International Lawyer

Volume 41
Number 2 *International Legal Developments in Review: 2006*

Article 33

2007

Asia and Pacific Law

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The Asia-Pacific Committee covers the Asia-Pacific region, including Afghanistan, Australia, Bangladesh, Bhutan, Brunei, Cambodia, the Cook Islands, India, Indonesia, Japan, North Korea, South Korea, Laos, Malaysia, Myanmar, Nepal, New Zealand, Pakistan, the Philippines, Singapore, Sri Lanka, Thailand, and Vietnam. This article highlights selected 2006 legal developments in India, Japan, South Korea, Malaysia, the Philippines, Thailand, and Vietnam.

I. India**

In 2006, India continued with its rapid economic growth by enacting significant legislation and making policy decisions aimed at harmonizing its laws with international regimes and further liberalizing the Indian economy. Certain key legal developments of particular interest to the international community are highlighted below.

A. Electronic Filing of Corporate Documents

Effective May 29, 2006, the Companies (Amendment) Act, 2006[1] came into force, allowing companies to undertake online filing of statutory documents with the Registrar of Company offices.[2] To facilitate maintenance of electronic records, the Amendment incorporates the provisions of the Information Technology Act, 2000[3] into the Companies Act,

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1. Full text of the Companies (Amendment) Act, 200, is available at http://www.mca.gov.in/MinistryWebsite/dca/actsbills/pdf/Comp_Amendment_Act_2006.pdf (last visited Mar. 5, 2007).

2. *See* § 610B(1)(a) of the Companies Act, 1956 (inserted by the Companies (Amendment) Act, 2006) [hereinafter Companies Act].

3. Full text of the Information Technology Act, 2000 is available at http://indiacode.nic.in/fullact1.asp?tfnm=200021 (last visited Mar. 5, 2007).

1956.[4] These provisions were inserted to further the major e-governance initiative of the Ministry of Company Affairs, known as the MCA-21 project.[5]

The Amendment has also made it mandatory for existing and prospective directors to obtain a Director Identification Number (DIN), while prohibiting companies from appointing or re-appointing individuals as directors without valid DINs.[6]

B. Amendments to the Securities and Exchange Board of India (SEBI) Disclosure & Investor Protection (DIP) Guidelines, 2000

During 2006, the SEBI made four key amendments to the SEBI DIP Guidelines, 2000.[7]

1. *Provision for Qualified Institutions Placement*[8]

In May 2006, the SEBI introduced Chapter XIIIA to the SEBI DIP Guidelines, 2000 providing an additional mode for listed companies to raise funds from domestic markets in the form of Qualified Institutions Placement (QIP). Under these provisions, a company whose equity shares are listed on a stock exchange having nationwide trading terminals and is complying with the prescribed requirements of minimum public shareholding of the listing agreement will be eligible to raise funds in the domestic market by placing securities with Qualified Institutional Buyers (QIBs).[9]

Only equity shares and any securities other than warrants that are convertible into or exchangeable with equity shares (specified securities) may be issued through QIP.[10] The specified securities must be made fully paid up at the time of allotment[11] and may be issued only to QIBs, who must not be promoters or related, directly or indirectly, to promoters of the issuer.[12]

Each placement of the specified securities issued through QIP must be on private placement basis and in compliance with the requirements of the Companies Act, 1956. A minimum of 10 percent of the securities in each placement must be allotted to mutual funds.[13] For each placement, there must be at least two allottees for an issue of size up to Indian Rupees 2.5 billion and at least five allottees for an issue size in excess of Indian Rupees 2.5 billion. Further, no single allottee shall be allotted in excess of 50 percent of the issue

4. *See* Companies Act, *supra* note 2, §§ 610B-E. These provisions relate to the authentication of electronic documents, electronic service and delivery of documents, maintenance of electronic records, online inspection of documents, and electronic payment of statutory fees.

5. MCA-21 is India's largest e-governance initiative of the Ministry of Company Affairs (MCA), in collaboration with Tata Consultancy Services Ltd., to provide electronic access to information, online submission of forms, and delivery of services to all the stakeholders of the MCA in the 21st century.

6. *See* Companies Act, 1956, §§ 253 (proviso), 266A-G; inserted by the Companies Act, *supra* note 2. DINs can now be obtained by filing online applications available at http://www.mca.gov.in.

7. The full text of the SEBI (DIP) Guidelines, 2000, updated up to October 18, 2006, is available at http://www.sebi.gov.in/acts/ipguidelines.pdf.

8. Inserted vide SEBI Circular No.SEBI/CFD/DIL/DIP/22/2006/8/5, dated May 8, 2006, is available at http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=25&sub_sec_id=25.

9. *See* SEBI (DIP) Guidelines, 2000, cl. 13A.1.

10. *Id.* at cl. 13A.1.1.

11. *Id.* at cl. 13A.3.3.

12. *Id.* at cl. 13A.2.4.

13. *Id.* at cl. 13A.2.2.

size.[14] Investors will not be allowed to withdraw their bids or applications after closure of the issue.[15] The floor price of the specified securities will be determined on a basis similar to that for Global Depository Receipt or foreign Currency Convertible Bond issues and will be subject to adjustment in case of corporate actions, such as stock splits, rights issue, bonus issue, etc.[16]

The aggregate funds that may be raised through QIPs in one financial year cannot exceed five times of the net worth of the issuer at the end of its previous financial year.[17] Further, there must be a gap of at least six months between each placement in case of multiple placements of specified securities pursuant to authority of the same shareholders' resolution.[18]

2. *Changes in Venture Capital Funds Lock-in Periods for IPOs*[19]

On October 16, 2006, the SEBI amended the SEBI (DIP) Guidelines, 2000 to clarify that the benefit of the "no lock-in period" for shares held by Venture Capital Funds (VCFs) and Foreign Venture Capital Investors (FVCIs) in a company prior to making an initial public offering would be limited to (1) shares held by the SEBI registered VCFs/ FVCIs for a period of at least one year at the time of filing of draft prospectus with the SEBI, and (2) shares issued to the SEBI registered VCFs/FVCIs upon conversion of convertible instruments during the period of one year prior to the date of filing draft prospectus with the SEBI, provided that the period of holding such convertible instruments as fully paid up, together with the period of holding shares resulting from conversion, by the VCFs and FVCIs, is at least one year from the date of filing the draft prospectus with the SEBI.[20]

3. *Restrictions on Pre-Issue Publicity by Issuer Companies*[21]

Effective October 18, 2006, every issuer company will have to follow certain guidelines concerning "Restrictions on Pre-issue Publicity" from the time the issuer company's board approves the issue until the actual allotment of shares in the issue. The restrictions, *inter alia*, require an issuer company to ensure that its publicity is consistent with its past practices and does not contain projections, estimates, or any information extraneous to the offer document filed with the SEBI. The issuer company is also required to make prompt, true, and fair disclosure of all material developments taking place during the above period, relating to its business and securities and also relating to the business and securities of its

14. *Id.* at cl. 13A.8.1.
15. *Id.* at cl. 13A.2.5.
16. *Id.* at cl. 13A.4.1.
17. *Id.* at cl. 13A.9.1.
18. *Id.* at cl. 13A.6.3.
19. Inserted vide SEBI Circular No. SEBI/CFD/DIL/DIP/23/2006/16/10, dated Oct. 16, 2006, is available at http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=25&sub_sec_id=25.
20. *See* SEBI (DIP) Guidelines, 2000, cl. 4.14.2(i). Prior to the Amendment, pre-issue shares of an unlisted company making an initial public offering were not required to be locked in, if the same were held by VCFs or FVCIs registered with the SEBI.
21. *Id.* at cl. 9.1.14. Inserted vide SEBI Circular No. SEBI/CFD/DIL/DIP/24/2006/18/10, dated October 18, 2006, is available at http://www.sebi.gov.in/Index.jsp?contentDisp= SubSection&sec_id=25&sub_sec_id= 25.

subsidiaries, group companies, etc., which may have a material effect on the issuer company by issuing public notices in newspapers.

4. *Guidelines for Issuers of Indian Depository Receipts*[22]

In April 2006, the SEBI issued certain guidelines to be followed by an Indian Depository Receipts (IDRs) issuer for coming out with such an issue. The guidelines, which are set forth in the new Chapter VIA to the SEBI (DIP) Guidelines, 2000, clarify that nonresident Indians and foreign institutional investors cannot purchase or posses IDRs without the prior permission of the Reserve Bank of India (RBI).[23]

The guidelines also set forth a minimum issue size of Indian Rupees 500 million[24] and stipulate that only companies with a good track record in the securities market that are listed in their home country and are not otherwise prohibited to issue securities by any regulatory body will be allowed to raise funds.[25]

C. Amendments To the SEBI (Foreign Institutional Investors) (FII) Regulations, 1995

In June 2006, the SEBI enacted the SEBI (FII) (Amendment) Regulations, 2006,[26] which amended the SEBI (FII) Regulations, 1995[27] by, *inter alia*, reducing the validity period of a registration certificate for FIIs from five years to three years[28] and increasing the registration fee from US$5,000 to US$10,000 and the renewal fee from US$1,000 to US$2,000.[29]

In September 2006, the SEBI again amended the SEBI (FII) Regulations, 1995 vide the SEBI (FII) (Second Amendment) Regulations, 2006,[30] whereby it expanded the list of foreign entities and funds eligible for registration as FIIs. The amended Regulations now permit foreign established or incorporated insurance companies, reinsurance companies, international or multilateral organizations or their agencies, foreign governmental agency, foreign central banks, and investment managers, or investment advisors proposing to make investments in India on behalf of broad based funds or its proprietary funds to be registered as a FII.[31]

22. Inserted vide SEBI Circular No. SEBI/CFD/DIL/DIP/20/2006/3/4, dated April 3, 2006, is available at http://web.sebi.gov.in/circulars/2006/cir092006.html.

23. *See* SEBI (DIP) Guidelines, 2000, cl. 6A.3(1).

24. *Id.* at cl. 6A.4.

25. *Id.* at cl. 6A.2.

26. Full text of the SEBI Circular No.SEBI/LAD/DOP/69520/2006, dated June 26, 2006, is available at http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=25&sub_sec_id=25.

27. Full text of the SEBI (FII) Regulations, 1995, updated through May 3, 2004, is available at http://www.sebi.gov.in/Index.jsp?.

28. *See* SEBI (FII) Regulations, 1995, reg. 8.

29. *Id.* at Second Schedule.

30. Full text of the SEBI Notification No. S.O. 1332(E), dated Aug. 21, 2006, is available at http://www.sebi.gov.in/acts/famend.pdf.

31. *See* SEBI (FII) Regulations, 1995, reg. 6(1)(d)(i)(i-a), (ii).

D. Liberalization Of Overseas Investment Under The Employee Stock Option Scheme

Effective April 15, 2006,[32] the RBI has allowed authorized foreign exchange dealers to handle remittances abroad for acquiring shares under stock option plans, provided that the dealer verifies that: (1) the foreign issuer owns at least 51 percent of the India subsidiary whose employees/directors are being offered stock options, (2) the shares under the plan are being offered by the foreign issuer globally on an uniform basis, and (3) the India subsidiary files an annual return with the RBI through authorized dealers giving details of remittances, beneficiaries, etc.[33]

The RBI has also granted a general permission to foreign companies to repurchase the shares issued to their Indian employees/directors under the stock option plan provided that: (1) the shares were issued in accordance with the requirements specified above, (2) the shares are being repurchased in terms of the initial offer document, and (3) the India subsidiary files an annual return with the RBI through authorized dealers giving details of remittances, beneficiaries, etc.[34]

E. Guidelines For Real Estate Mutual Funds

In June 2006, the SEBI approved certain guidelines for Real Estate Mutual Funds (REMFs) permitting them to invest directly in real estate properties in India.[35] REMF schemes will also be permitted to invest in: (1) mortgage (housing lease) backed securities, (2) equity shares/bonds/debentures of listed and unlisted companies, which deal in properties and also undertake property development, and (3) other securities.

The schemes must initially operate as close-ended schemes and must be compulsorily listed on the stock exchanges. Their net asset values will have to be declared daily. REMFs are required to appoint a custodian, certified by the SEBI, to carry on the business of custodian of securities for the safe keeping of title of real estate properties held by REMFs.

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32. *See* RBI Circular No. RBI/2005-06/353, dated April 5, 2006, is available at http://rbidocs.rbi.org.in/rdocs/notification/PDFs/69708.pdf.

33. Prior to the notification, foreign exchange dealers were permitted to allow remittances, without any monetary limit, where the foreign issuer held at least a 51% stake in the Indian company, whether directly or indirectly (i.e., through a special purpose vehicle or a step down subsidiary) where such remittances were made directly by the foreign issuer offering shares under the stock option plan. *See* Notification No. FEMA.120/RB-2004, reg. 22(2), dated July 7, 2004, *available at* http://www.rbi.org.in/Scripts/BS_FemaNotifications.aspx?Id=2126 (for previous regulations).

34. Previously, prior RBI permission was required to repurchase any shares issued by the foreign issuer under the stock option plan.

35. Press Release, SEBI, No. PR-166/2006, SEBI Board Approves (1) Guidelines for Real Estate Mutual Funds and (2) Changes in Venture Capital Fund Lock-In Period for IPOs (June 26, 2006), *available at* http://www.sebi.gov.in/Index.jsp?contentDisp=SubSection&sec_id=25&sub_sec_id=25.

F. Move Towards A Fuller Capital Account Convertibility

The RBI-appointed Committee on Fuller Capital Account Convertibility submitted its report on July 31, 2006.[36] The Committee, while considering fuller capital account convertibility, incidentally observed that though the overall regime had undergone a significant degree of liberalization, in practice, some regulations relating to an earlier period of tight controls continued to remain, giving rise to a disconnect between the regulatory intent and the procedure in use. Pursuant to the Committee's recommendations, the RBI has convened an internal task force to re-examine the extant regulations and make recommendations to remove the operational impediments in the path of liberalization already in place. The task force was expected to complete its work by December 4, 2006.[37]

G. Simplification of Special Economic Zones

The Special Economic Zones Act (SEZ), 2005,[38] came into force on February 10, 2006. The legislation aims to provide a duty-free environment,[39] generate additional economic activity, promote the export of goods and services, promote investment from domestic and foreign sources, and create employment opportunities.[40] The SEZs Rules, 2006,[41] issued pursuant to the SEZ Act, have drastically simplified procedures by providing minimum documentation for various activities of a unit, and a single window clearance facility on matters relating to central and state governments.[42]

H. Harmonization of Patent Laws

On May 5, 2006, the Ministry of Commerce and Industry notified the Patent (Amendment) Rules, 2006,[43] which have amended various provisions of the Patent Rules, 2003.[44] Under the new provisions, patent applications are to be compulsorily published within one month after expiration of the statutory period of eighteen months and, in the case of a request for early publication, within one month from the date of such request.[45]

Definitive time frames have also been prescribed for various functions performed by the patent offices. Accordingly, it is mandatory that patent applications be referred to an examiner within one month of filing of a request for examination,[46] and the controller is

36. Full text of the Committee on Fuller Capital Account Convertibility Report is available at http://www.rbi.org.in/scripts/PublicationReportDetails.aspx?fromdate=09/1/06&SecId=21&SubSecId=0 (last visited Mar. 5, 2007).

37. As of Dec. 13, 2006, the task force had not submitted its report.

38. Full text of the Special Economic Zones Act, 2005 is available at http://www.sezindia.nic.in/SEZ%20Act,%202005.pdf (last visited Mar. 5, 2007).

39. *See* SEZ Act, 2005, First Schedule, §§ 7, 26.

40. *Id.* § 5.

41. Full text of the Special Economic Zones Rules, 2006 is available at http://www.sezindia.nic.in/sez-rules 2006.pdf (last visited Mar. 5, 2007).

42. *See* SEZ Act, 2005, ch. V, §§ 13-25; SEZ Rules, 2006, § 5(5)(h).

43. Full text of the Patents (Amendment) Rules, 2006 is available at http://patentoffice.nic.in/ipr/patent/patent_rules_2006.pdf (last visited Mar. 5, 2007).

44. Full text of the Patents Rules, 2003 is available at http://patentoffice.nic.in/ipr/patent/patent_re_03.pdf (last visited Mar. 5, 2007).

45. *See* R. 7 of the Patents (Amendment) Rules, 2006.

46. *Id.* at R. 8(b)(i).

required to make a decision on the report of the examiner within one month of its submission.[47] The time for granting of permission to file patent applications abroad has been reduced to a mere twenty-one days as opposed to the previous three months.[48] On the other hand, timelines available to applicants and the public have been increased. For example, the time for making a request for examination has been extended from thirty-six months to forty-eight months,[49] the time for filing a pre-grant opposition has been extended from three months to six months,[50] and the time for meeting requirements of the first examination report has been increased to twelve months.[51]

The patent administration has also been decentralized, with the Patent Office branches at Delhi, Mumbai, and Chennai being allowed to undertake registration of patent agents, filing of patents outside India, revocation of patents, and amendment of complete specifications on directions from the central government in cases relating to atomic energy.[52]

II. Japan*

In 2006, Japan continued along its propitious path of legal reform by enacting and implementing statutes aimed at a broad range of areas, including Japan's emerging market for corporate control, corporate governance, financial instruments, business entity formation, mergers and acquisitions, and, perhaps most significantly, privatization of Japan Post, Japan's $3 trillion postal system that has long housed not only government-operated mail and delivery services, but also one-third of Japan's household savings and life insurance policies. The policy goals underlying these reforms center around the need for Japan to ensure its apparent recovery from its fifteen-year recession and to enable Japanese companies to better compete in the global marketplace. Also, in September 2006, Japan's charismatic Prime Minister, Junichiro Koizumi, stepped down, leaving some to wonder whether Koizumi's legacy of structural reforms will endure, or whether Japan will revert to its old ways of managed competition, pork barrel politics, *amakudari*,[53] and practices discouraging the inbound foreign investment that Japan so desperately needs.[54]

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47. *Id.* at R. 8(b)(ii).
48. *Id.* at R. 14.
49. *Id.* at R. 8(a).
50. *Id.* at R. 11(a).
51. *Id.* at R. 8(d).
52. *Id.* at R. 2.

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53. *Amakudari*, which literally means "descent from heaven," refers to an entrenched corporate norm involving the implicit agreement by firms to hire retiring bureaucrats as senior executives once the bureaucrats descend from their government positions. There is an implicit understanding that the former bureaucrat will garner advantageous government treatment for his new employer. *See* EDWARD J. LINCOLN, ARTHRITIC JAPAN—THE SLOW PACE OF ECONOMIC REFORM 48-49, 79, 104-06, 149, 185-86, 149-50 (2001). "At least until the mid-1990s, concepts such as group consciousness, *amae* by a paternalistic government, and strong government-private personal relationships reinforced by the practice of *amakudari* played a role in shaping deregulation." *Id.* at 150.

54. Because Japan's population is aging so rapidly, Japan needs more foreign investment to sustain its gross domestic product. In 2002, Prime Minister Koizumi set the goal of doubling foreign direct investment by the year 2007; however, this appears highly unlikely, especially in light of the government's decision to delay the effective date of a controversial provision in the 2005 Companies Law sanctioning cross-border triangular mergers as an acquisition technique. The provision sparked fears—arguably unfounded—that it would trig-

When Koizumi was elected Prime Minister in 2001, Japan's financial system was paralyzed with bad bank loans and a seemingly moribund economy. In September 2006, Koizumi left the new Prime Minister, Shinzo Abe, a different Japan—one with rehabilitated banks, a promising economy, and a more receptive attitude toward market-based and corporate governance reforms. Koizumi's legacy is threefold. First, he created a blueprint for future leaders on how to centralize power.[55] Second, Koizumi was able to resolve the banking crisis by insisting on a greater measure of market discipline.[56] Third, Koizumi was able to convince a majority of the public that, to sustain Japan's future economic growth, Japan's quasi-socialist financial system needed to be greatly downsized and modernized, and a high percentage of Japanese households' portfolios needed to move from government guaranteed savings deposits to risk-based investments in the private sector.[57]

Between late June 2005 and 2006, Japan's Diet (national legislature) enacted three major pieces of legislation to accomplish the goal of transforming savings into investments and to infuse market-based principles into Japan's financial system. These mammoth legislative reforms include: (1) the new Financial Instruments and Exchange Law (FIEL), which was adopted into law in June 2006;[58] (2) the new Companies Law,[59] which was

ger a spate of foreign hostile takeovers. In late 2006, the government set a new goal of doubling foreign direct investment by 2010.

55. Unlike his predecessors, Koizumi was able to exploit several political tools created by legislative amendments in the 1990s, including: (1) U.S.-style legislative districts designed to reduce factionalism, (2) a new cabinet ministry called the Cabinet Office, and (3) a new body called the Council on Economic and Fiscal Policy. Koizumi transformed the Economic Council into a powerful executive committee with which to spearhead and push through legislative reforms. *See* Sebastian Moffett, *New Blueprint—Koizumi's Success charts the Path to Japan's Future*, WALL ST. J., Aug. 28, 2006, at A1.

56. In 2002, Japan's banks—long accustomed to government bail-outs when they routinely became over-extended by propping up cadaver companies—were ordered to halve their bad debts by 2005. Some banks failed—once an unthinkable occurrence in postwar Japan. However, the tough-love approach infused market principles into the banking system and proved critical to Japan's economic recovery.

57. Nearly 51% of Japanese households' financial portfolios are held in cash and deposits, as opposed to just 18.5% in stocks, bonds, mutual funds, and investment trusts. By contrast, U.S. households' portfolios average 13.5% in cash and deposits and 53% in stocks, bonds, mutual funds, etc., while German households average 35% in cash and deposits and 33.4% in stocks, bonds, mutual funds, etc. *See* FINANCIAL SERVICES AGENCY, JAPAN, NEW LEGISLATIVE FRAMEWORK FOR INVESTOR PROTECTION—FINANCIAL INSTRUMENTS AND EXCHANGE LAW 3 (2006), *available at* http://www.fsa.go.jp/en/policy/fiel/20061010.pdf.

58. Financial Instruments and Exchange Law, Law No. 65 of 2006 [hereinafter FIEL]. The FIEL, which is slated to take effect incrementally between July 2006 and April 2008, replaces Japan's old Securities and Exchange Law, changing its name to the FIEL. The FIEL, abolishes four statutes and amends eighty-nine different laws—portions of which are being consolidated into the new FIEL. The FIEL (1) regulates a much broader class of securities and financial instruments than the old SEL; (2) imposes tougher penalties for fraud, disclosure violations, and market abuse; (3) contains more explicit parameters for conducting takeover bids, including a mandatory bid provision; and (4) imposes much more stringent (and controversial) disclosure requirements on marketers of financial products. For a detailed discussion of the FIEL, *see* an article in this volume of The International Lawyer: Pamela A. Fuller, *International Securities and Capital Markets*, Section VI, Japan, 41 INT'L LAW. __ (2007).

59. Kaisha Ho (Companies Law), Law No. 86 of 2005 [hereinafter Japan Companies Law]. The new statute, passed by the Diet on June 29, 2005, along with an accompanying Coordination Law, constitutes the most extensive revision of Japan's Commercial Code since World War II. The new legislation broadly amends and integrates several existing laws covering Japan's various business entities, including rules applicable to their incorporation, their internal governance, and their power to flexibly engage in M&A transactions. *See* Pamela A. Fuller, *Asia and Pacific Law*, Section I, Japan, 40 INT'L LAW. 515, 521-523 (2006); Pamela Ann Fuller, *International Mergers and Acquisitions*, Section XII, Japan, 40 INT'L LAW. 311, 325-328 (2006) (for an overview of the new Japan Companies Law provisions).

enacted in 2005 and became effective in May 2006 (except for a controversial triangular merger provision slated to take effect in May 2007);[60] and (3) enactment of a package of laws requiring Japan's largest state-subsidized enterprise, Japan Post, be privatized over a ten-year period stretching from 2007 to 2017 (Privatization Act).[61] Although the enactment of the FIEL and new Companies Law is expected to go a long way toward Koizumi's goal of moving savings into investments, the successful privatization of Japan's mammoth postal institutions, which would liberate nearly 200 trillion yen of personal savings, would likely prove an even more critical factor in creating more robust financial markets—not only in Japan, but in international markets as well.

Prime Minister Koizumi staked his political future on passage of the Privatization Act when, after Parliament's initial refusal to pass the legislation, Koizumi dissolved the lower house and called for a snap election on September 11, 2005, turning the election into a virtual referendum on privatizing Japan Post. Koizumi, whose motto became "the private sector can do what it can do," won the de facto referendum by a landslide, with many privatization defectors ousted from their seats by the voters. The Privatization Act was passed into law the following month, and now the process of implementing the Act—by hammering out the details, guidelines, and cabinet orders, and by making appointments and establishing procedures—will begin. The actual implementation of the Act will determine whether privatization will be authentic. The question remains whether Koizumi's successor, Prime Minister Abe, can continue to hold off the entrenched opponents of privatization.

60. The controversial provision, adopted in Japan's 2005 Companies Law, expands the categories of permissible consideration in triangular mergers to include cash, bonds, and shares of foreign corporations. This new provision will permit a Japanese target corporation to merge into a Japanese subsidiary of a foreign corporation with the target's shareholders receiving as consideration the acquiring foreign parent's stock and a limited percentage of cash or bonds. The amendment thus makes it easier and less expensive for foreign corporations to acquire Japanese companies, and to buy out any dissenting shareholders. But this very possibility is still generating a lot of resistance by Japan's powerful business lobby due to concerns that the provision will make foreign triangular mergers too easy to execute. Amid widespread fears of a sudden surge in foreign hostile takeovers of Japanese companies, Japan's legislature postponed the effective date of the foreign-merger provision to 2007—a move that has been disparaged by foreign business interests as too protective and discriminatory. At the end of 2006, there were calls to delay its effective date even further. Mariko Sanchanta, *Demand for Tough Line on Share Swaps*, FINANCIAL TIMES, Nov. 22, 2006, at 30. Even when foreign triangular mergers become legal under Japanese law in May 2007, they are not likely to become a popular acquisition technique unless Japan's tax law is also amended to make them tax deferred to the target's shareholders, which is the tax treatment accorded such transactions by many of Japan's trading partners, including the United States. *See, e.g.*, U.S. Treas. Reg. §§ 1.367(a)-3(c); 1.367(a)-3(d)(3), Ex. 5 (1998).

61. The Privatization Act is known in Japan as "Yusei Min-ei-ka Kanren Roppou," which means "the Laws related to Privatization of the Postal Services." The Privatization Act is comprised of six separate statutes including: (1) Yubin mineikaho [Japan Postal Services Privatization Law], Law No. 97 of 2005; (2) Nihon yusei kabushiki-gaishaho [Japan Postal Services Holding Company Law], Law No. 98 of 2005; (3) Yubin jigyo kabushiki-gaishaho [Japan Postal Delivery Services Company Law], Law No. 99 of 2005; (4) Yubinkyoku kabushiki-gaishaho [Japan Post Office Company Law], Law No. 100 of 2005; (5) Dokuritsu gyosei hojin yubin chokin, Kan'i seimei hoken kanri kikoho [Law for the Independent Administration of the Public Corporation to Manage Postal Savings/Postal Life Insurance], Law No. 101 of 2005; (6) Yusei min'eika ho to no shiko ni tomonau kankei horitsu no seibi to ni kansuru horitsu [Law Relating to Improvements, Etc., of Relevant Laws Accompanied by Enforcement of the Postal Privatization Law], Law No. 102 of 2005.

A. The World's Biggest Savings Bank: Japan Post

Japan Post is easily the world's largest financial institution. It not only operates Japan's sprawling post offices and mail delivery system, but also runs the world's largest private savings bank and life insurance company, accounting for 30 percent of Japan's individual savings, 40 percent of Japan's life insurance market, and 25 percent of all personal assets in Japan. Together, these assets are valued at US$3.45 trillion.[62] In all, Japan Post holds assets of approximately 330 trillion yen, which is approximately 65 percent of Japan's gross domestic product,[63] and easily more than any other private bank. Beginning in 2007, more than 200 trillion yen (US$1.7 trillion) will be available to be removed from Japan's postal institutions. Full privatization of an entity the size of Japan Post will have profound implications, not only for Japan's financial system, but for the entire world. Already, many global asset managers, investment banks, and marketers of financial products are jockeying for position to take advantage of what promises to be an impending flood of prospective customers' money into the private marketplace.[64] Given its colossal size, there is little wonder why the dispute over Japan Post's privatization continues, with the debate now focused on the sufficiency, implementation, and future effect of the 2005 Privatization Act. Some have questioned whether Koizumi's dream will ever be realized.

B. Implementing the 2005 Privatization Act

Initial implementation of the 2005 Privatization Act began in January 2006 with the formation of a new oversight company and appointment of its board members, who are considering various business models and guidelines to carryout the ten-year privatization plan. Specifically, Article 5 of the Privatization Act mandates that on October 1, 2007, Japan Post—a quasi-public corporation[65] heavily dependent on interest free loans and government subsidies—be divided into four separate corporate subsidiaries of a new holding company, which will be called Japan Postal Services Holding Corporation (JPSHC). Japan Post's four main businesses—mail delivery, postal savings, postal insurance, and its network of nearly 25,000 post office branches—will each be dropped into one of the four

62. Japan Post, Postal Services in Japan 2004: Annual Report, 2004; Japanese Bankers Assoc., Financial Statements of All Banks, 2004; Insurance Research Institute, Statistics of Life Insurance Business in Japan, 2004.

63. Thomas F. Cargill & Hal S. Scott, *Postal Savings in Japan and Mortgage Markets in the U.S.*, FRBSF Economic Letter (Newsletter No. 20006-03), March 3, 2006, at 2.

64. See Carol Wood, *Special Delivery: Japan Post to be Privatized—When the Government Opens Japan's Postal System to Private Entities, More Than 200 Trillion Yen of Personal Savings Will be Ripe for Picking*, Bus. Week Online, April 5, 2006, http://www.businessweek.com/print/investor/content/apr2006/pi20060405_205672.htm (noting that Goldman Sachs has "projected that by year-end 2010, total mutual fund balances held through [Japan's] postal offices could total over $60 billion, if sales follow the same pattern as" when the former ban on mutual fund sales by banks was lifted in 1998).

65. As a part of a 1999 ministerial program ostensibly aimed at reforming the Fiscal Investment and Loan Program (FILP), Japan Post was incorporated in April 2003 with the government's postal businesses then controlled by the Ministry of Internal Affairs and Communications. *See* Ministry of Finance, Framework of the Fundamental Reform of the Fiscal Investment and Loan Program (FILP) (provisional translation, 1999), *available at* http://www.mof.go.jp/english/zaito/zae055.htm (last visited Mar. 5, 2007) (for an overview of the 1999 reform effort of the FILP). Thus, beginning in 2003, Japan's postal system businesses were no longer owned and operated directly by the government, although they have continued to enjoy substantial subsidies in an interest-free and tax-free environment.

wholly owned subsidiaries of JPSHC. Initially, the government will hold 100 percent of the JPSHC's stock.[66] But by October 2017 (the end of the ten-year transition period), the Act requires JPSHC to put up for public sale all of its shares in two of its subsidiaries (the savings and life insurance companies), though JPSHC may immediately repurchase the shares. The mail and branch network businesses will continue to be held as wholly owned subsidiaries of JPSHC.[67]

The Act also mandates that the government sell most of its shares in JPSHC by 2017, although it is required to maintain a one-third equity interest even after the transition period. Under the Act, only the postal savings and life insurance obligations existing in 2017 will continue to be guaranteed by the government, and these grandfathered accounts will be placed into government bonds. All employees of Japan Post will lose their status as "government employees" (but not necessarily their jobs), and the postal savings and insurance subsidiaries, as well as JPSHC, will be taxed as business corporations. The postal savings system (PSS) will be required to start contributing to the national deposit insurance system like any other private savings institution. Finally, the postal savings and insurance subsidiaries will be given special licenses enabling them to conduct a full range of business activities, domestically and internationally. The details of the implicit government guarantees and the licenses, however, have yet to be delineated.

1. *Privatization Debate*

Those favoring privatization (including many economists), argue that to meet the current and future requirements of Japan's economic growth, the existing structure and size of Japan Post must be made more efficient and profitable.[68] One catalyst driving the reform effort is that Japan's rapidly aging population is creating an increasingly higher ratio of individuals who strain government resources for pensions and healthcare.[69] Japan's GDP per capita is likely to decline unless these demographic changes are offset by increased productivity. Japan's staggering national debt, which it incurred during its long recession, already exceeds 164 percent of its GDP.[70] While the economic and structural reforms that began in the 1990s with the Big Bang movement have succeeded in incrementally moving Japan toward a more market-driven economy and further away from its postwar quasi-socialist system—in which competition was managed by elite bureaucrats through administrative guidance, and capital was allocated without reference to risk—the

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66. Japan Postal Services Privatization Law, Law No. 97 (Oct. 21, 2005), art. 5.

67. *Id.* In a clarification to the final bills that were passed in October 2005, both the mail delivery company and the network of branch post offices will be required to maintain "universal service," and will not be allowed to close rural branches or more remote delivery sites, even if they prove unprofitable.

68. *See, e.g.*, Cargill & Scott, *supra* note 63, at 2; Edward J. Lincoln, *Arthritic Japan—The Slow Pace of Economic Reform* 207 (2001) ("[O]ver the next decade, demography creates its own problems, with a shrinking and aging population leading toward a social security and pension fund crisis. A poorly performing economy will not be in good shape to cope with this looming problem.").

69. In 2000, the ratio in Japan of "productive members" to "dependent members" stood at 4 to 1. But by 2050, this ratio is projected to drop to 1.5, which is approximately 4 productive members to every 2.5 dependent members. *See* National Institute of Population and Social Security Research, Future Estimated Population of Japan (2002).

70. *See* International Monetary Fund [IMF] Japan, *Staff Report for the 2005 art. IV Consultation*, July 26, 2005. By comparison, the U.S. public debt is 63.7% of U.S. GDP. *See* IMF U.S., *Staff Report for the 2005 art. IV Consultation*, July 30, 2005.

last fifteen years of reforms will be frustrated and perhaps completely undermined if the government continues to subsidize and insulate Japan's postal institutions from market pressures to become more efficient. In sum, privatization proponents argue that Japan Post essentially functions as the national bureaucracy's pocketbook, misallocating capital to boondoggles and public works projects of questionable social value in exchange for votes. And, because these investments are guaranteed by the government, they expose Japanese taxpayers to large losses, infusing unreasonable systemic risk into the economy.

Privatization's opponents, on the other hand, have long argued that giving Japan Post's services completely to the private sector will be too disruptive and throw much of Japan's infrastructure into disarray. The public is concerned that the quality of mail delivery and depository services will diminish under a private competition model because it may prove too tempting for a private company to simply close delivery services and branches that fail to generate profits.[71] One of the most vociferous opponents to privatization of the postal system, along with the conservative branch of Japan's powerful Liberal Democratic Party (LDP), is Japan's construction lobby because construction companies are reaping the benefits of the huge public works construction contracts that are financed with interest-free loans from the postal savings system. Even some financial institutions are opposed to privatization of Japan Post, primarily because they worry that they won't be able to compete with such a massive corporation, especially if the advantages now enjoyed by the postal companies are continued.[72]

2. *Risk of Political Tinkering, Backpedaling, and Collusion*

If the Privatization Act has one major flaw, it is that many issues are left unaddressed and, thus, are susceptible to political tinkering, if not outright manipulation, by Japan Post's old vested interests. Although Article 2 of the Postal Services Privatization Law commits Japan to implementing "measures to ensure equivalent conditions of competition between [the privatized postal entities] and other companies engaged in like businesses," certain features of the Act appear to conflict with international best practices on privatizing state-owned enterprises, as well as Japan's international trade obligations.[73]

In particular, the Act provides that the government's holdings in the new JPSHC will at no time drop below 30 percent. Private competitors and foreign investors are concerned that, given this stipulation in the Act, the affiliated group of entities that formerly comprised Japan Post will continue to be the biggest player in Japan's financial system, and will continue to enjoy implicit government guarantees and financial breaks. Moreover, although the privatized postal companies will be held in separate subsidiaries, they pose a classic transfer pricing problem in that it will be difficult to impose a fair-market-value, arm's length standard on their inter-company dealings, given their brother-sister corpo-

71. Although the Privatization Act requires "universal service", some critics worry that this requirement may ultimately be lifted.

72. Lawrence White, *Yucho: "Whale in a Pond" Makes a Break for Open Waters*, EUROMONEY, Nov. 2006, at 1.

73. For example, the Privatization Act fails to delineate "clear, objective criteria upon which the ministers must base their approvals or upon which the Privatization Commission must base its recommendations to ensure a level playing field before the Privatized Entities are allowed to expand their range of businesses." American Chamber of Commerce in Japan, Privatization Task Force, Applying Global Best Practices to the Implementation of the Postal Privatization Laws 12 (Nov. 2005) [hereinafter Privatization Task Force].

rate relationship and their present level of functional integration. Under the Act, PSS and the life insurance companies will still be able to use the network branches during and after the implementation period when the privatization is to be complete,[74] an advantage that was not negotiated at arm's length. Although the new subsidiaries will be required to pay tax and deposit insurance, the Act is silent as to whether the rates will be the same as any other private institution.

With respect to numerous other points, relationships, and conceivable scenarios, the Privatization Act is ambiguous and vague, raising genuine concerns that the ostensible privatization of Japan Post—one of the world's largest state-owned enterprises (SOEs)—may, in the end, tend to serve Japan's entrenched bureaucratic elites and others with vested interests in the status quo, perhaps becoming a fiasco reminiscent of the disastrous privatization of SOEs in Eastern Europe following the collapse of the Soviet Union—a naive privatization effort that was immediately impaired by collusion and corruption.[75] Although Japan has an infinitely stronger set of complementary institutions than did the former Soviet satellite countries,[76] there is certainly room within the porous parameters of

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74. White, *supra* note 72, at 1.

75. *See* Masahiko Aoki, Information, Corporate Governance, and Institutional Diversity 95-117 (Stacey Jehlik, English trans., Oxford University Press 2000) (originally published in Japanese by Toyo Keizai Shinpo Sha, 1995). Discussing the relevance of corporate governance to transition economies, Aoki states: "As Sergei Braguinski recently warned, the insider control problem in Russia should not be seen by Japan today as somebody else's problem." *Id.* at 98. When the communist economies of the former Soviet Union and Eastern Europe (e.g., Poland, the Czech Republic, and Hungary) suddenly collapsed in the early 1990s, the Walrasian Anglo-American system was chosen as "the model" to emulate. Accordingly, state-owned enterprises (SOEs) were rapidly privatized in hopes that a vibrant stock market would surface to effectively monitor the companies' managers. But clearly that is not what happened. Instead, a monitoring vacuum was created, resulting in widespread corruption and insider control. Directors of the former SOEs acquired the majority rights in the newly privatized corporations and then colluded with middle managers and workers to exact a host of private benefits.

Advocates of privatization had underestimated the lingering legacies of communism. Towards the dusk of these communist regimes, the Communist Party bureaucrats had already yielded much of the managerial control over SOEs to their directors. The rank-and-file employees also had acquired extensive vested interests in the enterprises in the form of job security, housing, pensions, health and childcare, and recreational facilities. Fearing they would lose their existing privileges, the SOE managers sought other employees as their allies in an effort to construct collusive empires, free of external monitoring and legal constraints. In the absence of an independent and powerful privatization agency, like that which reformed East Germany's economy, it proved very difficult to transfer property rights in the corporations to widely dispersed new shareholders without making political concessions to those with vested interests and managerial control. Because the reformers feared that the property rights would inevitably be captured by the omnipresent bureaucrats, who were accustomed to exacting private benefits under the old communist order, the reformers themselves were anxious to cut deals. Thus, collusive side agreements became the norm. Moreover, Russian managers began to enlist the services of the Russian Mafia in order to resolve contract disputes in their favor. In short, everyone wanted a piece of the crumbling economic pie and the newly privatized corporations were essentially looted as a result. The new corporate insiders were free from market discipline except for possible bankruptcy. However, even this possibility was mitigated by continued state subsidies that were disguised as legitimate credits. *See id.* at 95-96, 98-102.

76. History shows the inherent difficulty of transplanting economic models that have evolved over time in their own unique environments. Economies tend to be path-dependent; preconditions must exist for there to be a meaningful change in their direction. In order for a vibrant market for corporate control to be established, a receptive institutional environment needs to either be cultivated or already in existence. Complementary institutions for a market economy include private property rights, legally enforceable contracts, independent securities regulators, investment banks, securities analysts, rating agencies, and rules or incentives geared toward the full and accurate public disclosure of publicly held corporations' financial state and

the Privatization Act for collusion and unfair business practices to emerge (or continue). The American Chamber of Commerce in Japan (ACCJ) is sufficiently concerned about this risk that it has issued a white paper calling for Japan to apply global "best practices" in hammering out the details of Japan Post's privatization.[77] In particular, the ACCJ advocates compliance with privatization guidelines issued by the Organisation for Economic Co-operation and Development (OECD).[78]

3. *Global "Best Practices" and "National Treatment": Will Japan Apply Them in Implementing Privatization?*

The OECD, of which Japan has long been a member, has established nonbinding guidelines on the corporate governance of SOEs, which arguably represent an international benchmark to assist governments in improving the way they perform their ownership (or de facto ownership) functions.[79] At the heart of the guidelines is the OECD's emphasis on ensuring a "level regulatory playing field" between the privatized entities and their competitive counterparts in the private sector. In a 2005 policy brief, the OECD explicitly interpreted this principle with respect to the privatization of Japan Post.[80] After noting the benefits privatization will confer, the OECD states in its policy brief that the actual realization of "the desired benefits requires that:

- There should be a level playing field between Postal Savings and Postal Life Insurance and private institutions, including equal treatment under the regulatory framework.
- Postal Savings and Postal Life Insurance should not be allowed to offer new products before the establishment of equal treatment.
- The privatisation, which is to be finished by 2017 at the latest, should aim at a complete divestiture of the government's holdings in financial services."[81]

In addition, the OECD has stated that "[a]t a minimum, equal treatment would require that—in addition to paying taxes and premiums for deposit and insurance contracts—Postal Savings and Postal Life Insurance would be subject to the same regulatory framework as private institutions."[82] As detailed by the ACCJ, the Privatization Act, as presently drafted, does not live up to these OECD criteria for best practices.

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performance. The former Soviet Union and Eastern Europe lacked these institutions. Thus, the initial attempts to prophylactically apply the Walrasian model in those countries failed. The actual transition to a market economy in Russia and Eastern Europe has turned out to be a much slower process than what anyone expected when the quick-fix reform efforts began there in the early 1990s. *See id.* at 95-104, 166-68.

77. *See* Privatization Task Force, *supra* note 73.

78. *See id.* at 5-7, 10-16; *see also* OECD, *Policy Brief, Economic Survey of Japan*, at 7 (2005), *available at* http://www.oecd.org/dataoecd/50/37/34286799.pdf [hereinafter OECD Policy Brief].

79. *See* OECD Working Group on Privatisation and Corporate Governance of State-Owned Assets, *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2005), *available at* http://www.oecd.org/dataoecd/46/51/34803211.pdf. (last visited March 26, 2007). Although the guidelines are not legally binding, they purport to set forth a general consensus on the best international practices and benchmarks.

80. OECD Policy Brief, *supra* note 78.

81. *See id.* at 7, col. 1. The IMF has also emphasized "the importance of taking timely steps ahead of full privatization to ensure fair competition with private institutions." *See* IMF Japan, *Staff Report for the 2005 art. IV Consultation*, (July 26, 2005).

82. OECD, *OECD Economic Surveys–Japan*, Vol. 2005/3 (March 2005).

Moreover, the Act appears to fall short of Japan's international trade commitments as a member of the World Trade Organization[83]—in particular, the requirements that Japan, in privatizing Japan Post, accord "most favored nation" (MFN) status to other WTO members, and comparable "national treatment" to foreign producers and most foreign services providers that is no less favorable than the treatment Japan normally affords to its domestic goods and service providers.[84] To the extent the Act and the forthcoming Implementing Rules allow the privatized institutions to continue to enjoy competitive advantages over non-domestic providers of goods and services, the national treatment requirement may be directly violated. In any event, certain provisions in the Act lack sufficient detail to establish the level-playing-field environment contemplated by the national treatment standard.[85]

In light of the requirement in Article 2 of the Postal Services Privatization Law that Japan implement measures and rules designed to "ensure equivalent conditions of competition," the ACCJ advocates that the forthcoming Implementation Rules, the drafting of which was begun in 2006, explicitly require the following:

- Measures to ensure that the privatized institutions objectively meet the same licensing and supervisory requirements as private-sector financial institutions, including requisite risk management and internal control requirements and full government supervision;

83. One of the fundamental policy objectives underlying the privatization of Japan Post is to allow Japan to compete more readily in the international marketplace. To this end, the privatization effort should comport with international law, particularly Japan's commitments under the World Trade Organization's Uruguay Round Agreements. *See* Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, Apr. 15, 1994, 33 I.L.M. 1125 (1994); General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A-11, 55 U.N.T.S. 194 [hereinafter GATT]. More specifically, implementation of privatization must be consistent with Japan's obligations under the GATT, as well as the General Agreement on Trade in Services (GATS), and the Agreement on Government Procurement, all of which incorporate the MFN and national treatment standards in some form. *See infra* note 84. (Under GATS, national treatment only applies to listed services, but usually includes financial services.) *See* General Agreement on Trade in Services, in Uruguay Round Final Act, Dec. 15, 1993, Annex 1B, GATT Doc. No. MTN/FA, 33 I.L.M. 1130 (1994) [hereinafter GATS]; Agreement on Government Procurement, Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 4(b), 1915 U.N.T.S. 103 (1996).

84. The MFN clause is a "favor one, favor all" nondiscrimination clause that generally requires all WTO members to provide their best trade terms to all other official members of the WTO. The national treatment clause, on the other hand, requires WTO members to bestow on all *foreign* producers and service providers (regardless of their WTO membership status) the same regulatory treatment that they would ordinarily bestow on their *domestic* producers and service providers. Although GATS only applies the national treatment standard to listed services, financial services are generally subject to the standard. *See* GATS, art. XVII Japan, "Schedule of Specific Commitments," GATS/SC/46 (1994); Japan, "Schedule of Specific Commitments," Supp. 3 GATS/SC/46/Suppl.3 (1998).

85. Although Japan has made great strides over the last few decades to embrace the new era of globalization, Japan has not been "a progressive force in the WTO," and has a history of placing strict constraints on foreign investors. Provisions designed to inject market principles into cross-border trade and investment issues have usually been the result of *gaiatsu* (foreign pressure). *See* LINCOLN, *supra* note 53, at 14-15; DAN FENNO HENDERSON, FOREIGN ENTERPRISE IN JAPAN, 237-257 (1973) (describing Japan's more liberalized attitude towards international law as "controlled liberalization."). *See also* Carol Wood, *Special Delivery: Japan Post to be Privatised*, BUS. WEEK ONLINE April 5, 2006, http://www.businessweek.com/investor/content/apr 2006 ("Past efforts by non-domestic money managers to infiltrate the world's second-largest economy have met with disappointment.").

- That the privatized institutions be strictly prohibited from expanding their businesses until such proper licensing criteria are in place and such requirements are met;
- Objective criteria to ensure that when the current restrictions on the scope of the privatized institutions' businesses are lifted, the privatized institutions are fully compliant with the licensing standards imposed on private sector competitors;
- Clear, objective criteria regarding the conditions under which disbursements from the postal institutions may take place so as to ensure a regulatory playing field and compliance with Japan's international trade commitments, particularly those under the GATS;
- Measures to ensure that all transactions between the JPSHC and the privatized postal entities are conducted on an arm's length basis (consistent with Japan's transfer pricing regulations in its tax law) to prevent the transfer of risk (and tax obligations) on a non-market basis;
- Measures to ensure that the privatized institutions do not receive any special tax exemptions that will provide them with unfair advantages over their competitors; and
- A transparent rulemaking process, subjecting the Implementing Rules to a meaningful public comment period, including public hearings regarding all recommendations made by the Privatization Commission.[86]

The ten-year formal process for implementing Japan's new Privatization Act is slated to begin in early 2007. On the surface, Japan appears to be making real headway in adopting sweeping legal reforms and government initiatives aimed at overcoming traditional practices, infusing market principles into financial industry regulations, and liberalizing its institutions from cozy relationships that have proved crippling in Japan's recent past. Japan's recent economic progress has provoked exclamations that "Japan is back!" However, the most appropriate question may be, "but for how long?" Whether Japan can manifest Prime Minister Koizumi's vision of privatizing Japan Post, the largest savings bank in the world, may answer that question. Hopefully, the ministers and officials in charge of implementing the Privatization Act and drafting the Implementation Rules will heed the advice of economist Edward Lincoln, who might conceivably exclaim: "Let the market do it!"[87]

III. South Korea I*

The year 2006 witnessed growing efforts in the Korean public sector to reform some of the key economic regulations. The common underlying theme of the recent regulatory

86. *See* Privatization Task Force, *supra* note 73, at 10-16.

87. *See* LINCOLN, *supra* note 53, at 186.

> [The] government's continuing role in industrial policy and its interference in industries and markets has [sic] not elicited much criticism because so many in society take it for granted. Any economist who believes in the efficiency of markets must be dismayed by the reality of Japanese government behavior. One is tempted to shout out, "Let the market do it!"

Id.

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reforms has been the promotion of economic efficiency through the enhancement of regulatory effectiveness and, at the same time, elimination of unnecessary red tape. In line with these reforms, the Government has sought to improve the transparency of corporate governance and accountability through amendment of the corporate law section of the Korean Commercial Code so that the Korean legal system may keep up with firmly established legal norms, standards, and principles of Western legal systems.

In addition, noteworthy changes have been made in Korea's bankruptcy and rehabilitation laws in order to effectively, and in a more coherent way, achieve a fair resolution for all parties. But first and foremost, a recent case from the Supreme Court of Korea is worth noting in that it serves as the landmark case in addressing the issue of leveraged buyouts in corporate mergers and acquisitions in Korea.

A. The Legitimacy of Leveraged Buyouts under Korean Law

The leveraged buyout scheme is one of the most often employed in the practice of mergers and acquisitions throughout the world. Yet in Korea, the legitimacy of leveraged buyouts remains uncertain. Against this backdrop, a recent decision from the Korean Supreme Court[88] provides a modicum of guidance as to the debt financing structure that the directors of the target company must take pains to avoid in any leveraged buyout scheme in view of their fiduciary duty.

In this landmark case, the Supreme Court of Korea addressed director liability for a criminal breach of fiduciary duty under the Korean Criminal Code.[89] The facts of the case involve a defendant who organized a special purpose company to acquire a controlling block of shares in a target company. The share purchase was debt financed in exchange for the granting of a stock pledge on the acquired shares in favor of the lenders. Upon share acquisition, the defendant caused himself to be elected as the director of the target company while also causing the target company to provide its corporate assets to the lenders as collateral in lieu of the stock pledge.

On the issue of whether the defendant's act of causing the target company to provide its assets as collateral to secure the obligation of the acquiring company breached his fiduciary duty as the director of the target company, the Supreme Court found the defendant liable for a criminal breach of fiduciary duty on the grounds that: (1) the defendant's act of encumbering the assets of the target company constituted loss to the target company due to the company's exposure to the risk of foreclosure on its assets in case of the acquiring company's default on the debt financing obligation with no consideration flowing back to the target company; (2) the defendant had the requisite mental state for his criminal breach of fiduciary duty because he intended to confer a benefit upon the acquiring company at the expense of the target company; and (3) the approval from the shareholders of the target company did not constitute a valid defense for the defendant who owed a fiduciary duty solely to the target company, not to its shareholders.

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88. Judgment of Nov. 9, 2006, Supreme Court of Korea, 2004 Do 7027.

89. The Korean Criminal Code stipulates that a criminal breach of fiduciary duty shall be committed where a person who has been entrusted by another to administers the affairs of such other person acts in breach of his duty owed to such other person and, as consequence of such act in breach, reaps personal gains or causes another third person to reap such gains and thereby causes harm to such other person. Korean Criminal Code § 355(2).

Overall, the case clearly shows that the directors of a company must not utilize the assets of the company without providing the company with adequate consideration in return for the newly created risk to the corporate assets. The case also reconfirms the well-established principle that directors owe their fiduciary duty to the company, not to its shareholders.

Notwithstanding the Supreme Court's decision, there still exists overwhelming uncertainty about what forms a leveraged buyout scheme may take, or how it may be lawfully structured under Korean law. The conclusion that must be drawn from this case is that the legitimacy of the leveraged buyout scheme as a whole still needs to be tested in Korea.

B. Reorganization and Bankruptcy Procedures Consolidated under a New Statute

The statutory framework of Korea's corporate reorganization and bankruptcy law was fundamentally restructured on March 31, 2005, with the promulgation of the Debtor Reorganization and Bankruptcy Act (DRBA) (Act No. 7428). The purpose of this law, which took effect on April 1, 2006, is to consolidate existing bankruptcy and reorganization statutes into a single comprehensive statute applicable to all types of debtors, from large corporations to individuals.

The enforcement of this new Act, which is intended to replace the Bankruptcy Act, the Corporate Reorganization Act, the Composition Act, and the Individual Debtor Rehabilitation Act,[90] will bring a number of important changes to the existing systems of bankruptcy and rehabilitation. Significant changes under the DRBA include the following:

1. All types of legal entities, as well as individual persons, will be able to avail themselves of the unified reorganization and rehabilitation procedures under the DRBA.[91]
2. Under the DRBA, a court will be authorized to issue a comprehensive injunction against enforcement proceedings by any and all creditors against the assets of the debtor if the court determines that individual injunctions will be inadequate to achieve the purposes of the reorganization. Upon the issuance of a comprehensive injunction, enforcement proceedings already underway will be suspended pending further instruction from the court. Furthermore, the court will be authorized to cancel such enforcement proceedings where such action is deemed necessary for the continuance of the debtor's business. On the other hand, if the court determines that a creditor may sustain irreparable damage as a result of a comprehensive injunction, the court may revoke the injunction with respect to that particular creditor.[92]
3. The DRBA preserves the current system of providing for the appointment of a permanent receiver subject to the supervision of the court in reorganization procedures. In addition, however, the new statute provides that, in principle, the debtor

90. The Debtor Reorganization and Bankruptcy Act, addendum art. 2.

91. *Id.* at arts. 34, 294, 579.

92. *Id.* at arts. 43-45.

under reorganization or its representative, rather than a third party, should be designated as the receiver.[93]

4. The compulsory declaration of bankruptcy in reorganization procedures is limited to cases involving a final decision to terminate reorganization procedures following the approval of the reorganization plan. Declaration of bankruptcy is optional in any case involving: (1) dismissal of a petition for the commencement of reorganization procedures; (2) failure to gain approval for a reorganization plan; and (3) receipt of a court order to terminate reorganization procedures prior to the approval of a reorganization plan.[94]
5. The DRBA makes it easier for a court to avoid debtor's transactions with certain shareholders or equity holders who are related to the debtor (specially related persons), by presuming that the specially-related persons acted knowingly in such transactions. Whereas the old Bankruptcy Act provided for the avoidance of acts relating to nonobligatory grants of security or extinguishment of obligations within sixty days prior to insolvency, the DRBA extends this sixty-day period to one year in the case of transactions with specially-related persons. Similarly, the DRBA extends the current avoidance period from sixty days to one year for gratuitous transfers of assets to specially-related persons without the exchange of fair value.[95]
6. The DRBA features a number of new provisions intended to contribute to the preservation of the value of an insolvent company by facilitating mergers and acquisitions in the context of corporate reorganization. Such measures are expected to fill serious gaps in current law, which include only procedures for identifying and confirming creditors and a system for retiring the shares of the insolvent company. Among others, the new provisions include the following:
   (i) Under the DRBA, a company undergoing reorganization procedures may enter into a business transfer agreement with court permission even prior to court approval of such company's reorganization plan.[96]
   (ii) Where a reorganization plan provides for the liquidation of an insolvent company, the DRBA provides that court approval will require the approval of only 80 percent of the secured creditors of such company.[97]
7. The DRBA incorporates a new provision preventing a bankruptcy trustee or debtor-in-possession from exercising its rights of avoidance or termination with respect to: (1) certain types of payments designated by the Governor of the Bank of Korea, and (2) payments made in connection with close-out netting agreements entered into in connection with certain securities or derivatives-related transactions conducted pursuant to a master agreement (except where it is determined that the contract parties entered into the relevant transaction for the purpose of avoiding payments to the creditors of the insolvent party).[98]

93. *Id.* at art. 74(2).
94. *Id.* at arts. 286, 288.
95. *Id.* at arts. 100-01.
96. *Id.* at art. 62.
97. *Id.* at art. 237.
98. *Id.* at art. 120.

8. The DRBA introduces provisions dealing with foreign and cross-border insolvency and bankruptcy proceedings in a separate chapter. Prominent features include:
   (i) Whereas the old Korean insolvency laws did not recognize insolvency proceedings initiated outside Korea for assets located in Korea, the DRBA will permit the receiver or trustee appointed in a foreign insolvency proceeding to file a petition with a Korean court to commence an insolvency proceeding under Korean law.[99]
   (ii) Under the DRBA, Korean courts will be authorized to order the suspension of litigation or other proceedings related to the disposition of a foreign debtor's business or other assets located in Korea where one or more approved insolvency proceeding is already taking place outside Korea. Similarly, Korean courts may enjoin a debtor from repaying creditors or otherwise disposing of its Korean assets pending the resolution of approved foreign insolvency proceedings.[100]
   (iii) In cases involving multiple approved foreign insolvency proceedings, the DRBA permits Korean courts to consolidate all such proceedings to minimize the inefficiency that would result if all such proceedings were conducted independently. Alternatively, the DRBA authorizes Korean courts to designate one main action after taking the debtor's location and the interests of creditors into account.[101]
   (iv) To prevent the depletion of the foreign assets of a debtor involved in insolvency proceedings in Korea, the DRBA authorizes a receiver or trustee to be appointed in the domestic action to exercise its authority with respect to such assets outside Korea to the extent permitted under the laws of the applicable foreign jurisdiction.[102]
   (v) The DRBA also ensures equal treatment of Korean and foreign creditors in the insolvency proceedings initiated both in and outside Korea.[103]

C. Corporate Law Reforms Proposed by Korean Government

On October 4, 2006, the Ministry of Justice proposed a number of amendments to the corporate law provisions of the Commercial Code by way of announcement of legislative proceedings for the Commercial Code amendment. The most important element of the proposed amendments is the introduction of a Western-style executive officer system.

Under the proposed legislation, companies will be permitted to choose between the existing representative director system and the new executive officer system.[104] Under the existing system, the board of directors typically plays an active role in day-to-day management under the formal supervision of one or two representative directors. By contrast, for

99. *Id.* at arts. 629, 631-32.
100. *Id.* at art. 636.
101. *Id.* at art. 639.
102. *Id.* at art. 640.
103. *Id.* at arts. 641-42.
104. The Department of Justice, *The Major Aspects as for the Proposed Amendments to the Commercial Code*, at 1, (Oct. 4, 2006).

companies that adopt the new executive officer system, managerial responsibility will be distributed among a group of executive officers including a CEO, CFO, CTO, COO, etc., while the role of the board of directors will be restricted to more significant matters such as the issuance of bonds or shares.

The formal introduction of an executive officer system is expected to improve the accountability of management to companies and to provide foreseeability to third parties.[105] Under the existing system, liability for mismanagement is, in principle, borne by the registered directors. In practice, however, a separate category of unregistered directors is permitted to take part in management without any clear liability for their actions. For companies that adopt the executive officer system, civil and criminal liability for mismanagement will be borne by the executive officers that were best positioned to prevent such mismanagement in the first place.[106] If shareholders suffer damages as a result of fraud, conflict of interest, or other criminal or tortious acts of mismanagement, the principal defendants in any ensuing litigation will be the company's executive officers themselves (and, where applicable, the board of directors).

Although companies will be initially given the option to choose between the two systems, it is expected that the executive officer system will be adopted by more companies in response to pressure from lenders and shareholders that prefer the enhanced accountability offered by the executive officer system.

Other significant amendments of the proposed corporate law include:

- Standing to file a derivative action against the directors of a subsidiary will be extended to minority shareholders of the parent company as long as the shareholding of the parent company in the relevant subsidiary exceeds 50 percent. To qualify, the minority shareholders bringing the derivative action must hold at least 1 percent of the issued and outstanding shares of the parent company.[107]
- Restrictions on self-dealing by directors will be extended to cover transactions between a company and (1) a director's spouse, (2) parents and children of a director, (3) parents and children of a director's spouse, and (4) companies (including subsidiaries) in which any of the foregoing parties hold more than 50 percent of the voting stock, whether individually or jointly.[108] As under existing law, transactions between a company and any of the subject parties will be permitted only where: (1) the terms of the transaction are fair and (2) the board of directors approves the transaction in advance.
- In order to attract top talent and to encourage aggressive management practices, companies will be permitted to adopt shareholder resolutions indemnifying directors and certain officers against liability for violations of law or the company's constitutional documents (except for gross negligence or willful misconducts) up to a fixed limit. In the case of a director, indemnification will be allowed up to a limit of six times the amount of the director's compensation for the most recent year.[109]

105. *Id.*
106. *Id.*
107. *Id.* at 2.
108. *Id.* at 4.
109. *Id.* at 5.

- The range of permitted corporate forms will be expanded to include U.S.-style limited partnerships (LPs) and limited liability companies (LLCs). It is expected that these new corporate forms will be widely utilized by private equity funds, venture capital companies, and venture companies as well as SMEs, among others.[110]

Following a public comment period, the enactment is expected to occur as early as the first half of 2007.

IV. South Korea II*

A. Securities

1. *Securities and Exchange Law*

Effective as of March 30, 2006, an amendment to the Securities and Exchange Law (1) allows listed companies to acquire shares which are held by a trustee in trust form for the benefit of the company as treasury stocks upon the termination of the trust agreement;[111] (2) restricts officers and employees of securities companies, who avoided sanctions by retiring before the sanctions were issued, from serving as officers for a specified period of time;[112] and (3) introduces certain restrictions when offering stock options to employees based on board resolutions (e.g., directors are excluded as permissible recipients of such stock options).[113]

2. *Presidential Decrees of Securities and Exchange Law, Futures Trading Law, and Indirect Asset Management Business Law*

Effective as of January 30, 2006, amendments to the Presidential Decrees of Securities and Exchange Law, Futures Trading Law, and Indirect Asset Management Business Law mandate that investors who plan to acquire shares of securities companies, future companies, or asset management companies, thereby becoming the controlling shareholder (i.e., largest shareholders, specially-related parties of the largest shareholder, and major shareholders) of such companies under such laws, are required to obtain prior approval from the Financial Supervisory Commission.[114]

3. *Indirect Investment Asset Management Business Act (IIAMBA)*

Amendments to the IIAMBA made a number of changes providing additional flexibility for funds. Among the most significant changes: (1) local distributors of funds, such as banks, securities companies, and insurance companies, may delegate fund solicitation activities to qualified insurance planners and investment counselors;[115] (2) domestic funds

110. *Id.* at 10.

* Timothy J. O'Brien prepared this section; he is with Kim & Chang, Seoul, Korea.

111. Securities and Exchange Law, No. 7762 (2006), art. 189-2, para. 1, item 3.

112. *Id.* at art. 33, para. 2, item 6.

113. *Id.* at art. 189-4, para. 3.

114. Presidential Decree No. 19300 (Jan. 30, 2006), art. 18; Presidential Decree No. 19301 (Jan. 30, 2006), art. 10-3; Presidentical Decree No. 19302 (Jan. 30, 2006), art. 13-2.

115. Presidential Decree No. 19455 (Apr. 27, 2006), art. 55, para. 1, item 6.

can invest 20 percent (up from 5 percent) of their assets in offshore funds (domestic funds that delegate management of more than 95 percent of their fund assets to a foreign asset manager are deemed offshore funds for this purpose);[116] (3) domestic funds can invest 30 percent (up from 10 percent) of their assets in commercial paper issued by government-invested institutions and financial institutions;[117] (4) domestic funds can invest in futures and derivatives traded in any of the sixty-four countries with which Korea has tax treaties (previously limited to the thirty OECD countries);[118] and (5) the 50 percent limit on investing in funds managed by a single manager, which applies to funds of funds, would not apply if the invested funds are managed by foreign asset managers.[119]

B. Tax

1. *Corporate Income Tax Law (CITL)*

The following amendments to CITL became effective on December 31, 2005: (1) the existing definition of a "domestic corporation" was expanded to include "a corporation having an effective management place of business in Korea on or after January 1, 2006" (previously only a corporation with a head office or principal office in Korea was covered);[120] and (2) if a resident distributes investment income (e.g., dividends, interest, capital gains from share transfer, etc.) to a foreign corporation located in one of the jurisdictions designated by the Ministry of Finance and Economy (as of now, only the Federal Territory of Labuan, Malaysia, has been so designated), taxes on such income will first be withheld in accordance with domestic tax law unless advance approval is obtained from the tax authorities.[121] The foreign corporation can file for a refund within three years by submitting documents proving that it is a beneficial owner of the income.[122]

2. *International Tax Coordination Law (ITCL)*

The ITCL was partially revised on May 24, 2006 to prevent international tax avoidance by applying the substance-over-form principle to international transactions.[123] The substance-over-form principle refers to the theory that tax law and tax treaties should be applied to the beneficial owner of the relevant income. Prior to the amendment, there was uncertainty as to whether the legal substance, which focuses on the legal form of the transaction chosen by a taxpayer, or the economic substance, which focuses on the economic effect of the transaction, should be the relevant standard when applying the substance-over-form principle for Korean tax purposes. The revised ITCL specifies that the economic substance should be the basis for applying the substance-over-form principle to international transactions.[124]

116. *Id.* at art. 72, item 3.
117. *Id.* at art. 73, items 2-4.
118. *Id.* at art. 8.
119. *Id.* at art. 70, para. 3, item 1.
120. Corporate Income Tax Law, No. 7838 (2005), art. 1, para. 1.
121. *Id.* at art. 98-5, para.1.
122. *Id.* at para. 2.
123. International Tax Coordination Law (ITCL), No. 7956 (2006), art. 2-2.
124. *Id.*

Another amendment to the ITCL redefines special relationship for purposes of the transfer pricing rules.[125] Prior to the amendment, a special relationship was recognized in the case where one party can, in substance, control the business policy of another party (Effective Control Relationship Requirement), or a common interest is deemed to exist between the two parties (Common Interest Relationship Requirement). The revised ITCL, however, states that a special relationship can be deemed to exist only in the case where both of the above relationship requirements are satisfied.[126]

C. Telecommunications—Electronic Financial Transaction Act (EFTA)

EFTA, which regulates the operation of the electronic finance business of non-financial institutions, was passed by the National Assembly on April 28, 2006, and became effective on January 1, 2007. Under EFTA, non-financial institutions may engage in the electronic finance business after taking the following steps: (1) eligible companies (i.e., joint stock companies whose paid-in capital is KRW 5 billion or more) must obtain approval from the Financial Supervisory Commission (FSC) before engaging in the issuance and management of electronic cash;[127] (2) eligible companies must register with the FSC and must meet the minimum requirement of paid-in capital or fundamental assets before engaging in electronic money transfers, issuance and management of debit electronic payment instruments, issuance and management of pre-paid electronic payment instruments, payment gateway, and other electronic finance business.[128] For the electronic cash business, approval should be obtained by March 31, 2007; for other businesses registration should be completed by June 30, 2007.[129]

D. Human Resources—Trade Union and Labor Relations Adjustment Act

On September 11, 2006, the Tripartite Commission—comprised of management, labor, and government representatives—reached agreement on revision of the country's labor and employment laws in an effort to improve the framework of industrial relations.[130] The following are the key changes:

- The implementation date for allowing multiple unions to be formed at one company and prohibiting employers from supporting wage payments to full-time union officers will be delayed for three years to January 1, 2010.[131]
- Compulsory government arbitration of labor disputes at businesses classified as essential public works will be abolished. In exchange, (1) more business categories will be added to the list of essential public works, including air transportation; and (2) some core duties at essential public works businesses which affect the public interest will be required to be performed even during strikes.[132]

125. *Id.* at art. 2, para. 1, item 8.
126. *Id.*
127. Electronic Finance Transaction Act, No. 7929 (2007), art. 28, para. 1.
128. *Id.* at para. 2.
129. *Id.* at addendum 3, para. 1, 2.
130. Proclamation of Tripartite Grand Agreement for the Advancement of Labor-Management Relations (Sept. 11, 2006).
131. Ministry of Labor, Public Announcement No. 2006-160 (Sept. 14, 2006).
132. *Id.*

- Businesses classified as essential public works will be permitted to replace striking workers with new hires, subcontracted workers, or dispatched workers during strikes.[133] Such actions are prohibited under the current law.
- Even where the collective bargaining agreement has provided for a union shop, a company will no longer be permitted to terminate or otherwise penalize an employee for withdrawing from the union.[134]

V. Malaysia*

Throughout 2006, Malaysia continued the process of privatization initiatives begun six years ago, and continued to encourage foreign direct investment in the country. The focus of the government has been to continue the transformation of Malaysia from an agricultural/raw materials-based society, into an industrial society, and finally into a knowledge-based economy (K-Economy), in line with the Vision 2020 initiative, which strives to transform Malaysia into a developed nation by the year 2020.[135] Among the long-term strategic plans adopted over the last six years are:

- The Financial Sector Master Plan, intended to establish a competitive, dynamic, and resilient financial system.[136]
- The Capital Market Master Plan, for the comprehensive development of the capital market;[137] and
- The Knowledge-Based Economy Master Plan, which entails making the paradigm shift from a production-based economy to one that utilizes knowledge, creativity, and innovation to generate stronger economic growth.[138]

A. Moving Forward—The Ninth Malaysia Plan (9MP)[139]

In line with the initiatives mentioned above, the Prime Minister of Malaysia, the Honorable Dato Seri Abdullah Ahmad Badawi, announced the 9MP at the beginning of 2006, which is intended to revitalize Malaysia's economy. The macroeconomic strategies of the

133. *Id.*

134. *Id.*

* Norwen Shahredza Mohamad Ghazali and Murzali Mohd Ali prepared this section; both are with Azmi & Associates, Malaysia.

135. The Honorable Dato' Seri Abdullah bin Haji Ahmad Badawi, Prime Minister, Address at the Second World Knowledge Conference (Mar. 8, 2000) (transcript available at www.globalknowledge.org).

136. The Financial Sector Master Plan was released by Bank Negara Malaysia on March 1, 2001. Bank Negara Malaysia, Financial Sector Master Plan, *available at* http://www.bnm.gov.my/index.php?ch=20 (2001).

137. The Capital Market Master Plan was released in Feb. 2001 by the Securities Commission. Securities Commission, Capital Market Master Plan, *available at* http://www.sc.com.my/eng/html/cmp/reports.html (2001).

138. The Knowledge-Based Economy Master Plan was prepared by the Institute of Strategic and International Studies Malaysia under the guidance of a steering committee chaired by the Ministry of Finance. It was released by the Minister of Finance on Sept. 6, 2002. Institute of Strategic and International Studies Malaysia, Knowledge-Based Economy Master Plan, *available at* http://www.epu.jpm.my/new%20folder/publication/knoweco.htm (2002).

139. The Ninth Malaysia Plan is available at http://www.epu.jpm.my/rm9/html/english.htm [hereinafter 9MP]. See The Honorable Dato' Seri Abdullah bin Haji Ahmad Badawi, Prime Minister, Malaysia, Speech

9MP include: (1) higher contribution from the private sector and government-linked companies (GLCs); (2) attracting quality foreign direct investment (FDI); (3) accelerating progress into the high-end technology sector; (4) promoting new growth in agriculture, manufacturing, and the services sector; and (5) broadening the K-Economy.[140] The budget sum allocated under the 9MP is RM 200 billion, with an additional RM 20 billion for the Private Finance Initiative (PFI).[141] According to the Prime Minister, the 9MP is projected to bring about annual average growth of 6 percent over five years from 2006.[142]

B. Implementing PFI In Malaysia[143]

In the 9MP, the government announced that PFIs would be introduced in the implementation of privatized projects.[144] Previous PFIs were plagued by rumors of corruption, nepotism, cronyism, and "bail-out-ism", whereby government projects undertaken by the private sector which ran into trouble would be bailed out by the government, leaving the government and the people of Malaysia with unfinished projects or shoddy workmanship for public utilities and amenities.[145]

The government has defined PFI as involving the transfer of the responsibility to finance and manage capital investment and services in relation to public sector assets to the private sector in return for lease charges that commensurate with the quality of services and an amount sufficient to ensure returns on investment.[146] The PFI mode is expected to finance some RM20 billion of the country's infrastructure development over the next five years.[147]

The 9MP sets out certain key principles with respect to the PFI program. In particular, some of the terminologies used are:[148]

- *Key Performance Indicators (KPI)*: All privatized projects will have output specifications and KPIs. In other words, privatized entities will be given performance targets.[149]

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to the Dewan Rakyat at the Tabling of the Ninth Malaysia Plan, 2006-2010 (Mar. 31, 2006) [hereinafter Prime Minister's Tabling Speech].

140. Prime Minister's Tabling Speech, *supra* note 139, at 9-10, § 12.

141. *Id.* at 50, § 105.

142. *Id.* at 12, § 17.

143. *Id.* at 22, § 40.

144. The 9MP defines PFI as involving the transfer of the responsibility to finance and manage capital investment and public sector services to the private sector in return for lease charges that reflect the level, quality, and timeliness of the service provided throughout the concession period and ensure a sufficient return on investment. *See Government Introduces PFI for Implementing Privatisation Projects*, Bernama News Rep., Mar. 31, 2006. The structure of the lease rental payment for PFI projects will guarantee a total return to the concessionaire of its capital investment expenditures, including financing costs, and a profit to investment; in exchange the asset and facilities will be transferred to the public sector at the expiry of the concession period. *See* 9MP, *supra* note 139, § 10.22, ch. 10, at 230.

145. The Honorable Dato' Seri Abdullah bin Haji Ahmad Badawi, Prime Minister, Malaysia, Speech at the Kuala Lumpur Business Club Dinner (April 24, 2006).

146. *Government Introduces PFI for Implementing Privatisation Projects*, Bernama News Rep., Mar. 31, 2006.

147. Prime Minister's Tabling Speech, *supra* note 139, at 50, § 105.

148. *Id.*

149. 9MP, *supra* note 139, at 230.

- *Reward and Penalty System*: Payments to privatized entities will be linked to their performance. Deductions will be made to penalize entities that fail to meet these targets.[150]
- *Maintenance*: Privatized entities will be expected to manage and maintain facilities throughout the duration of the concessions. This will introduce the concept of "whole-life costing" to the projects. Therefore, the design of new facilities must incorporate the lowest possible maintenance costs.[151]
- *Public Sector Comparator (PSC)*: All proposals by the private sector will be compared to a public sector comparator (i.e., costing prepared by public works) for each project. This is to introduce the concept of value for money. The private sector's proposals must offer better value for money than those that the public sector could have offered.[152]
- *Financing mechanism*: The purpose of this provision is to enable the government to tap the private sector financing sources and provident funds.[153]
- *Risk distribution*: The government seeks to ensure that the private sector assumes the major risks involved in design, construction, operations, and maintenance. Privatized entities will now have to ensure that the facilities built are functional and must also deliver the services for the duration of the concession periods.[154]
- *Capacity-building*: This refers to the creation of effective training programs to provide the public sector officers the technical knowledge in project evaluation and performance auditing.[155]

The 9MP represents a paradigm shift in thinking. The PFI program under the 9MP will see a stronger working relationship between the government and the private sector. In addition to providing financing, the private sector is expected to bear some of the risks of projects too. Thus, the government will no longer guarantee a bail-out for private sector projects that fail, and the stricter requirements and penalties should ensure that only the best qualified and most capable will be awarded such projects.

C. An Overview of the Arbitration Act 2005[156]

As part of the initiative to further encourage foreign investment in Malaysia, and the desire to increase the attractiveness of Malaysia as a seat for commercial arbitration, the New Arbitration Act 2005, Act 646 (New Act) came into effect on the March 15, 2006.[157] The New Act repeals two previous Acts, namely the preceding Arbitration Act 1952 (1952 Act) and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards Act 1985. However, the 1952 Act will continue to apply to arbitral proceedings that were commenced prior to the operative date of the New Act.

150. *Id.*
151. *Id.* at 230, § 10.22, ch. 10.
152. *Id.* at 230, § 10.23, ch. 10.
153. *Id.* at 231, § 10.24, ch. 10.
154. *Id.* at 231, § 10.26, ch. 10.
155. *Id.* at 231, § 10.28, ch. 10.
156. Arbitration Act 2005, Act 646. Date of coming into operation, 15 March 2006 (P.U. (B) 65/2006), *available at* http://www.eurasialegalnetwork.com/library/pdfs/nl_ArbitrationAct2005.pdf.
157. *Id.*

The New Act embodies major provisions that are contained in the UNCITRAL Model Law on International Commercial Arbitration (Model Law).[158] In 1985, the U.N. General Assembly recommended "that all States give due consideration to the [adoption of the] Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice."[159] Nevertheless, the New Act is not a verbatim transposition of the Model Law into Malaysian law. In particular, there are a number of important issues arising from the New Act of which to be aware.

1. *Court Intervention*

Section 8 of the New Act states that "[u]nless otherwise provided, no court shall intervene in any of the matters governed by this Act."[160] This section ensures that the independence of the arbitration is preserved, and that the arbitral proceedings will not be usurped by the court. Nevertheless, under the New Act, the court retains some functions in various matters, including the granting of interim measures of protection (Section 11); providing assistance in taking evidence (Section 29); setting aside the award on the basis that the same is in conflict with public policy (Section 37); recognizing and enforcing awards of a domestic arbitration or from a foreign State (Section 38); and in relation to domestic arbitration, the determination of a preliminary point of law (Section 41).

2. *Applicable Law of the Arbitration*

Section 30(1) of the New Act provides that in a domestic arbitration, the arbitral tribunal shall decide the dispute in accordance with the substantive law of Malaysia.[161] For an international arbitration, however, the dispute is to be decided in accordance with the law as agreed upon by the parties as applicable to the substance of the dispute, or, in the absence of such agreement, in accordance with Malaysian conflict of laws rules.[162] It would appear that under the New Act, parties to a domestic arbitration are not entitled to choose the substantive law that will govern their dispute. This is a departure from the previous position under the 1952 Act, which allowed parties to do so.

VI. The Philippines*

In 2006, there were significant legal developments in the Philippines in the following areas: (1) investments; (2) real estate; (3) criminal law and human rights; and (4) political and constitutional law.

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158. UNCITRAL Model Law on International Commercial Arbitration (Model Law), *available at* http://www.uncitral.org/pdf/english/texts/arbitration/ml-arb/06-54671_Ebook.pdf.
159. G.A. Res. 40/72, para. 2, U.N. Doc. A/Res/40/72 (Dec. 11, 1985).
160. Arbitration Act 2005, Act 646, § 8 (2005) (Malay.).
161. *Id.* § 30(1).
162. *Id.* §§ 30(2), (4).
* Albert Vincent Y. Yu Chang and Ben Dominic R. Yap prepared this section. Albert Vincent Y. Yu Chang is an attorney with Warner Norcross & Judd LLP in Grand Rapids, Michigan. Ben Dominic R. Yap is a Partner with Caguioa & Gatmaytan in Makati City, Philippines.

A. INVESTMENTS

The Revised Implementing Rules and Regulations (Revised Rules) of the Build-Operate Transfer (BOT) Law[163] took effect on April 13, 2006. The BOT Law authorizes the financing, construction, operation, and maintenance of infrastructure projects[164] by the private sector. The Revised Rules aim to further encourage domestic and foreign private investments in infrastructure projects by providing: (1) a climate of minimum government regulation; (2) reasonable returns on investments; (3) transparency and competitiveness in the bidding and award of projects; (4) appropriate sharing of risks between the government and project proponents; (5) coordination between national government and local government units; and (6) compliance by the government and the project proponents with their obligations and undertakings.[165]

The revisions relate to, among other things, the qualifications of project proponents and the administrative processes. Among the salient revisions are the following: (1) invitations to pre-qualify and bid must be posted on the website of the agency or local government unit concerned;[166] (2) for projects consisting at least US$10 million, the invitation may be published in international publications;[167] (3) the project proponent may enter into a management contract with a wholly foreign-owned entity for the day-to-day operations of the facility;[168] (4) the appropriate government agency or local government unit shall determine the appropriate rate of return for the project;[169] (5) accreditation requirements for foreign contractors are amended;[170] and (6) the Philippine government may provide direct and indirect support or contribution, such as direct government subsidy, direct government equity, performance undertaking, or legal and security assistance.[171]

163. An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector and for Other Purposes, Rep. Act No. 6957, (July 9, 1990) (Phil.); An Act Amending Certain Sections of Republic Act No. 6957, Entitled "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector and for Other Purposes," Rep. Act No. 7718 (May 5, 1994) (Phil.).

164. Rep. Act 6957, as amended, § 2. Under the BOT Law, private sector investment in infrastructure projects may by carried out in one of several schemes: (1) Build-and-Transfer; (2) Build-Lease-Transfer; (3) Build-Operate-Transfer; (4) Build-Own-Operate; (5) Build-Transfer-Operate; (6) Develop-Operate-and-Transfer; (7) Rehabilitate-Operate-and-Transfer; and (8) Rehabilitate-Own-Operate.

165. NAT'L ECON. & DEV. AUTH., IMPLEMENTING RULES AND REGULATIONS OF R.A. NO. 6957, AS AMENDED BY R.A. NO. 7718, "AN ACT AUTHORIZING THE FINANCING, CONSTRUCTION, OPERATION AND MAINTENANCE OF INFRASTRUCTURE PROJECTS BY THE PRIVATE SECTOR AND FOR OTHER PURPOSES", AS AMENDED BY R.A. NO. 7718, § 1.1 (Apr. 13, 2006) (Phil.), *available at* http://www.neda.gov.ph/references.asp#RA.

166. *Id.* § 5.2.

167. *Id.*

168. *Id.* § 5.4.

169. *Id.*

170. *Id.*

171. *Id.* § 13.3.

B. Real Estate—Rent Control

On December 21, 2005, Philippine President Gloria Macapagal-Arroyo signed into law the Rent Control Act of 2005 (RCA).[172] Effective until December 31, 2008,[173] the RCA limits the increase in the rent of specified residential units to no more than 10 percent annually.[174] This cap in rent applies to residential units in Metro Manila and other highly urbanized cities where the total monthly rent does not exceed 10,000 pesos, and to residential units in all other areas where the monthly rent does not exceed 5000 pesos.[175] This cap applies only as long as the same lessee occupies the unit; when the unit is vacated by the occupant, the lessor may charge a new rate for the next occupant.[176] The RCA also provides the lessee with additional protection, including provisions that: (1) a lessee cannot be ejected on the ground that the leased premises have been sold or mortgaged to a third person, whether or not the lease or mortgage is registered;[177] (2) a lessor cannot demand more than one month advance rent and more than two months deposit;[178] and (3) lessee may only be ejected judicially on grounds specified under the RCA.[179] A violation of the RCA may be penalized with a fine or imprisonment.[180]

C. Criminal Law and Human Rights

Recent criminal law developments have advanced the human rights of both criminal offenders and victims.

1. *Abolition of Death Penalty*

The Philippines recently joined the ranks of 124 other countries (including twenty-four other countries in the Asia Pacific region)[181] that have abolished capital punishment either in law or in practice.[182] On June 24, 2006, President Arroyo signed the Death Penalty

172. An Act Establishing Reforms in the Regulation of Rent for Certain Residential Units, Providing for the Mechanisms Therefore and for Other Purposes, Rep. Act No. 9341(Dec. 21, 2005), *available at* http://www.senate.gov.ph/republic_acts/RA%209341.pdf.

173. *Id.* § 17.

174. *Id.* § 3.

175. *Id.* § 11.

176. *Id.* § 3.

177. *Id.* § 8.

178. *Id.* § 5.

179. *Id.* § 7. Under the RCA, ejectment shall be allowed on the following grounds: (1) the leasing or subleasing, in whole or in part of the unit, including acceptance of boarders or bed spacers without written consent of the owner or lessor; (2) arrears in payment of rent for three months or more; (3) in case of a legitimate need of the owner or lessor to repossess his property for his own use of that of an immediate family member as residential unit provided that the lease for a definite period has expired and a formal notice of three months in advance has been given; (4) the need to make repairs provided that the lessee has a right of first refusal after repairs have been made; and (5) expiration of the lease period.

180. The RCA imposes a fine of P5,000 to P15,000 or imprisonment of one month and a day to six months.

181. Press Release, Amnesty Int'l, Public Statement, (June 7, 2006) *available at* http://www.web.amnesty.org/library/Index/ENGASA350042006 (last accessed Mar. 5, 2007).

182. Amnesty Int'l, Facts and Figures on the Death Penalty, http://web.amnesty.org/pages/deathpenalty-facts-eng (last accessed Mar. 5, 2007). It was the second time that death penalty was abolished in the Philippines: In 1987, the Philippines set a historic precedent when it became the first country in Asia in modern times to abolish the death penalty for all crimes; however, in 1993, Rep. Act No. 7659 imposed the death

Law[183] which prohibits the imposition of death penalty in the Philippines. The Death Penalty Law reduces the penalty for crimes punished by death to *reclusion perpetua*, or life imprisonment. Convicts whose sentences have been reduced to *reclusion perpetua* will not be eligible for parole.[184]

2. *Juvenile Justice and Welfare*

The Juvenile Justice and Welfare Act of 2006[185] (Juvenile Act) establishes a juvenile justice and welfare system that deals with children at risk and children in conflict with the law.[186] It outlines programs and services for the prevention, diversion, rehabilitation, re-integration, and aftercare to ensure the normal development of young offenders.[187] It expressly recognizes rights specific to juvenile offenders, including the right not to be tortured or subjected to other cruel, inhuman, or degrading punishment, and the right not to be imposed a sentence of capital punishment or life imprisonment without the possibility of release.[188] Among its key provisions, the Juvenile Act exempts from criminal liability a child offender who is fifteen years old or younger at the time of the commission of the crime.[189] It also exempts children who are older than fifteen but younger than eighteen from criminal liability, unless they acted with discernment.[190]

3. *Women and Children Victims*

To protect the privacy of women and children victims, the Supreme Court has ruled that the names of women and children victims should be withheld from its decisions.[191] Furthermore, the Supreme Court added that the personal circumstances of victim-survivors, or any other information tending to establish or compromise their identities, as well as those of their immediate family or household members, should not be disclosed.[192]

D. Political and Constitutional Law

While President Arroyo aimed to bring about improvements in national economic performance, her presidency has been hounded by political controversies, including serious

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penalty on certain heinous crimes, such as murder, infanticide, kidnapping, and rape; *see also* CONST. (1987), art. III, § 19, (Phil.).

183. An Act Prohibiting the Imposition of Death Penalty in the Philippines, Rep. Act No. 9346 (June 24, 2006) (Phil.), *available at* http://www.senate.gov.ph/republic_acts/ra%209346.pdf.

184. People v. Salome, G.R. No. 169077, (S.C. Aug. 31, 2006) (Phil.); People v. Quiachon, G.R. No. 170236, (S.C. Aug. 31, 2006) (Phil.); People v. Tubongbanua, G.R. No. 171271, (S.C. Aug. 31, 2006) (Phil.).

185. An Act Establishing a Comprehensive Juvenile Justice and Welfare System, Creating the Juvenile Justice and Welfare Council Under the Department of Justice, Appropriating Funds Therefor and for Other Purposes, Rep. Act No. 9344 (Apr. 28, 2006) (Phil.), *available at* http://www.senate.gov.ph/republic_acts/RA%209344.pdf.

186. *Id.* § 4(m).

187. *Id.*

188. *Id.* § 5.

189. *Id.* § 6.

190. *Id.*

191. People v. Mangitngit, G.R. No. 171270, (S.C. Sept. 20, 2006) (Phil.), People v. Cabalquinto, G.R. No. 167693, (S.C. Sept. 19, 2006) (Phil.).

192. *Mangitngit*, G.R. No. 171270; *Cabalquinto*, G.R. No. 167693.

allegations of electoral fraud.[193] These controversies have caused massive street demonstrations and a series of congressional investigations. President Arroyo responded with presidential issuances and initiatives, most of which have been voided by the Philippine Supreme Court. In so doing, the Supreme Court—dominated by Arroyo-appointees—demonstrated the independence of the Philippine Judiciary.[194]

1. *Congressional Investigations in Aid of Legislation*

Executive Order No. 464, issued on September 26, 2006, required cabinet members, police and military generals, senior national security officials, and other officers "as may be determined by the President" to first seek the President's approval before appearing before any inquiry of the Senate or the House of Representatives. In the consolidated cases of *Senate v. Ermita*,[195] *Bayan Muna v. Ermita*,[196] *Chavez v. Ermita*,[197] *Alternative Law Groups, Inc.* v. *Ermita*,[198] *PDP Laban v. Ermita*,[199] *and Cadiz v. Ermita*,[200] the Supreme Court partially voided Executive Order No. 464 to the extent that it infringed on the power of Congress to compel the appearance of executive officials in congressional inquiries in aid of legislation. However, the Supreme Court upheld Executive Order No. 464 insofar as it applies to congressional investigations that do not relate to specific legislation. Moreover, the Court affirmed the President's right to invoke the executive privilege and her power to authorize the Executive Secretary to invoke the privilege on her behalf, with a qualification that the right to invoke the executive privilege did not extend to "implied claims" of privilege by lesser officials.

2. *Right to Assembly*

At the height of street protests, President Arroyo, through her Executive Secretary, issued a policy of Calibrated Preemptive Response (CPR), which instructed the Philippine National Police (PNP), as well as the local government units, to: (1) strictly enforce a "no permit, no rally" policy; (2) disperse groups that ran afoul of this standard; and (3) arrest all persons violating the laws and ordinances on the proper conduct of mass actions and demonstrations. The CPR stated that it was in force "in lieu of maximum tolerance."[201]

193. *Philippine Gov't Dismisses Arroyo's Lower Support Rate*, PEOPLE'S DAILY ONLINE, Sept. 10, 2004, http://english.people.com.cn/200409/10/eng20040910_156601.html.

194. *See* T.J. Burgonio, *Senators Praise Justices, Claim Win*, PHILIPPINE DAILY INQUIRER, Apr. 21, 2006, at Front Page, *available at* http://news.inq7.net/nation/index.php?index=1&story_id=73220; Armand N. Nocum, *SC Chief: The Only Winner is Justice*, PHILIPPINE DAILY INQUIRER, Apr. 22, 2006, at Front Page, *available at* http://news.inq7.net/nation/index.php?index=1&story_id=73323.

195. Senate of the Phil. v. Ermita, G.R. No. 169777, (S.C. Apr. 20, 2006), *available at* http://www.supremecourt.gov.ph/.

196. Bayan Muna v. Ermita, G.R. No. 169659, (S.C. Apr. 20, 2006), *available at* http://www.supremecourt.gov.ph/.

197. Chavez v. Ermita, G.R. No. 169660, (S.C. Apr. 20, 2006), *available at* http://www.supremecourt.gov.ph/.

198. Alt. Law Groups, Inc. v. Ermita, G.R. No. 169667, (S.C. Apr. 20, 2006), *available at* http://www.supremecourt.gov.ph/.

199. PDP-Laban v. Ermita, G.R. No. 169834, (S.C. Apr. 20, 2006), *available at* http://www.supremecourt.gov.ph/.

200. Cadiz v. Ermita, G.R. No. 171246, (S.C. Apr. 20, 2006), *available at* http://www.supremecourt.gov.ph/.

201. Press Release No. 2, Office of the President (Sept. 21, 2005).

The CPR was supposedly issued based on the Public Assembly Act of 1985[202] (Public Assembly Act), which adopted a policy of "maximum tolerance."[203] The Public Assembly Act requires a written permit for any person or persons to organize and hold a public assembly, but does not require a written permit if the assembly will be done in a freedom park, at a private party, or on the campus of a government-owned and operated educational institution.[204]

In three consolidated cases, *Bayan, Karaptan, Kilusang Magbubukid Ng Pilipinas (KMP) v. Ermita*,[205] *Del Prado v. Ermita*,[206] *and Kilusang Mayo Uno v. Lumibao*,[207] the Supreme Court upheld the Public Assembly Act but struck down the CPR. The Court pointed out that the Executive Secretary had stated in an affidavit that the CPR is in consonance with the legal definition of "maximum tolerance" under Section 3(c) of the Public Assembly Act, and concluded that because the CPR was consistent with the Public Assembly Act, the CPR "serves no valid purpose."[208]

3. *Warrantless Arrests and Presidential Lawmaking Powers*

Acting on intelligence reports of an alleged conspiracy to bring down the government, President Arroyo issued Proclamation No. 1017 on February 24, 2006, declaring a state of national emergency and commanding the Armed Forces of the Philippines (AFP) "to maintain law and order throughout the Philippines, prevent or suppress all forms of lawless violence, as well as any act of insurrection or rebellion and to enforce obedience to all the laws and to all decrees, orders and regulations promulgated by [the President] personally or upon [her] direction."[209] Based in part on Proclamation No. 1017, several high profile personalities—including a respected university professor, a congressman, and a retired general—were arrested without warrants of arrest, and the offices of a newspaper were searched without a search warrant.[210]

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202. An Act Ensuring the Free Exercise by the People of their Right Peaceably to Assemble and Petition the Government for Other Purposes, B.P. Blg. 880 (Oct. 22, 1985), *available at* http://www.lawphil.net/statutes/bataspam/bp1985/bp_880_1985.html.

203. Maximum tolerance means the highest degree of restraint that the military, police, and other peace keeping authorities shall observe during a public assembly or in the dispersal of the same. *Id.* § 3(c).

204. An Act Ensuring the Free Exercise by the People of Their Right Peaceably to Assemble and Petition the Government for Other Purposes, Batas Pambansa Blg. 880 (Oct. 22, 1985), *available at* http://www.lawphil.net/statutes/bataspam/bp1985/bp_880_1985.html.

205. Bayan, Karapatan, Kilusand Magbubukid Ng Pilipinas (KMP) v. Ermita, G.R. No. 169838, (S.C. Apr. 25, 2006), *available at* http://www.supremecourt.gov.ph/.

206. Del Prado v. Ermita, G.R. No. 169848, (S.C. Apr. 25, 2006), *available at* http://www.supremecourt.gov.ph/.

207. Kilusang Mayo Uno v. Ermita, G.R. No. 169881, (S.C. Apr. 25, 2006), *available at* http://www.supreme court.gov.ph/.

208. *Id.*

209. President Arroyo also issued General Order No. 5, directing the Chief of Staff of the AFP and the Chief of the Philippine National Police (PNP), "to immediately carry out the necessary and appropriate actions and measures to suppress and prevent acts of terrorism and lawless violence." Proclamation Declaring a State of National Emergency, Proc. 1017—O.G.—, (Feb. 24, 2006) (Phil.).

210. *See* David v. Macapagal-Arroyo, G.R. No. 171396 (S.C. May 3, 2006), *available at* http://www.supreme court.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm; Cacho Olivares v. Ermita, G.R. No. 171409 (S.C. May 3, 2006), *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm; Escudero v. Ermita, G.R. No. 171485 (S.C. May 3, 2006), *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm; Kilusang Mayo

In the consolidated cases of *David v. Macapagal-Arroyo*,[211] *Cacho Olivares v. Ermita*,[212] *Escudero v. Ermita*,[213] *Kilusang Mayo Uno v. Ermita*,[214] *Alternative Law Group, Inc. v. Ermita*,[215] *Cadiz v. Ermita*,[216] and *Legarda v. Macapagal-Arroyo*,[217] the Supreme Court declared Proclamation No. 1017 unconstitutional. While the Supreme Court recognized the power of the President to declare a state of national emergency, it struck down Proclamation No. 1017 on the ground that its "extraneous provisions" giving the President express or implied power to: (1) issue decrees; (2) direct the AFP to enforce obedience to all laws, including those not related to lawless violence, and all decrees promulgated to the President; and (3) impose standards on media or any form of prior restraint on the press are "*ultra vires* and unconstitutional."[218] As to the warrant-less search of the offices of a local newspaper, the Court ruled that the President cannot take over privately owned public utilities or private businesses affected with public interest in the absence of legislation.[219]

4. *People's Initiative to Revise the Constitution*

The Arroyo administration also strongly supported an initiative to propose major revisions to the 1987 Philippine Constitution. The initiative mainly advocated a shift from a bicameral-presidential to a unicameral-parliamentary form of government; however, the initiative also proposed (1) an indefinite extension of the term of the members of the lower house of the Philippine Congress while the proposed shift in form of government is in transition, and (2) that further amendments to the Constitution may be made by the interim parliament.[220] In the consolidated cases of *Lambino v. Commission on Elections* and *Binay v. Commission on Elections*, the Supreme Court upheld the Commission on Elections' dismissal of the initiative to revise the Constitution.[221] The Supreme Court sternly warned that "[n]o one can trivialize the Constitution by cavalierly amending or revising it in blatant violation of the clearly specified modes of amendment and revision laid down in

Uno v. Ermita, G.R. No. 171483 (S.C. May 3, 2006), *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm; Alternative Law Group, Inc. v. Ermita, G.R. No. 171400 (S.C. May 3, 2006), *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm; Cadiz v. Ermita, G.R. No. 171489 (S.C. May 3, 2006), *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm; Legarda v. Macapagal-Arroyo, G.R. No. 171424 (S.C. May 3, 2006), *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/may2006/G.R.%20No.%20171396.htm.

211. *David*, G.R. No. 171396.

212. *Cacho Olivares*, G.R. No. 171409.

213. *Escudero*, G.R. No. 171485.

214. Kilusang Mayo Uno v. Macapagal—Arroyo, G.R. No. 171483.

215. *Alt. Law Groups, Inc.*, G.R. No. 171400.

216. *Cadiz*, G.R. No. 171489.

217. *Legarda*, G.R. No. 171424.

218. *See, e.g., David*, G.R. No. 171396; *Cacho Olivares*, G.R. No. 171409; *Escudero*, G.R. No. 171485; *Kilusang Mayo Uno*, G.R. No. 171483; *Alt. Law Group, Inc.*, G.R. No. 171400; *Cadiz*, G.R. No. 171489; *Legarda*, G.R. No. 171424.

219. *Id.*

220. *Lambirio v. Comelec*, GR No. 174153 (S.C. Oct. 25, 2006); *Binay v. Comelec*, GR No. 174299 (S.C. Oct. 25, 2006), both *available at* http://www.supremecourt.gov.ph/jurisprudence/2006/october2006/174153.htm.

221. The Supreme Court decision has become final with the denial of a motion for reconsideration filed by the petitioners. *Min. Res.*, G.R. No. 174153, *available at* http://www.supremecourt.gov.ph/(Phil.).

the Constitution itself."[222] The Court explained that major revisions could not be proposed by an initiative because only amendments may be proposed by an initiative. According to the Court, "[b]y any legal test and under any jurisdiction, a shift from a [b]icameral-[p]residential to a [u]nicameral-[p]arliamentary system, involving the abolition of the Office of the President and the abolition of one chamber of Congress, is 'a revision', and 'not a mere amendment.'"[223] Under the Philippine Constitution, revisions may be proposed only by (1) Congress, upon a vote of three-fourths of all its members, or (2) a constitutional convention.[224]

The Supreme Court also found it objectionable that "proposed changes were not incorporated with, or attached to, the signature sheets" when the people were invited to sign.[225] Finally, the Supreme Court frowned upon, and labeled as "logrolling," the fact that the initiative advocated an extension of the terms of the members of the lower house and proposed a provision that would allow the interim parliament to introduce further amendments or revisions to the Constitution—which the Court characterized as "a subject matter totally unrelated to the shift in the form of government."[226]

VII. Thailand*

The widely publicized demonstrations against the Prime Minister and the subsequent military coup on September 19 made 2006 a turbulent year for Thailand. This unrest set the stage for some significant government policy changes impacting foreign investment. The most significant of these policy changes concerns the government's stance with respect to the use of Thai nominee shareholders by foreign investors. The object of this section is to summarize these changes and to explain their legal significance with respect to foreign investors in Thailand.

A. The Use of Nominee Shareholders in Thailand

Like many developing countries, Thai law makes a distinction between investment by local Thai companies and investment by foreign companies.[227] The relevance of the distinction is that the law regulates the types of business activities foreign companies are allowed to pursue in Thailand.[228] Regulated business activities include land ownership, all retail and wholesale selling, telecommunications, agriculture, all types of services, and many other activities.[229] Generally, the law stipulates that foreigners seeking to engage in regulated activities must first seek various government approvals before commencing operation.[230]

222. *Lambino*, G.R. No. 174153; *Binay*, G.R. No. 174299.
223. *Id.*
224. Const. (1987), art. XVII, § 1, (Phil.).
225. *Id.*
226. *Id.*
* Michael Doyle prepared this section; he is a partner with the law firm of Seri Manop & Doyle, Bangkok, Thailand.
227. Foreign Business Act, B.E. 2542 (1999), § 4.
228. *Id.* at List One, Two, and Three.
229. *Id.*
230. *Id.* § 8.

To avoid the investment of time necessary to apply for these approvals, many foreign investors have historically utilized Thai nominee shareholders. This means that the foreign investors arrange for Thai citizens to hold shares of a Thailand registered company on the foreigners' behalf, while the true ownership and control of the company resides with the foreign investor. By doing this, the company appears on paper to be a majority Thai-held company, and thus not subject to special restrictions. Although Thai law expressly forbids this practice,[231] the government did not begin to take strong steps to eliminate the practice until 2006 when it issued a series of announcements. These announcements targeted the use of nominees in Thailand's real estate sector, as well as in the other regulated sectors as is set forth below.

B. Foreign Ownership of Land

Thai law prohibits foreign ownership of land unless prior special permission is obtained from the government.[232] To avoid this prohibition, however, many foreign investors have historically established companies utilizing Thai nominee shareholders for the specific purpose of purchasing land. In fact, many resort areas in Thailand such as Phuket and Koh Samui have experienced a real estate boom in recent years with the vast majority of the land purchases being made by foreigners.[233] On May 15, 2006, however, the government began to take significant steps to eliminate this practice.[234]

Because the practice of using nominees was already in violation of the law, the steps taken by the government did not take the form of new legislation, but rather as official internal memoranda, issued by the Department of Lands to the governors of all of Thailand's provinces.[235] The May 15 memorandum stated that "the Interior Ministry has received reports that there are foreigners joining with Thais, or employing Thai's to incorporate companies to engage in the real estate trading business" in violation of the law and that these Thai shareholders had not actually invested in the company.[236] The memorandum instructed land officials to investigate all land transfers in which it appears that foreigners may be utilizing Thai's nominees to avoid legal restrictions.

Over the months that followed the issuance of this memorandum to the public, an additional announcement was issued further clarifying the requirements to be implemented by land officials when companies with foreign shareholders attempt to purchase land.[237]

This action by the government has caused many foreign real estate developers in Thailand to change their business models from an ownership structure to a long-term-lease structure which is permissible by law. The maximum lease period available under Thai

231. *Id.* § 36.

232. Act Promulgating the Land Code, B.E. 2497 (1954) (last revised 2000), § 86.

233. Many real estate experts in Thailand estimate that over 90% of the purchasers in Thailand's resort areas are made indirectly by non-Thai purchasers.

234. Memo. Ref. 0515/1562 dated 15th May 2006 from Department of Lands Office of Land Register Standards To: Governors of Every Province, Subject: Application for Land Belonging to a Juristic Person with Foreign Shareholders.

235. *Id.*

236. *Id.*

237. Memorandum from Ministry of Interior to Governors of Every Province, Application for Land Belonging to a Juristic Person with Foreign Shareholders, Ref. 0515/Wor 2430 (July 21, 2006).

law is thirty years.[238] This policy change has caused the real estate sector in these resort areas to go through a significant adjustment. The long term impact on the sector is not yet clear.

C. General Business

Similar to what occurred with regard to the real estate sector, the government also issued ministerial regulations targeting the practice of foreigners utilizing Thai companies as nominee shareholders to engage in all regulated business activities.[239] These new regulations state:

> In the event of the registration of a partnership or company which foreign partner or shareholder invests in or holds the shares of such partnership or company from 40 percent to 50 percent of the register capital OR in the event the foreign national invests in or holds the shares of such partnership or company less than 40 percent of the registered capital, but such foreign national acts as the authorized person of the partnership or company, all Thai partners or shareholders must submit the evidence demonstrating the source of fund to supplement to the registration application. The said documents must show the fund that conforms to the amount being used for investment or holding the shares of each partner or shareholder as follows:
> 1. Copy of bank pass book or copy of bank statement in preceding [six] months; or
> 2. Document issued by the bank which certifies or shows the financial status of the partner or shareholder; or
> 3. Copy of evidence showing source of fund being used for investment or holding shares.[240]

The implications of the above regulations are arguably even greater than those directed towards the real estate sector alone because they impact all companies utilizing Thai nominee shareholders to avoid legal restrictions, instead of just a single sector.

D. Conclusion

In both of the situations described above, the Thai government's intentions seem clear. Going forward, the government seeks to eliminate the practice of using nominees by more closely scrutinizing situations where it may appear that foreigners are seeking to utilize Thai nominees to avoid legal restrictions. What is not yet clear, however, is the government's stance with respect to those companies which already hold title to land, and those companies already in operation in other areas which currently use Thai nominee shareholders. Many foreign investors fear that these government actions may just be the beginning of additional regulation in this area, ultimately resulting in the elimination of all companies utilizing nominees. Because the practice of using nominees has been widespread for many years, there is a fear that this would be highly disruptive. To date, the

238. Civil & Commercial Code, § 540 (19_1) (Thail.).

239. Ministerial Regulations, RE: Establishing the Partnership and Company Register Office, Appointing the Registrars and Prescribing Rules and Procedures for Partnership and Limited Company Registration, B.E. 2549 (2006) (Thail.).

240. *Id.*

Thai government has made no clear indication of how it intends to deal with this issue moving forward.