that this is more acute in certain communities, where there is a tight social network because there is a high level of trust. This complements Jones’s observations that, ‘Social norms have the potential to motivate good conduct, but they are also capable of supporting undesirable conduct. For this reason, the norms-based justifications for the hands-off self-regulatory approach to corporate governance must be carefully examined.’

Corbett and Bottomley criticised the dependency on laws, as an instrument to prevent bad norms from taking over the governance of a company has become too narrow and out-dated. Farrar noted that the self-regulatory approach to regulate corporate governance, apart from its flexibility, ease of amenability, has a relatively lower cost compared to laws, ‘it is argued that self regulatory norms operate from a higher threshold [compared to laws].’ There is no shortage of self-regulatory guidelines and codes at both international and domestic levels drafted by international and local agencies or professional bodies. Du Plessis, McConvill and Bagaric argued that self-regulation clearly is an influential benchmark used to shape corporate governance practices. Critics disagreed on the merits of such a system by arguing that it can result in unnecessary duplication with legal requirements, it has a lack of public accountability, it does not possess legal powers to investigate, and it is based on a system of consent. Further, in light of recent corporate scandals and collapses like Enron, Worldcom, and the economic crisis of 2009-10 in the US, there is a trend

309 Ibid, 473.
310 Ibid, 473.
313 Ibid, 377-386.
314 Jean du Plessis, James McConvill, and Mirko Bagaric, Principles of Contemporary Corporate Governance (Cambridge University, Press, 2005) 120.
315 Farrar, above n 312, 377. Note that from a political economic perspective, Mann argued that self-regulatory principles and practices are built upon the use of force, threat and coercion of governments, see Scott Mann, ‘US Power and Transnational Governance’, (2011) 15 University of Western Sydney Law Review, 94.
towards more legislative intervention as with The Sarbanes-Oxley Act,\textsuperscript{316} and the Frank-Dodds Wall Street Reform and Consumer Protection Act. Whilst it is beyond the scope of this thesis to examine this issue in-depth, Farrar depicted the relationship between laws and self-regulation as complementary. He mapped out the structure of corporate governance with a diagram where legal rules are at the centre and various self-regulation measures are on the outer rim.\textsuperscript{317} Du Plessis, Hargovan and Bagaric instead used Ayres and Braithwaite’s regulatory pyramid to lay out the relationship of legal rules at the apex of a pyramid and self-regulatory rules consisting of hybrids and soft laws at the lower levels.\textsuperscript{318} Another important point is that from the various corporate scandals and collapses one thing is certain, no matter the number of, or quality of the self-regulatory measures and legal rules, human vices or greed cannot be subjugated.\textsuperscript{319} Therefore, neither legal rules nor self-regulatory measures are superior.

However, how does this apply to the regulations of directors of Chinese family companies, especially when prevailing laws are culturally ill suited for these regulatees? This is where self-regulatory instruments could be a possible fit because self-regulation is conceived as value based norm driven measures that rely on cohesive membership of like-minded participants to advance and preserve certain shared norms and values to regulate its members.\textsuperscript{320} But, one thing is clear, given the incongruities between the values underlying the transplanted British laws and

\begin{footnotes}
\footnotetext{316}{Kenneth Kim, John Nofsinger and Derek Mohr, \textit{Corporate Governance} (Pearson, 3\textsuperscript{rd} ed, 2010) 129-45.}
\footnotetext{317}{Farrar, above n 313, 4.}
\footnotetext{318}{Du Plessis, McConvill, and Bagaric, above n 314, 110-22. Note that hybrids are listing rules because they are enforced self-regulation delegated by the state onto listing bodies and has certain legal sanctions if those listing rules are breached. Soft laws are purely voluntary codes and guidelines considered to be best practices. See pages 117-122. For more on regulatory pyramid and enforced self-regulation, see Ian Ayres and John Braithwaite, \textit{Responsive Regulation: Transcending the Deregulation Debate} (Oxford University Press, 1992).}
\footnotetext{319}{See John Adams et al, \textit{Collapse Incorporated: Tales, Safeguards & Responsibilities of Corporate Australia} (CCH Australia, 2001); Trevor Sykes, Two Centuries of Panic: A History of Corporate Collapses in Australia (Allen & Unwin, 1998); Stewart Hamilton and Alicia Micklethwait, \textit{Greed and Corporate Failure: The Lessons from Recent Disasters} (Palgrave MacMillan, 2006); Frank Clarke, Graeme Dean and Kyle Oliver, \textit{Corporate Collapse: Accounting, Regulatory and Ethical Failure} (Cambridge University Press, 2\textsuperscript{nd} ed, 2003).}
\footnotetext{320}{Freiberg, above n 109, 27-9.}
\end{footnotes}
Chinese governance practices, prevailing laws will not take on a complementary role in this culturally inspired self-regulatory framework.

### 7.3.4 Relationship Orientated Values as a Basis to Regulate Directors of Chinese Family Companies

This section will draw on the discussions from Chapters 5 and 6 to conceptualise regulatory principles for directors of Chinese family companies. From the two chapters it is clear that relationships and relational obligations take on a key role in Hong Kong’s socio-economic life, in particular for Chinese family companies. This relational outlook means that maintaining good relationships is a priority in this network community. Further each person has role-bearing obligations to another. Therefore, preserving this relational accord is central to good governance from a Chinese cultural perspective.

The notion of relationships and trust being the focal point of regulation has also received some attention in contract law. MacNeil first raised his relational theory of contract in the mid-1960s.\(^{321}\) He began to work on the notion of cooperation as one of the basic elements of a contract and social relations were part of this social conception of a contract.\(^{322}\) This is where social and relational norms are recognised as integral elements in the formation of contracts.\(^{323}\) What MacNeil pointed to is the issue of relationships and relational norms should be recognised in cooperation.\(^{324}\) Then again, relationships alone are not enough to build trust. Trust is another important element in regulating or governing communities because it defines a relationship between individuals or groups concerning the tension between individual

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and collective interests. Trust, in this sense, is the bridge between individuals or groups as an enabler of good governance and enhances confidence in institutional structures. Braithwaite found that for those who favour harmony values, the relationship between self and other is not in conflict but is mutually reinforcing. In these cultures communal norms are central to trust. Thus, for those who subscribe to harmony values and communal norms, there is a greater preference for cooperation. As such, these communities favour regulatory bodies that facilitate cooperation to achieve certain objectives. Therefore, relationships, trust, and cooperation are important elements in cultures where harmony values are prevalent. This applies to Chinese societies like Hong Kong where a sense of relational obligations binds and regulates behaviour of individuals and groups; this means that maintaining good relationships between directors is central to the governance of Chinese family companies in Hong Kong.

At this point it is pertinent to recap the discussions in Chapters 5.3, as a prelude to the forthcoming discussion. It was argued that paternalism is a key element of governance in Chinese family companies in Hong Kong. It was further noted that children are expected to practice xiao towards their parents. In a family company context, it meant that they ought to follow the lead of the patriarch or matriarch. The family patriarch or matriarch is thus expected to be a benevolent leader. This type of leadership has two key attributes; first the leader is expected to practice self-cultivation as a means to acquire the virtues of a junzi, and the second is to lead by example. Historically in China, Chinese entrepreneurs that have been able to

325 Valerie Braithwaite, ‘Communal and Exchange Trust Norms: Their Value Base and Relevance to Institutional Trust’ in Valerie Braithwaite and Margaret Levi (eds), Trust and Governance (Russell Sage Foundation, 1998) 46, 47.
327 Braithwaite, above n 237, 49-53.
328 Ibid, 57-70.
330 See Chapter 5.3.2.
331 Confucius has equates individuals that excel in morals in wu chang as ‘superior’ or ‘noble’ man (junzi), see Chapter 6.2.1.
demonstrate the application of Confucian doctrines into their business dealings have been labelled *rushang* (Confucian entrepreneurs). In addition, empirical studies by Farh and Cheng in the 1990s found that, ‘survey results indicate that Chinese employees in PRC, Hong Kong and Taiwan held strong expectation of benevolent leadership, and this tendency did not vary across age or educational status. These findings suggest that leader benevolence is still expected and appreciated by employees.’

Another aspect of this Confucian influenced governance is the notion of harmony. As noted in Chapter 5.3.2, the cohesiveness of a family for the Chinese means the relationship between every member is to maintain a strong sense of responsibility and obligation towards one another. This implies that potential or actual differences between individuals are subordinated in favour of achieving harmony. Harmony is maintained when each party performs dutifully according to their roles. Therefore, a key concern of a paternalistic leader is to foster harmony amongst family members. But what happens when paternalism breakdowns and harmony deteriorates and disputes spiral into conflicts? More importantly, how does one go about setting standards, guidelines, or even principle based regulatory criteria for paternalism and harmonious relationships? The clue as noted in Chapter 6.3.3 is the use of clan, guild, or *tongxiang* to resolve disputes. The enforcement of these moral obligations and precepts was achieved through the combination of

persuasion, dialogue, and compromises. \(^{339}\) Besides, paternalism and harmonious relationships are normative archetypes, not apt to be turned into prescriptive, proscriptive, or prohibitive rules.

Chapter 4.3.2 discussed a number of litigations concerning the governance of Chinese family companies. It demonstrated when family relationships breakdown in Chinese family companies in Hong Kong, it could negatively impact on the governance of these companies. More interestingly, instead of undertaking legal proceedings under directors’ duties, they had chosen to take action under minority oppression and winding up on just and equitable grounds because the aim of the petitioners was *fen jia*. Chapters 1.4 and 5.3.3, noted that when the disputes in Chinese family companies had got to a point of no return, it might result *fen jia*. Given that the disputes in the cases discussed in Chapter 4.3.2 were more to do with family rather than the governance of those companies the Hong Kong courts had thrown those cases out because the evidence clearly did not merit a finding for the plaintiffs.

Therefore, it is clear from the above analysis maintaining and repairing the relationships of family members is central to the governance of Chinese family companies in Hong Kong. The emphasis should be on restoring paternalistic control and harmonious relations. Whilst it is evident that the benchmarks for governance are different from the West, critics like Li argued that the Chinese relationship centre mode of regulation as a privatised form of insiders’ justice was at the expense of distributional justice and the rule of law.\(^{340}\) Then again, at the heart of Confucius’s contribution to Chinese legal tradition is a non-legal form of normative social ordering to regulate relationships between people.\(^{341}\) Even though the Confucian regulatory doctrine of *li* is ritualistic control of human behaviour, the object and

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\(^{341}\) See Chapter 6.3.

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The substance of this Confucian doctrine is in essence, based on moral ideals. More importantly, such ideals are still relevant in Hong Kong. In 2007, the Hong Kong Institute of Chartered Secretaries and Hong Kong Shue Yan University jointly conducted a survey about business ethics with business executives and managers of 1,150 companies in Hong Kong. This study stated that:

The suggestion of teaching Confucius’ sayings (論語) as a means of promoting business ethics illustrates the recent trend of reinventing the value and applicability of certain ancient Chinese literature and philosophy to the modern commercial world. This is an interesting phenomenon which seems to be flourishing in Hong Kong. The virtues preached by these ancient literary works are also based on ethics.

However, even if ethical values might serve a norm of good behaviour, the question then is, how do these ideals translate into a set of regulatory principles and a framework? Goh argued that:

Suffice to say that the overriding stress on morality – rather than on law – was the principal tenet of Confucian teaching which resulted in the traditional preference for disputes and their settlement … The best way to restore this harmony was through compromise. There were in existence customary rules, social sanctions and ethical precepts which regulated the traditional Chinese society. … in the traditional Chinese society, the family, rather than the individual, was considered as a unit. The family was deemed the foundation of social order. Moreover, families were extended to include kinship organisations or clan groups. One of the duties of the clan (tsu) head was to maintain social harmony within his clan. Such a unique feature evident in the traditional Chinese social structure coupled with Confucian ideology leaned favourably towards the informal process of dispute resolution.

Such approach to justice as Wachtel and McCold pointed out that it, ‘goes beyond resolution of specific incidents of wrong-doing to providing a general social mechanism for the reinforcement of standards of appropriate behaviour.’ And since Chapters 4.3.2 and 4.4 noted that the courts are inappropriate venues for settling the disputes of members of a family concerning the governance of Chinese

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342 Hong Kong Institute of Chartered Secretaries, ‘Business Ethics: A Path to Success’ (2007) 1 <http://www.hkics.org.hk/media/publication/attachment/2073_Business%20Ethics.pdf>. A survey of 1,150 listed companies in HK was handed out in April and May 2007, the response rate only 5.48% (63 responses).
344 Goh, above n 339, 65.
family companies in Hong Kong, the next issue is to locate a suitable forum where such matters could be resolved.

### 7.3.5 Forum to Restore Harmonious Relationships in Chinese Family Companies

As mentioned in Chapter 5.2, Hong Kong’s brand of entrepreneurialism is based on families and networks of family companies. The links between ‘entrepreneurial familism’ and Hong Kong’s network economic structure is a direct one because the interpersonal bonds between the heads of Chinese family companies enable them to pool resources together and collaborate on large business projects (also known as the ‘Bamboo Network’). Underpinning this network economy are shared beliefs and common values rooted in Confucian doctrines. This guanxi based networking economy is essential to doing business in Hong Kong amongst Chinese family companies because they rely more on xingyong (trust) than contracts to conduct their business. This guanxi based xingyong creates reciprocal relational obligations, a binding sense of duty to carry out the terms of an agreement, as well as becoming a member of an informal business network. Evidently, Hong Kong’s networks are regulated through communal norms and relationships to build trust. Thus, its regulative disposition is leaning towards a network based means of informal social ordering.

This regulatory phenomenon is nothing new, as Nelken observed that, ‘He [Ehrlich] too would have recognized the new governance image of a network with nodes

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connecting the strands in which law is not necessarily centred on the state.\textsuperscript{349} Nodes are sites of governance, where knowledge, capacity and resources are mobilised to manage events.\textsuperscript{350} According to Burris, Drahos, and Shearing, nodes exhibit the following characteristics: a way of thinking about the matters that the node has emerged to govern; a set of methods for exerting influence over events; resources to support the operation of the node and exertion of influence; and a structure that enables the directed mobilisation of resources.\textsuperscript{351} They added that:

All nodes are not created equal...[N]odes govern by mobilizing their resources and governing technologies to cajole, coerce or otherwise move those they wish to govern to comply with their directions. A node may use rules or laws, or threats, or social pressure or stigma or any other mode of control at its disposal. Nodes have directly governed the people who are subject to their influence...\textsuperscript{352}

Nodes include state and non-state organisations. Drahos remarked that the role of nodes can be linked to the creation of concentrations of power for the purposes of exercising governance.\textsuperscript{353} Nodes are also actors within a network tied together for a common purpose.\textsuperscript{354} This is nodal governance. This theory of nodal governance as a regulatory framework provides part of an account of how a governing order emerged out of highly complex systems.\textsuperscript{355} This is a polycentric (pluralistic) regulatory regime where the state is not the locus of authority or the state plays a minimalist or no role at all.\textsuperscript{356}

The effectiveness of nodal governance depends on collaboration between key actors at a particular node, and the ability of these actors to tie the various strands together

\textsuperscript{349} Nelken, above n 251, 465.
\textsuperscript{351} Ibid, 37-38. Note that it is beyond the scope of this thesis to examine other form or types of regulatory structures and frameworks like enforced self regulation, co-regulation, smart regulation or meta regulation. For details about these regulatory frameworks see John Wright and Brian Head, ‘Reconsidering Regulation and Governance Theory: A Learning Approach’ (2009) 31 Law and Policy, 192.
\textsuperscript{352} Ibid, 39.
\textsuperscript{354} Ibid.
\textsuperscript{355} Burris, Drahos and Shearing, above n 349, 34.
in to an effective web of control. This control is also perpetuated by the ability to inflict collective sanctions. Jones, Hesterly and Borgatti noted that, ‘Collective sanctions involve group members punishing other members who violate group norms, values or goals and range from gossip and rumours to ostracism (exclusion from the network for short periods or indefinitely) and sabotage; these sanctions are employed in network governance.’ This appears to have some similarities to the Chinese clans’ administration of justice. Wang Liu wrote that, ‘From the viewpoint of the clan, punitive power was a logical extension of its moral disciplinary function. The ability to deal with intra-group disputes, misdemeanours, and minor criminal offences helped the elimination of these misconducts and the protection of group reputation.’

Another important factor is reputation. Jones, Hesterly and Borgatti offered the following explanation, ‘Reputation reduces behavioural uncertainty by providing information about the reliability and goodwill of others.’ As noted in Chapter 5.2.2 mianzi (face) is critical for Chinese business people, and as a form of social currency in business and social circles this is relatively close to the notion of reputation as a safeguard, relaying the detection of, and serving to deter, deviant behaviour or anything that could jeopardise trust and cooperation. In addition, guarding one's reputation serves as another type of deterrent against deviant behaviour and this appears to have links with the discussions in Chapter 6.2.2 about chi (a sense of shame). This suggests that a person with chi will be less inclined to do anything which would adversely affect their reputation. Chinese clans’ justice also includes shaming in the form of oral censure as a penalty for wrongdoing. Wang Liu found that, ‘Oral censure was an official act of the clan. The clan officers either reprimanded the offender personally or declared his censure at a clan meeting in the ancestral hall. Sometimes, the clan ordered the family head to reprimand the

357 Freiberg, above n 109, 25.
360 Ibid, 933.
361 Ibid, 933.
362 Liu, above n 359, 40.
Clearly, clan administered justice draws from the Confucian moral of *chi*, and the need to preserve one’s *mianzi* as a deterrent measure. These detailed analyses of both nodes and the unique controlling aspects of Chinese cultural nuances point to nodal governance as a viable model for a self-regulatory framework.

However, nodal governance is primarily a descriptive theory where the state’s role is weak, and so its emphasis on the plural locations of power and legitimacy might give rise to the possibility of an uncertain and fragmented social order. Then again, the state is not entirely removed from the regulatory framework. The state and non-state nodes work under a cooperative arrangement. The downside is that the lines of authority and the public and private divide can be blurred. Poststructuralists add to this debate by arguing that nodal governance is a polycentric regulatory regime where the state is not the locus of authority rather they are partners in a cooperative regulatory framework. The effectiveness of this regulatory approach would depend on the close collaboration within the network of nodes and the institutionalisation of the norms and values by these nodes in the form of contractual like agreed regulatory objectives and mechanisms. According to Gillespie and Peerenboom there is growing evidence to suggest regulation developed by non-state actors and business networks are gaining popularity across many Asian countries. Many of these self-regulatory regimes, developed by non-state actors, regulate through network governance based on traditional Asian values with the state taking on a minimal role. Therefore, despite the fact that the above regulatory framework has been

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363 Ibid, 40.
366 Freiberg, above n 109, 26.
367 Wright and Head, above n 364, 207.
368 Freiberg, above n 109, 25-6.
370 John Gillespie, ‘The Role of State, Non-state, and Hybrid Actors in the Localizing Global Scripts in East Asia’ in John Gillespie and Randall Peerenboom (eds), Regulation in Asia: Pushing Back on Globalization (Routledge, 2009) 24; Christopher Antons, ‘Traditional Knowledge in Asia: Global Agendas and Local Subjects’ in John Gillespie and Randall Peerenboom (eds), Regulation in Asia: Pushing Back on Globalization (Routledge, 2009) 64.
developed by academics from the West, this could be a model for the regulation of directors in Chinese family companies in Hong Kong and would allow for the tapping into Confucian values and extensive networks of Chinese family companies.

As mentioned in Chapter 6.4, Chinese associations known as *huiguan* and *tongxiang*, regulated their members with self-regulated *gui* (rules). Chinese family companies could consider reviving *huiguans* to regulate directors. Goh found empirical evidence that such forums had been successful in resolving disputes amongst Chinese living in modern day Malaysia. Then again, *huiguans* are relics of the past; a search of business associations in Hong Kong reveals that there are presently two leading institutions.

The Hong Kong General Chamber of Commerce (HKGCC), founded in 1861 is the oldest and largest business organisation in Hong Kong, with around 4,000 members. On closer inspection, from their list of past chairmen, it is apparent HKGCC represent the interests of many large listed companies, multi-nationals, and international companies. Their code of ethics states that:

> The Chamber expects each member to observe a high standard of business ethics, and to be honest in their dealings with government, officials, the public, firms or other corporations, entities, or organizations with whom the member company transacts, or is likely to transact.

> The Chamber expects each member to observe and comply with all laws, rules, and regulations of the Special Administrative Region of Hong Kong, in which members are registered as lawful business entities.

> Members should avoid any activities that involve or would lead to the involvement of the company in any unlawful practices. Accordingly, each member should understand the legal standards and restrictions that apply to all registered businesses in Hong Kong.

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371 Goh, above n 339, 105-17.
Clearly, this body does not reflect the Chinese values or represent Chinese family companies’ interests.

Another is the Chinese General Chamber of Commerce (CGCC) founded in 1900 it is one of the oldest and largest chambers in Hong Kong with a membership of over 6,000. The objectives of CGCC are:

- To promote trade and industry and enhance the prosperity of Hong Kong.
- To protect the right and interests of the business and industrial community in Hong Kong.
- To participate in public affairs and reflect the views of the business and industrial community.
- To develop international and regional communication with a view to promoting economic co-operation.

From CGCC’s website this organisation seems to be a body to voice their interests to the government and be represented in a number of governmental and community organisations. Again, despite the name, which includes the word, ‘Chinese’, nothing on CGCC’s website gave the impression that there was any concern with Chinese cultural values or that it represents Chinese family companies.

It would appear that there is not any business organisation or association in Hong Kong that formally represents the Chinese family companies. The network of Chinese family companies in Hong Kong is most likely to be informal, loose, and ad hoc. Therefore, instituting voluntary self-regulatory bodies or arrangements require the Chinese business community to come together to institute dispute resolution forums like those found in the huiguan or clans. Furthermore, even if such associations are community based, there still needs to be some form of recognition.

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from the Hong Kong government.\(^{378}\) Thus, the role of the Hong Kong government in such a self-regulatory arrangement has to be considered. Until such discussion is convened by the community of Chinese family companies, seeking resolutions to restore harmony between members of a family in a culturally appropriate manner will remain unavailable.

It is also worth noting that restoring harmony via mediation as noted in Chapter 6.3.1, were commonly held at *huiguan* in China for centuries. As such this regulatory mechanism could be revived to resolve disputes arising from Chinese family companies in Hong Kong. The use of mediation, as briefly mentioned in Chapter 3.4 is a means to resolve dispute between shareholders and the company and shareholders. Thus, it is a viable alternative to litigation. Wilson made some interesting remarks about meditation in Hong Kong as she noted that,

> Mediation is not a novel concept to Hong Kong people… [C]hinese society is renowned for placing high value on loyalty, trust and respect. Disputes were considered to be damaging to the harmony of society… [D]ue to the nature of a community-centred lifestyle, it was not considered strange that an elder should become involved in resolving the disputes of others. In contrast, such attempts would not have been construed kindly in Western cultures.\(^{379}\)

Whilst the early years of the colonial rule of Hong Kong statutes enacted in 1853 and 1899 respectively to stipulate that certain civil disputes could be resolved through mediation, they were repealed in 1910 because the colonial administrators felt as the legal system strengthen, disputes should be settled in the court of law.\(^{380}\) It was not until June 2012 the Mediation Ordinance (MO) was enacted and the act came into effect in January 2013.

\(^{378}\) Refer to the paragraphs in the above about the role of the state under the theory of nodal governance.

\(^{379}\) Claire Wilson, *Hong Kong Mediation Ordinance: Commentary and Annotations* (Sweet & Maxwell, 2013) 3.

\(^{380}\) Ibid, 7.
The impetus to enact the MO was prompted by the Chief Executive’s policy address in 2007-8, where he articulated the desire to alleviate conflicts and foster harmony, reduce the cost of litigation, and more importantly, help parties concerned to rebuild their relationship. \(^{381}\) In the search for a mediation framework for Hong Kong, the government working group on mediation was established by the HKSAR Department of Justice. This working group examined many mediation models in the US, Britain, Australia and New Zealand. \(^{382}\) More importantly, the working group recommended enacting legislation and listed model laws from many jurisdictions in Europe and Western countries, namely Denmark, England, Australia, Austria, France, Germany, Italy, Netherlands, New Zealand, Switzerland, and US, with the exceptions of Singapore and South Africa. \(^{383}\) Whilst it is difficult to be certain which of the above listed jurisdictions the MO was modelled upon, one thing is certain it is not based on traditional Chinese notions of mediation as practiced by huiguan and clans in China for centuries.

It is also important to note that Western and traditional Chinese notion of mediation differs substantially. As Goh observed,

In short, traditional Chinese mediation is vertically structured whereas Western-style mediation is meant to be horizontally based. This observation reflects the collectivism-individualism dimension. In another instance, the Western approach to mediation tends to be right-based and the Chinese style is predominantly obligations-based, with these features again being reflective of the individualism-collectivism variant. In light of this, culture does play a pivotal role in shaping the perceptual and procedural aspects of mediation, rendering its respective process with a particular hue and moulding them in specific style. One may concede that, ultimately, mediation serves the purpose of dispute resolution in a compromise-seeking, amicable and largely non-confrontational way. But in reality is that there are present cultural factor which contribute to the various subtle differences practices in the East and in the West. \(^{384}\)


\(^{382}\) Ibid.

\(^{383}\) Ibid.

\(^{384}\) Goh, above n 339, 17.
Therefore, it is fair to say that whilst mediation is a alternative to resolving disputes and restoring harmony and order in Chinese family companies in Hong Kong Western models are not suitable. This is why traditional Chinese approaches to mediation are more relevant in the search for a regulatory framework for Chinese family companies in Hong Kong.

7.4 Summary and Commentaries

This chapter has engaged in a wide range of legal, governance, cultural, philosophical, and social issues. Starting from the open ended debate about convergence versus path dependent models of corporate governance, this chapter suggested the possibility of a pluralistic governance model because each jurisdiction would have their own set of political, historical, cultural and economic factors to consider and failing to do so would be to ignore domestic concerns and reality. At the same time, no country or territory would be immune from the pressures of the globalisation of markets. Therefore, it is under the demands of these two distinct forces that a pluralistic corporate governance regime could transpire. This is certainly the case in Hong Kong where there coexists a set of formal rules transplanted from Britain to regulate the directors of companies, and another informal normative order embedded in the practices of Chinese family companies.

Such pluralistic order is not new from a legal perspective because Europe’s chequered history is an example of legal pluralism. But for Hong Kong, legal pluralism is weak because it has been subordinated to common law principles. Furthermore, legal pluralism exists in the form of customary laws in Hong Kong. Under this legal system, customary laws are limited to the subject matters, new legislative constraints, and to a certain extent, geographic boundaries to the north of the territory. Further, discussions in Chapter 4.4 found the courts have difficulties in applying common law principles onto Chinese customs and practices, in particular with traditional ancestral and commercial Chinese trusts. Given that prevailing laws are ill suited and the courts are not the right forum to resolve the disputes concerning members of a Chinese family company in a culturally appropriate manner, a separate corporate governance regulatory framework has to be conceptualised.
The search for a regulatory solution led one back to the fundamentals of regulation - values and norms. Whilst values and norms are integral to the constitutions of legal rules, Enrlich observed that customary practices and cultural values have a regulatory effect, labelling this as ‘living law’. Furthermore, he contended that it is not uncommon for people to follow social norms instead of official laws. For these people the centre of gravity of legal development lies not in legislation, but in society. For corporate governance, even though both laws and self-regulatory measures are central to the regulation of directors, in Hong Kong’s Chinese family companies, the Chinese value system, practices and norms have governed and self-regulated these companies because prevailing laws are ill suited to regulate them.

Since for the Chinese, ‘relationships’ and ‘the family and immediate community’ are central to the constitution of Chinese societies, the regulatory solution would have to build upon these two key elements. This relational outlook means that maintaining good relationships is a priority in this network community. Further, as the Chinese social structure is hierarchical in nature paternalism is deemed to be a social good, because a fatherly figure is expected be a benevolent leader. However, like any system it is vulnerable to exploitation. Paternalism without morality is nothing more than authoritarianism. Another facet of this relationally centred culture is harmonious relationships. Therefore, personal bonding and compromises are part and parcel of social interactions and dealings. Again, without the moral content this relational duty could be a form of coercion because the stronger party could compel the weaker party into an exploitative relationship. Therefore, the socialisation of morals and safeguarding of morals through relational interactions is an important part of this system of norms. Apart from the morality, dispute or conflict resolution in this relationally centred norm lies with the use of mediation to restore or repair relationships. As Goh wrote,

> mediation and conciliation as the prime method of dispute resolution for the Chinese may be traced to the Chinese cultural tradition of preserving harmony, maintaining peace, cultivating group solidarity through avoiding confrontation and engaging in aggression.
Litigation, which epitomises the latter traits, has traditionally been viewed with suspicion and discomfort by the Chinese because it runs counter to the traditional Chinese society... 

She added that:

Justice without courts, in traditional China, was prevalent practice. The idea of a continuum between humanity and nature categorically expressed the significance of the traditional dispute settlement process. Between the disputing parties, there should be no standard for what was right or wrong, and since everybody was positioned within a continuum, what really mattered was the approval of disputants standing in a definite relationship to each other and to the community at large.

It is in this light that directors of Chinese family companies should be regulated, and where their differences and disputes could be resolved.

Since the courts are not a culturally appropriate forum, and as noted there is no equivalent to a tongxiang, huiguan or business association that represents the uniquely Chinese aspects of Chinese family companies in Hong Kong, and given the informal nature of the business network some kind of arrangement has to be established, or at least some kind of consensus about instituting such a body or node to allow disputants to seek redress for their grievances is vital. Even though such recommendations are notional, it is a culturally apt proposition to fill the gap in regulation with the establishment of a pluralistic corporate governance framework in Hong Kong.

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385 Goh, above n 339, 66.
386 Ibid, 85.
Chapter 8 : Conclusions

8.0 Summary and Key Arguments of the Thesis

To reiterate from Chapter 1.0, Hong Kong had been a British colony for well over a century, yet this does not mean that the local Chinese residents have necessarily adopted the ways and culture of their former colonial masters. In fact many have held onto their Chinese cultural values and identities. Even though the transplanted laws from Britain have remained a key feature of the governance of the territory in its postcolonial era, it would be a mistake to think that they are unproblematic. The differences in the value systems embedded in the laws and in local Chinese cultural practices have created some ideological tensions, with each culture having its own strongly held assumptions about what is right or good, of which the governance of Chinese family companies is one example.

Regulatory tensions have arisen because Chinese family companies in Hong Kong are characterised as insider systems, with no one outside the family or extended family allowed to become shareholders and board members so both the shareholdings and directorships are held by the same individuals, but the law as it stands assumes that there is a separation between ownership and control. More importantly, the governance of these companies has clear Chinese cultural influences that steer the behaviour and mindsets of the directors. Hence, the values espoused in directors’ duties obliging all company directors in Hong Kong to be accountable and transparent are incongruent with the values and norms held by directors of Chinese family companies. This regulatory peculiarity affects about more than half a million companies in Hong Kong. However, given the distinct differences in the regulatory ethos of the British laws and the self-regulatory values embedded in Chinese companies it is not simply a matter of amending the law to incorporate Chinese values. Furthermore, the territory is an international financial centre, and to retain this status it is important for the laws to reflect international best practices so as to maintain the confidence of international investors. This could help explain why the regulation of Chinese family companies has not featured in the government’s policy or past reform agenda.
The incongruity in regulation could be traced to the source - the transplantation of a set of alien laws from Britain into Hong Kong during the era of Hong Kong’s colonial administration. Although the transplantation of laws is increasingly common around the world because of the globalisation of markets, this line of thinking neglects the cultural aspects of regulation. Laws are more than a set of rules; they are an expression or aspect of culture in the sense of shared traditions, values or beliefs. Therefore the discrepancy between what the law that seeks to regulate (accountability and transparency), and the actual conduct (paternalism and harmonious relationships) of Chinese family companies meant that the law as it stands is ineffective. Conceptually, a way to deal with the incompatibilities and differences between legal systems, norms and values is to establish a pluralistic regulatory framework. Legal pluralism suggests that an awareness of the socio-cultural plurality in societies is sparked by transplantation of laws creating more than one form of normative ordering. Plurality is therefore posed as a possible solution to address this gap in regulation. Thus, the research question of this thesis, as noted in Chapter 1.2.1 is:

Is a pluralistic framework more apt to deal with the incongruity between the law and practice in the regulation of the directors of Chinese family companies in Hong Kong?

A plain reading of the question raises a number of macro and micro issues and highlights contextual considerations. As such this thesis examined a number of disciplines, including law, jurisprudence, philosophy, history, culture, sociology, economics, international management, organisational behaviour, and public policy. By drawing on such diverse knowledge, this research endeavoured to analyse both extra-legal and non-legal issues. The methodological challenge was to bring together all those issues in a coherent manner. As mentioned in Chapter 1.2.2.1 a socio-legal approach was chosen because of the methodological malleability in incorporating such an array of issues so as to conceptualise a regulatory alternative for directors of Chinese family companies in Hong Kong.

The answer to the above research question was formulated into three key hypotheses. They are:
Hypothesis 1: Hong Kong’s corporate governance reforms do not reflect the needs and attributes of Chinese family companies.

Hypothesis 2: The values and norms espoused in Hong Kong’s prevailing directors’ duties transplanted from Britain are ill suited to regulate directors of Chinese family companies, because the way these companies are governed is based on a vastly different paradigm and value system.

Hypothesis 3: The differences between the transplanted laws and the indigenous Chinese value system and norms are irreconcilable. Thus, institutionalising Chinese governance practices under the umbrella of a pluralistic regulatory framework is expected to be a more receptive regime for the Chinese family companies in Hong Kong.

Each of the hypotheses is like a piece in a jigsaw puzzle. Putting them together has laid the foundation for the development of an alternative regulatory framework for the governance of Chinese family companies in Hong Kong.

8.0.1 Key Arguments and Conclusions in Part 1

Part one consisted of two chapters. Chapter 2.1 began with discussions about why the Hong Kong government is preoccupied with the adoption of international standards in corporate governance reforms. Their justification is to maintain Hong Kong’s position of an international financial centre. As noted in Chapter 1.1.1, the financial sector is one of the four pillar industries. Such is the significance of this sector it was even drafted in Article 109 of the Basic Law, which implies having a robust set of corporate governance regulations is a constitutional matter for Hong Kong. Apart from historical reasons the need for consistency (given that Hong Kong was a British colony) is another reason to continue using British laws as model laws for Hong Kong; furthermore, they have credibility as they are deemed to be an international benchmark upholding shareholders’ rights. Thus the acceptance of these laws is expected to reassure international investors that their interests are safeguarded by the rules and laws drawn from international best practices, as well as an independent judiciary.
When it came to reforming directors’ duties in Hong Kong, early attempts by the government in the 1980s to codify those duties failed. In 1994, a consultant commissioned by the government revisited this issue, and a report produced was in favour of codifying directors’ duties. However, the government’s advisory body on corporate law reform SCCLR was not convinced. Instead, they opted for a non-legal guideline to educate directors of their core legal obligations in plain English. The most recent attempt to reform Companies Ordinance was in 2006 when the codification of directors’ duties was back on the agenda. This time, there was some success with the growing consensus amongst the key policy stakeholders in favour of codifying only the directors’ duty of care, skill and diligence. There was however very little support to codify directors’ general law fiduciary duties. Since the release of the draft Bill, the Companies Ordinance Bill was gazetted on the 14 January 2011, and was subsequently introduced to the Hong Kong Legislative Council for its first reading on 26 January 2011. The Legislative Council finally passed this Bill on 12 July 2012. The new CO is expected to commence operation in 2014.

However, the discourse, debate and reform efforts have focused on non-family and publicly listed companies where there is separation between control and ownership. As noted in Chapters 1.1.2 and 1.1.3, the needs of Chinese family companies where the values are derived from their Confucian influence was missing from the reform agenda. This gap in corporate governance should not be overlooked any longer, for without proper regulations, governance problems could affect over half a million family companies in Hong Kong. However, before discussing a feasible solution for Chinese family companies in Hong Kong, it is essential to examine in detail the objects, values, and nature of directors’ duties so as to develop a better understanding of why Hong Kong chose British laws as a benchmark for its reforms.

Chapter 3.1 argued that as controllers of a company, directors have wide discretionary powers, thus they have to be accountable for their decisions and actions to the company. The primary objective of regulating directors was to reinforce the notions of accountability and transparency. To achieve this, the law imposed fiduciary obligations and duty of care onto each director. Directors from a legal perspective were deemed to be agents and trustees of the company. Concerning the
duty of care, this duty focused on director’s faults rather than the results he or she achieves. More importantly, the underlying assumption of these rules was that there was a separation between ownership and control.

Chapter 3.2 located a raft of court decisions in Hong Kong that mirrored primarily British judicial precedence. More interestingly, when it came to fiduciary duties, in the recent round of reforms, Hong Kong’s elite members of the business community and professionals voiced their preference for retaining the general law approach, whereas when it came to the duty of care the government was able to obtain some consensus from the policy community to adopt s174(1) and (2) of the British CA. This new statutory duty of care will be created in the new s465 of the CO, to be effective from 2014. This development is in line with the Hong Kong government’s policy objective to maintain the territory as an international financial centre by transplanting international best practices and governance standards.

Also this policy position was the product of regulatory capture of big businesses and elite members of professional bodies. Therefore, it is not surprising that Chinese family companies had never featured on the agenda of the reform. Part of the reason for this might be that they are self-sufficient in terms funding, or, that these companies are governed so differently from Western norms and ideals that the law as it stands seems to represent a social order that exists in a parallel universe from the directors of Chinese family companies. This adds to the point that the law for them is irrelevant to the governance of this type of companies.

In sum, part one of this thesis affirmed hypothesis one. So if more than a century of colonial government has had little impact on the way the directors of Chinese family companies think and behave, it is sensible to conclude that Western laws would not likely change the way that Chinese family companies in Hong Kong are governed. Logically, it is important to understand how these companies operate and are governed. This entails an appreciation of the Chinese values and norms as they form the building blocks of the governance of Chinese family companies in Hong Kong.
Further, the implications of this conclusion is apparent that there should be one set of rules for publicly listed and non-family companies with a diverse shareholding structure, and a different set of regulatory standards for Chinese family companies because the conceptualisation of governance is distinct.

8.0.2 Key Arguments and Conclusions in Part 2

This part was made up of three chapters. The central aim of this part has been to offer some explanation as to why western laws are not suited for Chinese family companies in Hong Kong. Chapter 4.1.1 argued that the development and prevalence of family-centred companies in Hong Kong ran against conventional economic sociological views that a modern capitalistic economy operates on principles antithetical to those of the family. Furthermore, in spite of Western influences and the modern attitudes of the Hong Kong Chinese, when it comes to the family, traditional Chinese values remain embedded. Thus, such Chinese value orientation has an inexorable effect on the governance of these family companies.

Before dispelling western laws in its entirety Chapter 4.2 examined some common law countries’ experiences in having separate legislations for family companies to see if there are any lessons that could be drawn from those experiences. Whilst family company laws in the US, South Africa, and Australia\textsuperscript{1800} have showed that legislators acknowledged the fact there is often no separation between control and ownership, the remedy in the US has been to impose fiduciary duties between shareholders. However, legal cases in Hong Kong about the disputes between members of Chinese family companies revealed that instead of taking action under directors’ duties they have chosen to seek remedies under s168A (unfair prejudice) and s177(1)(f) (winding up on just and equitable grounds). Thus, fiduciary duties did not feature in the dispute of these types of companies. From a Chinese cultural perspective, if harmonious relationships between members of the family have broken down, deadlock in management would occur and in the worst-case scenario fen jia (division of assets leading to liquidation) could transpire.

\textsuperscript{1800} Note that due to constitutional reasons Australia’s family company law was not enacted see Chapter 4.2.3.
Furthermore, Chapter 4.3.1 looked at two empirical studies to show that many directors in Hong Kong had very low awareness of their legal duties. Whilst some might think an education campaign could assist in increasing legal awareness, the most likely explanation is that familial and cultural concerns, rather than the law in Hong Kong dominated matters about governance. A few judges in the cases cited in Chapter 4.3.2 remarked in their obiter dicta that the importance of relationships amongst family members was a key factor in the continuation of their business operations. This suggests that the courts are not appropriate forums to mend relationships and create harmony amongst litigants. Yet, without an alternative, the directors of these companies have nowhere else to seek redress to their grievances. Other legal avenues were considered in Chapter 4.3.3 that included the possibility of amending the company’s articles or the use of shareholders’ agreement as governance substitutes for directors’ duties in Chinese family companies. However, such legal maneuver is most likely to succeed because the courts are not likely to unhold any arrangement to bypass general law obligations and statutory duties. Besides, s165 of the CO stipulates that directors could not lessen obligations encapsulated in fiduciary duties.

Moreover, Chapter 4.4 has also highlighted that the former colonial government attempted to regulate Chinese enterprises under the CPO and courts adjudicated on disputes concerning or in relation to tongs (Chinese ancestral trusts). However, the CPO was a complete failure because over a 35-year period only one such partnership was registered. As for the cases concerning tongs, the courts found it difficult to understand how these organisations operated let alone apply English legal principles onto Chinese traditions and practices, possibly due to the fact that it is difficult to apply common law principles onto Chinese customs and practices. In conclusion the discussions have so far pointed to fact that the Chinese culture does matter, especially when it comes to the governance of Chinese family companies in Hong Kong.

Chapter 5.1 drew from various literatures to show value differences between people in the workplace between Hong Kong and Britain. Amongst the differences between the two value systems, Hong Kong is collectivist, with high power distance, and
prone towards long term-orientation, all of which affected its business culture and
governance. Then Chapter 5.2 delved into Hong Kong’s business culture and
Chinese values to find the territory’s family centred form of entrepreneurialism and
its traditional Chinese value driven practices predated the British colonial
administration. This phenomenon was described by Gordon Redding as the ‘Spirit of
Chinese Capitalism’. This cultural imperative was also responsible for the formation
of an informal business network. This network structure helped Chinese family
companies gain access to markets, resources, sub-contracting arrangements and other
benefits, sustained through close personal interactions and not formal agreements.
This relational network system is based on mutual trust (xingyong) and personal
bonds (renqing, mianzi and guanxi). It is important to note that mutual trust
(xingyong) and personal bonds (renqing, mianzi and guanxi) are interrelated and
interlinked concepts where relationships are paramount in Chinese business culture
and practices in Hong Kong- even more important than the terms that are written into
legal contracts. It also has a regulatory effect, as they are binding on those who are
inside this network. For Hong Kong, the business network has helped preserve
‘entrepreneurial familism’ and it is sustained by shared values. This means the values
they hold affect the way these companies are governed.

Chapter 5.3.1 mapped out the key differences between Anglo-American and Chinese
family models of corporate governance. This mapping exercised revealed further
differences between the two systems of governance, in particular the importance of
paternalism and trust emanating from relationships. Chapter 5.3.2 looked into
paternalism and found that a parent-like relationship within the organisation exists
between the head and everyone in the company; this brand of leadership is
personality centred with the head of the company having hands on control. Finally,
there is an expectation of benevolent leadership, and the importance of harmonious
relationships meant that cooperation and avoidance of conflict was central. Therefore,
maintaining hierarchical order and good relationships between members of the
family is critical to its governance. Since prevailing laws are ill suited for Chinese
family companies, left to their own devices, tensions between family members might
trigger a breakdown in the corporate governance. Therefore, a culturally appropriate
framework is needed to regulate the governance of these companies.
Another important feature that has emerged from the discussions of the governance of Chinese family companies is the centrality of control held in the hands of the head of the family. Such a governance ethos could easily be deemed as authoritarian. In contrast, this chapter also briefly mentioned the Confucian influence in Chinese business culture and governance. Without Confucian morality the Chinese way of governance would be nothing more than the exercise of authority and the display of power in an either amoral or opportunistic sense. This in turn could allow corrupt practices and cronyism to manifest, whereas with Confucian morality as guiding principles, it is expected to bring about harmony. Therefore, it was important to explore Confucianism with greater detail in the following chapter.

Chapter 6.1 began with a short foreword about Confucianism highlighting the distinctiveness of his teachings from Western ideological perspectives, and the fact that these doctrines are not without controversies. However, the primary the objective of this chapter was simply to develop an understanding of Confucianism and not critique it. More importantly, the key to the Confucian notion of governance as noted in Chapter 6.2.1 is found in the concept of *san gang*. It refers to the three bonds – between ruler and subject, father and son, husband and wife, out of which the bonds between ruler and subject, and father and son, are the most important. The core obligation between subject and ruler was one of *zhong* (loyalty) and between son and father was *xiao* (filial piety). Both *zhong* and *xiao* shared a common thread; the relationships were vertical and strict. *Xiao* was not only the bedrock of a hierarchical order in a family but it was also the key measure of the moral excellence of a person. The father or fatherly figure also has a reciprocal obligation; he is expected to be benevolent towards his child and the family at large.

Whilst this hierarchical order might seem to be domineering and rigid to many, it was merely a social structure or framework to govern relationships. The substance or foundation of Confucianism is humaneness and the cultivation of moral precepts known as *wu chang* (five constant virtues). These five virtues were central to
individual morality and excellence. As discussed in Chapter 6.2.1, they are: *ren* (benevolence), *yi* (righteousness), *li* (propriety), *zhi* (wisdom), and *xin* (good faith). These virtues have to be internalised through self-cultivation. When one is able to master and practice *wu chang* these individuals were labelled *junzi* (noble person). They were observed out of a sense of obligation to society, or out of a sense of shame or guilt from fear of social sanctions for non-compliance. Furthermore, what Confucian principles of governance had shown was that it did not require legal rules and sanctions. They were social norms based on moral values. More importantly, it demonstrated that the Confucian system of governance builds self-regulation on an individual and group level. They are learnt and nurtured through the process of socialisation, forging a community of practitioners, which in turn is embedded in society as a norm. As Chapter 6.2.2 noted that the ends of such governance regime was to create a harmonious society. Harmony for Confucius was not uniformity, rather its where diversity can co-exist; as such the Confucian notion of governance is in itself pluralistic because it did not prescribe detailed rules. His notion of governance was to nurture moral values through people who yield to their positions of responsibilities while acting as moral exemplars to create a harmonious society.

As noted in Chapter 6.3, the Confucian theory of regulation is a non-legal, non-rule form of normative code of conduct governing the interactions with people, and mapping out different standards of appropriate behaviour in accordance with one’s social status or place in the family. This Confucian regulatory doctrine, known as *li* (an extension of the moral values discussed in Chapter 6.2.1) was deemed to have a regulative effect because it moderates human behaviour, regulates speech, attitudes and actions. It would vary according to one’s relations with other people. The significance of *li* (rituals and propriety) as a regulatory instrument is that it is a non-legal form self-discipline, self-restraint, and self-control – moderating what ‘thou shall and thou shall not’ in accordance with one’s role and the situation that he or she faces. Confucians claimed that this principle originated from heaven and was conveyed to humanity by ancient sages. Therefore, it is akin to the Western medieval natural law, but in reality, *li* is a socio-ethical regulatory imperative.
Next, Chapter 6.4 retraced some historical evidence of the application of the Confucian notion of governance and regulation. It is important to mention that China never had an indigenous company law, or ever felt the need to enact one until pressure from the West compelled the Qing dynasty to enact a company law. For centuries, what the imperial governments did not provide, in terms of business laws and regulations, the merchant and trade associations (*tongxiang* and *huiguan*) did. Much of the contents of these self-governing rules found in clans, *tongxiang* and *huiguan* were said to have some references to Confucian doctrines.

Even if time and modern developments had eroded the local Chinese familiarity and close affinity with Confucian doctrine, Chapter 5.3 has demonstrated that paternalism and harmonious relationships are products of Confucian teachings. Therefore, the regulatory solution is not simply a matter of amending the law to incorporate Chinese values as the two are incongruent. Under the current system of recourse to the courts the laws are culturally inadequate in cases involving family disputes and the outcomes for these companies might be *fen jia* which might not be necessary.

Nevertheless, the key message from the three chapters is that Western laws are not suitable for Chinese family companies in Hong Kong, validating the second hypothesis. Furthermore, part two of the thesis identified practice and norms in the governance of Chinese family companies, as well the roots of those attributes from Confucianism. The next step is to harness these norms and values to help to conceptualise a regulatory framework for directors of Chinese family companies that is culturally apt and appropriate.

### 8.0.3 Key Arguments and Conclusions in Part 3

Part 3 consisted of one chapter that sought to address the third hypothesis of this thesis. This chapter began by considering the ongoing debates about whether corporate governance regimes across the world are converging towards the Anglo-American model. Those in favour argued that this model was superior because of the
failure of alternative models, as well as being the ‘best thing’ for shareholders. Opponents to this line of argument are path dependence theorists; their core arguments were that corporate governance regulations were a product of a country’s history, political choices, stages of economic development, and socio-cultural values. Then again, no country or territory would be immune from the pressures of the globalisation of markets. Further, while there were merits in each argument, the general assumption was that only one could dominate, so is it possible for more than one form of corporate governance regime to co-exist? This is certainly the case in Hong Kong where there is a set of formal rules, transplanted from Britain to regulate the directors of companies, and another informal normative order embedded in the practices of Chinese family companies co-existing, thereby affirming the third hypothesis of this thesis.

Chapter 7.2 noted that Hong Kong’s legal system is in essence a pluralistic one, where there is one source of laws consisting of legislation and case law, and another source from Chinese customs. This was reinforced in Articles 8 and 40 of the Basic Law. It was a product of its colonial legacy. However, the applications of customary laws in Hong Kong are limited to certain areas. As noted, judicial precedence in Hong Kong defined customary laws as pre-colonial Qing codes and traditional Chinese customs. One of those is land disputes in Hong Kong’s New Territories, and others include customary marriages, traditional Chinese adoptions, and succession in traditional Chinese families. Furthermore, customary laws are subjected to many other limitations due to various statutes enacted over the decades. The limited scope of application was consistent with the notion of weak legal pluralism discussed in Chapter 7.2.3. This is when the state defined the parameters of the operation of such indigenous laws in such a way that they were inferior or subordinated to national laws. More importantly, Chinese customary law is only applicable as long as it is not repugnant to the fundamental principles of English common law and equity. Hence, to regulate the governance of Chinese family companies via Chinese customary laws would not only be deficient, but would also be limiting to tongs (Chinese ancestral trust) in the north of Hong Kong. Besides, Chapter 4.4 argued that the courts found it difficult to apply the common law principles onto tongs. Therefore, an alternative regulative framework to regulate the governance of Chinese family companies needs
to be conceptualised under the auspices of a pluralistic regime because the transplanted laws appear to be permanent.

The journey begins with the basics: the values and norms that have a regulative effect on individuals and the wider society. Whilst values and norms have been adopted as the foundation for laws, customary practices and cultural values of themselves, have a significant regulatory effect. Furthermore, it is not uncommon for people to follow social norms instead of official laws. For these people the centre of gravity of legal development lies not in legislation, but in society. For corporate governance, even though both laws and self-regulatory measures are central to the regulation of directors, in Hong Kong’s Chinese family companies, the Chinese value system, practices and norms have governed and self-regulated these companies because prevailing laws are ill suited to regulate them.

For the Chinese, ‘relationships’ and ‘the family and immediate community’ are central to the constitution of society. So the regulatory solution for the governance of Chinese family companies in Hong Kong would have to build upon these two key elements. However, like any system it is vulnerable to exploitation. Paternalism without morality is nothing more than authoritarianism. Other facets of this relationally centred culture are obligations and harmony of relationships. Again, without the moral content of this relational duty there could be a form of coercion because the stronger party could compel the weaker party into an exploitative relationship. Therefore, the socialisation of morals and safeguarding of morals through relational interactions is an important part of this system of norms. So this morality could be applied in the process of dispute or conflict resolution through traditional Chinese mediation to restore or repair relationships. It is in this light that directors of Chinese family companies should be regulated.

Given that the courts and current mediation framework under the MO are not a culturally appropriate forum; without a body equivalent to a tongxiang, huiguan or business association that represents the Chinese family companies in Hong Kong; and the informal nature of Hong Kong business networks; some alternatives have to be established. There should be some kind of consensus about instituting such a body
or mechanism for disputants to seek redress for their grievances. Given that such a body or arrangement does not exist, instituting this regulatory framework would be necessary to achieve the above aim.

8.1 Recommendations for Reform

The regulatory solution proposed in Chapter 7 raised a number of issues to consider. Firstly, about establishing standards based on the Chinese value system (self-regulatory instruments); and secondly, the establishment of a regulatory body where the regulatory standards are formulated and enforced (self-regulatory responsibilities). From these two aspects of regulation, a third has emerged. This third was briefly mentioned but not discussed in depth. This third issue is about the relationship between the government and a self-regulatory body or community which should be stipulated or at least considered. Thus, these three issues are interrelated and key to the regulatory solution requiring further analysis.

8.1.1 Conceptualising Regulatory Standards for Directors of Chinese Family Companies

To reiterate, the focus of governance concerns for Chinese family companies (as identified in Chapter 5) is paternalism and harmonious relationships. Unlike Western notions of accountability and transparency realised through fiduciary duties and duty of care, paternalism and harmonious relationships are broad value based principles with no prescribed provisions. Since the foundation of governance practices are influenced by Confucian doctrines, it is sensible to look into his teachings as a reference point in the search for modern Chinese governance standards.

To begin with Confucianism is an ancient doctrine. On the one hand, his ideals might not appeal to people in the 21st Century. They could be deemed as obsolete or even repressive when measured against modern Western moral benchmarks like fairness or accountability. On the other hand, his teachings have been entwined with Chinese culture, and so are embedded into one’s cultural identity. Having has said this, over time, Confucian moral ideals have either eroded or mutated into more moderate forms of a xiao (child) and a ren (father). And notions of what is appropriate behaviour according to li might be reduced to superficial compliance of socio-
cultural norms. Thus authoritarian governance is said to exist when paternalism is practiced void of morality.

The legitimacy of such control tends to be weak and not sustainable because it is dependent on the retention of near absolute control of the company. This could create resentment or rebellious elements when other members of the family disagree with the decisions of the patriarch. Furthermore, if disagreements are not settled, conflicts could escalate and cause deadlocks in the management of the company inducing the risk of *fen jia* (division of assets leading to liquidation), as has been seen in cases examined in Chapter 4.3.2.

Alternatively, paternalism and harmonious relationships are sustainable if they are based on moral precepts inspired or influenced by Confucian doctrines. Thus, this take on morality and moral benchmarks not only offers legitimacy for the paternalistic leader, it is the spirit that sustains this normative order. However, conflicts might emerge if morality wanes. Even if the patriarch believed he had acted morally, other members of the family might still disagree. Such tensions could turn into conflicts. Thus intervention and assistance in a culturally appropriate manner is vital.

Another important fact is that paternalism and harmonious relationships are not regulatory standards *per se*. They are in fact values and norms drawn from ideological archetypes. The ‘Chinese way’ to achieve this is by way of compromises and reconciliation between parties; they are normative archetypes, not apt to be turn into prescriptive, proscriptive, or prohibitive rules. Yet reliance upon the wider society to foster these regulatory values and norms might be too ambitious and impracticable. So instituting a body or coming to an arrangement to foster and reinforce the above is crucial. Furthermore, the regulation of the governance of Chinese family companies is a specific or targeted group of regulatees. Therefore, establishing a community of practice with the aid of a regulatory node or body is essential.

**8.1.2 The ‘Regulator’ or ‘Regulatory Arrangement’ in the Scheme of Things**
Drawing from the theory of nodal governance, this approach contends that nodes and networks could be instituted as an alternative to the conventional state led ‘command and control’ model of regulation to achieve regulatory objectives. Given that Hong Kong’s Chinese family companies have a closed system of informal networks,\textsuperscript{1801} this grouping could play a vital role in the self-regulation of directors of Chinese family companies. Historically, \textit{huiguan} regulated commerce and their members through \textit{gui} for centuries in China.\textsuperscript{1802} The establishment of a node or body for Chinese family companies in Hong Kong would in effect be enforced Chinese values and norms amidst dispute resolution between members of a family or extended family through the combination of persuasion, dialogue, and compromises.\textsuperscript{1803} However, such a body or node would not be a rigid or formalised association like professional bodies, because a directorship of a Chinese family company is not a professionalised occupation, nor does it require a specialised set of skills. Further, as mentioned in Chapter 8.1.1, paternalism and harmonious relationships could not be regulated through legal or even prescriptive rules. Instead through the mediation process moral ideals are applied to come to a resolution. Therefore, regulative order is restored by way of negotiated outcomes and reconciliation of relationships.

Moreover, as discussed in Chapter 7.3.5, nodal governance theory suggests that the government is not completely removed from the regulatory framework. Governmental recognition of a Chinese self-regulatory node or body would more than likely afford directors of Chinese family companies with greater confidence in seeking recourse through this suggested node or body. Under existing arrangements stipulated in judicial Practice Direction 31, the Hong Kong courts could encourage parties to seek alternative dispute resolution procedures like mediation to facilitate settlement of disputes.\textsuperscript{1804} As such the mediated outcomes of the proposed Chinese self-regulatory node or body could be acceptable to the courts. And since 1 January 2010 Practice Direction 3.3 allows voluntary mediation for petitions presented under s168A (unfair prejudice) and s177(1)(f) (winding up on just and equitable grounds) of the CO, if there are no allegations of insolvency concerning the subject

\textsuperscript{1801} See Chapter 5.2.2.
\textsuperscript{1802} See Chapter 6.4.
\textsuperscript{1803} See Chapter 7.3.5.
Therefore it would further bolster the regulatory role and the legitimacy of the mediated outcomes of the proposed Chinese self-regulatory node or body if a practice direction would be drafted by the government to allow the courts to direct disputes involving the governance and related issues of Chinese family companies in Hong Kong to this node or body.

8.1.3 Limitations of the Recommendations

The regulatory proposals in this section are based on the assumptions that if the regulatory framework is culturally apt, there will not only be acceptance amongst the directors of Chinese family companies in Hong Kong, compliance will not require much coercion. More importantly, the Confucian inspired ideals about governance and regulation could create order without the need for laws, and justice without courts. However, nothing was said about the mediation process or the mediator.

Goh’s account of traditional Chinese mediation in contemporary Malaysia amongst the rural Chinese Malaysians made out the process to be ad hoc, and it would seem that the character and influence of the mediator is important to the outcome. The same might apply to Hong Kong if the proposal discussed in the above should be instituted. Therefore, restoring paternalistic governance and reconciling relationships might lie in the hands of the person that mediates between members of the family during a dispute. Thus, this regulatory framework is overly dependent on personality and the ability of such a person to bring about compromises and reconciliation.

Another matter of concern is that even if the mediation succeeded there are no guarantees that the parties involved would be obliged to comply with the agreement. Furthermore, the proposal relies on the directors of Chinese family companies’ willingness to seek help and resolution of their disputes from such a proposed body. And given that this suggested body is not like a professional association with powers

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to expel members or withdraw their accreditation, the feasibility of the above recommendations might hinge upon the ability of such body to come up with some kind of sanctions to impose on parties for non-compliance.

Then again, paragraph 13(1) of Part B of the Practice Direction 31 stipulates that if the parties could not reach an agreement from mediation, they may seek to resolve the matter in court.\textsuperscript{1807} If this should occur, the directors of Chinese family companies would face similar problems like cases before them discussed in Chapters 4.3.2 and 4.4. Therefore, there is a choice, either dispute resolution by the courts using the transplanted British laws as regulatory standards or mediation via a Chinese self-regulatory body or node that reinforces the values of paternalism and harmonious relationships.

\section*{8.2 Areas for Future Research}

Thus far the proposed regulatory solution to the gap in regulation of Chinese family companies in Hong Kong is conceptual. It is based on certain assumptions about the Chinese value system and governance practices of these companies drawn from various sources and disciplines. Therefore, empirical research will be needed to test the viability of such a regulatory proposition. Ideally, this requires primary data from directors of Chinese family companies in Hong Kong.

Another area that should be given some attention is that at the moment there is no body, association, or even syndicate representing Chinese family companies in Hong Kong.\textsuperscript{1808} The most prominent business association is the Hong Kong Chamber of Commerce, but they represent large, publicly listed and multinational companies in Hong Kong. So the feasibility of establishing a \textit{huiguan} like body for Chinese family companies in Hong Kong also needs to be examined. Lastly, as noted in the above, government recognition is important. Thus seeking the views of the government is


\textsuperscript{1808} See Chapter 7.3.5.
another important part of this proposed regulatory solution. All of these aspects should be explored in future research.

### 8.3 Conclusions

This thesis is not about the search for a more robust and effective corporate governance regime in general. Nor is it about comparing which system of corporate governance, Western or Chinese is better. The primary objective is to seek a regulatory solution to deal with the incongruity between the law and the practices in the regulation of the directors of Chinese family companies in Hong Kong. This research argues that the establishment of a pluralistic corporate governance framework is the solution to the stated problems.

Whilst the British colonial administrators had helped transform this ‘barren rock’\(^{1809}\) into a global city, it would be a mistake to think that the laws regulating corporate governance transplanted from Britain would be unproblematic for some local Chinese in Hong Kong. To complicate the issue further, the transplanted laws are there to stay because the government and elite members of the territory’s business and professional community believed that these laws helped Hong Kong become an international financial centre. Admittedly, this is most probably true, since a large proportion of the investors in the territory’s equity market are from developed Western countries. These laws would provide investors legal safeguards that are comparable to international best practices and thus inspire confidence in Hong Kong’s equity markets.

In spite of this, Chapters 4, 5 and 6 have argued that these laws are ill suited to regulate the governance of Chinese family companies as the values and norms shaping the governance of these companies are Chinese. Such are the differences between the values espoused in the prevailing laws and those found in Chinese values and norms, the regulatory solution lies beyond existing boundaries of law

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\(^{1809}\) See explanation for this term in Chapter 2.1.1.
reform. Besides, cases involving the governance and related matters of Chinese family companies in Chapters 4.3.2 and 4.4 have demonstrated that the courts found it difficult to apply English principles of common law and equity due to the fact that they are irreconcilable with Chinese values and norms.

Chapter 5 found that the governance of these companies is hierarchical and relational-oriented. In essence, the underlining values of Chinese governance are paternalism and harmonious relationships. Confucian notions of san gang wu chang influence such practices. Yet left unregulated, governance and related problems in Chinese family companies could result in fen jia. So a regulatory solution is needed. Furthermore, Chapter 6.3 argued that for Confucius regulation is not based on legal rules, instead on social norms, as well as Chapter 6.4 had noted that historically the Chinese had relied on guilds and associations like huiguan to regulate commerce, therefore the solution does not rest on legal reforms.

Given the differences in governance and regulation between the West and the Chinese is so distinct, pluralism is proposed as a solution to the problem. Whilst Chapter 7.2.1 showed that legal pluralism exists in Hong Kong’s legal system as customary laws, Chapters 4.4 and 7.2.4 argued that they are limited to certain subject matters and geographically bound to the northern region of Hong Kong, as well as weak because legislation had reduced its scope and the courts had found it difficult to adjudicate. Therefore, an alternative regulatory framework for directors of Chinese family companies in Hong Kong has to be conceptualised. Chapters 7.3.4 and 7.3.5 has shown that paternalism and harmonious relationships are fostered through the mediation process of disputes. This process allows Chinese values and norms to be reinforced and applied to bring about compromises and reconciliation. Such a forum could be instituted by making use of informal Chinese business networks like a huiguan, but it would also require recognition by the government to gain wider legitimacy. Since governmental recognition and judicial practice, direction on mediation in Hong Kong is already in place, the mediated outcomes by a Chinese self-regulatory node or body could be acceptable to the courts.
Whilst Chapter 8.1.3 noted the limitation of the recommendations for reform, as well Chapter 8.2 highlighted the fact that more research needed to be done as this gap in regulation affects more than half million companies in Hong Kong. Much work is needed to realise a Chinese corporate governance regime like the establishment of a Chinese self-regulatory body. Nonetheless, the recommendations of this thesis are to address a long neglected area of corporate governance regulations in Hong Kong.
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**Thesis**


