

SINGAPORE'S ECONOMIC BALANCING ACT: HOW A COMPANY'S COLLAPSE CHALLENGED THE COUNTRY'S NEW CORPORATE GOVERNANCE REGIME

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I. INTRODUCTION

The collapse of China Aviation Oil (CAO) exposed the precarious position of Singapore's economy. Singapore is currently performing several balancing acts simultaneously. The balancing act most prominently displayed in the CAO scandal—which resulted in the implosion of one of Singapore's most highly regarded corporations—is Singapore's place within both the

regional and the international economy. Singapore has long hoped to develop into a global financial center. In order to attract investors from the West, Singapore has emphasized its reputation for being corruption free and maintaining strict corporate governance regulations. While this may make Western investors more comfortable about sending their money into the country, it has the potential to alienate Singapore from its regional trading partners, especially China. China's corporations are often secretive and unwilling to adhere to the transparency standards of Western countries. Furthermore, many Chinese corporations are state-owned or recently privatized and, as a result, may have objectives other than increasing shareholder wealth.

Subsumed in this tension of being both a regional player and an international player is the balancing act of upholding its reputation for having strict corporate governance regulations and, at the same time, being a country where companies that value their privacy, such as those from China, feel comfortable doing business. Singapore has succeeded in balancing these competing interests. Singapore's ability to continually walk this fine line is due to the government's control of the economy, and its economic discipline leads to the country's third balancing act. In order to achieve this control over the economy, Singapore has limited the civil and political liberties of its people. The government argues that these restrictions have made possible the country's economic prosperity. Though it is rare for a country to be both authoritarian and prosperous, Singapore has, thus far, been able to balance both.

This paper explores all three of these balancing acts as they are shown in the CAO crisis. Part two of this paper describes the CAO scandal and identifies the key players in the crisis and the role they played. The third section examines the tensions in Singapore's economy and political system that were mentioned above. The fourth section explores the influence China has had on Singapore's economy and legal system. The final section details Singapore's response to the CAO scandal in light of the close relationship between China and Singapore.

II. FACTUAL BACKGROUND

In late November 2004, China Aviation Oil (CAO) announced that it had suffered losses from derivatives trading totaling US \$550 million. The company subsequently filed for protection from its creditors.¹ At the time of this filing, CAO was listed on the Singapore Stock Exchange, and China Aviation

1. *Trading Turbulence Downs China Aviation*, INTERNATIONAL PETROLEUM FINANCE, Dec. 1, 2004, at 1, available at 2004 WLNR 15501343.

Oil Holding Company (CAOHC), a company wholly owned by China, owned 60 percent of CAO.² Prior to this announcement, CAO was held up as the darling of Singapore's business community, and its chief executive, Chen Jiulin, was considered a genius able to turn around the company.³

CAO apparently began trading in oil derivatives in 2003. Some of this trading was for hedging purposes, but CAO extended its trading activity to speculative derivatives trading. For Chinese companies, derivatives "are only used for hedging purposes," and speculative trading is not allowed. CAO, however, had the freedom to conduct speculative trading because it was a Singapore-listed company and was therefore governed by Singapore regulations, not Chinese regulations.⁴

There were internal controls in place at CAO that should have limited the losses of such trading. For instance, each of the company's traders was subject to a loss limit of US \$200,000. The internal controls called for the CEO and risk management committee to be notified if this limit was exceeded. As soon as a trader's losses reached US \$500,000, the trader's positions would immediately be shut down. Only the CEO could grant approval to keep the trader's position open.⁵ With only six traders in the company, the maximum amount of losses allowed by these internal controls would have been US \$3 million. Obviously, the company did not adhere to these controls because the loss limits were exceeded by US \$547 million.

News of the losses first started to come out on November 16, 2004, when CAO announced that it was ending all of its speculative trading. At that point the company did not divulge just how much it had lost. One news report stated that "some analysts have pegged the losses at US \$5 million." The same report quoted an analyst as saying that "there was still confidence in CAO's fundamentals."⁶ This shows how CAO—a public company—was able to keep everyone in the dark regarding its balance sheets.

There is more to this scandal than just a company ignoring its publicly stated internal controls. On October 20, 2004, CAO's

2. *Trading Turbulence*, *supra* note 1.

3. Indeed, just a few months earlier, the Chinese newspaper *Zaobao* wrote about Mr. Chen in an article titled "CAO's Shine All Due to One Man." *CAO's Shine All Due to One Man*, ZAOBAO, August 19, 2004, available at http://ir.zaobao.com/caosco/news/cao190804b_e.html.

4. *Trading Turbulence*, *supra* note 1, at 2.

5. *Id.*

6. *China Aviation Oil to End All Speculative Oil-Dealing Activity*, ZAOBAO, Nov. 17, 2004, available at [HTTP://IR.ZAOBAO.COM/CAOSCO/NEWS/CAO171104A_E.HTML](http://ir.zaobao.com/caosco/news/cao171104a_e.html).

parent company CAOHC sold a 15 percent stake in the company—lowering its holdings from 75 percent to 60 percent. The sale raised US \$120 million. CAOHC initially did not indicate the purpose for the stock sale. Only after the sale did a CAO spokesman say that CAOHC “had an investment they are making and they need to raise the cash.”⁷

However, according to an affidavit by Chen Jiulin, CAO’s CEO at the time, on October 10, 2004—ten days before the stock sale—Mr. Chen notified CAOHC’s board for the first time of the substantial derivatives losses. The losses were estimated to be US \$180 million at the time Mr. Chen reported to CAOHC. According to Mr. Chen’s affidavit, CAOHC’s stock sale was made “in a bid to raise capital for the margin calls.”⁸ In his affidavit, Mr. Chen stated that the entire amount raised by the placement was immediately loaned to CAO in hopes that the money would save the subsidiary. CAOHC, however, never made any mention of these financial troubles when it sold the block of stock.⁹

This stock sale was reportedly made mostly to institutional investors. One of these investors was Temasek Holdings, the investment arm of the Singaporean government, which bought a 2 percent share of CAO in the sale.¹⁰ Temasek, however, did not file suit against either CAO or CAOHC, as other shareholders did. To the contrary, Temasek agreed to bail out CAO by partnering with CAOHC for each of them to inject US \$50 million in the company.¹¹ That, along with the creditors agreeing to a restructuring plan, was enough to save CAO from bankruptcy.

CAOHC for its part in the scandal was fined US \$4.8 million by the Monetary Authority of Singapore. In addition, several CAO and CAOHC executives, including Mr. Chen, were arrested.

A. KEY PLAYERS

This story is ultimately about two countries, China and Singapore. The governments of both countries enjoy ultimate control over their respective economies. The issues raised by the

7. Francesco Guerrera et al., *Collapse Causes Concern About Business with Beijing*, FIN. TIMES, Jan. 20, 2005, available at http://search.ft.com/ftArticle?queryText=loong&page=4&activeTab=ftComment&id=050120008259&ct=0&nlick_check=1.

8. *Id.*

9. *Trading Turbulence*, *supra* note 1.

10. *Investors Find it Hard to get CAO Compensation*, FIN. TIMES, Dec. 21, 2004, available at <http://www.ft.com/cms/s/0/68671a82-5351-11d9-b6e4-0000e2511c8.html>.

11. John Burton, *City State Gets Tough on Governance*, FIN. TIMES, June 8, 2005, available at http://us.ft.com/ftgateway/superpage.ft?news_id=fto060820050088001966&page=1.

CAO debacle draw attention to the relationship between the two countries at the time of the scandal and how this will affect their relationship going forward. In this situation, China is clearly the party in the driver's seat. China has a massive population and, more importantly, a big, thriving economy that continues to grow rapidly. Singapore, on the other hand, is small and desperately needs China as a friend and cooperative business partner. As a result, this scandal places Singapore in the precarious position of not only having to punish China in order to save face with the rest of the world, but also of having to enforce its regulations in a way that will not cause China to pull away.

Both countries are represented by various parties in this episode. China is mainly represented in the form of CAO and CAOHC. China Aviation Oil was started in 1993 as a joint venture between China Aviation Oil Supply Corporation (CAOSC), China Foreign Trade Corporation and Neptune Orient Lines Ltd of Singapore.¹² (Temasek was and still is the controlling shareholder of Neptune Orient Lines.¹³) CAO was originally started as a shipping broker. Two years later, CAOSC bought out the other two partners to become sole shareholder of CAO, and, in 1997, it entered the business of oil trading. By 1999, it held a monopoly on all jet fuel trading in China, and, in 2001, it held its IPO on the Singapore Stock Exchange.¹⁴

In 2002, CAOSC transferred its shares to CAOHC. Until late 2004, CAOHC held 75 percent of CAO's shares. CAOHC is wholly owned by the Chinese government. Until recently, Chen Julin was chief executive of CAO, and Jia Changbin was the chairman of the board of CAO and was also the president of CAOHC.¹⁵

Singapore is represented in this case by several key players. Again, like China, all of Singapore's players are controlled by the government. They include the Monetary Authority of Singapore and the Singapore Stock Exchange. The leading Singaporean party in this scandal, however, is Temasek Holdings. Temasek is the Singaporean government's investment agency. The company was started in 1974 with the mission to oversee the government's role in the economy.¹⁶ It is wholly owned by the country's finance ministry. The current CEO of Temasek is Ho Ching, who is also the wife of Singapore's Prime Minister Lee Hsien Loong, himself the son of modern Singapore's founding father, Lee

12. CHINA AVIATION OIL, 2003 ANN. REP. 3.

13. NEPTUNE ORIENT LINES FACT SHEET, available at http://www.nol.com.sg/investor/documents/Fact011204_001.pdf.

14. ANN. REP., *supra* note 12.

15. *Id.*

16. *Temasek: First Singapore, Next the World*, ECONOMIST, Aug. 14, 2004.

Kuan Yew.¹⁷ An extremely private company, Temasek only released its first annual report in 2004, and it has not committed to releasing such a report every year.¹⁸

III. SINGAPORE'S COMPETING INTERESTS

The CAO disaster exposed the risk of a main piece in Singapore's economic strategy—strengthening its ties with China. Singapore's economy is increasingly becoming a financial-services based economy. As a result, Singapore specifically hopes to attract more Chinese companies to do business in Singapore and list on the Singapore Stock Exchange (SGX). This is a risky strategy because of the opaque nature of Chinese corporations. As Standard & Poor stated, China's "complex corporate structures and unreliable accounting practices make it difficult to perform substantive analysis on some China-related companies."¹⁹ A Chinese company such as CAO is particularly risky. It is a public company that comes with a ready-made monopoly on China's jet-fuel market. Therefore, to seek growth it looks to risky ventures like the derivatives trading that caused its downfall. Investors are aware of the risks that Chinese companies pose. That risk results in the stocks of Chinese companies trading at a 13 percent to 14 percent discount from a similar stock in a developed country. That discount rate is about the same as Indonesia's.²⁰

A. FINANCIAL SECTOR

In 2001, Singapore found itself in its worst recession in a generation. At the time, the country admitted that "the biggest drag" on the economy came from its manufacturing sector.²¹ For example, in August, 2001, output from manufacturing dropped 21 percent. That was the steepest drop in output in over fifteen years.²² Increased competition in the region was hurting Singapore, primarily the economic cooperation between China and Taiwan. One economist at the time proposed that "the solution to this problem is a shift in Singapore's strategy from export of goods to capital." In fact, that strategy had already been adopted

17. *Id.*

18. *Translucent Temasek*, CFO ASIA, Nov. 2004.

19. *Police Start an Inquiry into China Aviation Oil*, TIMES, Dec. 4, 2004, available at 2004 WLNR 13037772.

20. *Chinese Business at Risk from Monopoly Mindset*, FIN. TIMES, Dec. 6, 2004, available at <http://search.ft.com/ftArticle?queryText=cornerstone+Overseas+Investment+Limited&id=041206008671&ct=0>.

21. *Singapore Needs More Entrepreneurship*, FIN. TIMES, Dec. 5, 2001 available at <http://www.singapore-window.org/sw01/011205ft.htm>.

22. *Id.*

by Singapore, if not yet implemented. At the time, there was much talk about “reinventing” the economy into a “knowledge-based economy,” allowing it to rely less on its manufacturing sector.²³

Singapore faces increasing competition in its financial sector just as it did with its manufacturing sector. In contrast, however, the competition is not necessarily from China but for China. There are several stock exchanges vying for Chinese companies. At the end of 2004, Hong Kong led the pack with over 200 Chinese listings on its stock exchange. The New York Stock Exchange had sixteen, NASDAQ had only six, and the London Stock Exchange also had six. The LSE recently opened an office in Hong Kong in the hopes of enticing more Chinese companies. Singapore, for its part, had at least thirty-four.²⁴ That was up from only three Chinese companies ten years earlier.

In addition to turning into a service-based economy, Singapore also had to look beyond its borders to expand its financial sector. The domestic economy was simply too limited to be a growth engine for the Stock Exchange of Singapore (SGX). As part of its strategy, SGX “focused on wooing mid-sized Chinese companies, such as CAO, that might be ignored in bigger bourses.”²⁵ Singapore was successful at attracting these smaller companies, while the larger companies generally listed on Hong Kong’s exchange. Chinese stocks are some of the more popular ones listed on SGX,²⁶ and Chinese stocks have been a boon to SGX’s bottom line. The turnover of China stocks is 170 percent compared with 50 percent for Singapore companies.²⁷

B. REGIONALIZATION

Singapore had no choice but to take an international approach for its entire economy, not just its financial sector. Its domestic economy was too small to survive on its own. In the early 1990s, the Singaporean government developed a concrete plan for internationalizing its economy. The government took an active role in attempting to form joint ventures with companies around the world, including companies in North America and

23. *Id.*

24. *London Stock Exchange Opens Regional Office in H.K.*, ASIAN ECONOMIC NEWS, Oct. 25, 2004, available at http://findarticles.com/p/articles/mi_m0WDP/is_2004_Oct_25/ai_n6283862.

25. John Burton, *Singapore Waits on Regulatory Review*, FIN. TIMES, Dec. 17, 2004 at 27.

26. The best performing stock, in fact, is the Chinese company Midas, which was up 500 percent for 2004.

27. *Scandal Cools Taste for China*, STANDARD, Mar. 7, 2005, available at 2005 WLNR 3455448.

Western Europe. Many of these ventures failed.²⁸ As a result, the government pulled back considerably from its ambitious international approach and focused instead on a policy of regionalization. Now close to 60 percent of Singapore's foreign investment goes to other Asian countries.²⁹ Singapore has been able to rely in part on its personal contacts and relationships when doing business within the region, particularly when doing business with China.

Singapore's regionalization strategy may actually end up helping it achieve international economic success as well. As the region's economy continues to grow, an increasing number of multinational corporations (MNCs) are drawn to the region. Singapore has been able to exploit its reputation for being a "stable, corrupt-free" system.³⁰ MNCs that want to enter the region may feel more comfortable having their investments go through Singapore, as opposed to countries that do not have the same reputation, such as China or Indonesia.

In fact, some believe that Singapore "has been a de facto linchpin of integration in Southeast Asia for a long time." This reputation allows the Singapore government to function as "a facilitator, a one-stop agency for foreign MNCs which want to invest in the region."³¹

Singapore is deliberately pursuing this policy, which will allow the country to be both a regional player as well as an international player. This policy may continue to work so long as Singapore can manage the right balance of Eastern and Western institutions, thereby pleasing both sides. As one scholar writes, "Hence we witness another balancing act between regionalization and globalization. Deliberate promotion of Singapore as a site for regional headquarters of MNCs tends to strengthen the regional economic networks and the international connections simultaneously and keeps Singapore in the focal point."³²

C. GOVERNMENT CONTROL

As was demonstrated in the CAO scandal, Singapore's economy is largely driven by the government. In fact, the government became actively involved in the economy immediately after the

28. CAROLINE YEOH ET. AL, SINGAPORE'S REGIONALIZATION BLUEPRINT: A CASE OF STRATEGIC MANAGEMENT, STATE ENTERPRISE NETWORK AND SELECTIVE INTERVENTION 4, available at <http://ssrn.com/abstract=380560>.

29. *Id.* at 5.

30. Hans C. Blomqvist, *Development Policies of Singapore: Dynamics of Internationalisation versus Regionalism*, UNIV. OF VAASA WORKING PAPER NO. 275, (Sept. 2000) available at <http://ssrn.com/abstract=248489>, at 27.

31. *Id.*

32. *Id.*

country's independence. In order to spur development, Singapore created government-linked corporations (GLCs) in sectors that were particularly underdeveloped.³³ Three government-controlled holding companies—Temasek Holdings, MDN Holdings, and Sheng-Li Holding Company—serve as the government's investment companies. One example of an early GLC is the Development Bank of Singapore (DBS) which was formed in 1968. The government then listed the bank on the Singapore Stock Exchange in order to involve the private sector. At the time it had a market capitalization of US\$59 million. Now it is one of the 100 biggest banks in the world with a market cap of US\$14 billion, and it is one of the top three companies listed on SGX. It should be noted that the other two largest companies on SGX are also GLCs.³⁴

The boards of GLCs are generally made up of political appointees and high ranking civil servants.³⁵ Having political appointees serve on the board allows the government to monitor and maintain control of the companies. Of course, government ownership can cause problems as well. The board members may have conflicting goals. As a representative of the government, a board member may hope to satisfy certain demands or goals of the government other than shareholder maximization, which most likely is the goal of the minority shareholders.

Indeed, as is discussed in part five of this paper, Temasek's response to the CAO scandal may have been heavily influenced by interests other than shareholder returns. Instead, as a government-controlled investment company, its board members may have been more interested in maintaining its good relationship with China than with protecting its investment.

D. POLITICAL SYSTEM

Singaporean elites believe that their country's success is a result of the government's control over the economy and political system. This philosophy was formed in the country's humble beginnings. Singapore was originally a part of the Malaysian Federation, itself a British colony until 1959. Then in 1965, Singapore was expelled from Malaysia and forced to become an independent state.³⁶ Singapore's future was bleak. It had no

33. John W. Thomas & Lim Siong Guan, *Using Markets to Govern Better in Singapore*, HARVARD UNIV. SCH. OF GOV'T WORKING PAPER NO. RWP01-010, (August 2001) available at <http://ssrn.com/abstract=310862>, at 15.

34. *Id.*

35. Phillip H. Phan, Presentation at the Academy of International Business Annual Meeting, *Corporate Governance in Singapore: Development and Prognosis*, (Jul. 2004), at 12.

36. Thomas & Guan, *supra* note 33, at 1.

natural resources, little land, and was surrounded by “overtly hostile” neighbors. Poverty, a 50 percent literacy rate, and undeveloped infrastructure were also serious problems facing the new nation. Singapore, however, did have two things working in its favor: its location and its “strong, pragmatic leadership.”³⁷ The founder of modern Singapore, Lee Kuan Yew, assessed the situation in 1965 and knew that in order to survive Singapore had to be different. It had to be tougher and more disciplined than other countries. “I concluded an island city-state in Southeast Asia could not be ordinary if it was to survive. We had to make extraordinary efforts to become a tightly knit, rugged and adaptable people who could do things better and cheaper than our neighbors. . . .”³⁸ That mentality continues today, and it is arguably this mentality that is the core reason for the country’s success.

The political system that Mr. Lee implemented to ensure this discipline is categorized as “soft authoritarianism.” Mr. Lee described the necessity for such a system: “I believe what a country needs to develop is discipline more than democracy. The exuberance of democracy leads to indiscipline and disorderly conduct which are inimical to development.”³⁹ Thus far, Singapore has been able to balance prosperity with its soft authoritarianism. Some agree with Mr. Lee that democracy can, in fact, inhibit economic development. Democracy’s participatory structure—with various interest groups competing with one another for the government’s attention and approval—is antithetical to what Mr. Lee believed was necessary for his country.⁴⁰ Democracy is a luxury good, and with no natural resources and limited land, Singapore simply does not have the luxury to be democratic.

Moreover, democracy can result in “demosclerosis,” which is defined as “the paralysis of gridlock afflicting a lobbying-infested democracy.” The gains from democracy “can be outweighed by their costs from gridlock and unproductive profit-seeking.”⁴¹ Too much authoritarianism, however, has the potential to be even more inefficient. The absolute power that leaders of authoritarian regimes enjoy can lead to corruption and a lack of incentives to develop their economies. Jagdish N. Bhagwati ar-

37. *Id.*

38. *Id.* at 1, 2.

39. Jagdish Bhagwati, *Democracy and Development: Cruel Dilemma or Symbiotic Relationship?*, REVIEW OF DEVELOPMENT ECONOMIC, VOL. 6, pp. 151-162, (2002) available at <http://ssrn.com/abstract=312847>, at 151.

40. *Id.* at 155.

41. *Id.*

gues that “only a benign or ‘soft’ authoritarianism would avoid the trappings of corruption.”⁴²

Singapore is defying conventional wisdom by having both a thriving economy and an authoritarian regime. The conventional wisdom is generally stated as follows: “Economic growth produces an educated and entrepreneurial middle class that, sooner or later, begins to demand control over its own fate. Eventually, even repressive governments are forced to give in.”⁴³ However, as Bruce Bueno De Mesquita argues, authoritarian regimes are becoming more sophisticated at being able to contain their populations’ demand for more political power. Mesquita goes so far as to argue that “authoritarian regimes are getting better and better at avoiding the political fallout of economic growth—so good, in fact, that such growth now tends to increase rather than decrease their chances of survival.”⁴⁴ While the connection between economic prosperity and the demand for democracy still exists, these regimes are getting better at delaying reform.

Authoritarian incumbents have learned that by limiting some rights but not all rights, they can ensure their entrenchment while allowing for economic development. Mesquita argues that the goods that can be suppressed are coordination goods. This allows authoritarian incumbents to stymie the political opposition while not suppressing the goods and services necessary for economic progress. “By limiting coordination goods, autocrats can have it all: a contented constituency of power brokers and military leaders who benefit from economic growth, increased resources to cope with economic and political shocks, and a weak and dispirited political opposition.”⁴⁵

Singapore has successfully implemented this procedure. Indeed, one study found that Singapore was one of the few countries to rank low in terms of democracy and yet rank high when it comes to economic growth.⁴⁶ It should also be noted that Mr. Lee’s political party, the People’s Action Party (PAP), has been in power the entire time Singapore has been independent. However, it may be easier for Singapore to strike this balance than most other countries. Some believe that there is a willingness of Singapore’s population to fall in line that is not present in other

42. *Id.*

43. Bruce Bueno De Mesquita, *The Rise of Sustainable Autocracy*, FOREIGN AFFAIRS Sept./Oct. 2005, available at http://louisville.edu/democracydevelopment/home_files/MesquitaDownsArticle.pdf, 1.

44. *Id.* at 2.

45. *Id.* at 7.

46. Dani Rodrik, *Institutions for High-Quality Growth: What They Are and How to Acquire Them*, STUDIES IN COMPARATIVE INTERNATIONAL Development, (Fall 2000), available at <http://ksghome.harvard.edu/~drodrik/institutions.PDF>, at 24.

cultures. Mr. Lee's belief that Singapore needs to be more disciplined in order to survive has permeated the country's culture. The head of Singapore's civil service co-authored a paper in which he argued that: "This consensus makes possible policies and cultural norms that are often misunderstood and criticized by outsiders as being too authoritarian and insufficiently democratic. However, the consensus is broadly shared across Singaporean society by leaders and citizens of all ethnic groups. While criticisms are inevitably heard, there is no serious dissent."⁴⁷

Singapore then has the best of both worlds. It has the power to implement policies based on their effectiveness, regardless of their popularity. The government can simply impose these policies on the people if necessary for economic development in a way that liberal democracies cannot. This complete control over the economy and political system can be seen in Singapore's unified response to the CAO scandal discussed below.

IV. CHINA'S INFLUENCE ON SINGAPORE'S CORPORATE GOVERNANCE REGIME

Singapore has recently gone through major changes in its corporate governance regime. This may be a result of Singapore's close relationship with China. It is hoping to shed its reputation for being overly regulated in an attempt to be more attractive to Chinese companies. The Singapore stock exchange has been "aggressively promoting Singapore as a preferred listing venue for foreign issues," as the exchange states in its annual report.⁴⁸ In 2005, SGX added eighty new listings, forty-nine of these were foreign and thirty-four from Greater China. The annual report states that "Greater China remains a promising growth market for SGX."⁴⁹ Singapore has to contend with an abundance of competition for Chinese companies. In addition, Singapore has a reputation for being heavily regulated, or even overly regulated. In fact the chief executive of SGX mentions in the annual report that an executive of a foreign company considering listing on SGX expressed his concern that "Singapore is an inflexibly regulated market."⁵⁰

47. Thomas, *supra* note 32, at 21.

48. SGX 2005 ANN. REP., available at [http://www.sgx.com/shareholder/documents/Main_Report_\(corporate\)_2005.pdf](http://www.sgx.com/shareholder/documents/Main_Report_(corporate)_2005.pdf), at 59.

49. *Id.* at 59.

50. *Id.* at 48.

A. CORPORATE GOVERNANCE

Singapore has recently made significant changes to its corporate governance regime. The most significant change has been the move from a merit-based regime for public companies to a disclosure-based regime. The disclosure-based regime provides more freedom to the listed companies when making transactions, so long as they file periodic public disclosures. This change was the subject of much criticism following the CAO meltdown.

For the years under the merit based regulations, companies grew accustomed to disclosing the bare minimum to its shareholders.⁵¹ This is because under the old system, a company would have to receive approval from a regulatory agency prior to proceeding with a transaction. Therefore the shareholders did not have much say in the transactions of the companies whose stock they owned. As a result, the companies would not disclose much to the shareholders.⁵²

This mindset of minimum disclosure apparently continues, as companies continue to disclose the bare minimum. At the same time, shareholders are not asking for more information. It is questionable if a disclosure-based regime can work in an environment where neither the corporation nor the shareholders demand adequate disclosure. As the move to a disclosure-based regime places the onus on corporations, the regulatory agencies in Singapore are proceeding with a hands-off approach. While the government bodies move in a more laissez-faire direction, shareholder monitoring remains weak, and, as a result, some Singaporean companies continue to try to get away with disclosing as little as possible.⁵³

This lack of shareholder monitoring may prevent the disclosure-based regime from succeeding in Singapore. The structure of the market does not lend itself to an active monitoring environment. The equity market in Singapore is small. It is mainly comprised of the government, families and wealthy individuals. With the majority of corporations controlled by this small group, it makes possible the problem of minority-shareholder oppression. In addition, there is not much of a takeover market. For the most part when takeovers do occur, they are friendly and

51. Yuen Teen Mak, THE OECD/WORLD BANK 2ND ASIAN ROUNDTABLE ON CORPORATE GOVERNANCE ON THE ROLE OF DISCLOSURE IN STRENGTHENING CORPORATE GOVERNANCE AND ACCOUNTABILITY (HONG KONG): Corporate Governance Practices and Disclosures in Singapore: An Update (May 31 - June 2, 2000), available at <http://www.oecd.org/dataoecd/6/17/1931014.pdf>, at 9.

52. *Id.* at 7.

53. *Id.* at 42.

hostile takeovers are extremely rare. This, of course, can result in management entrenchment.⁵⁴

Singapore was heavily criticized when it changed its securities regulations from a merit-based to a disclosure-based approach.⁵⁵ Singapore made the change in 1997, while the Asian Financial Crisis was still afflicting the region. Many argued that Singapore had weathered the crisis much better than its neighboring countries because of—not despite—its paternalistic economic regulations. Critics worried that liberalizing the regulations would result in an increase in corporate scandals.⁵⁶ It can certainly be argued that the CAO scandal would have been prevented under the merit-based regime. For example, CAOHC's block sale of CAO stock would likely have been vetted under the old rules, possibly exposing the CAO's problems before others invested in the doomed company.

Even after the CAO scandal, SGX remains committed toward moving in a less regulated direction. SGX's chairman JY Pillay reflected this view in his statement in the annual report. Referring to the CAO scandal he stated, "That series of events does not necessarily suggest that the regulations, our Listing Rules, or the Corporate Governance Code (CGC), are defective."⁵⁷ This was enforced by the CEO's statement: "While rules and regulations are important for investor protection, it is ultimately the enforcement of them that sets a market apart. The ongoing proceedings of the China Aviation Oil (S) Corp Ltd case and others have demonstrated that rules and regulations in SGX and Singapore will be enforced expeditiously and resolutely."⁵⁸

B. CHINA'S INFLUENCE ON SINGAPORE

These changes in Singapore's corporate governance regime may be a reflection on China's influence on the country and its economy. China has long been an influence on Singapore, and today there are many similarities between the two countries. As trade between the two countries increases, their legal systems can also be expected to intermingle. Singapore, as noted above, would like to increase its trade with China because of China's thriving economy.

China's rapid economic development has come despite (or because of, depending on who you ask) the lack of rule of law.

54. *Id.* at 12.

55. Margaret Chew, *The Securities Regulator in Civil Pursuit: Quare a New Enforcement Option*, SING. J. LEGAL STUD. 596, 597 (1999).

56. *Id.*

57. ANN. REP., *supra* note 12.

58. *Id.* at 49.

Chinese capitalism has depended on the “rule of relationships” rather than the “rule of law.”⁵⁹ Chinese elites, like Mr. Lee in Singapore, argue that civil and political rights common in liberal democracies are obstacles to economic prosperity.

Instead of law, one of the governing features of Chinese capitalism is *guanxi*, the “rule of relationship.” *Guanxi* places priority on the personal relationships and trust between parties. In addition to *guanxi*, the role of family, or familism, is central to the role of businesses in China. Familism, where a company is owned and controlled by a family with family members in top positions in the company, is becoming the primary corporate form in China aside from State Owned Enterprises. Singapore is similar in this respect. Companies wholly owned by families control over 60 percent of the stocks in Singapore.⁶⁰

Theories of globalization and modernization often predict that the Chinese system will naturally transform into one with a “rule of law.” This is because, the argument goes, as more foreign capital flows into China from Western systems, it will inevitably have an influence on China. Moreover, Western corporations may begin demanding a change in the system if they are to continue pouring money into the country. What this argument fails to see is that globalization or transplantation is a two-way street. China is not simply importing foreign capital and foreign institutions, but rather it is exporting its capital and institutions as well. One writer goes so far as to argue that “[t]he participation of China and East Asia in the global market may therefore lead less to the ‘Americanization’ of the East and more to the ‘sinification’ of the West.”⁶¹ China is also protected from Western influences because its primary trading partners are not from the West but from the East, in the form of Japan and Hong Kong. Furthermore, “the majority of foreign investment in China flows from the Chinese in the Four Little Dragons [Singapore, Taiwan, Hong Kong and South Korea]—70 percent of China’s foreign investment comes from Chinese investors abroad.”⁶² This is a result of regionalization rather than globalization. China and its neighbors are more likely to continually reinforce their own legal systems than to be influenced from outside. This is likely to continue as the region’s economy grows. Indeed, the region is expected to be the world’s largest economy

59. Carol A.G. Jones, *Capitalism, Globalization and Rule of Law: An Alternative Trajectory of Legal Change in China*, Social & Legal Studies, Vol. 3 (1994), at 197.

60. *Id.*

61. *Id.* at 202.

62. *Id.*

by 2010. As such, it could be possible for the region to completely close itself off to outside influences.

This regionalization is likely to have a significant impact on Singapore. Singapore's legal system may possibly become more like China's and less like the West's. Singapore's cultural and historical connections with China make it a receptive transplant from Chinese law. (Over 75 percent of Singapore's population is Chinese.⁶³) A recent study found that "receptive transplants, i.e. those that adopted the imported law, or had a population that was familiar with it, show legality ratings that are statistically no different from those of origin countries."⁶⁴ A common legal history is another factor found in receptive transplants.

In fact, the same study found Singapore to be an unreceptive transplant to English common law during the period of colonization. Although the study found that in some cases countries that were colonized by Great Britain could be categorized as receptive transplants, Singapore was not one of those cases.⁶⁵ Instead, it is possible that Singapore is reverting back to a Chinese-based law after forty years of independence from Britain.

V. SINGAPORE'S RESPONSE TO THE CAO SCANDAL

These competing interests in Singaporean society help explain Singapore's response to the CAO scandal. Determining how to respond certainly was not an easy task. The scandal left Singapore in a bind. On the one hand, it has a reputation as being a model for corporate governance. Indeed, Singapore "touts itself as enjoying the world's best practices of corporate governance."⁶⁶ On the other hand, the country's economy is dependent on its financial services industry, and for Singapore, that means attracting companies to list on its stock exchange. Chinese companies, in particular, are a boon to Singapore's stock exchange because of their higher trading volume compared to Singapore's domestic companies.

Singapore, therefore, was forced to devise a punishment for this scandal that would at once uphold its reputation for strong corporate governance and not deter other Chinese companies from listing on SGX. From the outset, it seemed that both CAO and CAOHC could be punished for their respective roles in the

63. CIA Website, The World Factbook, <http://www.cia.gov/cia/publications/factbook/geos/sn.html>.

64. Pistor, Katharina, et. al, "The Transplant Effect," American Journal of Comparative Law (2003), 51 AM. J. COMP. L. 163, at 189, 190.

65. *Id.* at 197.

66. *Red Opportunity Makes Singapore Complacent Again*, TIMES UK, Dec. 3, 2004, available at 2004 WLNR 12966406.

scandal. CAO was culpable for not disclosing its heavy losses, and CAOHC was culpable for selling a large portion of its stake in CAO when it was aware of the mounting losses at its subsidiary. CAO was a less complicated target for punishment. It was based in Singapore and the Chinese government made clear from the outset that it would not stand in the way of Singapore punishing Mr. Chen.

CAOHC was a different story. First, there was a jurisdictional problem, as CAOHC is located in China. Second, CAOHC is wholly owned by the Chinese government and therefore is really an extension of the Chinese government. Punishing CAOHC was like punishing China, the very country Singapore is courting. This caused one industry publication to ask, "Would SGX risk offending the Chinese government?"⁶⁷ At the same time, however, Singapore, represented by its investment agency Temasek, was the largest victim of CAOHC's insider trading scheme. To save face, Singapore had to punish CAOHC. To not punish CAOHC would make clear that Chinese companies were subject to different rules than everyone else. Such a signal would hurt both Singapore's economy and the Chinese companies listed in Singapore.

The following details Singapore's response to the scandal. There were several Singaporean parties who could have responded to this scandal: creditors in Singapore, the Monetary Authority of Singapore, SGX, Temasek, and the Commercial Affairs Division of Singapore.

A. CREDITORS

With regard to the creditors, at least two Singaporean banks were owed money by CAO. Singapore's OCBC Bank was owed US \$15 million and United Overseas Bank was owed US \$9.6 million.⁶⁸ Temasek owns a large portion of each bank. In fact, Temasek's share of each company is larger than any other of the respective banks' shareholders. Temasek owns 28 percent of DBS Group Holding's shares which owns 19.98 percent of United Overseas Bank and 13.89 percent of OCBC Bank.⁶⁹ Temasek owns 35 percent of Raffles Holdings which owns 6.98 percent of United Overseas Bank and 8.37 percent of OCBC

67. *Trading Turbulence*, *supra* note 1.

68. *The China Aviation Oil Saga Governance Gone Wrong?*, THE ASIAN BANKER, Feb. 15, 2005, available at 2005 WLNR 2116697.

69. Temasek Website, http://www.temasekholdings.com.sg/our_investments/linked_companies.htm. United Overseas Bank Website, <http://www.uob.com.sg/pages/investor/shareholder/majorsh.html>. OCBC Website, http://www.ocbc.com.sg/global/investorrelations/Gco_Inv_OrdShareHolding.shtm?bcid=M4_C3_S2_P1.

Bank.⁷⁰ Despite their losses, the two banks did not file suit against CAO. This is in contrast to other CAO creditors. South Korea's SK Energy filed suit to recover the more than US \$14 million owed it by CAO. The Japanese banking group Sumitomo Mitsui also filed suit to recover US \$26 million. And shortly after the scandal broke, South Africa's Standard Bank threatened to sue unless it was repaid its US \$34.1 million.⁷¹ The Singapore banks did not sue and they did not object during the restructuring negotiations. Ultimately, the banks along with the other creditors struck a deal in which they would recover 54 percent of the money they were owed.⁷²

B. MONETARY AUTHORITY OF SINGAPORE

As the financial regulatory agency, the Monetary Authority of Singapore was stuck with the difficult job of bringing enforcement measures against CAO or CAOHC or both. Ultimately, it levied a fine against CAOHC. In August, 2005, the Monetary Authority of Singapore (MAS) reached an out of court settlement with CAOHC "for contravening the insider trading provisions under section 218(2)(a) of the Securities and Futures Act (SFA)." MAS fined CAOHC US \$4.8 million for defrauding investors out of US \$118 million.⁷³ In addition, the settlement allowed CAOHC to avoid any embarrassing courtroom proceedings. While small, the fine was significant. There was speculation at the beginning of the investigation that MAS would likely not go after CAOHC for fear of offending the Chinese government. Therefore, with the expectations for enforcement so low, MAS did not have to levy a large fine to give the appearance that it was not treating CAOHC any differently.

In setting forth the fine, MAS went out of its way to heap praise on CAOHC for its conduct following the scandal. The announcement quoted MAS's deputy managing director of market conduct as saying, "CAOHC has also subsequently acted responsibly in providing moral, management and financial support to assist CAO to put together swiftly a commercial restructuring plan that had received overwhelming support from creditors. In addition, CAOHC has cooperated with the authorities' investiga-

70. *Id.*

71. Jake Lloyd-Smith, *CAO Survival Plan Threatened*, FIN. TIMES, Feb. 3, 2005, available at 2005 WLNR 1511995.

72. Jean Chen Shu-Ching, *Chinese Company Faces Delisting*, DAILY DEAL, June 10, 2005, available at 2005 WLNR 9418377.

73. Monetary Authority of Singapore Website, http://www.mas.gov.sg/masmcm/bin/pt1MAS_Takes_Civil_Penalty_Enforcement_Action_Against.htm. This fine, of course, appears to be paltry when compared with the money CAOHC raised in the fraudulent offering.

tions. These actions highlight CAOHC's positive efforts following the collapse of CAO to deal with this matter responsibly under Singapore Law."⁷⁴

Nonetheless, the light penalty seems a stark contrast to Singapore's strong corporate governance reputation. As one publication writes, "It is hard to avoid the impression that the state parent got away lightly."⁷⁵

C. SINGAPORE STOCK EXCHANGE

Of all the parties, SGX may have had the most to lose, as its stated goal is to recruit more Chinese companies to list on its exchange. The conflict of Singapore's two interests of maintaining its corporate governance reputation and gaining more Chinese listings was embodied in SGX. In addition to being an exchange and a regulatory body, it is also a listed company. Its potential for growth rests in its ability to recruit more Chinese companies. For its part, SGX commissioned PriceWaterhouseCoopers to conduct an investigation into the scandal and how CAO's internal controls failed to control the losses. Additionally, after Mr. Chen fled Singapore to China, SGX asked the CAOHC to return Mr. Chen to Singapore. SGX also worked closely with the white collar crime unit of the Commercial Affairs Department.

The PriceWaterhouseCooper report found CAO had lax internal controls. It also implicated "many of CAO's senior officials and directors in questionable practices, some of which could lead to criminal charges." Another troubling finding of the report was that "several CAOHC officials who served on the CAO board should have known that CAO was engaged in speculative trading in violation of an order by the China Securities Regulatory Commission in 2002 to stop such activities."⁷⁶

On May 30, 2005, without mentioning CAO, SGX announced that it would enhance its standards of governance and listings. While SGX maintained that these amendments were part of "an annual review of SGX's regulatory framework and processes," they seemed to be geared toward reassuring investors still worried from the CAO debacle. SGX stated that the pro-

74. *Id.*

75. *Lex Column: China Aviation Oil*, FIN. TIMES, Aug. 20, 2005, available at <http://search.ft.com/ftArticle?queryText=china+aviation+oil&aje=false&id=05082000726&ct=0>.

76. John Burton, *Report Raises Doubts About CAO Oil & Gas*, FIN. TIMES, June 6, 2005, available at 2005 WLNR 8919563.

posed amendment “focused on two key areas - enhancing corporate governance and extending the role of intermediaries.”⁷⁷

D. TEMASEK

Temasek had possibly the most interesting reaction to the scandal. Temasek was the lead purchaser (or victim) of CAOHC’s block sale of CAO stock. Looking at the circumstances around CAOHC’s sale, it is a wonder that Temasek made the purchase at all. As one Chinese publication described it, it was a “large—and badly handled—share placement.”⁷⁸ CAOHC made the placement through Deutsche Bank. The sale price was at a 14 percent discount to its last trade price. In addition, CAO only released a short statement to the Singapore exchange reporting the placement without giving a reason for the share sale. On the same day, a CAO spokesperson told Bloomberg that CAOHC “had an investment they are making and they need to raise the cash.” Of course, it later came to light that the reason for the sale was to make a quick loan to CAO in hopes of bailing out the company from its huge derivatives losses.

Most would not expect a sophisticated investor such as Temasek to make a purchase under these circumstances. Indeed, one reason why other investors took part in the purchase was that they were following Temasek’s lead. As one stock broker in Singapore said, “Small investors often look to government-linked corporations such as Temasek Holdings for what stocks to buy. They seem to think that they have better information sources than the market would.”⁷⁹

Immediately after the scandal came to light, it became known that CAOHC most likely defrauded Temasek. Temasek was in as good a position as any to sue the parent company. Instead, Temasek’s response was quite the opposite. Instead of Temasek filing suit, CAOHC approached Temasek to help bail out CAO with an injection of capital. Even more shocking is the fact that Temasek agreed to help. CAOHC’s proposal was for “both Temasek and CAOHC to inject US \$50 million in return for a combined majority stake in CAO.”⁸⁰ At hearing the news of the proposal, “many analysts wonder[ed] why Temasek would want to throw good money into a company that is worth almost

77. SGX Website, <http://www.sgx.com/> (follow “About SGX” to “News & Info:” click “2005,” then “May;” follow “SGX SEEKS TO ENHANCE STANDARDS OF GOVERNANCE AND LISTINGS”).

78. *China Aviation’s Quarterly Earnings Drop 15% to \$9m*, ZAOBAO, Nov. 13, 2004, available at www.zaobao.com.

79. *Trading Turbulence*, *supra* note 1.

80. *Id.*

nothing,"⁸¹ not to mention that it was also the company that had just defrauded Temasek.

One possible explanation of Temasek's behavior is found in Singapore's economic strategy. Like SGX, Temasek's well being is closely tied to its investments in Chinese companies. Temasek hopes to increase its investments in China. Also, Temasek is particularly interested in Chinese companies listing on SGX and traders having confidence in the exchange, as Temasek is part owner of SGX and has a stake in many companies listed on SGX. In fact, in 2004, it was estimated that Temasek controlled more than 20 percent of the companies listed on the exchange.

Looking at the situation this way, it begins to make sense why Temasek would step in to bail out CAO, despite what the parent company did to Temasek. This bailout provided Singapore an opportunity to fortify its partnership with China. The proposal provided for Temasek and CAOHC to hold a combined majority stake in CAO. Of course, Temasek and CAOHC are merely agencies of their respective governments. In reality, it is Singapore and China partnering to keep CAO from going bankrupt, which is in alignment with Singapore's strategy of demonstrating to China that Singapore will be a friendly place for Chinese companies to list. At the same time, by allowing its investment agency to do this favor for China, Singapore was free to allow its regulatory agency to levy the fine against CAOHC, which helps Singapore maintain its reputation as a country with a strong corporate governance regime. At first, it appeared that Singapore was punishing CAOHC with its US \$4 million fine. But when you take into account the US \$50 million bailout from Temasek to CAO, China came out of Singapore's enforcement proceedings with a US \$45 million gain.

E. COMMERCIAL AFFAIRS DIVISION

The enforcement did not stop there. Shortly before the creditors meeting in June 2005, when the restructuring plan was agreed upon, Singaporean police from the white collar crime division of the Commercial Affairs Division announced the arrest of five executives of CAO and CAOHC. Those arrested were former chief executive of CAO, Chen Jiulin; CAO's chairman, Jia Changbin; CAO's former chief financial officer, Peter Lim; a CAO director and head of the restructuring team, Gu Yanfei; and another CAO director, Li Yongji. In addition to their positions with CAO, Mr. Jia also president of CAOHC and Ms. Gu is

81. *Id.*

general manager of CAOHC.⁸² These arrests were in addition to the arrest of Mr. Chen, the former CEO. This is the first time that executives from a Chinese state owned company have faced charges in a foreign country.

Some have portrayed the arrests as sending “a powerful signal to other Chinese state-owned companies” and demonstrating that Singapore is serious about improving corporate governance of companies listed on its exchange.⁸³ Others, however, believed the arrests were only show and that none of the CAOHC officials would be punished. Indeed, some at the parent company expected special treatment for their colleagues. They figured that “Singapore felt the need to act in order to save face, but the city state will not risk angering Beijing.” Ultimately, “some kind of deal will be reached,” one person with close ties to CAOHC stated.⁸⁴

Indeed, recent actions at CAO demonstrate that it believes Singapore will go lightly on the CAOHC officials. The corporate governance committee of CAO has reportedly chosen Gu Yanfei to be its next chief executive of the subsidiary. As a result of the charges she is currently facing, CAO believes it may have to appoint an interim chief executive until her charges are “resolved.”⁸⁵

VI. CONCLUSION

The CAO scandal demonstrated the many balancing acts Singapore is currently performing. Singapore’s close relationship with China may have influenced its decision to take a more hands-off approach to its corporate governance regulation, and this may have been what allowed the CAO implosion to happen. At the same time, Singapore remains concerned about its reputation in the West. It does not want to appear too similar to China, or else Western investors may be reluctant to invest in Singapore. In addition, the competing interests of China and the West largely influenced how Singapore dealt with the CAO crisis. Singapore responded in such a way that would at once signal to the West that it would enforce its regulations, while also signaling to

82. Wayne Arnold, “Five Arrested in Collapse of China Aviation Oil in 2004,” *N. Y. TIMES*, June 9, 2005, available at <http://www.nytimes.com/2005/06/09/business/worldbusiness/09aviation.html>.

83. Mure Dickie, *CAO Arrests Fade From Official View: Emphasis is on Good News not Bad on Industry Website*, *FIN. TIMES*, June 10, 2005, available at 2005 WLNR 9181946.

84. *Id.*

85. Frederick Lim, *Panel to Make Recommendations for New CAO Chief in Nov.* *CHANNEL NEWSASIA*, Oct. 19, 2005, available at <http://www.channelnewsasia.com/stories/singaporebusinessnews/view/174248/1.html>.

China that Singapore would continue to be a friendly place to do business. Finally, Singapore's government's control over the economy and political system made this orchestrated response possible.

