MODELING SECURITIES CLASS ACTIONS OUTSIDE THE UNITED STATES: THE ROLE OF NONPROFITS IN THE CASE OF TAIWAN

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Countries around the world are getting more interested in implementing procedures similar to those for class actions in the United States in order to deter corporate fraud and to enhance investor protection. This paper first explores the key elements in establishing a securities class action device in foreign countries and presents several examples that illustrate the difficulties in modeling a U.S.-style securities class action regime outside the United States. This paper then presents the case of Taiwan as a novel example insofar as the law granted a nonprofit organization, the Investors Protection Center, a monopoly in the organization's pursuit of securities class actions. Herein, the Securities Investors and Futures Traders Protection Act of 2002 has two important functions: it provides several provisions that relax restrictions in civil procedures that are hostile to group litigation, and it mandates the establishment of the Investors Protection Fund, which provides financial support for securities litigation.

The non-distribution constraint of nonprofit organizations provides the Taiwan approach a natural insulation from the problem of frivolous lawsuits suffered by the United States, where lawyers' incentives serve as the main motive behind securities class action practice. And although the Taiwan government's control over the Investors Protection Center has raised

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public concerns about the independence and the fairness of Taiwan's securities class action practice, the innovative practice of Taiwan's securities class actions serves as an excellent source for comparative legal studies, especially for countries whose government exercises most regulatory powers but whose goal is to promote private securities law enforcement.

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I. INTRODUCTION

More and more countries are seeking to establish a procedural device similar to U.S. class actions in order to promote private enforcement.[1] In the past few years, Denmark, England, Finland, France, Germany, Ireland, Italy, the Netherlands, Norway, and Sweden have all considered or adopted a new set of group litigation laws.[2] As a review of recent events puts it, "The next hot American import in Europe may well be class action litigation."[3] Furthermore, the recent participation of U.S. class-action plaintiff firms in the European market may well testify to the strength of the trend.[4]

The zeal for class actions extends to securities law enforcement.[5] Corporate scandals in recent years have prompted victimized investors outside the United States to demand that

1. John H. Beisner & Charles E. Borden, Expanding Private Causes of Action: Lessons from the U.S. Litigation Experience 1 (Oct 18, 2005), http://www.omm.com/communication/2005/10-18/final.pdf. In Europe, since the 1998 European Commission Directive requiring member states to consider adopting group litigation devices that better protect consumer interests, Europe's perception shifted toward favoring the adoption of procedural devices that expand the availability of group litigation or class actions. *See* Council Directive 98/27, Injunctions for the Protection of Consumers' Interests, 1998 O.J. (L166) 51 (EC).

2. Beisner & Borden, *supra* note 1, at 4-8; Stefano M. Grace, *Strengthening Investor Confidence in Europe: U.S.-Style Securities Class Actions and the* Acquis Communautaire, 15 J. TRANSNAT'L L. & POL'Y 281, 292-300 (2006).

3. Alexia Garamfalvi, *U.S. Firms Prepare for European Class Actions*, LEGAL TIMES, June 25, 2007, http://www.law.com/jsp/article.jsp?id=1182416759806&pos=ataglance.

4. *Id.* (explaining that U.S. plaintiff firm Cohen, Milstein, Hausfeld & Toll announced in early 2007 that it would open a branch in London, betting that its class-action expertise will soon be in demand in Europe). In light of the circumstances, experts have warned that recent legal developments in Europe may lead European countries to follow in the footsteps of the abusive U.S. class-action practices. *See generally* Linda A. Willett, *U.S.-Style Class Actions in Europe: A Growing Threat?*, BRIEFLY (Nat'l Legal Ctr. for the Pub. Int., Washington, D.C.), June 2005, *available at* http://www.europeanjusticeforum.org/pdf/LW%20ARTICLE%20FINAL_Jun05.pdf; Beisner & Borden, *supra* note 1, at 29.

5. *See* Posting of Ted Allen to Risk & Governance Blog, http://blog.riskmetrics.com/ (Mar. 7, 2006).

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these investors' own states institute a class-action-like device.[6] The Swedish Parliament passed the Group Proceeding Act in 2002 to make private group actions available in all areas of civil law, including in securities disputes[7]; China's Supreme People's Court issued a notice on January 15, 2002 to permit securities group litigation for misstatements in securities markets[8]; Taiwan enacted the Securities Investors and Futures Traders Protection Act in 2002, granting a government-controlled nonprofit organization monopoly in bringing securities class actions[9]; the Dutch Parliament passed the Collective Settlement of Mass Damages Act in 2004, being the first European country to adopt the "opt-out" provision of U.S.-style class actions[10]; South Korea passed the Securities-related Class Action Act, effective in January 2005, to provide remedies for minority shareholders of public listed companies in South Ko-

6. *See* Grace, *supra* note 2, at 292, 298 (discussing the passage of the Capital Investor's Model Proceeding Act in Germany in 2005 following investor pressure triggered by the Deutsche Telekom scandal).

7. *Id.* at 294.

8. Auigao renmin fayuan guanyu shouli xhengquan shichang yin xujiachengshu yinfa de minshi qunquan jiufen anjian youguan wenti de tongzhi [The Notice of the Supreme People's Court on the Acceptance of Civil Tort Cases Arising from Misstatements in Securities Markets] (Jan. 15, 2002). The Supreme People's Court further released rules regulating such securities group litigation. *See* Zuigao renmin fayuan guanyu shenli zhengquan shichang yin xujiachengshu yinfa de minshi peichang anjian de ruogan guiding [Several Provisions of the Supreme People's Court on Hearing Civil Damages Cases Arising from Misstatements in Securities Markets] (Jan. 9, 2003). *See generally* Sanzhu Zhu, *Civil Litigation Arising from False Statements on China's Securities Market*, 31 N.C. J. INT'L L. & COM. REG. 377 (2005) (providing a review of the rules).

9. Zhengquan Touzi Ren Ji Qihuo Jiaoyi Ren Baohu Fa [Securities Investor and Futures Trader Protection Act of the Republic of China, TOUZI REN BAOHU FA] (2002), *available at* http://db.lawbank.com.tw/Eng/FLAW/FLAWDAT0202.asp. Although the current securities group-litigation regime in Taiwan does not possess an important attribute of U.S. class actions (the "opt-out" provision), "class action" and "group litigation" are used interchangeably throughout this paper for convenience.

10. *See, e.g.*, *The Availability of "Class Actions" in Europe* (Ashurst LLP), Dec. 2007, at 15; *Class Actions Abroad: Opening Pandora's Box?*, BUS. LITIG. REP. (Quinn Emanuel Urquhart Oliver & Hedges, LLP, Los Angeles, C.A.), Mar. 2005, at 4; Ianika Tzankova, *Class Actions, Group Litigation and Other Forms of Collective Litigation Dutch Report*, National Report for The Globalization of Class Actions Conference (Oxford University, Dec. 2007), Sept. 24, 2007, http://www.law.stanford.edu/calendar/details/1066/The%20Globalization%20of%20Class%20Actions/.

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rea[11]; on July 8, 2005, Germany enacted the Capital Investor's Model Proceeding Act to provide a model procedure through which courts could issue—on the basis of a "test case"—binding rulings on common elements of claims.[12] Furthermore, recent soaring settlement amounts of U.S. securities class actions and the willingness of U.S. courts to certify "f-cubed" investors[13] as class members have put pressure on countries that are not equipped with securities group-litigation mechanisms.[14]

Although the reform in each country takes a different form, most of the reforms rely on private parties or, more specifically, the entrepreneurial lawyers to initiate the process. In this regard, the reforms resemble the U.S. model. And in this regard, Taiwan stands out by experimenting with a new form

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11. The Securities Class Action Act of South Korea has taken effect in two stages. Before January 1, 2007, the scope of the act was limited to publicly listed companies with assets of at least two trillion South Korean won (approximately two billion U.S. dollars). Since January 1, 2007, the act has applied to all publicly listed companies in South Korea. Walter Douglas Stuber et al., *International Securities and Capital Markets—Developments in 2005*, 40 INT'L LAW. 701, 714 (2006).

12. The German approach is drastically different from that of the United States and from those of other countries in that the German approach, rather than function to establish a group procedural device, functions to resolve different opinions among courts over a common question of law or of fact in order to maintain the legal system's stability. Furthermore, the act expressly rejects judgments that non-EU member states issue against German issuers. Commentators explain that this effort limits the extraterritorial effect of U.S. securities class actions on German issuers. *See* Grace, *supra* note 2, at 297-300.

13. The "f-cubed" problem concerns whether or not foreign investors who bought shares in foreign companies that trade on foreign exchanges can take part in class-action lawsuits brought in the United States.

14. *See, e.g.*, *In re* Vivendi Universal, S.A. Sec. Litig., 241 F.R.D. 213, 217 (S.D.N.Y. 2007) (granting the motion for class certification in part and certifying a class consisting of all persons from the United States, France, England, and the Netherlands, including those foreign investors who purchased Vivendi's shares on a foreign stock exchange). Other recent high-profile securities class actions, such as Parmalat Finanziaria S.p.A., Bayer AG, Royal Dutch Shell plc, and Royal Ahold, also encounter the problem of whether or not to certify "f-cubed" investors in the class. So far, the U.S. courts have not presented a unified opinion on how to resolve this problem. *See* Ilana T. Buschkin, *The Viability of Class Action Lawsuits in a Globalized Economy—Permitting Foreign Claimants to Be Members of Class Action Lawsuits in the U.S. Federal Courts*, 90 CORNELL L. REV. 1563, 1569 (2005) (urging U.S. courts to grant foreign claimants access to U.S. securities class actions in order to promote greater deterrence of corporate misconduct).

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of securities class actions that relies on a government-controlled nonprofit organization to police corporate misconduct and to promote investor protection. The transplanting of foreign legal systems often fails to function properly owing to unexpected local conditions; however, the novel form adopted by Taiwan derives from local environments and, thus, is more likely to succeed. The related experience of Taiwan may illuminate the issue for countries that intend to promote private securities law enforcement but are afraid of becoming a litigious society like the United States. The approach adopted by Taiwan holds special promise for countries that, in particular, rely more on the public sector than on the private sector to enforce securities-law violations and that, in general, assign most regulatory powers to the government. Commentators have considered China an appropriate regime for the adoption of a Taiwan-style partnership insofar as China already has both an investor-protection fund, which could provide funding for securities class actions, and a state-sponsored NPO in the consumer-protection area,[15] which could serve as a model for a future nonprofit investor protection organization.[16] The Taiwan-style partnership form may have potential in other transition economies as well, and this paper's review and analysis of the Taiwan approach serves as a rich source for those countries that seek to build up their own private securities litigation regime.

This paper begins by reviewing the experience of the United States, a country that is the leader and the originator of

15. The China Consumers' Association was established in 1984 and has served as an assistant to state actors in enforcing consumer-protection laws. *See* C. David Lee, *Legal Reform in China: A Role for Nongovernmental Organizations*, 25 YALE J. INT'L L. 363, 414-19 (2000).

16. China established a Securities Investors Protection Fund in 2005 to compensate investors when securities firms become insolvent. Rules Governing the Management of Securities Investors Protection Fund (July 1, 2005), http://www.csrc.gov.cn/n575458/n2470788/n2470973/n2475125/2947477.html. Commentators proposed that the Taiwan-style partnership form could be a good interim measure for China in developing a private securities litigation regime. *See* Curtis J. Milhaupt, *Nonprofit Organizations as Investor Protection: Economic Theory and Evidence from East Asia*, 29 YALE J. INT'L L. 169, 204 (2004); Wallace Wen-Yeu Wang and Jian-Lin Chen, *Reforming China's Securities Civil Actions: Lessons From US's PSLRA Reform and Taiwan's Government Sanctioned Non-profit Organization*, COLUM. J. ASIAN L. (forthcoming 2008) (manuscript at 34-37, on file with author).

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securities class-action practice, and identifying the problems faced by current practice. Then in Section III, this paper explores the key elements that go into foreign countries' development of securities class-action devices and the obstacles that these countries face in implementing a U.S.-style class-action regime. Section IV provides an introduction to the government-nonprofit partnership approach in Taiwan, analyzes the Taiwan approach on the basis of economic theories of NPOs, and examines the limitations and the potential concerns that characterize the Taiwan-style partnership approach. Section V concludes the paper.

II.
THE U.S. EXPERIENCE

Federal Rules of Civil Procedure 23 governs class actions in the U.S. federal courts. The prerequisites for bringing a federal class action include numerosity, commonality, typicality, and adequacy.[17] Rule 23 (b) further presents three categories of class actions that are functionally different—but not mutually exclusive—in relation to one another. Almost all securities class actions fall into the third category, the "common question" class actions, which have become the vehicle for damage class actions. A "common question" class action may be maintained if "the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."[18] The court will determine by order whether or not to certify the action as a class action and, if the court does, "the court must direct to class members the best notice practicable" about the proposed class action and give class members an option to be excluded from the class—the "opt out" right.[19] Otherwise, a class judgment will be binding on all class members, whether or not it is favorable to the class.[20]

In today's federal class-action landscape, securities class actions averagely comprise 47% to 48% of all pending class

17. FED. R. CIV. P. 23(a).
18. FED. R. CIV. P. 23(b)(3).
19. FED. R. CIV. P. 23(c)(2).
20. FED. R. CIV. P. 23(c)(3).

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actions in federal courts, percentages that outdistance all other kinds of class action suits.[21] In addition, securities class actions consume disproportionately a great deal of judicial time and attention because the class actions require more court monitors than do other types of actions.[22] A recent survey also reveals that of all types of securities law enforcement, over half of the monetary sanctions come from private enforcement actions and the vast majority are class-action settlements.[23] Securities class actions have become an essential part of the U.S. corporate-governance enforcement chain. Contingency fee arrangements, broad D&O insurance coverage, and collusive class-action settlements have motivated attorneys to file securities class actions.[24] On the flip side, these strong incentives turn into a plaintiff's attorney agency problem when

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21. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1539-40 (2006).

22. *Id.* at 1540-41. In addition to certifying a class, the court must appoint the lead plaintiff and class counsel. Although most securities class actions are settled, the court needs to approve settlements and to award reasonable attorney fees. *See* FED. R. CIV. P. 23(e), (g), (h). The appointment of a lead plaintiff is stipulated in the Private Securities Litigation Reform Act of 1995. The stipulation functions to help the class better monitor plaintiffs' attorneys and mitigate agency costs. *See* Securities Exchange Act of 1934 § 21D(a)(3), 15 U.S.C. § 78u-4(a)(3) (2000).

23. Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications* 27 (John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 521, 2005), *available at* http://ssrn.com/abstract=839250.

24. Procedural rules establishing the fee arrangements under which the plaintiffs' attorneys receive compensation make it possible for these attorneys to essentially act as "private Attorney Generals." These procedural rules include (1) the "American rule," under which each litigant bears his or her own litigation expenses; (2) the "common fund" doctrine; (3) the contingency fee arrangement; and (4) the statutory attorney fee shifting. John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 669-70 (1986). *See also* John C. Coffee, Jr., *The Unfaithful Champion: The Plaintiff as Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. 5 (1985). Forty years ago, Judge Jerome Frank coined the term "private Attorney General" to identify the role of private litigation in law enforcement. Associated Indus. v. Ickes, 134 F.2d 694, 704 (2d Cir. 1943) ("Such persons, so authorized, are, so to speak, private Attorney Generals."). For the role of "private attorney general" in class actions, *see, e.g.*, John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215 (1983) [hereinafter Coffee 1983].

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conflicts of interest arise between attorneys and their clients. Since the 1980s, the court has constantly shown concern over "the danger of vexatious litigation," as the number of securities-class-action filings have soared.[25] Empirical studies have also supported the assertions that shareholder litigation is a weak instrument for U.S. corporate governance and that most securities class actions have been frivolous.[26]

In 1995, Congress passed the Private Securities Litigation Reform Act (PSLRA)[27] to address the concern over frivolous lawsuits and over the agency problem of plaintiffs' attorneys. To curb frivolous lawsuits, the PSLRA heightened the pleading standard; and to mitigate plaintiffs' attorney agency problem, the PSLRA promoted institutional investors' role as lead plaintiffs who would monitor the attorneys on behalf of class members.[28] Since then, numerous empirical studies have tested the

25. Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 739-40 (1975) (upholding imposition of the purchaser-seller limitation on Rule 10b-5 claims, also known as the Birnbaum rule, out of concern over "the danger of vexatious litigation"). In 2006, the Supreme Court again noted the "special risk of vexatious litigation" that could "frustrate or delay normal business activity" by citing *Blue Chip Stamps*. Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit, 547 U.S. 71, 80, 85 (2006).

26. *See, e.g.*, Roberta Romano, *The Shareholder Suit: Litigation without Foundation?*, 7 J.L. ECON. & ORG. 55 (1991); Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 524-28 (1991); James Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PA. L. REV. 903, 979 (1996); Stephen J. Choi, *The Evidence on Securities Class Actions*, 57 VAND. L. REV. 1465, 1486-98 (2004) (reviewing empirical studies on filings and settlements and suggesting that non-meritorious suits existed prior to PSLRA and that more meritorious suits appeared after PSLRA). Similar critics also aroused against other form of class actions, *see generally* DEBORAH R. HENSLER ET AL., RAND INSTITUTE FOR CIVIL JUSTICE, CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAIN (2000).

27. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified as amended in scattered sections of 15 and 18 U.S.C.).

28. In the conference report, Congress explicitly listed certain abusive securities-litigation practices, including: "(1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so burdensome that it is often

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effects of the enactment of the PSLRA.[29] To date, in general, the number of filings has not gone down, as the annual average of 238 cases that characterized the 1998-2005 period stands in contrast to the annual average of 200 cases that characterized the 1991-1995 period.[30] Moreover, the filings have shifted away from lower-value claims to higher-value ones owing to the increased costs that the PSLRA imposes on plaintiffs' attorneys.[31] In addition, although most cases' parties still reach settlements, it takes longer to settle a case in the post-PSLRA period.[32]

As for the effectiveness with which PSLRA reduces frivolous lawsuits, research studies in general have confirmed that the enactment of the PSLRA increased the importance of merit-related factors in post-PSLRA settlements.[33] However, some scholars are concerned that the higher standard and costs would also impede the bringing of some meritorious litigation.[34] In fact, Choi, Tally, and other scholars have indepen-

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economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent." H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730.

29. For a detailed review of the empirical studies, *see* Choi, *supra* note 26; Stephen J. Choi & Robert B. Thompson, *Securities Litigation and Its Lawyers: Changes During the First Decade After the PSLRA*, 106 COLUM. L. REV. 1489, 1494-1512 (2006).

30. Calculations of the post-PSLRA average exclude years 1996 and 1997. There was a significant drop in federal filings in 1996 and 1997, as plaintiffs filed in state courts to avoid the limitations of PSLRA. Therefore, those numbers are atypical. RONALD I. MILLER ET AL., NERA ECON. CONSULTING, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: BEYOND THE MEGA-SETTLEMENTS, IS STABILIZATION AHEAD? 2 (2006), http://www.nera.com/image/BRO_RecentTrends2006_SEC979_PPB-FINAL.pdf.

31. Stephen J. Choi, *Do the Merits Matter Less After the Private Securities Litigation Reform Act?*, 23 J.L. ECON. & ORG. (forthcoming 2008) (manuscript at 11-20), *available at* http://ssrn.com/abstract=558285.

32. Mukesh Bajaj, Sumon C. Mazumdar, & Atulya Sarin, *Securities Class Action Settlements*, 43 SANTA CLARA L. REV. 1001, 1010 (2003).

33. Marilyn F. Johnson, Karen K. Nelson, & A. C. Pritchard, *Do the Merits Matter More? The Impact of the Private Securities Litigation Reform Act*, 23 J.L. ECON. & ORG. 627 (2007); Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 950-51 (2003).

34. In fact, President Clinton used this reason to veto the heightened pleading standard in PSLRA. MESSAGE FROM THE PRESIDENT OF THE UNITED STATES, H.R. DOC. NO. 104-150, at 1-2 (1995). For scholarly research that raises the same concern, *see, e.g.*, Lynn A. Stout, *Type I Error, Type II Error, and*

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dently suggested that the PSLRA may have discouraged meritorious lawsuits as well as frivolous ones.[35] It is important to note, also, that the PSLRA promotes the participation of institutional investors to address the agency problem in relation to plaintiffs' attorneys. Studies have shown that the presence of institutional lead plaintiffs leads to higher settlement amounts[36] and that the percentage of cases where institutional investors served as lead plaintiffs has risen dramatically since 2000.[37]

In addition to legislative efforts, the Supreme Court of the United States has tried to limit the use of securities-fraud class actions through several critical decisions since the mid-1990s. In 1994, the Supreme Court ruled in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* that a private plaintiff may not maintain an "aiding and abetting" suit under Securities Exchange Act §10(b), a decision that substantially limits the scope of Rule 10b-5 lawsuits.[38] In 2005, the Supreme Court opined in *Dura Pharmaceuticals, Inc. v. Broudo* that a plaintiff cannot satisfy the loss-causation requirement in Securities Exchange Act §10(b) simply by both alleging in the complaint

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the Private Securities Litigation Reform Act, 38 ARIZ. L. REV. 711 (1996); Hillary A. Sale, *Heightened Pleading and Discovery Stays: An Analysis of the Effect of the PSLRA's Internal-Information Standard on '33 and '34 Act Claims*, 76 WASH. U. L.Q. 537 (1998).

35. Choi, *supra* note 31; Eric Talley & Gudrun Johnsen, *Corporate Governance, Executive Compensation, and Securities Litigation* (USC CLEO Research Paper Series, Research Paper No. C04-4, 2004), *available at* http://ssrn.com/abstract=536963.

36. James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter? An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1587, 1624, 1630-32 (2006).

37. Choi & Thompson, *supra* note 29, at 1503-04. Nevertheless, institutional investors are somehow passive in filing settlement claims. *See* James D. Cox & Randall S. Thomas, *Letting Billions Slip Through Your Fingers: Empirical Evidence and Legal Implications of the Failure of Financial Institutions to Participate in Securities Class Action Settlements*, 58 STAN. L. REV. 411 (2005); and their earlier pilot study, James D. Cox & Randall S. Thomas, *Leaving Money on the Table: Do Institutional Investors Fail to File Claims in Securities Class Actions?*, 80 WASH. U. L.Q. 855 (2002) (providing evidence and explanations on the passivity of institutional investors in both prosecuting securities class actions and filing claims in class settlements after PSLRA).

38. However, the Supreme Court posited that secondary actors may be liable as a primary violator under Rule 10b-5, assuming all of the requirements for primary liability under Rule 10b-5 are met. Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164, 191 (1994).

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and subsequently establishing that the misrepresentation inflated the price of the security on the date of purchase.[39] Instead, the defrauded investor must plead and then prove that a misrepresentation is the proximate cause of an economic loss.[40] In its conclusion, the Court further observed that the remedies provided by the securities laws are not intended to provide investors with insurance against market risks.[41]

In 2007, the Supreme Court considered the PSLRA's scienter requirement—regarding fraudulent intent. In *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Court ruled that in determining whether or not securities-fraud complaints give rise to "strong inference" of scienter, a court must consider competing inferences, and that a plaintiff alleging fraud in a Rule 10b-5 lawsuit must plead facts rendering inference of scienter at least as likely as any plausible opposing inference.[42] On January 15, 2008, the Supreme Court further followed the position taken in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.* and ruled in *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.* that the Rule 10b-5 private rights of action does not extend to "secondary actors", such as the suppliers of defendant company in this case.[43] Once again, the Supreme Court has taken a stricter view in interpreting the provisions in PSLRA, by which the Congress intended to curb frivolous, lawyer-driven litigation.[44]

Apparently, the market for U.S. securities class actions has shown signs of failure in many respects. Judicial and legislative departments have tried to fix the dysfunction. Academia has also offered proposals to help rectify the market failure.[45] Re-

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39. Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 338 (2005).

40. *Id.* at 346.

41. *Id.* at 345-48.

42. Tellabs, Inc. v. Makor Issues & Rights, Ltd., 127 S.Ct. 2499, 2504-05, 2509-13 (2007).

43. Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2008).

44. Warren R. Stern et al., Wachtell, Lipton, Rosen & Katz, *Supreme Court Enforces Strict Pleading Standard for Private Securities Actions*, June 21, 2007, http://blogs.law.harvard.edu/corpgov/files/2007/07/20070702-wlrk-on-pleading-standards-case.pdf.

45. *See generally* Coffee, *supra* note 21 (arguing that the fundamental problem of securities class actions lies in the pocket-shifting wealth transfer among shareholders, which is the so-called "circularity problem," and providing policy suggestions to shift penalties onto the culpable actors); Tom

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cent reports have attributed the declining competitiveness of the U.S. equity market in global capital markets to the burden of regulation and litigation in the United States and have called for further reform relative to securities-class-action lawsuits.[46] Other countries should carefully examine the failures that the United States has experienced and their causes when considering transplanting a U.S.-style securities class action device.[47]

III.
KEY ELEMENTS IN ESTABLISHING A SECURITIES CLASS-ACTION DEVICE

Despite the many criticisms they receive, U.S. class-action proceedings not only incentivize the greatest number of securities-fraud claims but also provide the most generous monetary compensation to investors around the world. Class-action proceedings are a response to modern disputes where the claims of many individuals arise from the same misconduct of a defendant. Securities-fraud claims are especially suitable for class-action proceedings in that the costs of bringing securities-

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Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795, 1821-26, 1832-35, 1840-42 (2007) (finding that the failure of D&O insurers in playing a monitoring role in both corporate governance and litigation defense costs is due, in part, to the agency problem in the corporate context, and calling public corporations to purchase only Side A coverage, not entity-level D&O insurance).

46. COMM. ON CAPITAL MKTS. REGULATION, INTERIM REPORT OF THE COMMITTEE ON CAPITAL MARKETS REGULATION 45-48 (2006), http://www.capmktsreg.org/pdfs/11.30Committee_Interim_ReportREV2.pdf; MCKINSEY & CO., SUSTAINING NEW YORK'S AND THE US' GLOBAL FINANCIAL SERVICES LEADERSHIP, 73-94, 100-04 (2007), http://www.schumer.senate.gov/SchumerWebsite/pressroom/special_reports/2007/NY_REPORT%20_FINAL.pdf.

47. However, excessive caution is not necessary. For example, the new Securities-related Class Action Act of South Korea, which took effect in January 2005, employs several restrictive rules in order to rein in problems that characterize the U.S. securities-class-action experience. However, reliable data show that no case was brought in 2005. The findings suggest that the restrictive rules might be excessive. Wen-Yeu Wang & Ji-Ming Chang, *Securities Class Actions Led by the Non-Profit Organization: The Case of Investors Protection Center in Taiwan*, 15 CROSS-STRAIT L. REV. 5, 12-14 (2007). For a detailed introduction to South Korea's securities-related class-action act, *see* Dae Hwan Chung, *Introduction to South Korea's New Securities-Related Class Action*, 30 J. CORP. L. 165 (2004).

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fraud litigation are almost always greater than the losses to an individual investor. A lawsuit will make sense only when the total loss of the investors is greater than the costs of pursuing the suit. In this type of situation, the traditional single-party model of adjudication can no longer meet the needs of investors in seeking monetary redress for corporate fraud.

However, class actions constitute a uniquely American form of litigation. Although some countries have similar proceedings such as representative proceedings or group litigation, those proceedings normally are not equipped with the "opt-out" provision. Furthermore, most of these proceedings are limited to claims arising from certain disputes, such as defective products, fair contract practices, competition, or environmental conditions.[48] Few countries adopt a general representative proceeding that may apply to all civil claims.[49] Especially in continental Europe, group litigation is very limited because of the strict qualifications for representative plaintiffs and because of the limited cause of action. For example, German law provides for group litigation (*Verbandsklage*, association's suit) only in a few substantive law contexts and limits the remedy to injunctive relief: no monetary claims are involved.[50] In addition, only certain qualified associations can bring such litigation.[51]

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48. Detailing the development of class actions or of similar proceedings in foreign countries is beyond the scope of this article. *See, e.g.*, Neil Andrews, *Multi-party Proceedings in England: Representative and Group Actions*, 11 DUKE J. COMP. & INT'L L. 249 (2001); Samuel P. Baumgartner, *Class Actions and Group Litigation in Switzerland*, 27 NW. J. INT'L L. & BUS. 301 (2007); Antonio Gidi, *Class Actions in Brazil: A Model for Civil Law Countries*, 51 AM. J. COMP. L. 311 (2003); Christopher Hodges, *Multi-Party Actions: A European Approach*, 11 DUKE J. COMP. & INT'L L. 321 (2001); Roberth Nordh, *Group Actions in Sweden: Reflections on the Purpose of Civil Litigation, the Need for Reforms, and a Forthcoming Proposal*, 11 DUKE J. COMP. & INT'L L. 381 (2001); Gerhard Walter, *Mass Tort Litigation in Germany and Switzerland*, 11 DUKE J. COMP. & INT'L L. 369 (2001); Garry D. Watson, *Class Actions: The Canadian Experience*, 11 DUKE J. COMP. & INT'L L. 269 (2001).

49. Such countries include Canada, Australia, and England. *See* Edward F. Sherman, *Group Litigation Under Foreign Legal Systems: Variations and Alternatives to American Class Actions*, 52 DEPAUL L. REV. 401, 422-32 (2002).

50. Such substantive law areas include certain statues concerning business self-regulation, consumer regulation, labor law, industrial property, and environmental protection. Harald Koch, *Non-Class Group Litigation Under EU and German Law*, 11 DUKE J. COMP. & INT'L L. 355, 358 (2001).

51. Sherman, *supra* note 49, at 419.

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For reasons stated below, more and more countries are interested in ways to incentivize the private enforcement of corporate governance in order to better deter potential corporate fraud.[52] On the one hand, most jurisdictions outside the United States only provide limited legal remedies with which securities investors can seek redress regarding their grievances; on the other, deterring corporate fraud has become one of the most critical issues in improving a country's investment environment. In addition, the recently skyrocketing settlements in U.S.-listed foreign companies would certainly create pressure for changes in foreign countries.[53] To date, no country in the world has adopted the pure form of U.S.-style class action.[54] Even within adopted proceedings (e.g., Canada's and Australia's) similar to those of the United States, we see no similarly sized class-action market.[55]

Indeed, every country's path in adopting and developing a class-action device depends on the country's past.[56] In other words, a country's transplantation of a class-action regime is influenced by the current state of the country's political, legal, societal, and cultural environment.[57] In addition to the institutional obstacles that pre-exist in a system, we see a general resistance from other countries to a U.S.-like litigious society.

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52. In Europe, there is a trend away from public enforcement and toward private enforcement of corporate governance in order to better deter corporate malfeasance and to enhance investor protection. *See* Securities Litigation Watch, http://slw.issproxy.com/ (June 14, 2005); Grace, *supra* note 2, at 282.

53. As of December 2006, three of the top ten securities class-action settlements involved foreign companies, two for Nortel Networks of Canada and one for Royal Ahold, N.V. of the Netherlands. The settlement mounts for the two Nortel Networks settlements were $1.1 billion and $1 billion respectively, while the settlement amount for Royal Ahold, N.V. was $1.1 billion. *See* TODD FOSTER ET AL., NERA ECON. CONSULTING, RECENT TRENDS IN SHAREHOLDER CLASS ACTION LITIGATION: FILINGS PLUMMET, SETTLEMENTS SOAR 5 (2007), http://www.nera.com/image/BRO_Recent%20Trends_%201288_FINAL_online.pdf.

54. Sherman, *supra* note 49, at 402.

55. *Id.*

56. Nobel Laureate Douglass North explores the path of institutional change by applying path dependence theory, arguing that institutional change, similar to technological change, exhibits the characteristics of path dependence. *See* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 92-104 (1990).

57. *See, e.g.*, Grace, *supra* note 2, at 291.

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Such resistance holds countries back from adopting the pure form of the U.S.-style class-action regime yet cannot stop the paradigm shift toward it.[58] Imagine the various class-action mechanisms, group-litigation mechanisms, and representative-proceeding mechanisms that are located on the spectrum of class-action regimes around the world: the U.S.-style class-action device sits on one extreme end while the devices of most other countries sit near the other end but keep inching their way toward the U.S. end of the spectrum. In this section, this paper explores some key elements in the formation of a class-action device and the obstacles that foreign countries face when transplanting the class-action regime.

A. *Fee-shifting Rules and Litigation Financing*

From an economic point of view, private plaintiffs will bring a damage lawsuit only when the expected net award, meaning the expected damage award minus the litigation cost, is positive. If the expected damage award is large and the expected litigation cost is low, it is certain to trigger a large number of litigations or a large number of litigants. This is exactly what happens in U.S. class-action practice. With class-action litigation's history of generous monetary awards and of large-size settlements, the expected damage award or settlement amount in U.S. class actions is much larger than those in any other country.[59] Moreover, the expected litigation cost for plaintiffs in the United States is relatively low because of the absence of the loser-pays (or English) rule and because of the tolerance of contingency fee arrangements, which calculate the fee in proportion to the verdict recovered.

In most of the rest of the world, a losing party is usually responsible for a substantial portion of the winning adversary's reasonable legal fees, and contingency fee arrangements between plaintiffs and their attorneys are generally not acceptable.[60] Class actions, which notably suffer from the collective-

58. Baumgartner, *supra* note 48, at 308-12.

59. Almost all public companies in the United States buy D&O insurance. Without active monitoring from D&O insurers, most securities class actions are settled collusively by the "bounty hunter" lawyers, whose main concern is contingency fee, and by managers, who just want to escape from any liability. *See* Baker & Griffith, *supra* note 45.

60. Thomas D. Rowe, Jr., *Shift Happens: Pressure on Foreign Attorney-fee Paradigms from Class Actions*, 11 DUKE J. COMP. & INT'L L. 125, 128 (2003). For the

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action problem, can barely survive in an environment where losing plaintiffs not only run the risk of being liable for the adversary's legal fees but also lack any financing option for their own attorney fees. Therefore, to make class action available, foreign countries face pressure to revise the loser-pays rule or to relax the ban on contingency fee arrangements or both.[61]

For example, the Canadian fee-shifting rule follows the loser-pays rule.[62] Although Canada permits contingency fee arrangements,[63] Canadian scholars still recognized that the loser-pays rule creates considerable difficulty for class actions in Canada.[64] In response to such concern, several changes have been made to make the class-action device viable and, in particular, to alleviate this financial burden on plaintiffs. For instance, Quebec originally mandated that losing representative plaintiffs would be liable for the winning party's legal fees. However, after one very large fee award, the legislation changed this mandate, requiring that the losing party pay only nominal costs.[65] In Ontario, the Ontario Class Proceedings Fund began operating to relieve unsuccessful representative plaintiffs from liability for defendants' costs.[66]

In Australia, although class-action lawsuits have been permitted since 1992,[67] relevant cost rules and litigation-funding practices are now still hostile to the plaintiffs—the loser-pays rule dominates and only restrictive form of contingency-fee arrangements are allowed.[68] Furthermore, in circumstances

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current state of contingency fee practice in European countries, *see* Grace, *supra* note 2, at 287.

61. *See generally* Rowe, *supra* note 60 (arguing that the foreign attorney-fee paradigm should change if there are to be viable class-action devices, and that the existence of class actions would create pressures for change).

62. Watson, *supra* note 48, at 274.

63. *Id.* at 272-73.

64. *Id.* at 274.

65. *Id.*

66. *Id.* at 275.

67. Such procedures are referred to as "representative proceedings" and are provided only in the Federal Court of Australia. S. Stuart Clark & Christina Harris, *Multi-Plaintiff Litigation in Australia: A Comparative Perspective*, 11 DUKE J. COMP. & INT'L L. 289, 291 (2001).

68. *Id.* at 295, 301-02 & n.33. *See, e.g.*, Posting of Ted Allen to Risk & Governance Blog, *supra* note 5 (discussing Australian "conditional fee arrangements where no fee is owed unless the client prevails"); Vince

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where the court finds that the plaintiffs commenced a class action that had no prospect of success, the court can order the plaintiffs' lawyers to assume responsibility for some of the defendant's costs.[69] In response to the hostile fee-shifting rules, several litigation-funding corporations emerged, contributing to the prosperity of Australia's class-action practice. These funding corporations provide funding for litigation, monitor and manage litigation when filed, and extend indemnities for class members against adverse cost orders.[70] Among these corporations is IMF (Australia) Ltd., the largest litigation funder in Australia and the first to be publicly listed on the Australian Stock Exchange.[71] It is expected that more class-action lawsuits will be brought with the support of those litigation-funding corporations.

From the above examples, we know that both the fee-shifting rule and litigation-financing options are crucial to the survival of a class-action device; nevertheless, it is not necessary to follow the U.S. model in order for the class-action regime to prosper. Alternatives such as the publicly created fund in Ontario, Canada and the litigation-funding corporation in Australia exist, and can serve to complement the existing hostile rules that are sometimes hard to change owing to political or cultural factors.

Morabito, *Group Litigation in Australia – "Desperately Seeking" Effective Class Action Regimes*, National Report for The Globalization of Class Actions Conference (Oxford University, Dec. 2007), at 24, *available at* http://www.law.stanford.edu/calendar/details/1066/The%20Globalization%20of%20Class%20Actions/.

69. *Id.* at 302.

70. Although litigation funding by a third party might run afoul of traditional common law rules against maintenance and champerty, the recent decision in the Australian case *Campbells Cash & Carry Pty Ltd v. Fostif Pty Ltd* took a favorable view of funding arrangements. (2006) 80 A.L.J.R. 1441. In *Fostif*, the High Court of Australia opined that funding agreements that provide money to a party to bring lawsuits in return for a share of the proceeds of the litigation do not violate any public policy rules. Michael Mills & Jason Betts, *Class Actions and* Fostif *Create a New Risk Environment for Directors and Officers*, FREEHILLS UPDATE (Freehills, Sydney, Austl.), Sept. 1, 2006, http://www.freehills.com.au/print/publications_6114.html.

71. For more information about IMF (Australia) Ltd., *see* http://www.imf.com.au/.

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B. *The Opt-out Provision and the Res Judicata Effect*

One critical attribute of American securities class action proceeding is the "opt-out" provision. In contrast to a traditional civil litigation where plaintiffs have to affirmatively join or "opt in" the litigation, the U.S. Federal Rules of Civil Procedure allow the court to certify the plaintiff class of a Rule 23(b)(3) or "common question" class action without the affirmative consent of the plaintiffs. After the court certifying a Rule 23(b)(3) class, class members will be given "the best notice practicable" notifying the members, among other things, their rights to "opt out" of the class.[72] If class members choose to stay with the class, they need not do anything; if they choose to "opt out," they will need to request exclusion so that they won't be bound by the *res judicata* binding effect of the final judgment.[73] For those who do nothing but stay with the class, the final judgment will bind on them even if they do not attend the court hearings or participate in the procedures. By extending the binding effect of court rulings, U.S.-style class actions resolve all claims against the defendant of the same issue once and for all and promote consistency by avoiding differing court rulings on one issue.[74]

Despite its benefits, the "opt-out" provision receives criticism from other countries while they consider establishing their own class-action regime. Foreign countries tend to reject the "opt out" provision in order to protect the litigation right of the absent class members whose claims are not entirely common to the class.[75] Furthermore, by extending finality to all class members, the powerful *res judicata* effect might provide representative plaintiffs or their attorneys too much leverage

72. FED. R. CIV. P. 23(b)(3), (c)(2)–(3).

73. The Latin phrase *res judicata* means "the thing has been decided." In traditional single-party civil litigation, only persons who are parties to the litigation will be bound by the ruling's *res judicata* binding effect. However, Rule 23(b)(3) of the U.S. Federal Rules of Civil Procedure created a special rule for the doctrine of *res judicata* and provides that all class members—not only the representative plaintiff who brings the lawsuit—should be bound by the *res judicata* binding effect of the rulings unless he or she elects to "opt out." For an introduction to the principle of finality and to the doctrine of *res judicata*, see LINDA J. SILBERMAN, ALLAN R. STEIN, & TOBIAS BARRINGTON WOLFF, CIVIL PROCEDURE: THEORY AND PRACTICE 805-60 (2d ed. 2006).

74. Grace, *supra* note 2, at 289.

75. *See id.*; *see also* Baumgartner, *supra* note 48, 310-11.

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in the settlement negotiation and, in turn, might force the defendants into settlements of frivolous lawsuits.[76]

The "opt out" provision is a critical feature of U.S.-style class-action procedure and is crucial to the proliferation of class-action lawsuits. Table 1 shows the character of some countries' class-action regimes. As Table 1 shows, countries with "opt out" provisions in their class-action or group-litigation procedures, such as Canada and Australia, are recognized as having a more plaintiff-friendly class-action regime.[77] Other countries generally resist adopting the "opt out" provision for the reasons stated above; therefore, this type of provision is almost nowhere to be found outside North America and Australia. The Netherlands was the first country in Europe to adopt the U.S.-style "opt out" class-action device.[78] In their 2005 Securities-related Class Action Act, South Korea may have been the first Asian country to adopt an "opt out" provision.[79]

C. *Legal Culture*

In addition to the procedural rules, scholars have raised legal culture as a key impediment to modeling U.S.-style class-action regimes in foreign countries. Explaining the difference between European-style collective actions and U.S.-style class actions, a German scholar attributed Europeans' distaste for the lawyer-entrepreneur model to cultural reasons, and the scholar added that, according to European tradition, Europeans "entrust the public interest to public institutions rather than to private law enforcers."[80] In England, Lord Steyn, a

76. JOHN H. BEISNER & CHARLES E. BORDEN, U.S. CHAMBER INST. FOR LEGAL REFORM, ON THE ROAD TO LITIGATION ABUSE: THE CONTINUING EXPORT OF U.S. CLASS ACTION AND ANTITRUST LAW 4-5 (2006), http://www.omm.com/webcode/webdata/content/newsevents/Chamber_European_developments_article.pdf.

77. *See* Clark & Harris, *supra* note 67, at 289 (stating that "Australia is the most likely place outside North America for a plaintiff to bring a class action suit."). *See also* Sherman, *supra* note 49, at 402; Securities Litigation Watch, *supra* note 52; Posting of Ted Allen to Risk & Governance Blog, *supra* note 5.

78. *See supra* note 10.

79. Chung, *supra* note 47, at 172.

80. Koch, *supra* note 50, at 357-58 ("[T]here is no method of self-appointment of an individual champion (plaintiff) and no concept of an individual private Attorney General, whose initiative is fostered by fee incentives or by an alluring contingency fee arrangement. To be sure, this may be well-deserved because of the risk assumed and the attorney's hard work; however,

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TABLE 1 CHARACTERISTICS OF CLASS-ACTION REGIMES AROUND THE WORLD

	U.S.	Canada	Australia	England[a]	Netherlands[b]	Sweden[c]	South Korea[d]	Taiwan[e]
No Loser-pays Rules	●							
Contingency Fee	●	●	○	○		○		○
Opt-Out	●	●	●		●		●	

○: Only certain forms of the contingency fee arrangements are allowed.

[a] The England regime here refers to the group litigation order procedure that England implemented through amendments to the 1998 Civil Procedure Rules in 2000.

[b] The Netherlands regime here refers only to the Collective Settlement of Mass Damages Act which came into force on Aug. 1, 2005.

[c] The Sweden regime refers to the Group Proceedings Act which came into effect in Jan. 2003.

[d] The South Korea regime refers to the Securities-related Class Action Act which came into effect in Jan. 2005.

[e] The Taiwan regime refers to the Securities Investors and Futures Traders Protection Act which came into effect in Jan. 2003.

Lord of Appeal in Ordinary, also made interesting observations about the general attitudes of English senior judges toward class actions and suggested that "English senior judges are opposed to a 'litigious society'."[81]

In East Asia, the tradition of Confucianism supports a hierarchical society and authoritarian regimes. Lawrence S. Liu, a noted Taiwanese scholar, claims that the Confucianism-established traditional order of social status is an impediment to financial development and reform.[82] Regarding the cultural effect of East Asian culture on East Asia's development of shareholder litigation, scholars suspect that these Confucian-inspired East Asian societies may have developed other norms

in the European tradition—although this may be slightly over-simplified—we entrust the public interest to public institutions rather than to private law enforcers.").

81. Neil Andrews documented Lord Steyn's observation: "He [Lord Steyn] suggested that English senior judges are opposed to a litigious society, that is, an over-excited tendency for citizens and businessmen to 'blame and claim' by bringing actions in the ordinary courts rather than pursuing grievance procedures through political systems of democratic accountability, pressure groups, ombudsmen, arbitration, conciliation, etc. . . . [H]e said this view reflected a sense, which is widely shared within the community, of the place of civil law and of its relationship to the other organs of political and social life." Andrews, *supra* note 48, at 266.

82. Lawrence S. Liu, *Law and Political Economy of Capital Market Regulation in the Republic of China on Taiwan*, 28 LAW & POL'Y INT'L BUS. 813, 844-45 (1997).

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to address grievances, norms that may explain the scarcity of shareholder litigation in these societies.[83]

Empirical research has suggested that rule of law and that other social norms of governance correlate strongly and systematically with cultural values.[84] By using refined statistical techniques, the current study presents further evidence that culture has a significant influence on the rule of law.[85] European countries' attitude toward U.S.-style class-action regimes, as illustrated by German scholar Harold Koch, serves as a good example. Germany's Capital Investors' Model Proceeding Act, which became effective on November 1, 2005, can be seen as an outright rejection of U.S.-style class-action regimes.[86] The German act retained no U.S. class-action attributes; instead, the act provides a proceeding where a "test case" can be brought before an appellate court if at least ten plaintiffs with common elements of claims petition within a four-month notice period. The ruling of such a "test case" regarding a common question of law or fact will be binding on all other courts.[87]

Other studies suggest opposing view to the role of legal culture. Research evidence reveals that the emergence of shareholder litigation in Japan and South Korea in the 1990s may have stemmed from legal reforms that lowered the legal

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83. Amir N. Licht et al., *Culture, Law, and Corporate Governance*, 25 INT'L REV. L. & ECON. 229, 252 (2005) ("These societies [Confucian-inspired Asian societies, such as South Korea and China] may have developed norms of social responsibility that do not rely on court litigation nor on other accountability mechanisms known in the West. . . . [T]here are preliminary signs of somewhat greater willingness to file shareholder suits in both Korea and Japan, possibly due to legal reforms that follow economic downturns. Nonetheless, the fact that such proceedings are so celebrated attests to their being exceptional, at least at this point.").

84. Amir N. Licht et al., Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance 19-22 (Dec. 12, 2006) (unpublished manuscript, on file with the New York University Journal of Law and Business).

85. *Id.* at 26.

86. Grace, *supra* note 2, at 297.

87. *New Laws and a New Landscape in Europe*, INDUS. INSIGHT (Zurich Fin. Servs. Group, Zurich, Switz.), Nov. 2005, *available at* http://www.zurich.com/main/productsandsolutions/industryinsight/2005/november2005/industryinsight20051026_003.htm; Grace, *supra* note 2, at 299.

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or financial threshold for bringing such litigation.[88] One research study shows that the lack of shareholder litigation in Japan prior to 1993 was due not to cultural mores but to high filing fees, high attorney fees, corporate-governance constraints, and comparatively low compensation incentives for Japanese attorneys.[89] In addition, the "explosion" of shareholder litigation in Japan after the 1993 legislative reduction of filing fees may be attributable to attorney incentives and to non-monetary factors.[90] In Taiwan, the number of securities group litigation increased more rapidly and the claim load increased seven-fold after the government's promulgation of the Investors Protection Act,[91] which relaxes many procedural hurdles in bringing securities class action.[92]

IV.
THE CASE OF THE INVESTORS PROTECTION CENTER IN TAIWAN

A. *Historical Background*

1. *Increasing Demand for Investor Protection*

Taiwan's stock market has a relatively short history. The Taiwan Stock Exchange (TSE) was established in 1962; however, it was not until 1988, when the government lifted the restriction on establishing securities brokerage firms, that the securities market began to prosper.[93] Although the Asian Financial Crisis did not directly affect Taiwan, approximately 44

88. Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 352 (2001).

89. Mark D. West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 Nw. U. L. REV. 1436 (1994).

90. *See* West, *supra* note 88.

91. The courts saw 23 lawsuits between 1998 and 2002, but have seen 36 lawsuits since 2003. *See* Lian-Yu Liu & Chun Hung Lin, *Touziren Tuanti Susong Xinshidai de Lailin [A New Era in Securities Class Actions]*, 111 TAIWAN L. REV. 80, 88 (2004); *infra* Appendix.

92. Zhengquan Touzi Ren Ji Qihuo Jiaoyi Ren Baohu Fa [Securities Investor and Futures Trader Protection Act of the Republic of China, TOUZI REN BAOHU FA], art. 34, 35 (2002), *available at* http://db.lawbank.com.tw/Eng/FLAW/FLAWDAT0202.asp.

93. The trading value of the stock market was approximately New Taiwan Dollar ("NT$") 29,619 billion in 1987 (approximately US$89 billion); was NT$29,292 billion (about US$976 billion) in 1988; and suddenly increased to NT$30,527 billion (about US$1,018 billion) in 1989. Taiwan Stock Exchange, Summary Data of Stock Market, http://www.tse.com.tw/ch/statistics/statistics_list.php?tm=07&stm=001 (last visited Nov. 28, 2007).

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public companies in Taiwan experienced managerial irregularities in 1998 and 1999. These corporate scandals represented the first wave of corporate distress in Taiwan. Since then, demands for better investor protection and a sound related law-enforcement system have increased substantially.

In addition to the short history of Taiwan's stock market and the 1998 wave of corporate distress, the special characteristics of Taiwan's stock market stimulated the need for better investor protection. Taiwan's stock market is characterized as being "shallow" and "broad." It is "shallow" in the sense that it has relatively fewer listed companies than other foreign stock markets and "broad" in the sense that it has more individual investors involved in the stock market.[94] In Taiwan, individual investors conducted 72.81% of the stock market's transactions and accounted for 43.38% of listed companies' sources of capital.[95] In this kind of stock market, the volatility of stock prices is usually high, and given the broad spectrum of the population involved, the influence of corporate-distress events on society becomes significant.[96]

In general, individual investors have limited access to corporate information and do not possess professional knowledge about how to evaluate corporate performance; hence, they are more vulnerable to corporate fraud than institutional investors. Furthermore, the pre-1998 legal environment in Taiwan was hostile to securities class action: it lacked a special rule for group litigation, employed the loser-pays rule, required a high civil filing fee, restricted contingency fee arrangements, and so on. As a result, investors were generally incapable of initiating lawsuits against corporations in the event of securities fraud. It is reported that, after the 1998 corporate-distress wave in Tai-

94. Zheng-Xiong Qiu, *Taiwan Zibei Shichang Fazhan yu Jingji Chengzhang* [*The Development of the Capital Market and Economy in Taiwan*], Cai Jin (yan) 089-012 Hao, GUOZHENG YANJIU BAOGAO [NATIONAL POLICY FOUNDATION RESEARCH REPORT] (2000), *available at* http://old.npf.org.tw/PUBLICATION/FM/089/R/FM-R-089-012.HTM.

95. Taiwan Stock Exchange, Statistics: Securities Trading Values by Type of Investors, http://www.tse.com.tw/en/statistics/statistics_list.php?tm=07&stm=031 (last visited Nov. 28, 2007); Taiwan Stock Exchange, Statistics: Sources of Capital of Listed Companies (By Year), http://www.tse.com.tw/en/statistics/statistics_list.php?tm=07&stm=025 (last visited Nov. 28, 2007).

96. Qing-Ren Zhuang & Xi-Nan Xu, *Taiwan Gushi Xiangguan Zhengce dui Gushi de Yingxiang* [*The Impact of Public Policy on Taiwan's Stock Market*], 489 TSEC MONTHLY REV. 2, 2-3 (2003).

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wan, virtually no investors initiated a claim for damages through the legal system.[97]

Nonetheless, there is a stronger argument for compensation for individual investors in the context of contemporary securities litigation. Commentators have argued that, in securities class action, well-diversified investors, on an aggregate basis, are generally transferring wealth among themselves at the cost of litigation. Therefore, securities class action makes no sense to a well-diversified investor in terms of compensation.[98] In the context of Taiwan, individual investors account for over 70% of stock market transactions and are mostly undiversified. In addition, D&O insurance is yet to become popular among Taiwanese listed companies, avoiding the prevailing situation in the United States in which shareholders are in fact bearing the cost (the insurance premium) of compensation. Hence, securities class action in Taiwan is expected to serve a better role in compensating investors' loss in securities fraud events.

2. *The Investor Services Center in 1998*

To cope with individual investors' need to claim damages and to establish sound investor-protection mechanisms, Taiwan's securities authority, the Securities and Futures Commission (SFC), established an Investor Services Center under the Securities and Futures Institute (SFI) in March 1998 to coordinate claims against public companies on behalf of individual investors.[99] At the direction of the Taiwanese government, the SFI was founded as a nonprofit organization in 1984 and was funded by the Taiwan Stock Exchange and local securities and banking industries.[100] Since its establishment, the purpose of the SFI has been to promote the globalization and liberalization of Taiwan's securities market. The SFI has supported the government's policy for national economic development.[101]

Furthermore, the SFI has been a major force in promoting corporate governance in Taiwan and engages in both en-

97. Liu & Lin, *supra* note 91, at 84.

98. *See* Coffee, *supra* note 21, at 1558-59.

99. Liu & Lin, *supra* note 91, at 84.

100. 2003 SEC. & FUTURES INST. 9.

101. *Id.* at 9, 10.

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forcement activities and non-enforcement activities.[102] In bringing securities group litigation, the Investor Services Center of the SFI functions similarly to a public-interest law firm.[103] The SFI not only overcame collective-action problems in coordinating investors to bring securities lawsuits but also, when necessary, budgeted the payment of court fees and lawyer fees.[104] Some scholars even argue that the SFI, as a quasi-public organization, subsidizes the costs of private enforcement.[105] As of 2002, before the SFI transferred investor services to the Investors Protection Center, the SFI had filed *de facto* securities class actions against 23 companies on behalf of 6,028 investors, seeking NT$3.56 billion (approximately US$108 million) in civil damages.[106]

3. *Investors Protection Act in 2003—Establishment of the Investors Protection Center*

Although the SFI has actively promoted the private enforcement of corporate governance in Taiwan, the legal environment is antagonistic to group litigation. To reduce the costs and the other risks associated with securities group litigation, in July 2002, the Legislative Yuan (Taiwan's congress) passed the Securities Investors and Futures Traders Protection Act (the Act), which took effect in January 2003. The Act created an Investor Protection Fund (the Fund) to compensate investors when securities or futures firms become insolvent and were unable to settle their transactions.[107] The Act further

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102. SFI's non-enforcement activities include engaging in research and publication; offering training courses, qualification examinations, and professional licensing; and maintaining a database of public companies' information disclosure. Enforcement actions have included executing disgorgement rights for short-swing trading profits and acting as agents in shareholder suits and in *de facto* securities class actions. *See* 2003 SEC. & FUTURES INSTITUTE ANNUAL REP. 17-37 (2004) [hereinafter SFI 2003 ANNUAL REPORT], *available at* http://www.sfi.org.tw/newsfi/about/.

103. Lawrence S. Liu, Executive Vice President, China Development Financial Holding Corporation, The Merit of Shareholders Collective Actions, Presented to OECD Asian Roundtable on Corporate Governance (Nov. 2004).

104. Milhaupt, *supra* note 16, at 177.

105. Liu, *supra* note 103, at 9.

106. Liu & Lin, *supra* note 91, at 88.

107. Article 20 of the Investors Protection Act of Taiwan stipulates the usage of the Fund: "Use of the protection fund shall be limited to the follow-

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established the Securities and Futures Investors Protection Center (IPC) to manage the Fund and provide mediation services for disputes arising from the trading of securities and futures.[108]

Most important of all, the Act has opened a new phase of securities class action in Taiwan by granting the IPC a monopoly in bringing securities class actions on behalf of defrauded investors. According to the Investors Protection Act, the IPC may bring securities class actions or may undertake arbitration (doing so in its own name on behalf of investors) when the following conditions are met: (1) there should be a preoccupation with the public interest; (2) there should be a single event that causes damages to several investors; and (3) there should be more than 20 investors who delegate their litigation or arbi-

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ing: 1. Payments to securities investors or futures traders in accordance with Article 21. 2. Expenditures by the protection institution for operation in accordance with this Act and other necessary expenses. 3. Payment of fees for initiation of litigation or arbitration procedures in accordance with this Act. 4. Other uses as approved by the competent authority." TOUZI REN BAOHU FA art. 20 (2002).

108. *Id.* art. 7 ("The competent authority shall designate the following securities and futures market organizations to establish a protection institution: 1. Taiwan Stock Exchange Corporation 2. Taiwan Futures Exchange Corporation 3. GreTai Securities Market 4. Taiwan Securities Central Depository Company 5. Chinese Securities Association 6. Securities Investment Trust and Consulting Association of the R.O.C. 7. Federation of Futures Industry Associations 8. All securities finance enterprises 9. Other securities- or futures-related organizations or enterprises as designated by the competent authority. The securities- and futures-related organizations referred to in the preceding paragraph shall contribute a certain amount of assets, with the amount contributed to be determined through coordination by the competent authority."). For the authority of the IPC, *see id.* art. 10, sec. 1 ("The protection institution shall provide for the following in its operating rules: 1. Procedures for handling civil disputes between securities investors or futures traders and securities firms, securities service enterprises, futures enterprises, the Stock Exchange, the GreTai Securities Market, clearing institutions and other interested parties, arising out of securities offering, issuance, trading, or futures trading, and other related matters. 2. The means of custody and utilization of the protection fund. 3. The means of conducting inquiries into the financial operations of issuers, securities firms, securities service enterprises, and futures enterprises. 4. Consultation services in relation to acts and regulations governing securities and futures trading. 5. Matters to be handled on behalf of the competent authority. 6. Other matters helpful to achieving the purposes of this Act.").

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tration rights to the IPC.[109] The Fund is funded primarily by mandatory contributions from securities and futures firms and from self-regulatory organizations, such as stock exchanges, futures exchanges, and the OTC market.[110] In addition to compensating the investors when securities or futures firms are insolvent, the Fund can help defray the expenses that accrue from the litigation or arbitration brought by the IPC.[111]

B. *Attributes of Securities Class Actions in Taiwan*

1. *Fee-shifting Rules and Litigation Financing*

In principle, Taiwan follows the loser-pays rule, or English rule, for fee shifting in civil litigation.[112] However, the Taiwan rule differs from the traditional English rule insofar as the former rule does not obligate the losing party to pay the winning party's attorney fees because the retention of attorneys in civil litigation is optional in Taiwan.[113] Nevertheless, paying filing

109. *Id.* art. 28, sec. 1 ("For protection of the public interest and within the scope defined in its articles of incorporation, the protection institution may bring an action or submit a matter to arbitration in its own name with respect to a single securities or futures matter injurious to a majority of securities investors or futures traders, after having been so empowered by not less than 20 securities investors or futures traders. . .").

110. *Id.* art. 18, sec. 1 ("For the furtherance of its operations, the protection institution shall establish a protection fund. In addition to assets contributed in accordance with Article 7, paragraph 2, sources of fund assets shall include the following: 1. Allocation by every securities firm of 0.00000285 (2.85 millionths) of the total volume of consigned securities trades during the previous month, to be made by the 10th of each month. 2. Allocation by every futures commission merchant of NT$1.88 for each futures consignment contract executed during the previous month, to be made by the 10th of each month. 3. Allocation of 5 percent of the transaction charges received during the previous month by, respectively, the Taiwan Stock Exchange Corporation, the Taiwan Futures Exchange Corporation and the GreTai Securities Market, to be made by the 10th of each month. 4. Interest on and proceeds from utilization of the protection fund. 5. Assets donated by ROC or foreign companies, corporate bodies, groups or individuals.").

111. *Id.* art. 20.

112. MINGSHI SUSONG FA [CODE OF CIVIL PROCEDURE OF THE REPUBLIC OF CHINA] art. 78 (2003) ("Litigation fees shall be born by the losing party"). Commentators have argued that such a rule might be the biggest impediment to the success of securities class action in countries that derived their legal principles from England. *See* Securities Litigation Watch, *supra* note 52.

113. However, for civil cases at the Supreme Court (the court of last resort in Taiwan), attorney representation is mandatory. Therefore, the losing

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fees upfront and running the risk of being solely responsible for all litigation fees scares away most resource-poor investors. Before August 2002, to bring civil litigation in Taiwan, the plaintiff had to advance 1% of the claim as a filing fee at the district-court level and 1.5% at both the appellate court and the court of last resort.[114] After that, the law underwent several amendments that generally raised the fees, on the one hand, to discourage the waste of judicial resources and, on the other, to fund legal aid.[115] To understand the financial burden of plaintiffs, suppose that the average claim is NT$800 million (about US$24 million). The individual investors would have had to pay NT$6.282 million (about US$190,364) as a filing fee to file a civil case at a district court. Lacking litigation-financing options in Taiwan, individual investors find it nearly impossible to successfully fund a securities class action.

In addition to the loser-pays rule, another disincentive for bringing securities class actions in Taiwan is the restriction on contingency fee arrangements. According to the Professional Responsibility Rules published by the Taipei Bar Association, contingency fee arrangements are allowed in most civil cases.[116] However, the Taipei Bar Association capped the total fees that attorneys can charge in a single case, substantially

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party is responsible for the winning party's attorney fees. MINGSHI SUSONG FA art. 466-1, 466-3 (2003).

114. MINGSHI SUSONG FEIYONG FA [LAW GOVERNING FILING FEES FOR CIVIL CASES] art. 2, § 1, art. 18 (1980) (abolished on Sep. 10, 2003).

115. Currently, the formula for calculating the filing fee follows these rules: (1) the amount claimed under NT$100,000, charge NT$1,000; (2) for the amount claimed over NT$100,000 and under NT$1 million, charge 1.1%; (3) for the amount claimed over NT$1 million and under NT$10 million, charge 0.99%; (4) for the amount claimed over NT$10 million and under NT$100 million, charge 0.88%; (5) for the amount claimed over NT$100 million and under NT$1 billion, charge 0.77%; (6) for the amount claimed over NT$1 billion, charge 0.66%. *See* MINGSHI SUSONG FA art. 77-13, 77-16, 77-27; TAIWAN GAODENG FAYUAN MINGSHI SUSONG QIANGZHI ZHIXING FEIYONG TIGAO ZHENGSHOU BIAOZHUN [TAIWAN HIGH COURT: STANDARDS FOR RAISING FEES IN CIVIL LITIGATION AND CIVIL ENFORCEMENT CASES] (May 26, 2005).

116. However, the contingency fee arrangements are not allowed in family and criminal cases. *See* LUSHI LUNLI GUIFAN [TAIPEI BAR ASSOCIATION PROFESSIONAL RESPONSIBILITY RULES] art. 35 (1998) ("Attorneys should make clear about the ways the attorney's fees are calculated to their clients. Attorneys should not make contingency fee arrangements in family or criminal cases.").

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limiting the revenue of attorneys that represent class-action litigation. For the claimed amount under NT$5 million (US$151,000), attorney fees may not exceed NT$500,000 (US$15,151); for the amount over NT$5 million (US$151,000), attorneys can increase the fees by no more than 3% of the claimed amount.[117] It is substantially lower than the 25%-of-settlement amount, a percentage that would be deemed a reasonable attorney-fee award in securities class actions in U.S. courts.[118] Hence, the attorneys in Taiwan have far less financial incentive to coordinate securities class actions.

To facilitate securities class actions, the Act stipulates that the claimed amount that serves as the basis for calculating the filing fees will not exceed NT$100 million (about US$3.3 million).[119] This cap means that the filing fees for a district-court proceeding could not exceed NT$892,000 (about US$29,733), even if the amount claimed is over NT$100 million.[120] Even though the Investors Protection Act did not abolish the loser-pays rule, capping the filing fees substantially relieves the financial risks of the IPC in securities class actions.

To further facilitate securities class action, the Act mandates that, outside the required litigation fees, the IPC may not charge investors any fees.[121] In practice, the IPC will advance all litigation expenses for investors and will deduct the ex-

117. TAIPEI LUSHI GONGHUI ZHANGCHENG [TAIPEI BAR ASSOCIATION ARTICLES OF INCORPORATION] art. 29 (2000).

118. *See, e.g., In re* Sterling Foster & Co., Inc., Sec. Litig., 238 F. Supp. 2d 480, 490 (E.D.N.Y. 2002); *In re* Rite Aid Corp. Sec. Litig., 269 F. Supp. 2d 603, 612 (E.D. Pa. 2003); *In re* AMF Bowling Sec. Litig., 334 F. Supp. 2d 462, 470 (S.D.N.Y. 2004).

119. TOUZI REN BAOHU FA [SECURITIES INVESTOR AND FUTURES PROTECTION ACT] art. 35 (2002).

120. Even with the preferential treatment granted by the Investors Protection Act, compared to a flat fee of ¥8,200 (about US$80) in Japan, the financial cost of bringing a shareholder lawsuit in Taiwan is still much higher. In addition, the cap for filing fees in consumer group litigation in Taiwan is only NT$6,500 (about US$217), which is much lower than that for securities class actions. *See* XIAOFEIZHE BAOHU FA [CONSUMER PROTECTION LAW] art. 52 (2003).

121. TOUZI REN BAOHU FA [SECURITIES INVESTOR AND FUTURES PROTECTION ACT] art. 33 (2002) ("The protection institution shall disburse compensation it receives in an action or arbitration to the securities investors or futures traders who empowered it to initiate the action or arbitration after deducting the expenses required in either of those procedures. The protection institution is not entitled to seek remuneration for itself.").

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penses from the recovered amount, if any. If the IPC recovers no claims, the IPC will bear the litigation cost. In addition, IPC staff lawyers represent all the IPC-triggered securities class action lawsuits, saving the IPC a huge amount in attorney fees.[122] Therefore, whether the government bans or restricts contingency fee arrangements seems unimportant in Taiwan. It is worth noting, moreover, that such an arrangement both greatly relieves the financial burden of individual investors who want to participate in a class action and attests to the public-interest nature of the IPC in representing securities litigation.

In addition to the financial incentives in filing and litigating securities class action, the Act further grants the IPC privilege in filing a motion for provision relief. According to the Code of Civil Procedure, investors can file a motion for provisional relief, such as a pre-judgment injunction or post-judgment demand for satisfaction, to preserve plaintiffs' right to the defendant's property if the plaintiffs receive a favorable judgment.[123] The court can grant such a motion conditioned on the posting of security.[124] To mitigate the costs associated with a motion for provisional relief, the Act ruled that the court may waive the security-posting requirement when the IPC, on behalf of investors, files a motion for provisional relief.[125] Although the IPC still must pay an enforcement fee of 0.8% of the enforcement amount, the Act significantly reduces the financial burden on the IPC.[126] Such preferential treatment would seem to be good news for investors. However, it

122. One exception is the SFI's first case, which outside attorneys represented. That exception occurred because the SFI had not been able to hire qualified attorneys at the pioneering stage of investor protection. Telephone Interview with Chun Hung Lin, Chief Lawyer of the IPC (Feb. 24, 2005).

123. MINGSHI SUSONG FA [TAIWAN CODE OF CIVIL PROCEDURE] art. 389, 390, 522, 532.

124. *Id.* art. 392, 526, 533. In current court practice in Taiwan, investors must post a security worth the value of at least one-third of the attachment amount in advance.

125. TOUZI REN BAOHU FA [SECURITIES INVESTOR AND FUTURES PROTECTION ACT] art. 34, 36 (2002).

126. QIANGZHI ZHIXING FA [CIVIL ENFORCEMENT ACT] art. 28-2 (2000); TAIWAN HIGH COURT: STANDARDS FOR RAISING FEES IN CIVIL LITIGATION AND CIVIL ENFORCEMENT CASES, *supra* note 115.

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attracted critics.[127] While it is true that this extraordinary favorable treatment for the IPC provides it with tremendous power in protecting investors' rights, this treatment could be dangerous for public companies.[128]

The case of China Television Company (CTV) in 2004 exemplifies such concerns. CTV is a TSE-listed company and one of the statutory supervisors of Procomp Informatics, Ltd. At the end of 2004, the IPC decided to bring lawsuits against Procomp, its directors, and its statutory supervisors for fraudulent financial statements and fraudulent prospectuses. In November 2004, the IPC filed a motion for provisional relief against nineteen defendants in the Procomp case, including CTV. The court attached two CTV-owned buildings to the IPC without demanding any security from the IPC. The buildings' market value was over NT$2 billion (about US$66.7 million). However, the amount granted for provisional relief, NT$600 million (about US$20 million), was far less than the value of the buildings.[129] CTV filed a motion to dismiss the attachment order and alleged that, in terms of the value of the buildings, not only did the attachment action constitute over-enforcement but also the law over-protected the IPC by allowing the provisional attachment for "free."[130] In the end, the appellant

127. Scholars allege that the exemption of the security-posting requirement for the IPC violates the equality doctrine under civil procedure rules, which require that both parties be equal in the litigation process. Yuan-He Lai et al., *Touzi Ren Baohu Fa Yantaohui (2) —Tuanti, Gongyi Susong yu Zhengquan ji Qihuo Shichang zhi Yingyong [Seminar on Investors Protection Act (2): The Application of Group and Public Interest Litigation on Securities and Futures Markets]*, 49 TAIWAN L. REV. 68, 75-76 (1999).

128. Liu proposes that the court consult with the FSC before exempting the security requirement for pre-judgment injunctions. Nevertheless, for the post-judgment demand for satisfaction, the security requirement should remain. Lian-Yu Liu, *Investor Protection and Group Litigation*, 333 TAX & BUS. MONTHLY SERVS. 93, 98 (2002).

129. Shi-Huang Liang, *Boda Jiancha Ren Zhongshi Liang Dalou bei Kouya [Procomp Statutory Auditor: Two Buildings of China Television Were Attached]*, LIBERTY TIMES, Nov. 16, 2004, *available at* http://www.libertytimes.com.tw/2004/new/nov/16/today-t1.htm.

130. *See id.*; Shi-Huang Liang & Hwei-Tzu Yi, *Zhongshi Xiang Jietao xu Tuxiao Diya [CTV Needs to Write off the Statutory Mortgage in Order to Release the Attachment]*, LIBERTY TIMES, Nov. 17, 2004, *available at* http://www.libertytimes.com.tw/2004/new/nov/17/today-fo6.htm. Coincidentally, the Kuomintang (KMT), the opposition party and former leading party in Taiwan, is the major shareholder of CTV, and the attachment action was taken just

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court remanded the case and the lower court finally dismissed the attachment order conditioned on CTV's posting of a security valued at NT$121 million (approximately US$3.6 million).[131]

2. *Opt-in*

The Act did not adopt the U.S.-style opt-out provision. Instead, it grants the IPC legal standing to sue corporations, provided that more than 20 victimized investors empower the IPC to litigate or to settle for them.[132] In practice, the IPC will research potential target companies, identify a list of companies to sue, and post notice on the IPC website. The notice will specify a time frame in which qualifying investors can mail in standardized power-of-attorney documents and relevant proof documents to the IPC.[133] If fewer than 20 people participate, the IPC will not move forward with the case.[134] If more than 20 people empower the IPC in a specific case, the IPC will then sue that specific company in the name of the IPC. Investors who do not participate in the IPC-initiated lawsuit may bring a parallel lawsuit on their own.[135] However, those who participate will, of course, be bound to the court decision or the IPC-negotiated settlement agreement.

3. *The Role of the Taiwanese Government*

Research studies have revealed that the role of the government, the role of the judiciary, and the role of regulatory agen-

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before the election of national legislators. Critics also doubted the integrity of the IPC's intentions and alleged that political intervention may have occurred. Ming-Hui Chen, *Cong Zhongshi Jiakouya tan Toubao Zhongxing Dongshi Zeren* [*The Liability of Directors of the Investors Protection Center: From the Case of the Provisional Attachment of China Television Company*], ECON. DAILY, Mar. 7, 2005, at A7.

131. Sho-De Hu, *Bodaan Zhongshi 1.2 yi Danbao Zaijie yi "Dong"lou* [*Procomp Case: The Attachment Order was Dismissed Conditioned on CTV's Posting a 121-Million Security*], LIBERTY TIMES, Feb. 4, 2005, *available at* http://www.libertytimes.com.tw/2005/new/feb/4/today-so2.htm.

132. TOUZI REN BAOHU FA art. 28 (2002).

133. CAITUANFAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHUZHONGXIN BANLI TUANTI SUSONG HUO ZHONGCAI SHIJIAN CHULI BANFA [INVESTORS PROTECTION CENTER, STANDARD PROCEDURE FOR BRINGING GROUP LITIGATION OR ARBITRATION] art. 9 (2003).

134. *Id.* art. 3, §2.

135. Liu & Lin, *supra* note 91, at 88.

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cies in East Asian corporate governance have differed greatly from the corresponding roles in Western corporate governance.[136] For example, in most Western countries, including most of North America and much of Western Europe, the government sets the rules that govern the markets, but does not directly interfere with the functioning of the markets on a regular or discretionary basis. In addition, when disputes arise, it is expected that the judiciary system or an independent regulatory agency rather than, say, the prime minister, will resolve the issue.[137] However, in most East Asian countries, governments have frequently taken the lead in promoting specific industries or even particular companies.[138] Jackson and Gkantinis recently completed a survey in eight major jurisdictions regarding the allocation of regulatory responsibilities in capital markets.[139] The researchers specify three distinct models: a government-led model, a flexibility model, and a cooperation model.[140] Taiwan apparently follows the government-led model, where the central government has considerable control over the regulation of capital markets and leaves only minimum or necessary responsibilities to market institutions.

Under the government-led framework, government policy directs almost all aspects of capital markets' regulatory measures, including securities class actions. Unlike most nonprofit organizations, the IPC is neither purely independent nor purely voluntarily established. The Act mandates that the Financial Supervisory Commission (FSC), an administrative agency supervising all financial activities, has the right to mon-

136. Dwight H. Perkins, *Corporate Governance, Industrial Policy and the Rule of Law, in* GLOBAL CHANGE AND EAST ASIAN POLICY INITIATIVES 293, 294-295 (Shahid Yusuf et al. eds., 2004).

137. *Id.* at 294.

138. *Id.* at 295.

139. Howell E. Jackson & Stavros Gkantinis, *Markets as Regulators: A Survey* 3, (John M. Olin Ctr. for Law, Econ., & Bus., Discussion Paper No. 579, Jan. 2007), *available at* http://ssrn.com/abstract=960168 (identifying three distinct models of allocation of regulatory responsibilities to market infrastructure institutions, administrative agencies, or central government in capital markets regulation).

140. According to the survey, countries that follow the government-led model are France, Germany, and Japan; countries that follow the flexibility model are the United Kingdom, Hong Kong, and Australia; and countries that follow the cooperation model are the United States and Canada. *Id.*

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itor the business and financial conditions of the IPC.[141] The FSC appoints all the directors and the statutory auditors of the IPC.[142] According to the internal rules of the IPC, the IPC board of directors has the right to decide whether or not to file a case.[143] After filing every securities class action, the IPC must file a notice with the FSC.[144] Furthermore, the FSC, when necessary, may order the IPC to change its charter, internal rules, or board resolutions and the FSC has the right to discharge the duties of its directors, statutory supervisors, and managers or employees should the IPC not comply with the FSC orders.[145] From the above institutional arrangement, we find that the Taiwanese government has substantial control over the IPC board as well as over the lawsuits that the IPC intends to file. The IPC may be viewed as a government-controlled nonprofit organization. This relationship perfectly reflects the "paternalism" of Taiwan's securities authority in regulating the securities market.[146]

4. *Nonprofit Organizations as Plaintiffs' Attorneys*

In addition to the government, NPOs also play an important role in securities class action practice in Taiwan. It is

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141. The Financial Supervisory Commission of Taiwan was established on July 1, 2004 to consolidate the regulatory power over banking, securities, and insurance businesses. There are nine commissioners, nominated by the Premier of the Executive Yuan (that is, the Premier of the highest administrative organ of Taiwan) and appointed by the President. XINGZHENGYUAN JINRONG JIANDU GUANLI WEIYUANHUI ZUZHI FA [ORGANIC ACT GOVERNING THE ESTABLISHMENT OF THE FINANCIAL SUPERVISORY COMMISSION EXECUTIVE YUAN] art. 8 (2003).

142. At least two-thirds of the directors and statutory auditors must be appointed from among professors or other non-donor professionals, while the rest should be appointed from the delegates of donors. TOUZI REN BAOHU FA art. 11, § 2, art. 15 § 4 (2002); CAITUANFAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHUZHONGXIN JUANZHU ZHANGCHENG [CHARTERS OF THE SECURITIES INVESTORS AND FUTURES TRADERS PROTECTION CENTER] art. 10, § 2, art. 13, § 3 (2004).

143. INVESTORS PROTECTION CENTER, STANDARD PROCEDURE FOR BRINGING GROUP LITIGATION OR ARBITRATION, *supra* note 133, art. 8.

144. *Id.*

145. TOUZI REN BAOHU FA arts. 16, 39 (2002).

146. The view that the government should intervene because it knows what is in the best interest of individuals better than they themselves do is referred to as "paternalism." JOSEPH E. STIGLITZ, ECONOMICS OF THE PUBLIC SECTOR 87 (3d ed. 2000).

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hardly a novel idea that a government can grant organizations legal standing to sue on behalf of a group;[147] nonetheless, that a government can allow a nonprofit organization to bring securities class actions on behalf of defrauded investors may be an ice-breaking test. In East Asia, nonprofit organizations have been playing an active role in investor protection, such as policing various corporations by bringing shareholder derivative lawsuits.[148] The IPC in Taiwan,[149] the People's Solidarity for Participatory Democracy (PSPD) in South Korea, and the Kabunushi Ombudsman in Japan exemplify this type of nonprofit organization.[150] Nevertheless, Taiwan may be the first

147. The 1998 European Directive on injunctions for the protection of consumers' interests enables "qualified entities"—organizations or independent public bodies—to file group litigation on behalf of harmed consumers. However, the remedy is limited to injunctive relief. In fact, the associations' action was practiced in many European countries before 1998. Council Directive 98/27, Injunctions for the Protection of Consumers' Interests, 1998 O.J. (L166) 51 (EC); *see* Koch, *supra* note 50, at 359-60.

148. *See* Milhaupt, *supra* note 16, at 170.

149. Recently, the IPC in Taiwan extended its reach by actively policing corporate behaviors. To conduct this policing, the IPC has been attending shareholders meetings, bringing lawsuits to nullify or revoke the decision of shareholders meetings, and applying for provisional enforcement to stop corporate misconduct. For example, the IPC attended BenQ's shareholder meeting in June 2007 to question the ongoing insider-trading investigation of BenQ's CEO. The IPC brought litigation against Eastern Media International Corporation to nullify the decision of a shareholders' meeting. In addition, the IPC posted a NT$100 million (US$3.03 million) bond to apply for provisional enforcement and, thereby, to stop a private placement procedure that could be harmful for the investors. Yi-Hong Wang, *Lee Kun-Yao: Jiashida Mingnian Baozheng Huoli* [*KY Lee: Quisda Will Definitely Be Profitable Next Year*], LIBERTY TIMES, June 16, 2007, *available at* http://www.epochtimes.com/b5/7/6/16/n1745687.htm; Zhi-Yi Pan, *Toubao Zhongxing xiang Fayuan Tisu Dongsen Guoji Gudonghui Jueyi Wuxiao* [*The IPC Brings Lawsuit Against Eastern Media International Corporation to Nullify Decision of a Shareholders' Meeting*], CENT. NEWS AGENCY, June 26, 2007, *available at* http://www.epochtimes.com/b5/7/6/26/n1755693.htm; Hao-Ting Yuan, *Touziren Baohu Zhongxing ti Jiachufen Zhanmao Simuan Fayuan Potianhuang Dongjie* [*The Court Approved Provisional Enforcement Brought by the IPC Against AMTC*], CHINA TIMES ENEWS, May 18, 2007, *available at* http://news.yam.com/chinatimes/computer/200705/20070518276516.html.

150. *See generally* Jooyoung Kim & Joongi Kim, *Shareholder Activism in Korea: A Review of How PSPD Has Used Legal Measures to Strengthen Korean Corporate Governance*, 1 J. KOREAN L. 51 (2001); Hyuk-Rae Kim, *NGOs in Pursuit of 'the Public Good' in South Korea*, *in* COLLECTIVE GOODS, COLLECTIVE FUTURES IN ASIA (Sally Sargeson ed., 2002); Yu-Hsin Lin, Nonprofit Organizations as Plaintiffs' Attorneys: Shareholder Litigation in Taiwan (May 2005) (unpub-

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East Asian government to grant an NPO a monopoly with regard to bringing securities class actions.

The benefit of having NPOs as the main driving force behind securities class-action litigation is that the non-distribution constraint of NPOs serves as a "built-in safeguard against frivolous litigation."[151] Long plaguing the lawyer-entrepreneurial model of U.S. securities class actions has been the concern over non-meritorious or frivolous litigation. Frivolous suits increase not only the cost of business but also that of the judicial system.[152] Under the allure of contingency fees, lawyers, being the major beneficiaries of the settlements following frivolous litigation, bring up all potential lawsuits, regardless of their merit, to maximize their "portfolio" gains.

In contrast to the profit-driven lawyers, NPOs, by nature, prohibit the distribution of profits—the "non-distribution constraint."[153] Besides, most NPO funding is dependent on voluntary donations, which are unstable in comparison to the revenues earned by for-profit organizations.[154] Because of the non-distribution constraint and funding limitations, NPOs tend to be more cautious in selecting their cases and, in turn, less likely to bring frivolous suits. Empirical evidence shows that NPOs in Japan, South Korea, and Taiwan bring few lawsuits in comparison to attorneys in the United States.[155]

Because the goal of nonprofits is to pursue public interest, NPOs are more likely to bring lawsuits that maximize social welfare than to bring lawsuits that only maximize personal profits.[156] Evidence shows that, in selecting cases, NPOs tend to choose the ones that will have a greater deterrence effect on, for example, corporate misconduct. A precise example is the PSPD's minority-shareholder campaign, which has targeted South Korea's premier companies, including Sam-

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lished J.S.M. thesis, Stanford Law School) (on file with Robert Crown Law Library, Stanford Law School); Milhaupt, *supra* note 16, at 175-81; West, *supra* note 88.

151. Milhaupt, *supra* note 16, at 202.

152. *See supra* text accompanying notes 21-22.

153. Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 838 (1980).

154. *Id.* at 877.

155. Milhaupt, *supra* note 16, at 175-81.

156. *Id.* at 202.

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sung Electronics, and which annually announces a target company list to the public.[157]

In Taiwan, the IPC uses the investor protection fund, which is funded by the stock exchange and securities firms, to support securities class actions. Compared to the funding of regular NPOs, which rests on voluntary donations, the funding of the IPC has been quite abundant so far.[158] Nevertheless, the legal environment in Taiwan forces the IPC to heavily rely on administrative and criminal investigation processes to obtain evidence necessary for the establishment of a civil claim. This condition seriously confines the scope within which the IPC can pursue lawsuits. To date, the IPC has brought 36 securities class actions on behalf of more than 57,470 investors, seeking NT$21.731 billion (about US$658 million) in civil damages.[159] Among them, 34 cases have had parallel criminal proceedings and the IPC has filed most of the related civil filings after the criminal prosecution.[160] In all the cases where the defendants were declared innocent in the criminal proceedings, the civil judgments were against the IPC.[161] As of 2006, the IPC has won 11 cases in court—6 in final judgments and 5 at the district-court level—and has collected settlements amounting to more than NT$878 million (US$26.6 million) on behalf of investors.[162] The Appendix lists all class actions brought by the IPC since 2003, and Table 2 shows the summary statistics.

157. The PSPD believes that it is critical for leading companies to be the first to reform their corporate governance, since they can serve as role models for other companies. Kim & Kim, *supra* note 150, at 53.

158. For a discussion of concerns over IPC funding shortages, *see* discussion *infra* Part IV.D.2.

159. *See* Appendix for a list of securities class actions brought by the IPC in Taiwan.

160. *See* discussion *infra* Part IV.B.5.

161. These cases include Hua Hsia Rental and Royal Information Electronics. *See* 2006 SEC. & FUTURES INVESTORS PROT. CTR. ANNUAL REP. 43, 45 [hereinafter IPC 2006 ANNUAL REPORT].

162. *Id.* at 22-23.

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TABLE 2 SUMMARY STATISTICS OF SECURITIES CLASS ACTIONS IN TAIWAN[163]

	2003	2004	2005	2006	2007	Total
Number of Class Actions	4	13	3	12	4	36
Number of Investors Represented	947	13,460	34,005	8,392	666	57,470
Claimed Amount (NTD million)	440	6,808	11,090	3,305	88	21,731
(USD million)	13	206	336	100	3	658

5. *Reliance on Public Enforcement*

Information is crucial to both of the parties in litigation. In securities law cases, the company normally possesses most of the information that is essential for pursuing the claim. There are two major ways to obtain information: through the market or from the government. The media or securities analysts are the main sources of information available from the market. Generally, in private litigation, the parties can collect information only from the market. If the information is possessed by one party and not available to the public, the law should mandate that the party who possesses the information share it with the other party so that both of the parties are equal in the process, as is the case in the civil discovery system in the United States. However, the markets for media analysts or securities analysts in Taiwan are not as developed as those in the United States; moreover, disclosure requirements for public companies are not as high as in the United States. And the civil discovery process is not available in Taiwan. Consequently, investors bear high information costs in bringing securities litigation.

According to the economic theory of enforcement, if a private party naturally possesses information about the identity of the accused injurers, then the private party should have a reasonably good incentive to report information about the parties to whom the law should apply. Otherwise, public enforcement activity may be justified.[164] In the context of securities lawsuits, shareholders, especially injured minority shareholders, normally do not possess information about the fraud or corporate misconduct at issue. Therefore, we see a consistent trend in East Asia where shareholder suits are usually

163. *See infra* Appendix.

164. Steven Shavell, *The Optimal Structure of Law Enforcement*, 36 J.L. & ECON. 255, 268-69 (1993).

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brought after the criminal investigation or the administrative investigation either is underway or has been completed. Because the information costs for shareholders in East Asia to initiate a shareholder suit are higher than is the case in the United States, East Asian shareholders are more likely to rely on public enforcement than are U.S. shareholders. Even in the United States, where information costs are lower, data show that SEC enforcement action is usually the foundation of successful private securities lawsuits.[165]

To solve information asymmetry problems, the IPC in Taiwan relies heavily on criminal prosecution to obtain information.[166] When selecting cases for filing, the IPC will first consider the cases that are under either investigation or prosecution in which the government has already gathered evidence.[167] Government enforcement actions are an integral part of IPC calculations when the IPC is deciding whether or not to bring a lawsuit.[168] Among the 36 cases brought by the IPC, 34 have had parallel criminal proceedings: the criminal prosecutions of 30 cases preceded civil filings, and 10 civil claims "piggybacked" on criminal proceedings.[169] A similar situation prevails in Japan. Of the 140 cases of shareholder litigation examined by West, 20 in which criminal penalties were imposed, 20 involving pending criminal cases, and another 13 were the subject of some sort of official investigation. In 50 of

165. *See* James D. Cox, Randall S. Thomas & Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 737-38 (2003).

166. Liu & Lin, *supra* note 91, at 88, 92-93.

167. *Id.* at 88.

168. Shi-Huang Liang, *Jiujinan Chuji Toubao Zhongxin Chushi Shenshou* [*The IPC's First Try: The Chou Chin Industrial Case*], LIBERTY TIMES, June 29, 2003, *available at* http://www.libertytimes.com.tw/2003/new/jun/29/today-e3.htm. Criminal prosecution is especially important for the cases involving insider trading and the manipulation of stock prices, when information is normally not publicly available and when acquiring it depends more on the government's investigative power. Telephone Interview with Chun Hung Lin, *supra* note 122.

169. There are two main reasons for bringing "piggyback" lawsuits: to save filing fees and to obtain evidence. According to the Criminal Procedures Code of Taiwan, criminal victims can file a civil claim "piggybacked" on criminal proceedings, if the civil damages arise from a criminal act. If the facts and the evidence of such a "piggyback" civil claim are too complicated and too time-consuming for the criminal judges, the criminal court can decide to transfer the case to the civil court without asking plaintiffs for filing fees. CODE OF CRIMINAL PROCEDURE art. 487, § 1, art. 504 § 1 & 2 (2007).

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these 53 cases, criminal enforcement preceded civil enforcement.[170]

To solve the information problem facing the IPC, the Investor Protection Act grants the IPC the right to ask issuers, securities firms, or other securities market participants for assistance in finding or providing relevant documents or information for the purpose of bringing securities litigation.[171] Some scholars call this provision "discovery," while others consider it to be quasi-investigation power.[172] However, because there is virtually no penalty for violating this clause, the quasi-investigation power of the IPC is relatively weak. In addition, it would be difficult for the IPC to collect evidence through the use of the quasi-investigation power because market participants either may not have the information that the IPC needs or may not want to share the information with the IPC. The difficulty in obtaining evidence is still the most significant obstacle that the IPC faces when bringing securities litigation.[173]

C. *Economic Theories Underpinning the Taiwan Approach*

Several economic theories may enable us to understand the relationship between the emergence of NPOs and the strengthening of both investor protection and corporate-governance enforcement. This section of the current paper will introduce theories that explain the rationale for the emergence of NPOs and will apply them to the government-nonprofit partnership approach in Taiwan. By doing so, this section will not only bring to light the reasons for Taiwan's use of nonprofit organizations in investor protection, but also the applicability of current NPO theories.

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170. West further finds that "prosecutorial subpoena and investigative powers became a substitute for the lack of effective means of information gathering by shareholders." The evidence suggests that "plaintiffs may be successful only in cases in which prosecutors go forward." West, *supra* note 88, at 377-78.

171. TOUZI REN BAOHU FA art.17 (2002).

172. Liu, *supra* note 128, at 96; Lin Jin-Fu, *Yingjie Tuantisusong Shidai de Lailin—Zhengquan Touzi Ren Ji Qihuo Jiaoyi Ren Baohu Fa Jiexi* [*Welcoming the Era of Group Litigation—Analysis of Securities Investor and Futures Trader Protection Act*], 214 THE JOURNAL OF NATIONAL FEDERATION OF CERTIFIED PUBLIC ACCOUNTANT OF THE REPUBLIC OF CHINA (NFCPA), Mar. 2003, 15, 18 (2003).

173. Telephone Interview with Chun Hung Lin, *supra* note 122; *see also* Liu & Lin, *supra* note 91, at 92.

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1. *"Market and Government Failure" Theory*

The "market and government failure" theory suggests that voluntary sectors, or NPOs, emerge to meet an unsatisfied demand for public goods owing to both market failure and government failure.[174] In classical economics, market failure is the major justification for government intervention.[175] However, in a democratic society, the government will produce only the range and the quantity of public goods that can command majority support.[176] Hence, NPOs exist to supply a range of public goods desired by one segment of a community but not necessarily by a majority. As a result, the more diverse the community is, the larger the unsatisfied need for public goods.[177] This theory explains perfectly the reason for the emergence of NPOs funded voluntarily by private sectors—for example, the PSPD in South Korea.

However, such a theory cannot fully explain the government-nonprofit partnership approach in Taiwan. Although the IPC in Taiwan is not directly funded by the government, the government directed the passage of both the Investors Protection Act and the establishment of the IPC. Actual participants in the securities market did not voluntarily found the IPC. In addition, the government has considerable control over the operation of the IPC. The FSC can also delegate some of its administrative power to the IPC if the FSC deems it to be necessary.[178]

The evidence above suggests that the IPC serves as a tool that the government uses to implement public policy. In this regard, the Taiwanese government does not fail to provide the public goods of corporate law enforcement and securities law enforcement; the government attempts to provide such services through NPOs. Therefore, according to this theory, the rise of the IPC for investor protection is a response to market failure rather than a response to government failure. The part-

174. *See* BURTON A. WEISBROD, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy, in* THE VOLUNTARY NONPROFIT SECTOR: AN ECONOMIC ANALYSIS 52-61 (1977).

175. *See* STIGLITZ, *supra* note 146, at 76-93.

176. BURTON A. WEISBROD, THE NONPROFIT ECONOMY 26 (1988); *see also* WEISBROD, *supra* note 174, at 63 (indicating that from a historical perspective, governmental provision will not satisfy the minority demand for goods).

177. WEISBROD, *supra* note 174, at 67-68.

178. TOUZI REN BAOHU FA, art. 10 (2002).

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nership approach reflects an attempt by the government to respond to failures in both the market mechanisms and the nonprofit sectors.

2. *"Contract Failure" Theory*

The "contract failure" theory proposed by Hansmann suggests that the NPO is an organization that solves (1) the market failures arising from the separation of purchasers and recipients of public goods and services and (2) the information asymmetry problems arising therefrom.[179] Hansmann uses the term "contract failures" to refer to purchasers' inability to police producers insofar as the policing rests on ordinary contractual devices.[180] Hansmann defines a nonprofit organization as an organization that is barred from distributing its net earnings to individuals who exercise control over it and who include members, officers, directors, or trustees.[181] Hansmann refers to the prohibition on the distribution of profit as the "non-distribution constraint" of NPOs, which is central to his theory of nonprofit behavior.[182]

This theory fits the concept of donative nonprofits perfectly. A typical example of this type of nonprofit concerns the charitable organizations that used donors' money to buy food for the victims of the South East Asian tsunami in 2004. It was difficult for those donors (the purchasers) to examine the quality of food to be delivered to those victims (the recipients). In a situation in which for-profit organizations deliver such goods, "market competition may well provide insufficient discipline for a profit-seeking producer; the producer will have the capacity to charge excessive prices for inferior goods. As a consequence, consumer welfare may suffer considerably."[183] In such circumstances, nonprofit organizations are more trustworthy than for-profit organizations, because NPOs lack the incentive to exploit consumer welfare owing to the non-distribution constraint.[184] Hence, an NPO is a better organizational

179. Hansmann, *supra* note 153, at 847.
180. *Id.* at 845.
181. *Id.* at 838.
182. *Id.*
183. *Id.* at 843-44.
184. *See id.* at 846-48.

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form for solving the contract-failure problem in the production of public goods and services.

Under this theory, Hansmann did not anticipate the fact that government would contract with nonprofits to provide public services.[185] Hence, the contract failure theory does not provide a satisfactory explanation for the cooperation between the government and the IPC in Taiwan. Furthermore, this theory has limited explanatory power for the situation in which the sources of funding differ from the controlling power, as is the case in Taiwan. If we agree that corporate and securities law enforcement is a public good, the recipients of such a good would normally be the shareholders or investors. However, under contract failure theory, securities market participants, such as stock exchanges and brokerage firms that funded the IPC are the purchasers of public goods. Why do these market players want to purchase such public goods and services for investors? According to the implications of "law and finance" theory, the reasons may relate to the fact that investor protection matters in capital-market development and that the prosperity of the capital market is vital to the business of these market players.[186] However, in Taiwan, the actual driving force behind the establishment of the IPC is the government. Hence, there is difficulty in matching the purchaser's role according to contract failure theory in the context of Taiwan. Moreover, whether or not the government or those market participants "assume" the purchaser's role, such a purchase is made through neither contracts nor market mechanisms, as the theory assumes. Rather, such a purchase is mandated by law—in Taiwan's case, the Securities Investors and Futures Traders Protection Act. Therefore, under this scenario, there cannot be contract failures.

In sum, both "market and government failure" theory and "contract failure" theory fall short in explaining the role of the

185. STEVEN RATHGEB SMITH & MICHAEL LIPSKY, NONPROFITS FOR HIRE: THE WELFARE STATE IN THE AGE OF CONTRACTING 28 (1993).

186. For this series of research studies, *see generally* Rafael La Porta et al., *Legal Determinants of External Finance*, 52 J. FIN. 1131 (1997); Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998); Rafael La Porta et al., *Investor Protection and Corporate Governance*, 58 J. FIN. ECON. 3, 4 (2000); Rafael La Porta et al., *Investor Protection and Corporate Valuation*, 57 J. FIN. 1147 (2002); Rafael La Porta et al., *What Works in Securities Laws?*, 61 J. FIN. 1 (2006).

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government under the partnership approach. Traditional economic theories of NPOs assume the voluntary attribute of nonprofits but ignore the existence of government-nonprofit cooperation. Thus, a third theory—"voluntary failure" theory—is required to vividly capture the picture of the nonprofit sectors.

3. *"Voluntary Failure" Theory*

The "voluntary failure" theory proposed by Salamon emerged in response to the shortcomings of the prevailing theories and the longstanding ignorance regarding the government-nonprofit partnership in both the political theory of the welfare state and the economic theory of NPOs.[187] Rejecting the view that government intervention is a typical response to market failure, voluntary failure theory turns the market and government failure theory on its head. Basically, voluntary failure theory views voluntary organizations as the primary response to market failure and views the government as the derivative institution responding to "voluntary failure."[188] The government subsidizes the nonprofit, or voluntary, sector in cases of voluntary failures, when the nonprofit sector is unable or unwilling to provide adequate levels of public goods or services.[189]

This theoretical rationale provides a powerful explanation for the government-nonprofit cooperation in the Taiwanese context. However, this theoretical rationale does not necessarily suggest that the resulting partnership is better for either the government or the nonprofit sector. Criticism of this view concerns the effect of government support on the nonprofit

187. LESTER M. SALAMON, PARTNERS IN PUBLIC SERVICE: GOVERNMENT-NONPROFIT RELATIONS IN THE MODERN WELFARE STATE 35-36 (1995). The central argument for this theory is that "[t]he 'transaction costs' involved in mobilizing governmental responses to shortages of collective goods tend to be much higher than the costs of mobilizing voluntary action. . . . It is reasonable to expect, therefore, that the private, nonprofit sector will typically provide the first line of response to perceived 'market failures,' and that government will be called on only as the voluntary response proves insufficient. So conceived, it becomes clear that government involvement is less a substitute for, than a supplement to, private nonprofit action." *Id.* at 44.

188. *Id.* at 44. The voluntary failure theory refers to four types of failures, namely philanthropic insufficiency, philanthropic particularism, philanthropic paternalism, and philanthropic amateurism. For detailed definitions of these four voluntary failures, *see id.* at 45-48.

189. *Id.* at 44.

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sector and alleges that government support undermines the independence of nonprofit organizations and harms the civic virtues of the voluntary sector.[190] However, Salamon finds that although nonprofit organizations may be heavily dependent on the government for financial support, they are not without resources of their own. In addition, the interdependence between the government and voluntary sectors gives the two sides significant bargaining advantages.[191]

In the case of Taiwan, demand for securities class actions rose dramatically after the corporate scandal wave between 1998 and 1999; however, there was no pre-existing legal-services market for securities class actions or any kind of class actions.[192] With the high costs and relatively low returns of bringing class-action lawsuits, there are today, in Taiwan, virtually no financial incentives for lawyers to represent, or even initiate, such lawsuits on behalf of investors.[193] Compounding this problem, the lack of a civil-discovery system imposes a significant information-asymmetry problem on both lawyers and investors. When there are asymmetries of information or enforcement problems, markets may not exist.[194] Consequently, in Taiwan, market failure exists in the legal services market for securities class action lawsuits.

Currently, Taiwan hosts no nonprofit organization that "voluntarily" addresses the "voluntary failures" to provide support to investors regarding the litigation of securities class action. Hence, the Taiwanese government mandated that market participants should establish the IPC, which would fulfill the need for securities law enforcement. So far, the voluntary failure theory explains the Taiwanese situation well. However,

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190. *See, e.g.*, Michael Lipsky & Steven Rathgeb Smith, *Nonprofit Organizations, Government, and the Welfare State*, 104 POL. SCI. Q. 625, 629 (1989).

191. SALAMON, *supra* note 187, at 102.

192. The first class-action lawsuit in Taiwan was a consumer class-action lawsuit brought by the Consumer's Foundation on February 21, 2000 on behalf of 225 residents who, while in "The Doctor's House," suffered damages from the collapse of their houses resulting from a significant earthquake on September 21, 1999. http://www.consumers.org.tw/unit412.aspx?id=83 (last visited August 16, 2007).

193. *See supra* Part IV.B.1.

194. *See generally* George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970); *see also* Michael Rothschild & Joseph Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 Q. J. ECON. 629 (1976).

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one remaining puzzle is the fact that in the case of Taiwan, the government does not financially subsidize the IPC. Instead, through the promulgation of the Investors Protection Act, the government mandated market participants' funding of the IPC but reserved the right to appoint the IPC directors and statutory auditors.

Apparently, this type of relationship is not the model example that voluntary failure theory was designed to address. However, although the Taiwanese government does not financially subsidize the IPC, the relationship between them is a so-called government-nonprofit partnership as described in voluntary failure theory. To gain control on the one hand and to avoid criticism for political intervention on the other, the government passed the Investor Protection Act, mandating that market participants fund and continuously lend financial support to the IPC to maintain the "independence" of the IPC. Because these market participants did not fund the IPC "voluntarily," these "founders" of the IPC are merely proxies for the government in achieving public policy. And because the government still controls the IPC directors and the IPC statutory auditors, the substance of the relationship in question would be the same as the "government-nonprofit partnership" mentioned in voluntary failure theory.

D. *Potential Concerns*

1. *Improper Political Intervention*

Perhaps the most significant concern with the government-nonprofit partnership approach is political intervention. If political power can drive the filing and the settlement of securities class actions, political concerns could compromise investors' rights, even causing them to suffer considerably. As mentioned, the government has substantial control over the IPC board as well as the lawsuits that the IPC intends to file.[195] In addition to the filing of the lawsuits, the government intervenes in the settlement of lawsuits brought by the IPC.

The settlement of the *Procomp Informatics, Ltd.* case, the highest-profile corporate scandal of 2004, is a recent example of political intervention in securities class-action settlements. On March 18, 2005, the IPC and four underwriters reached a

195. *See supra* Part IV.B.3.

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partial settlement in the amount of NT$78.1 million (about US$2.6 million).[196] The Taiwanese media revealed that the parties had reached the settlement through the mediation of the FSC.[197] Interestingly, the FSC also served as the supervisory agency of those underwriters. Before the settlement, the FSC had yet to decide the level of the administrative penalty against the four securities firms for their being underwriters of Procomp's securities offering.[198] It is possible that these four securities firms were forced to settle the case and to indemnify the investors in exchange for minor administrative penalties or for good relationships with supervisory agencies.[199]

Although having a link to political power sometimes strengthens the power of the IPC, as in the Procomp settlement, most of the time, it impairs and casts doubt on the public-interest nature of the IPC. Confidence in the IPC as a nonprofit organization will be diluted as long as the government remains in control of the IPC. Currently, we can rely only on an independent and professional court system in deciding the proper use of the preferential power granted by the Act. However, the court plays no role in the current settlement procedure of IPC-initiated securities claims. It is therefore suggested that Taiwan should require court approvals on securities class action settlements, as in the United States, to prevent a possible collusive or unjust resolution of a class action.[200] In the end, a professional and honest court system, insulated from political power, would provide the best balancing power and

196. Xiu-Ming Zou & Zhong-Ying Sun, *Bodaan 4 Quanshang Buchang Touziren 7810 wan [Procomp Case: Four Underwriters Indemnify Investors NT$78.10 million]*, UNITED DAILY NEWS, Mar. 19, 2005, at A1.

197. *Id.*

198. *Id.*

199. Some securities firms and accounting firms have revealed that the IPC and the FSC sometimes force them to settle not by presenting evidence of misconduct but by simply wielding daunting supervisory power. Sometimes the IPC even told defendants that they should negotiate the settlement terms according to FSC instructions. Wang & Chang, *supra* note 47, at 28-29.

200. A class action settlement in the United States requires court approvals. FED. R. CIV. P. 23(e)(1)(A) provides that the court must approve "any settlement, voluntary dismissal, or compromise of the claims, issues, or defenses of a certified class." The court must send out notices and disclosures and conduct a settlement hearing, at which class members may appear and object to the proposal. A court may then approve the settlement only if it finds the settlement to be "fair, reasonable, and adequate." FED. R. CIV. P. 23(e)(1)(C).

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compensation for the institutional defects of the IPC. But before the law granted the courts power to monitor class-action settlements, the IPC could at least make the settlement process more transparent by making the settlement agreement available to the investors and the public.[201]

2. *Funding Limitations*

By nature, a nonprofit organization cannot sell equity shares and, for its financial sources, must rely on donations, retained earnings, and debt for capital financing.[202] However, these funding sources are relatively limited. For example, donations may merely reflect the whims of contributors. Hence, while some NPOs have accumulated capital that exceeds their needs, many others have difficulty in matching their capital with demand.[203]

Unlike regular NPOs, the IPC manages—by mandate of the Act—the funding of the Investor Protection Fund. Securities and Futures firms as well as stock exchanges are obligated to contribute a certain percentage of their income to the Fund.[204] The initial funding of the Fund was about NT$1 billion (about US$34 million); by the end of 2006, the Fund had about NT$3.1 billion (about US$94 million).[205] From the funding that the IPC has received thus far, it seems that the IPC's funds are quite abundant for the purpose of securities class actions. However, the main purpose for establishing the Fund is to indemnify investors when securities or futures firms are insolvent.[206] In addition, the Fund should defray the expenses of the IPC's business tasks, such as consultation, complaint filings, mediation, the enforcement of short-swing transaction disgorgement, and promotional campaigns.[207] Securities class actions constitute only part of the IPC's business.

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201. Taiwanese scholars have also urged the government to reform the settlement process in securities class action. *See* Wang & Chang, *supra* note 47, at 31-33.

202. Hansmann, *supra* note 153, at 877.

203. *Id.*

204. TOUZI REN BAOHU FA art. 18 (2002).

205. IPC 2006 ANNUAL REPORT, *supra* note 161, at 36-37.

206. SFI 2003 ANNUAL REPORT, *supra* note 102, at 21-22.

207. *Id.* at 15-23.

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Scholars have expressed concern about the possibility of a funding shortage in the future.[208] Although the Act mandates that securities and futures firms and self-regulatory organizations "donate" a certain percentage of their income to the Fund every month, the Act sets a cap of NT$50 billion (about US$1.7 billion) on the amount that can be donated to the Fund. When the Fund reaches that amount, the FSC has the right to order market participants to stop their "donation."[209] When reviewing the Act, the Legislative Yuan passed a "supplementary decision," suggesting that the duration of the mandatory "donation" from those market participants should not exceed five to seven years.[210] This decision appears to limit the IPC's funding. Although a "supplementary decision" is not legally binding, it has a certain politically binding effect. No one knows how future political situations will affect the IPC's funding.

From the evidence presented thus far, it seems that the future funding of the IPC is limited. If in the future, securities or futures firms suffer a significant insolvency that requires substantial compensation to investors from the Fund, there is the possibility that concerns about a funding shortage for the IPC will have been well founded. Such a shortage would definitely impede the future of securities litigation and investor protection, given the monopolistic position of the IPC. This is a practical problem other countries should be aware of when considering granting a nonprofit organization monopoly right to bring securities class action.

3. *Agency Problems*

The traditional agency costs incurred by management and shareholders in a dispersed-ownership corporation also exist in nonprofit organizations.[211] Agency costs generally refer to the costs that arise in a principal-agent relationship and that reflect efforts by the principal and the agent to align their

208. Lawrence S. Liu, *Cong Zhiye Gudong dao Tuanti Susong (3)* [*From Professional Shareholder to Group Litigation (3)*], ECON. DAILY, Aug. 2, 2002, at 6.

209. TOUZI REN BAOHU FA art. 18, § 3 (2002).

210. Liu, *supra* note 208, at 6.

211. For agency cost theory, *see generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 82 (1976).

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interests. These costs include the monitoring expenditures by the principal, the bonding expenditures by the agent, and any residual loss.[212] Agency costs in nonprofits arise when the management of the nonprofit, as the agent of the "patrons,"[213] uses funds improperly, for purposes such as renting an extraordinarily large office, buying a luxurious business car, or taking an expensive business trip.[214] Therefore, the agency costs that arise between the patrons and the management of nonprofits could lead to managerial inefficiency.[215] In sum, both empirical investigations and theoretical investigations suggest that nonprofits are, in fact, managed less efficiently than their for-profit counterparts.[216]

In addition to the traditional agency costs between management and shareholders, the government-nonprofit partnership in Taiwan incurs at least two kinds of non-traditional agency costs. One resides in the IPC's representation of investors in securities class actions. The agency cost for representation is similar to the plaintiff's attorney agency problem in the United States.[217] Nevertheless, the agency cost of the representation relationship between the IPC and investors might be lower than that in the United States because there is actually

212. *Id.* at 308-10.

213. Hansmann uses the word "patrons" to refer to those individuals who constitute the ultimate source of a nonprofit's income. Hansmann, *supra* note 153, at 841.

214. *See id.* at 844.

215. *See* PAUL MILGROM & JOHN ROBERTS, ECONOMICS, ORGANIZATION AND MANAGEMENT 524 (1992) (describing a number of scandals from NPOs in the real world); Richard Steinberg, *Economic Theories of Nonprofit Organizations, in* THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 117, 126-27 (Walter W. Powell & Richard Steinberg eds., 2006) (identifying a number of agency costs associated with NPOs).

216. WEISBROD, *supra* note 176, at 18, 23; Hansmann, *supra* note 153, at 844; Steinberg, *supra* note 215, at 127. *But see* Steinberg, *supra* note 215, at 128 (attacking current empirical results and arguing that NPOs seem less efficient because of their unmeasured outputs).

217. Proposals have been made to align the interests of lawyers with those of shareholder plaintiffs. *See* Coffee 1983, *supra* note 24; *see also* John C. Coffee, Jr., *Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation*, 100 COLUM. L. REV. 370 (2000). The PSLRA addresses the concern over plaintiffs' attorney-agency problem by encouraging institutional investors to act as lead plaintiffs. For the effect of institutional investors' participation on securities class actions, *see generally* Cox & Thomas, *supra* note 36.

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less divergence in financial interests between the IPC and investors than there is between U.S. "bounty hunter" attorneys and their clients.[218]

Another non-traditional kind of agency cost lies between the government and the IPC. The Taiwanese government established the IPC to implement investor protection policy. In this regard, the IPC serves as the agent of the government in carrying out public policy. Although the government has direct control over the appointment of the IPC board, in theory, there is the possibility that the IPC may operate in a way that deviates from government policy. For example, although appointed by the government, the directors that represent securities firms (the patrons) may be primarily concerned about the interests of securities firms and may, therefore, oppose the bringing of a securities class action against a securities firm that has acted as the underwriter of a certain securities offering. In this situation, the board of the IPC may not act to fully implement the government's investor-protection policy.

More important is that the interests of these three principals sometimes conflict. In addition to the above-mentioned example, in which the interests of the patrons conflict with those of the investors, the interests of the government may not coincide with those of the investors. For instance, the government may oppose the pursuit of litigation against certain public companies for industrial policy or other political concerns. Because the government has considerable control over the directors and the operation of the IPC, it is probable that the government will influence the IPC's litigation decisions both at the cost of investors' welfare and to the benefit of the government's interests.

In conclusion, the institutional structure of the government-nonprofit partnership in Taiwan forces the IPC to serve as the agent of three parties: patrons, investors, and the government. This institutional arrangement not only increases the cost of the IPC, but also augments the influence of the government over securities class actions. This is a significant problem in the government-nonprofit partnership approach and must be specifically addressed in future reforms.

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218. These differences arise mainly because the IPC does not charge investors attorney fees and because the non-distribution constraint of nonprofits makes the IPC less vulnerable to financial incentives.

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V.
CONCLUSION

In seeking remedies for investors, more and more countries are now looking into class actions as a means to deter corporate misbehavior and to compensate investor losses. While "the laws on the books" can converge globally in a short time, enforcement action can take only the form that fits the local institutions. Empirical evidence shows that the level of enforcement of financial regulations varies remarkably among different countries.[219] The United States, being an outlier, brings the greatest number of enforcement actions and imposes the largest financial penalties, whether through public or private enforcement.[220]

However, it doesn't mean that one country would reach the "optimal" amount of enforcement action by merely transplanting the U.S.-style class action regime. Although it is always hard to assess the "optimal" level of enforcement, most of the time, only enforcement measures that fit local conditions are likely bring the "right" level of enforcement. Among the many countries that try to build their own class-action regime, Taiwan stands out in assigning the task of the "bounty hunter lawyers" to a nonprofit organization. The shift in organizational form—from profit-driven law firms to public-interest-centered NPOs—triggers an interesting chemical change, as it were, in the operation of securities class actions. Traditional enforcement theory's taxonomy of public and private enforcement seems inadequate to capture the special attributes of in-between nonprofits. And governmental intervention further complicates the analysis. By analyzing the Taiwan-style partnership approach, this paper sheds light on the alternatives to traditional enforcement mechanisms that might be helpful to other countries in designing a locally acceptable enforcement device.

219. *See* Jackson, *supra* note 23.
220. *Id.* at 25-29.

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APPENDIX: LIST OF SECURITIES CLASS ACTIONS IN TAIWAN[221]

	Defendant	Type of Claim				Claimed Amount (NT$ 1,000)	Class Size	Type of Filing		Filing Date	Progress	
		Misstatements in Financial Statements	Misstatements in Prospectus	Stock-price Manipulation	Insider Trading			Civil Lawsuit	"Piggyback" Lawsuit		Criminal Proceedings	Civil Proceedings
1	Hwa-Hsia Leasing		1			20,537	77		1	2003.04	Declared Innocent (2006.07.31)	Final judgment made against the IPC. (2006.09)
2	New Sun Metal	1				393,825	759	1		2003.08	In Progress	In Progress
3	Yang Iron Works	1				22,592	80	1		2003.12	The CEO and his brother were declared guilty of stock-price manipulation. (2006.07.04)	In Progress
4	Chung Yo Department Store	1				2,820	31	1		2003.12	Corporate insiders were declared guilty. (2007.03.29)	Settled (2005.01.26)
5	Taiwan Fertilizer			1		27,523	103		1	2004.01	In Progress	In Progress
6	Infodisc (1)				1	373,017	2,070	1		2004.03	The CEO and his wife were declared guilty of insider trading. (2005.03.24)	Final judgment made against the defendants. (2005.03.30)
7	Dayin (1)	1		1		309,268	714		1	2004.03	The CFO was declared guilty of making misstatements in financial statements. (2007.03.29)	In Progress
8	King Yuan Electronics		1			25,351	55	1		2004.06	Not prosecuted	In Progress
9	King Yuan Electronics (underwriter)		1			-	-	1		2004.06	Not prosecuted	In Progress

221. The list includes the cases brought by the IPC since 2003. The data are compiled from the IPC Securities Class Action Monthly Update July 2007, IPC 2003-2006 Annual Report and from the author's updates regarding recent court decisions.

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	Defendant	Type of Claim				Claimed Amount (NT$ 1,000)	Class Size	Type of Filing		Filing Date	Progress	
		Misstatements in Financial Statements	Misstatements in Prospectus	Stock-price Manipulation	Insider Trading			Civil Lawsuit	"Piggyback" Lawsuit		Criminal Proceedings	Civil Proceedings
10	Dayin (2)				1	15,328	196	1		2004.07	The CFO was declared guilty of insider trading. (2004.02.25)	Final judgment made against the defendants. (2005.03.24)
11	RoyalTek	1				128,786	119		1	2004.07	CEO and corporate insiders were declared innocent. (2006.04.26)	Final judgment made against the IPC. (2006.08)
12	Tung Zong Textile				1	2,809	28	1		2004.08	In Progress	Suspended
13	Aceland-Dynasty			1		60,309	87	1		2004.10	Guilty (2004.06.09)	Final judgment made against the defendants. (2005.02.14)
14	Procomp Informatics (1)		1			1,441	18	1		2004.11	In Progress	In Progress
15	Procomp Informatics (2)	1	1			5,824,779	10,038	1		2004.12	In Progress	In Progress
16	Great Sun Development			1		39,574	29	1		2004.12	The defendant was declared guilty. (2007.03.01)	Final judgment made against the IPC. (2006.09.13)
17	Mokoh & Associates				1	111	3	1		2004.12	The defendant was declared guilty. (2003.12.24)	Settled (2005.02.04)
18	Chou Chin Industrial	1	1			542,110	484	1		2005.02	The CEO and corporate insiders were declared guilty. (2006.08.31)	In Progress
19	Pacific Electric Wire & Cable	1				7,870,375	25,092	1		2005.04	In Progress	In Progress
20	Infodisc (2)	1			1	2,677,309	8,429	1		2005.09	In Progress	In Progress
21	Summit Computer Technology	1				364,468	1,590	1		2006.02	In Progress	In Progress
22	Well Communication	1	1			126,956	241	1		2006.02	In Progress	In Progress
23	Power Quotient International	1				442,766	781	1		2006.04	In Progress	In Progress

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	Defendant	Type of Claim				Claimed Amount (NT$ 1,000)	Class Size	Type of Filing		Filing Date	Progress	
		Misstatements in Financial Statements	Misstatements in Prospectus	Stock-price Manipulation	Insider Trading			Civil Lawsuit	"Piggyback" Lawsuit		Criminal Proceedings	Civil Proceedings
	(1)											
24	National Aerospace Fasteners	1		1		569,164	1,136	1		2006.04	In Progress	In Progress
25	Power Quotient International (2)				1	3,657	623	1		2006.08	In Progress	In Progress
26	Taiwan Sakura Co.				1	1,690	117	1		2006.06	In Progress	In Progress
27	Sayho	1	1			185,234	418	1		2006.10	Corporate insiders were declared guilty. (2006.10.20)	In Progress
28	Hold Key			1		60,135	271		1	2006.11	In Progress	In Progress
29	Sainfoin Technology	1	1			1,191,049	2,390	1		2006.11	In Progress	In Progress
30	CIS Technology				1	1,539	73		1	2006.11	The CEO was declared innocent. (2007.06.05)	Settled (2006.12.12)
31	Mosel Vitelic				1	35,701	535	1		2006.12	In Progress	In Progress
32	Xepex Electronics	1				323,030	217	1		2006.12	In Progress	In Progress
33	Chunghwa Picture Tubes				1	6,279	489		1	2007.01	In Progress	In Progress
34	Bao Chen Building				1	825	62		1	2007.03	In Progress	In Progress
35	Chain Qui Development				1	1,877	33		1	2007.03	In Progress	In Progress
36	Power Quotient International (3)			1		78,640	82		1	2007.04	In Progress	In Progress
	Total	**16**	**9**	**7**	**12**	**21,730,874**	**57,470**	**26**	**10**			

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