Publications Of The Faculty Of Law, University Of Malaya

Journal Of Malaysian And Comparative Law

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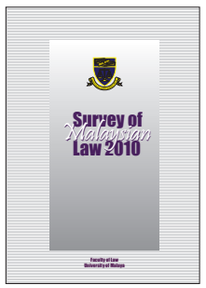

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ISSN: 0126-6322

(2013) 40 JMCL

JOURNAL OF MALAYSIAN AND COMPARATIVE LAW

Journal Of Malaysian And Comparative Law

Jurnal Undang-Undang

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JOURNAL OF MALAYSIAN AND COMPARATIVE LAW 2013

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Tel No: 03 - 7967 6509 / 6575
Fax No: 03 - 7957 3239 / 7967 6573
Email address: jcml@um.edu.my

Printed by University of Malaya Press, 50603 Kuala Lumpur

JOURNAL OF MALAYSIAN AND COMPARATIVE LAW

JURNAL UNDANG-UNDANG

VOLUME 40

2013

Faculty of Law
University of Malaya
50603 Kuala Lumpur
MALAYSIA

THE ISSUE MAY BE CITED AS (2013) 40 JMCL

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Re–Identifying Property in The Malaysian Penal Law

Wong Wai Wai*

Abstract

The lack of legal recognition, acknowledgment on the significance, importance and the value of online resources such as information, data, keyword and meta-tags has caused them to be held in a vulnerable position and subjected to various forms of misuses and abuses. Currently the existing cyber-specified provisions are specifically focussed its main task of regulating illegal acts and activities occurring daily in cyberspace rather than protecting online resources. The lack of adequate legal protection for these online valuable resources is seriously affecting the level of confidence of internet users in conducting their business in cyberspace.

One of the effective ways in protecting these online resources is to classify them as 'property'. Any violation of such should be governed by the relevant penal provisions relating to property. In Malaysia, the penal provisions for offences against property has confined its applicability to corporeal and moveable property only, such penal provisions could not be used to protect online resources in that they are incorporeal and intangible in nature. The penal provision as such lacks its identity in classifying what property is and its definition.

In proposing to extend the application of the Malaysian penal law to cyber cases relate to online resources, 'property' should further be redefined under the 'bundle of rights' theory. By defining property which consists of the bundle of rights and interests, this bundle theory would overcome the conceptual hurdle and that these online assets are to be regarded as property even though it lacks physical status and be accorded the same level of protection as any other type of property recognised by the law.

Introduction

The lack of legal recognition, acknowledgment on the significance, importance and the value of online resources such as information, data and keywords have exposed them to a vulnerable position and subjected to various forms of misuses and abuses. The single most effective way in protecting these online assets is to accord them the property status and hence any violation of their rights should be subjected to the relevant penal provisions. However, the current Malaysian penal law is confine to corporeal property and hence lacks clear principles in identifying property. The aim of this paper is to analyse the current

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position of the Malaysian penal law in identifying 'property'. This paper further proposes the adoption of new definition – the bundle of rights model in identifying property in the 21st century and to examine the possible issues and concerns in implementing this new definition in penal provisions in order to make it applicable to cases of misuse and abuse of online resources both in cyberspace and in the physical world.

Meaning of 'property' in the Malaysian Penal Law

In Malaysia, offences against property govern under the Malaysian Penal Code[1] which is modelled after the Indian Penal Code.[2] The various offences against property include theft, criminal misappropriation of property, criminal breach of trust, receiving stolen property, cheating and other offences.[3] The main purpose of enacting these offences against property under the Malaysian Penal Code is to conserve and preserve private rights in property against adverse attack against it. It is to protect persons against violations of their rights in property. The common ingredient within these offences is 'property'. The word 'property' has been used throughout these provisions has not been defined comprehensively under the Malaysian Penal Code.

Lack of clear definition has resulted into many different interpretations of the word 'property' by various provisions in the Penal Code. Section 380 deals with theft in dwelling house. However, the words 'custody of property' is used in this provision. The phrase 'custody of property' is again not clearly explained. However, withdrawing money or items by one party unilaterally from a joint bank account does not amount to theft under this provision as money and items are in the possession of the bank.[4] Section 380 connotes 'property' to mean something that must be held in a building, tent or vessels for human dwelling. In the case of *Che Man bin Che Mud v PP*[5] held that money held in a bank account and shown in a bank book held by a person was corporeal property as it is intangible.

Other provisions, such as section 383 provides for the offence of extortion. Extortion is committed when whoever intentionally puts any person in fear of any injury and dishonestly induces the person in fear to deliver to any person any property or valuable security, or anything signed or sealed which may be converted into a valuable security. The terms 'any property' include both moveable and immoveable property. From the wording of this provision, it connotes that letters written by a hostage or kidnapped person requesting ransom to be paid has been held to be 'property'.[6] A document which enables a person or which gives a person a reasonable hope or expectation of collecting a substantial amount of money is 'property'.[7]

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1 Act 574
2 Act No. XLV of 1860
3 Such as extortion, fraudulent deeds and dispositions of property, mischief and trespass
4 *Ratanlal and Dhirajilala's Law of Crimes Vol* 2 (24th Edition, 1998), p1869
5 Unreported, 22nd October, 1994; Criminal Appeal No: 42-21-1991
6 *Halsbury's Laws of Malaysia*, *Vol 11, Criminal Law, Malaysian Law Journal* (2001), 190.404, p437
7 *ibid*, 190.404, p438

Another provision, section 390 deals with the offence of robbery. Section 390 (2) states in order to commit robbery, the first element of theft must be fulfilled. Theft is committed when a person carries away or attempt to carry away property. This section uses the word 'property' and under this provision, 'property' is confine to moveable property in that the words 'carrying away' are being used. It corresponds to section 378 of the Penal Code.

Section 403 creates the offence of dishonest misappropriation of property. 'Property' here means both moveable and immoveable under this section. As explained by its illustration, if a person finds a government promissory note belonging to another, pledges it with a banker for security for a loan then he has committed an offence under this provision. The government promissory note or the loan is to be treated as 'property' for the purpose of this provision. Critics have commented that there can be no criminal misappropriation of property that has been abandoned.[8] The property must belong to an owner in order to make the person misappropriate it guilty.

For the offence of criminal breach of trust under section 405, whoever being in any manner entrusted with property, or with any dominion over property either solely or jointly with any other person, dishonestly misappropriates, or converts to his own use. The word 'property' in this section refers to both moveable and immoveable property. The word is also wide enough to include a chose in action as stated in the case of *Laxminarayan Joshi*.[9] The court therein stated that the appellant could only succeed if he could show that in lieu of chose in action which was property he had substituted securities of equal amount. In another reported decision of the Supreme Court,[10] their Lordships observed that a right to a sum of money is 'property'. However, merely because the claim stood pending before the arbitrator liable to be reduced in the award to be passed by him, or that the court would not allow enhancement of the awarded amount for which it is pending in this Court it would not affect the position of chose in action as 'property'.

In the case of *Dalmia RK v Delhi Administration,*[11] it was held that whether the offence defined in a particular section of the Penal Code (Indian Penal Code) can be committed in respect of any particular kind of property will depend not on the interpretation of the word 'property' but on the fact whether that particular kind of property can be subjected to the acts covered by that section.

Under section 415 of the Malaysian Penal Code, cheating is defined as fraudulently or dishonestly inducing the person so deceived to deliver any property to any person[12] or intentionally induces the person so deceived to do or omit to do anything which he would not do or omit that causes or likely to cause damage or harm to any person in body, mind, reputation or property. In this section, the word 'any property' is given it widest meanings. The property in this provision need not be in existence at the time of

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8 *Ratanlal and Dhirajlal's Laws of Crimes* Vol 2 (24th Edition, 1998), p1949 - 1950

9 AIR 1980, SC 439

10 *Ranojirao Shinde* (In C.A. No. 1730 of 1966) *and Krishnarao Shinde* (In C.A. No. 1731 of 1966)

11 AIR 1962, SC 1821

12 Section 415 (a)

cheating provided such property is, when made, delivered under the influence of the cheating.[13] Furthermore, the thing need not have any monetary or market value provided it has special value for the person concerned.[14] There is also no requirement that a person cheated must own the property.[15]

Section 378 of the Malaysian Penal Code creates the general offence of theft. The words 'moveable property' has been used in this provision. 'Moveable property' is defined under section 22 of the Code which means corporeal property of every description, except land and things attached to the earth, or permanently fastened to anything which is attached to the earth.

In reference to the explanation under the Indian Penal Code, 'moveable property' means a thing, so long as it is attached to the earth, it is not being moveable property and therefore is not subject to theft. But it becomes capable of being the subject of theft as soon as it is severed from the earth. Therefore, it is important that a thing must be capable of being moved before it could be subject to the offence of theft. The fact that the act of moving implies the thing must be a physical object of some sort. It must be able to perceive by the sense as opposed to 'incorporeal property' which is not perceivable in real sense and it is merely consider as an obligation.[16]

Based on the above analysis, my conclusion is that there is lack of identity in clearly defining what 'property' means under the Malaysian Penal Code. There are many provisions under the Penal Code and each of them dictates its own interpretation on the scope of 'property' under different property offences. There is clearly no consistency in its interpretation. As a result of this, there is uncertainty in the law. As the word 'property' is not clearly defined under the Penal Code, it is difficult to apprehend clearly what would be classified as 'property' within the penal law of Malaysia.

Inadequate protection on online resources

Lack of clear identity and well-defined concept of 'property' not only created interpretation problems within the Penal Code but it also has other serious implications. As one could not ascertain what 'property' is or what type of property is applicable in a given provision, other than what have been ruled in relevant cases. In the absence of clear guideline in identifying what 'property' is and its classification, it prevents new or future resource to be qualified and classified as 'property' and to attain the property status.

The rapid development of Internet and World Wide Web in the 21st century has created many valuable and useful online resources. The issue of the protection of online resources such as information, data, keyword and meta-tag and other future online resources as 'property' have always been the subject of great controversy. The lack of clear legal principles in cyber-specified laws and the inconsistency in existing penal laws

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13 Refer to illustration (c) of Section 415

14 *Ratanlal and Dhirajlal's Laws of Crimes* Vol 2 (24th Edition, 1998)

15 *Rahj bin Abdullah v PP* [1998] 1 SLR 447, also contrast with Section 403 in which the property must be owned by somebody

16 *Mallal's Penal Law*, Malayan Law Journal Sdn Bhd (2002), p29

in relation to the identity and classification of 'property' has created a vacuum in law. The lack of legal recognition, acknowledgement on the significance, importance and the value of these online resources makes them vulnerable to misuse and misappropriation. This present discussion would emphasis on the misuse and misappropriation of information, data, keyword and meta-tag.

Information and data

One of the most common misuse and misappropriation of personal information and data is phishing attack. The creation of the internet and the increase use of the databases for storing consumer information have facilitated perpetrators in gaining speedier access and to greater amounts of individual information at any one time. Once the perpetrator has obtained person's information, he may use such personal information to pursue further illegal activities such as applying for new credit card account or obtain home loan or car loan in the victim's name through online portals.[17] Internet has made it easier for perpetrator to manipulate personal information at anytime and potentially hundreds or thousands of personal information available over the internet are at risk. The victims of phishing attacks and identity theft not only suffer financial losses but also result in the victims' loss of valuable time and money spent trying to rebuild and restore his/her credibility and good name.

In Malaysia, the recently enacted Personal Data Protection Act of 2010 is to regulate the processing of personal data in commercial transactions by data users and to safeguard the interests of data subjects. However, the 2010 Act is only applicable to the processing of personal data in respect of commercial transactions. There are many data capable of being collected not via commercial transactions but in furtherance of employment; educational; professional or welfare purposes. In those instances, the application of the 2010 Act will be excluded. The 2010 Act in defining sensitive personal data has omitted data concerning racial or ethnic origin and sexual life of data subject. The 2010 Act also did not deal with issue of misappropriation of personal information and data.

The lack of clear principles in providing adequately protection for online resources in cyber-specified laws is also evidenced in the Computer Crime Act of 1997. The 1997 Act deals with offences relating to misuse of computers. Section 3 provides the offence for unauthorised access to computer material. This section provides that a person shall be guilty of an offence of he causes a computer to perform any function with intent to secure access to any program or data held in any computer.[18] For all intents and purposes, this section is to criminalise the 'act of unauthorised 'access' to computer material rather than specifically protect the computer material in question. It is also possible that the perpetrator may have authorised access to the computer material, such as employee's authorised access to company information. If an employee access company information in the course of his employment and he then proceed to keep a copy of the information

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17 Jennifer Lynch, *Identity Theft in Cyberspace: Crime Control Methods and Their Effectiveness in Combating Phishing Attacks*, 20 Berkeley Tech. L. J. 259, 2005, p2

18 Section 3 (1)(a)

for his future use, it is doubtful as to whether the employee would be made liable under this provision as his access to computer material was not unauthorised.

Keyword and meta-tag

Other types of online resources such as keyword and meta-tag are often subject to misuse and misappropriation. Keyword and meta-tag are used in search engines. The search engine provides the link to internet user who enters a search using a specific keyword or meta-tag. For instance, once an internet user key in the word 'cake', all the websites associated with 'cake' or its contents containing the word 'cake' would be listed in the search engine results accordingly. The purpose of misusing someone else's keyword or meta-tag is primarily to divert internet traffic and to secure potential clients away from its competitors. This can be achieved as internet has become one of the most powerful and yet inexpensive worldwide marketing platform for many businesses. In this competitive online marketing platform, eighty percent of the internet traffic is generated by search engines. There are many misuses and illegal search engine optimisation techniques are being used in order to ensure that a company is able to get the top listing from the search engine such as using trademarked words in meta-tags.

The legal issue often arise is whether meta-tag used by one website owner infringes the registered trademark of another company or its website. Trademark is a sign which serves to distinguish the goods or services of an industrial or a commercial enterprise to that of another. If a company has legally acquired a particular trademark for its business then such trademark will be used to represent the company, its goods or services, whether offline or online.

Today, modern advertising requires the setting up of a company's website and online advertising to secure customers are becoming common practices and it is highly possible that an online business or company may have or has used a keyword or meta-tag that is similar to a registered trademark belonging to another company offline. As trademark can be registered under the trademark system, anyone who uses the same or similar trademark duly registered by the others will amount to a trademark infringement. In the case of *National American Medical v Axiom*,[19] the court held that the competitor's use of the trademark in meta-tag which caused those trademarked term to appear in search result descriptions of defendant's website has infringed plaintiff's marks. The Court therein stated that:

> 'The facts of the instant case are absolutely clear that Axiom (defendant) used NAM's (Plaintiff's) two trademarks as meta tags as part of its effort to promote and advertise its products on the Internet. Under the plain meaning of the language of [the Lanham Act] such use constitutes a use in commerce in connection with the advertising of any goods.'

Trademarked term used in meta-tag is protected under the trademark system but on the other hand, there is no specific law to protect the use of meta-tag in search engines. The

[19] No. 07-11574 (11th Cir., April 7, 2008)

problem with this is that there are several cyber related services offering keywords or meta-tag ownership with a fee and each one of them may be selling the same keyword or meta-tag to different companies, or even to rival companies at the same time. Furthermore, some keyword or meta-tag will only work with the particular issuing companies' proprietary address bar plug-in.[20] Complication arises as there are many services offering search tools over the internet, there is no single system governing naming standard or to ensure that the purchaser secures the legal right to any of the terms they purchased and to synchronise all keyword or meta-tag registration and ownership across the board.

The results of misuse and misappropriation of these new online resources are very serious and if left unchecked would affect the level of confidence if internet users in conducting their business in cyberspace will be reluctant to conduct business transactions which necessitate the revealing of their personal information over the internet. The misuse of keyword or meta-tag leads to serious trademark infringement, branding dilution and fraud cases.

The fundamental question is whether these online resources should be protected at all. Information, data, keyword or meta-tag lacks the necessary degree of intellectual quality and the level of abstraction compare to other form of legally recognised resources such as literal work or compilation which may subject to copyright law protection. In protecting online resources in cyberspace, the fundamental issue is to accord them with some form 'property' status and hence acquire property status accordingly.

It is now necessary to address the inadequacies of the laws in protecting these online resources as these online resources has fast become one of the most crucial and valuable resources in the modern commercial world. Some online resources are valued more than physical property that people traditional perceived in the commercial world. The values of these online resources may not necessarily be quantified in fix monetary sum or figure. It could also be expressed in the form of pecuniary advantage in that other interests or business opportunity may be obtain or derive from these online resources. For instance, the exclusive use of keyword in the search engine generates internet traffic and business opportunity for the online business owner. One should not underestimate the value of internet traffic and business opportunity as they play an important role in the modern trade and commercial practice.

Therefore, in order to protect these online resources adequately, the single and most effective way is to identify and classify these online resources as 'property' and accord it with the same level of protection as any other form of property that has been recognised by the laws. The significance of granting these online resources property status is that it allows these online resources, the rights that could be derived from them capable of being owned. Once a resource has become a property, it allows the owners to exploit the resources further to the other interested parties beneficially. The use and the exercise of those rights would be subjected to the control of its owners. When a resource attains property status, laws in relation to the protection of property would be applicable

[20] Example of address bar plug-in is InstantFox Quick Search to speed up web search and search via address bar. It allows users to get search results instantly and customize own search shortcuts

and hence, any misuse, abuse and misappropriate of such would be sanctioned by the relevant law accordingly.

Serious misuse and misappropriation of online resources that result in significant consequence, the negative impact inflicted involves serious physical, social and financial harm resulting in potential loss of life, physical injury or loss of livelihood and should be governed by penal provisions. Penal law has been applied throughout recorded history to protect private property and its owners. The function of penal law is social control. It is the most effective branch of law in regulating illegal behaviours relating to property belonging to another. Penal sanction serves as punishment for wrongdoer and deterrence for potential violator. The threat of punishment such as long term imprisonment and execution associated with violations of criminal law are designed to prevent crimes before they occur. The fear of being punished deters criminal behaviours. The power of deterrence under the criminal law includes the authority by the State to sanction or punish offenders. It is the ability to control and restrain illegal behaviours by imposing punishment on offenders that makes penal law the most appropriate protection to safeguard one's property which is essential for the survival in the modern society and online environment as well.

Hence, the same should be applied to justify the application of penal law to serious misuse or misappropriate of online resources as the misuse and misappropriation of these online resources in the modern internet era has proven to have caused harm or risks of harm to interests detrimental to the others and society as a whole and threaten societal well-being at large or seriously infringe the rights of an individual. As the concept of property is complex and encompasses a lot of fundamental issues concerning ownership and control of rights, it is crucial to clearly identify what property is within the penal provision.

'What 'property' is?'

As stated earlier the fundamental concern is that as the Malaysian Penal Code do not defined what 'property' is, it is difficult to classify that online resources such as information, data, keyword or meta-tag to be regarded as 'property' within the scope of the Penal Code. In order to apprehend the true nature of 'property', reference may be made to the traditional classification and concept of property in general.

Classification and concept of property

The old fundamental theory of property refers property as 'things'.[21] The common understanding is that property as a 'thing' wherein the owner of such property has the exclusive right of free use, enjoyment and disposal of it.[22] This definition of property is based on the 'physicalist' sense of things.[23] In the physicalist theory, property can either

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[21] Tangible; corporeal material object, personal possessions or belongings

[22] Leif Wenar, *Essay: The Concept of Property and the Taking Clause*, 97 Colum. L. Rev. 1923, p3

[23] Denise R. Johnson, *Reflections on the bundle of rights,* 32 Vermont Law Review 247, p249-250

be classified as 'real property' such as land and things that are attached to the land or 'personal property' such as furniture, horses, money or things that are moveable and different rules are applicable to different type of property in question.

One of the most prominent writers who adopted the physicalist view was William Blackstone of the eighteenth century. According to William Blackstone, the function of a private property was that it secured freedom and autonomy for individuals who acquire its ownership and the only obligation attached to this was that no harm shall befall onto others in the exercise of one's rights in the property.[24] The notion of absolute dominion, the exclusive right of possession, enjoying and disposing well suited the situations in the eighteenth century for property that existed at that period of time was relatively simple and property then was being classified either as real or personal only.

However, the word 'property' has many different meanings. In a border sense, the word 'property' represents the ways to allocate resources among that society. In any social group, there have to be some shared understanding as to the manner of access to things and how scarce valued resources are to be arranged.[25] There is a need for common understanding about access to resources. Hence the function of the concept of property in essence deals with different problems which exist in relation to 'property' and how such problem should be resolved among the members of the society. In this sense, the word 'property' not only refers to an object or thing but as an 'institution' coordinating relationship among individuals who has right or interest in a subject matter. Hohfeld's analysis revealed that ownership in property was not only a non-social relationship between a person and a thing but was a complex set of legal relationship in which individuals are interdependent.[26] His theory contended that no one can enjoy complete freedom to use, possess and disposal of his/her property without conflicting and interfering the freedom of others. This would basically involve the balancing between an individual and collective rights for these rights are correlated with one another.

Can 'rights' be considered as property?

Despite many legal theorists expressing the various functions and concepts of property, 'property' is often perceived by layman as physical object only, such as a house or a piece of furniture. The thing-ownership concept of property is well accepted, generally. On the other hand, resources such as information, data, keyword and meta-tag and its rights are often perceived as something intangible and incorporeal, a long way from being recognised and accepted as a form of 'property' in the traditional and common sense.

The thing-ownership concept of property provides a very straight forward, simple and inflexible concept of property as it only recognises thing as property based on their physical existence and character. However, the concept of property is not only confine to traditional thing-ownership concept but a more liberal and flexible conception. These

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24 *Ibid* at p250

25 W T Murphy and S Roberts, *Understanding Property Law*, (3rd Edition 1998), Sweet and Maxwell, London, p1-5

26 Denise R. Johnson, *Reflections on the bundle of rights,* 32 Vermont Law Review 247, p251

liberal and flexible conceptions could be seen in early ancient laws. For instance, the Book II of the Napoleon Code, article 544 states: "Property is the right to enjoy and dispose of things in the most absolute manner, provided we do not overstep the limits prescribed by the laws and regulations." Similarly, the Roman law also defined 'property' as the right to use and abuse one's own within the limits of the law.

Both the Napoleon Code as well as the Roman law defines property as rights in property. Rights in property includes right to enjoy, dispose of things and right to use and even abuse one's own within the limit of the law. Hence, one may contend that 'property' is not only refers to the things own but rather as a system of law governing private property which primarily concerned with an individual's right to make decision about the use of a thing as property. The individual's right in property consists of two basic elements: first, it implies the absence of any obligation to use or refrain from using the property in any way whatsoever and secondly, private property implies that other people do not possess the same liberty as the owner.[27] It means others can only use the private property with permission or consent and it is up to the owner to decide whether or not to exclude them from the enjoyment of it.

Once we accept that property means rights in property, it is not impossible to argue that rights that could be derived from online resources such as information, data, keyword and meta-tag to be classified as 'property' and to attain the property status. However, there are various categories of rights in property and clear classification of such rights is of utmost importance.

There are basically two major categories of rights that exist in property. Proprietary right is the most important rights in property as it indicate that the person who possessed those rights acquires the status of ownership. Examples of proprietary right are the right to control the others from using the property or the right to determine the use of property. The other being that of personal right which have no implication of the status of ownership, personal rights are rights enforceable against a particular individual. When personal right has been violated, personal remedy is available allowing the claimant to claim the benefit of a specific obligation from the intruding party and most of time will be in the form of monetary compensation. Examples of personal rights are contractual rights arising from property such as easement or tenancy. However, some of the proprietary rights are also derivable from contract.[28]

A right in property which is proprietary in nature is to be considered as 'property' and hence such right acquire a property status. On the other hand, a right in property which is personal in nature could not be qualified to attain proprietary status as this right does not associate with ownership or proprietorship. Therefore, it is important to distinguish proprietary right from personal right accordingly.

An issue of identifying intangible rights as 'proprietary right' or 'property' has been seen in the case of *Victoria Park Racing and Recreation Grounds Co. Ltd v Taylor*.[29]

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27 Jeremy Waldron, *Property Law*, edited by Joel Feinberg and Jules Coleman, Philosophy of Law, (Seventh Edition, 2004) Thomson Wadsworth, p563

28 For instance, Sale and Purchase Agreement – the rights of the Purchaser

29 (1937) 58 CLR 479

In that case, the plaintiff company was the owner of the racecourse and it was enclosed by fence and the plaintiff charged members of the public for admission to enter into the racecourse. One of the defendants, Taylor owned a cottage opposite the racecourse. Taylor erected a wooden platform on his land which allowed him to secure the entire view of the racecourse and also hear information announced over the public address system to spectators at the racecourse. The defendant allowed another defendant, Commonwealth Broadcasting Corporation to station a commentator on Taylor's platform and to broadcast live radio reports of the ongoing races. The plaintiff as a result suffered a catastrophic loss of business and sued for an injunction on the grounds of nuisance and breach of copyright. The issue in this case was whether the 'right of view or observation' could be considered as 'property' belonging to the Plaintiff. The High Court of Australia by the narrow majority held that the defendants have done no wrong known to the law.

The significance of this case (which was left unsettled) was whether the defendants had taken anything that might be regarded as the plaintiff's property. The fundamental principle which also emerged in the majority decision of this case was that a resource can only be 'propertised' if it is 'excludable'. 'Excludable' means it is feasible for a legal person to exercise regulatory control over the access of strangers to the various benefits inherent to the resources.[30] By adopting the above principle in 'propertise' a resource, one must look for the element of 'exclusivity'. The study on the role of 'right to exclude' in defining property is crucial because it is considered as one of the most critical component of 'property'.

The notion of 'exclusion' or decision on the use of resources is bestowed on the rightful owner who acts as the manager or gatekeeper of the resource.[31] According to Merrill and Smith that "thing-ownership" can be reduced to an owner's right to exclude the others from his thing. Although such contention may be an over-simplification on the true nature of property, nevertheless, it is settled in property law that "dominion or indefinite right of user and disposition is when one may lawfully exercise over his rights over particular things or objects, and generally to the exclusion of all others".[32] The word "dominion" connotes a practical discretion which endows upon the owner of the property with the freedom from within which is to deploy the property to any of a wide range of uses.[33] Other writers such as Adam Mossoff[34] called the right to exclude as the 'right to use' in his article in explaining the exclusive use in patent law.[35]

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30 Sarah Worthington, *Personal Property Law*, *Text, Cases and Materials,* (2000) Hart Publishing, Oxford – Portland Oregon, p675

31 Eric R. Claeys, *Property 101: Is Property a Thing or a Bundle?,* Seattle University Law Review, forthcoming, George Mason University Law and Economics Research Paper Series, 09-09 http://ssrn.com/abstract_id=1338372 , p9

32 *The American and English Encyclopedia of Law 284*, (John Houston Merrill Edition 1887)

33 Eric R. Claeys, *Property 101: Is Property a Thing or a Bundle?*, Seattle University Law Review, forthcoming, George Mason University Law and Economics Research Paper Series, 09-09 http://ssrn.com/abstract_id=1338372 , p14

34 Adam Mossoff is an Associate Professor of Law at George Mason University School of Law. He specialises in intellectual property and property law

35 Adam Mossoff, *Exclusion and Exclusive Use in Patent Law*, 22 (2) Harvard Journal of Law & Technology 2009 22, Number 2 Spring 2009

In the Supreme Court case of *Kaiser Aetna v United States*[36] the Court considered the "right to exclude others" as one of the most essential stick in the bundle of rights that can commonly characterise the subject-matter as property. In the process of differentiating between a 'property' and an 'un-owned thing', the right to exclude others is a necessary essential condition of identifying the existence of "property". The right to exclude plays an important role in the defining of the thing that is owned by someone.

Therefore, for a right in property to be considered as 'proprietary', it must consist the basic element of 'exclusivity'. As oppose to the personal right in which the holder of personal right has no power to exclude the others from using or enjoying the resource in question.

Exclusive right of use determination

Furthermore, according to Eric R. Claeys, in order to obtain a better understanding on the nature of this right and also in the context of online resources, the 'right to exclude' should be construed as the '*exclusive right of use determination'* for it has more focus and determinacy in describing property as an interest.[37] 'Exclusive right of use determination' is conceptually different from 'right to exclude'. 'Right to exclude' states an outcome. On the other hand, 'exclusive right of use determination' encourages the owners to deploy his/her property to productive uses yet maintain the dominance over the property by exercising his/her exclusive right to determine.

Heller states that 'property' means 'right to exclude'.[38] He further explains that when legal and social factors internalise property as an interest in exclusive use determination, their conceptual priors automatically screens out veto or blockade rights.[39] Hence, the most essential right in property - *exclusive right of use determination* conceptually facilitates the process of transfer or assignment of rights to the others appropriately. It justifies property as a stable platform for both coordination and commercialisation and it allows the rights owners to use productively the things they own exclusively.[40] This is particularly important when dealing with property that is intangible and intellectual in nature in that the inaccessibility over intangible property will only result in such negative effect that will prevent it from further development and exploration.

It is important to differentiate 'right to exclude' and 'exclusive right of use determination'. Such differentiation was also explained by Michael Heller's 'Anti-commons' theory. This theory states anti-commons property can best be understood as

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36 444 U. S. 164, 176 (1979)

37 Eric R. Claeys, *Property 101: Is Property a Thing or a Bundle?*, Seattle University Law Review, forthcoming, George Mason University Law and Economics Research Paper Series, 09-09 http://ssrn.com/abstract_id=1338372, p15

38 Michael A. Heller, Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research,* Science 1 May 1998:Vol. 280. no. 5364, http://www.sciencemag.org/cgi/content/full/280/5364/698, pp698 – 701

39 Eric R. Claeys, *Property 101: Is Property a Thing or a Bundle?,* Seattle University Law Review, forthcoming, George Mason University Law and Economics Research Paper Series, 09-09 http://ssrn.com/abstract_id=1338372, p17

40 *ibid* at p31

the mirror image of commons property. A resource is prone to overuse in a tragedy of the commons when too many owners each have a privilege to use a given resource and no one has a right to exclude another.[41] Implicitly, Heller states that 'property' means 'right to exclude'. Heller further explains that when legal and social factors internalise property as an interest in exclusive use determination, their conceptual priors automatically screens out veto or blockade rights.[42] In the other words, exclusive right of use determination substantially differs from the right to exclude because exclusive right of use determination represents a positive attitude of allowing determination of right of use as oppose to the absolute exclusive attitude from the 'right to exclude'.

Re-identify property - the bundle of right theory

Once it is accepted that certain rights in online resources bear the characteristic and the quality to be classified as property, the next step is to search for a suitable definition of property. In view of the creation and development of cyberspace and online resources, 'property' should now be re-identified and re-defined by the metaphor – bundle of rights in which this metaphor describes property as a collection of proprietary rights and other rights in property. It is an abstract notion to describe property as a collection of rights.

The fundamental principle of the bundle of rights theory demonstrates the many ways in which a property can be divided and enjoyed by different parties. Each stick in the bundle is considered as property by itself.[43] When each stick in the bundle of rights is a property, then removing a stick from the bundle does not affect the remaining sticks in the bundle and therefore the removing of a property right is an independent act for alienation. For instance, a person is still considered as the owner of the land despite the fact that he has given away some of the interest binding upon land to somebody else such as easement or right of way. Easement and the right of way are rights incidental to ownership but are not proprietary in nature. The transfer or delegation of such does not affect owners' proprietorship. This example further illustrates that the notion of rights in property can be divided into many smaller segments of rights and this is peculiar to the bundle of rights theory.[44]

When property is being described as bundle, bundle means it is intentionally binding together of its item that were previously separated and interdependent.[45] Bundle also suggests that a finite set of definite items.[46] An example of the definite item can be seen in A. M. Honoré eleven standard incidents of ownership:

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41 Michael A. Heller, Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research,* Science 1 May 1998:Vol. 280. no. 5364, http://www.sciencemag.org/cgi/content/full/280/5364/698, pp698 – 701

42 Eric R. Claeys, *Property 101: Is Property a Thing or a Bundle?,* Seattle University Law Review, forthcoming, George Mason University Law and Economics Research Paper Series, 09-09 http://ssrn.com/abstract_id=1338372, p17

43 Note the bundle of right theory does not consider the distinction between proprietary right and personal right

44 Denise R. Johnson, *Reflections on the bundle of rights* 32*,* Vermont Law Review 247, p252

45 Daniel B. Klein and John Robinson, Property: *A Bundle of Rights? Prologue to the Property Symposium*, 8(3) ECON JOURNAL WATCH, 2011: 193-204, p1

46 *ibid*

- Right to possess;
- Right to use;
- Right to manage;
- Right to income;
- Right to alienate;
- Right to security;
- The incident of transmissibility;
- The incident of absence of term;
- The duty to prevent harm;
- Liability to execution and
- The incident of residuary

It is submitted that in defining property in cyberspace, the bundle of rights theory should be adopted in order to give rightful recognition to the rights that can be found in various online resources. In applying the bundle of rights theory, one should refer to Tony Honoré's eleven standard incidents of ownership. However, the eleven standard incidents of ownership need to be revised and extended further to accommodate the peculiar characters and interests that can be found in various resources available online.

Furthermore, it is important to classify the various rights in the bundle accordingly. Distinction has to be drawn between 'property rights' or 'proprietary rights' and 'personal rights' as explained above. In deciding the scope of 'property rights', reference can also be made to the definition of 'property right' by Cooter and Ulen as a comprehensive list of:

> "what a person may or may not do with the resources he owns: the extent to which he may possess, use, transform, bequeath, transfer, or exclude other from his property…The legal concept of property is, then, that a bundle of rights over resources that the owner is free to exercise and whose exercise is protected from interference by others…Property creates a zone of privacy in which owner can exercise their will over things without being answerable to others."[47]

Based on the above passage, property right includes a wide range of activities which include the right to decide and the right to exclude from access to the resources and so on.[48] A well-defined bundle of rights would include and specify all the relevant attributes of each use and the contingencies of such use of a particular resource. The relevant attributes of each use and the contingencies of such use depend on the nature of the resources in question and the circumstances in which it has been utilised. For instance, the relevant attributes of use and contingencies of use of personal information may includes right of data subject such as right to be informed; right to correct; right to withdraw consent on the use of personal data and also right to prevent processing personal data that likely to cause damage or distress.

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47 Nicita, Matteo Rizzolli and Maria Alessandra Rossi, *Towards a Theory of Incomplete Property Rights*, ISNIE Conference, Universidad Pompcu Fabra, Barcelona, 22-25 September 2005, p5

48 *ibid*

Implementation

The bundle of rights model should be adopted and incorporated in the Malaysian Penal Code in defining 'property' under the relevant provisions. It is submitted that 'property' should means bundle of rights – a list of proprietary, personal and residuary rights. This list of proprietary, personal and residuary rights should be annexed in the Penal Code. The traditional classification of property within the Penal Code such as moveable and immoveable property should no longer be used in view of the development and common usage of the internet and information technology in the modern world.

A unified definition of property – the bundle of rights model should be applied and incorporated in all the relevant provisions concerning property offences. For instance, Section 383 of the Malaysian Penal Code provides for the offence of extortion. Once the word 'property' in this provision is amended to incorporate and to include 'property rights', the delivery of subject matter within this provision is no longer restricted to any property in the traditional sense (moveable or immoveable) or any valuable security such as money, promissory note, a bond or sign or affix seal to a blank paper[49], it may well extend to include personal and financial information such as credit card number, credit card secure code, bank authorisation code or security box code.

Despite adopting the bundle of rights model in defining property and 'property' now means 'property rights', however, not every provision under the Penal Code is suitable to be amended and which is applicable to cases of misuse and abuse of online resources as proposed. Section 378 is a good example. After inserting the word 'property' to replace the words 'moveable property', Section 378 should read as follows:

> 'Whoever, intending to take dishonestly any (*property)* out of the possession of any person without such person's consent, moves that property in order to such taking, is said to commit theft.'

Despite the word 'moveable property' has been substituted by the word 'property' as proposed, property is now defined as a list of proprietary, personal and residuary rights (combination of such depends on the nature of subject matter in question). Here in Section 378 with the proposed amendment it will not produce the desired result and as it is inappropriate to apply to instances relating to misuse and abuse of online resources in that the other words contained in the provision will created inconsistency. The inconsistency lies within the provision as the words 'take', 'out of possession' and 'moves' has been used and these words stipulate that 'property' that are subjected to this provision bears the physical, tangible and corporeal nature. For this reason alone section 378 is only applicable to properties that are of physical and moveable nature only.

As a consequence in order for Section 378 to be applicable to instances of misuse and abuse of online resources, section 378 should be further amended as follows:

> Whoever, *violate* any property or intend to *violate* dishonestly any property *belonging* to another without the rightful property owner's consent, is said to be to have committed theft.

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[49] As explained in the illustrations (a) – (d)

With the now amended Section 378, it has widen its scope of application by virtue of the words 'violate' which will cover all forms of misuse and abuse as well as adverse attack of the property in question. Furthermore, from the wordings of this provision, it is not a pre-requisite that property subject to this provision needs to be physical, tangible or corporeal in nature. However, property subject to this provision must be a property belonging to someone. Hence, proof of ownership may become one of the important ingredients under this new offence.

However, it may be argued as to whether the new proposed section 378 with the new definition of property and disassociation with the notion of possession has contravene the fundamental offence of theft. The notion of 'possession' is fundamental to the offence of theft. Hume argued that people makes association in their minds between themselves and the 'things' they possess, physically.[50] The convention of respecting possession is based from the people's mutual expectation of their rights to control their property.[51] To violate such mutual expectation, the offence essentially consists of 'taking' and 'carrying away' the property of the victim with the intent of permanently deprives the victim of it.[52] The phrase 'permanently deprives the victim of it' means that the victim (owner) of the property is no longer able to possess and enjoy the property. The rules against 'taking or carrying away' property were designed to prohibit and to punish those disturbing public order by interfering with the right to 'own' something or the right to possess and use it.[53] The right to possess here is refers to the physical possession. The words 'take', 'out of possession' and 'moves' have often been associated with the offence of theft in the recorded history and it is clear that the offence of 'theft' must involve some form of physical taking and possession.

However, in cases of misuse and abuse of online resources, there is no issue of taking, moving out of possession of online resources from its owner as online resources is incapable of being taken away by the others. Online resources are non-physical and intangible in nature and no one can actually take or move online resources out of the possession from its owner. Thus, the notion of possession, physical possession and deprivation cannot be applied to cases of misuse and abuse of online resources. For online resources, it is the exclusive access and its control associated with dilution in its values that is of concern to the rightful owner or holder of the online resources and its rights. The exclusive use and access of these online resources, the notion of exclusivity is the basic underlying notion in dealing with non-physical; intangible nature of online resources. The notion of exclusivity differs substantially from the traditional concept of possession.

Therefore, with the new 'property' definition incorporated and section 378 amended accordingly, the fundamental question is whether misuse and abuse of online resources should be considered as 'theft' at all and hence the application of section 378. On one

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50 Thomas W. Merrill, Henry E. Smith, *Law and Morality: Property Law: The Morality of Property*, April 2007, 48 Wm and Mary L. Rev. 1849

51 *ibid*

52 Michael E. Tigar, *Symposium: A Critique of Rights: The Right of Property and the Law of Theft*, May 1984, 62 Tex. Rev. 1443

53 *ibid*

hand, it can be argued that Section 378 should not be applied at all because by looking at the meaning of 'theft' from the penal perspective, 'theft' traditionally should only be confined to physical taking and possession. It is impossible to cover cases of misuse and abuse of online resources. On the other hand, it is argued that the growing importance of online resources and growing instances of serious misuses of such urgently demand that the Penal law ought to be amended accordingly to reflect the current situation and to protect new creations and development of cyberspace technologies and its enhancements in its commercial values.

In the event section 378 is not be used in cases of misuse and abuse of online resources then section 403 as an alternative is to be amended in dealing with misuse and abuse of online resources. Section 403 creates an offence of dishonest misappropriation of property when a person dishonestly misappropriate; or converts to his own use, or causes any other person to dispose of any property. Misappropriation unfortunately is not defined under the Malaysian Penal Code. However, reference can be made to the explanations under the Indian Penal Code, wherein the word 'misappropriate' means nothing more than improperly setting apart for one's own use to the exclusion of the owner.[54]

Under the Indian Penal Law, an appropriation can also be considered as a mental act in which it implies an allocation of a thing as one's own. Appropriation is completed as long as a person decides to set a thing apart to one's exclusive use. The emphasis on 'the exclusive use' makes the notion of appropriation closely associate with physical, tangible property. The notion of appropriation and the exclusive use of such would deprive the owner of his property is very similar with the notion of possession. The notion of misappropriation under section 403 is still very much associated with some form of tangible, physical and corporeal property only.

Furthermore, Section 403 is essentially the same with section 378. The only distinguishing factor is that theft requires that the initial taking is wrongful but in criminal misappropriation, the initial taking may be innocent, but with the subsequent change of intention and knowledge of the new facts it makes the person liable under section 403.

Section 403 is in no better position when compared with section 378 for cases of misuse and abuse of online resources. It is submitted that the Malaysian Penal Code should adopt a wider and more flexible notion of misappropriation within its provision. Reference should be made to the English notion of appropriation under the Theft Act of 1968 as it incorporates a much wider meaning compared to the Malaysian and Indian Penal Law.

Under the English law, Section 3 of the Theft Act 1968 defined appropriation as an interference with any of the rights of an owner and this includes, where he has come by the property (innocently or not) without stealing it,[55] any later assumption of a right to it by keeping or dealing with it as owner.[56] This principle – in that appropriation is

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54 Dr. Sir Hari Singh Gour, *The Penal Law of India*, (11th Edition, Vol. 1 1998), Law Publishers (India) Pvt. Ltd., p3918

55 Contrast it with the Malaysian position. In the Malaysian Penal Code, Theft is distinguished from criminal misappropriation. Theft requires the initial taking is wrongful and in criminal misappropriation, the initial taking may be innocent, it is the subsequent change of intention and knowledge of the new facts make the person liable under criminal misappropriation

56 Section 3(1) of the English Theft Act, 1968

an interference with any rights of an owner; and any later assumption of a right to it by keeping or dealing with it as owner is of particular importance in the context of misuse and abuse of online resources. It is because the various forms of misuse and abuse could be summarised and being described as 'interference with any rights of an owner by the wrongdoer's assumption of a right to it by keeping or dealing with it as the owner'. For instance, the right to use is one of the rights that exist in information. Any wrongdoer who misuses that right of use of the information meant that it amounts to dealing with it as owner and hence amounting to an interference with such right of the rightful owner.

There are few English authorities concerning the meaning of appropriation under the English law. Interference with any of the rights of an owner was clearly explained in the case of *R v Morris*.[57] In that case, the defendant who switched the labels on two articles in the supermarket, with the intention of buying the more expensive item with the lower price tag. He had assumed the right of the owner on the basis that only the rightful owner of the goods has the right to label the goods. The offence of theft therefore committed as soon as the label was being switched. From the outset, it may not seem to fit neatly into the offence of theft because the defendant did not intent to deprive the owner of the less expensive item. But in law, the goods became stolen goods when the defendant assumed the right of the owner by amending the price of the goods.

Lord Roskill further in this case stated that it is not necessary for the accused to have assumed all the rights of the owner: 'it is enough for the prosecution if they have proved ... the assumption by the defendants of any of the rights of the owner of the goods.' For an appropriation to take place, there is no need for the defendant to actually deprive the owner of his property (whether permanently or temporarily).

The Morris case has given the most liberal and flexible meaning of appropriation - assumption of any of the right of the owner of the property amounts to appropriation and appropriation may takes place regardless of whether there is 'actual deprivation' of the property from its owner. Such principle is of particular importance because the element of deprivation is no longer part of the requirement for appropriation to take place. The English notion of appropriation is most appropriate to be applied to cases concerning online resources. The non-physical and non-exhaustive nature of online resources demand and require a flexible and liberal notion of appropriation rather than an orthodox notion of appropriation which is based on the idea of taking, carrying away or depriving the owner the possession of property permanently. Any misuse and abuse of online resources hence be interpreted and regarded as assumption of any of the rights of the owner of the property by way of the offender's assumption of a right to it by keeping or dealing with it as owner.[58] Therefore, the Malaysian Penal Code should adopt a more flexible and wider notion of misappropriation and to amend section 403 accordingly.[59]

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57 1984, AC 320

58 The rights of the owner of the property includes right to use, right to access, right to control and right to income…etc

59 However, one must take into account in that 'misappropriation' under the English law is one of the components for the offence of theft whereas 'misappropriation' is distinguished from the general offence of theft under the Malaysian Penal Code section 378

Conclusion

To conclude, the Malaysian Penal law requires a clear principle in identifying 'property'. The penal provision should not only confine its application to physical, corporeal property only. A flexible and adoptive definition in identifying property is needed within the penal provision in view of the rapid development of the internet and the use of information technology in our daily lives. With the new definition, some of the online resources would now be regarded as property and be protected by the Malaysian Penal Code accordingly. However, the legislative language used in provisions for offences against property under the Malaysian Penal Code is very much based on the notion of physical possession and appropriation and would need further legislative attention. Some of the terms being used throughout the provisions are fundamentally incompatible with the underlying nature of non-physical and non-exhaustive character of online resources and its rights. This paper raises some of the concerns in adopting and implementing the new definition of property under the Malaysian penal provisions. But those concerns need to be addressed adequately in order to ensure that various online resources are being protected adequately from the penal law perspective.

Adaptive Efficiency and the Corporate Governance of Chinese State-controlled Listed Companies: Evidence from the Risk Tolerance of Chinese Domestic Venture Capitalists

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Abstract

The existing literature on the corporate governance of Chinese state-controlled listed companies (the SCLCs) focuses more on agency costs. There is inadequate attention being paid to its adaptive efficiency through the perspective of venture capital (VC). With the template of American VCs, this article tries to fill this gap on the basis of the evidence from the risk tolerance of Chinese domestic venture capitalists. The existing research has established the linkage between the prosperity of the American VC industry and the remarkable risk tolerance of American venture capitalists. Unfortunately, with the institutional barriers imposed by the control-based model of the SCLCs, the risk tolerance of Chinese domestic venture capitalists is lower than their American counterparts. The implication from this study is that adaptive efficiency and agency costs are equally important factors which ought to be considered when we put forth any reform proposal for the corporate governance of the SCLCs. In case of neglecting either of them, the overall efficiency will be jeopardized.

Key Words: SCLCs, Venture Capital, Risk Tolerance, Adaptive Efficiency

I. Introduction

The issue of corporate governance has gained unprecedented attention in the international community after the ravages of the Asian financial crisis. In recent years, laying down the more sophisticated governance guidelines has become a vibrant campaign with the participation of various interested groups.[2] Given the on-going lackluster performance

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[2] For instance, the government of South Korea has taken a series of steps to reform the corporate governance of chaebol since 1998. The Organization of Economic Cooperation and Development (OECD) also released "OECD Principles of Corporate Governance" in 1999 in order to provide member and non-member countries with specific guidelines in improving the legal, institutional and regulatory framework that underpins corporate governance. In addition, intermediaries, such as McKinsey & Company, are also urging the overhaul of corporate governance in emerging and transitional economies. See Bernard Black, Barry Metzger, Timothy J O'Brien & Young Moo Shin, *Corporate Governance in Korea at the Millennium: Enhancing International Competitiveness*, 26 Journal of Corporation Law 537-608 (2001). In this report, with the request of the South Korean government, Professor Black and his colleagues proposed a systematic legal reform framework to the Ministry of Justice of South Korea for the purpose of improving the porous governance structure of chaebol; OECD, Principles of Corporate Governance, http:// www.oecd.org/dataoecd/32/18/31557724.pdf (Aug 7, 2009). Since its first issuance, this document was revised in 2003 and 2004. The above hyperlink leads to the 2004 revised version; McKinsey & Company, *Corporate Governance in Emerging Markets*, 3 McKinsey on Finance 15-18 (2002).

of its state-owned enterprises (SOEs) and the substantial competition emerging from its entry into the World Trade Organization (WTO), China has also put considerable emphasis on corporate governance in recent years.[3] At the core of such attention is the debate on how China can design an effective corporate governance system for the SCLCs through the perspective of agency theory.[4] Taking into account of a series of scandals related to the poor governance practices of the SCLCs after the establishment of Chinese stock markets,[5] it is not difficult to understand this kind of efforts. Correspondingly, along this Berle-Means path, the existing literauture contributed by company law scholars have almost exclusively linked the corporate governance of the SCLCs to the minimization of agency costs.[6] While these literatures have exerted positive influence on the improvement of the SCLCs' governance framework, they have also omitted another crucial efficacy - adaptive efficiency. As Nobel Prize laureate Douglass North defined,

> "adaptive efficiency...is concerned with the kinds of rules that shape the way an economy evolves through time. It is also concerned with the willingness of society to acquire knowledge and learning, to induce innovation, to undertake risk and creative activity of all sorts, as well as to resolve problems and bottlenecks of the society through time." [7]

On the basis of North's description, we can find out that adaptive efficiency is reinforced by an institutional structure that fosters technological innovation. According to taxonomy, technological innovation is usually divided into two kinds: the "in-house innovation" and the "external innovation".[8] The in-house innovation typically occurs in large, well-established firms and existing industries.[9] To the contrary, the external innovation generally takes place in the start-ups set up by entrepreneurs.[10] Those start-ups do not only have impact on existing industries but also develop entirely new industries.[11]

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3 Shuguang Li, *Company Control of China and the Reform in Its Transition*, 21 Tribune of Political Science and Law (Journal of China University of Political Science and Law) 3 (2003).

4 Qiao Liu, *Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants*, 52 CESifo Economic Studies 415-16 (2006); Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 China Economic Review 494 (2003).

5 Black, Metzger, O'Brien & Shin, *supra* note 2, at 600.

6 The literature in this category includes but is not limited to the following ones. See Leping Shen, *Analysis of the Current Situation of Enterprise Group Corporate Governance Structure and Counter-measures*, 25 Journal of Jinan University (Philosophy & Social Science Edition) 28-9 (2003); Peizhong Gan, *Government and Market in the Reduction of State Shares- the Analysis of this Failed Reform through the Perspective of Economic Law*, 4 Jurists' Review 87-90 (2002); Liufang Fang, The Setback Stemming from Over-regulation, http://www.civillaw.com.cn/article/default.asp?id=17186 (Aug 7, 2009).

7 Douglass C. North, Institutions, Institutional Change And Economic Performance 80 (1990). Cambridge University Press.

8 Curtis J. Milhaupt, *The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate*, 91 Northwestern University Law Review 874 (1997).

9 *Ibid.*

10 *Ibid.*

11 Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 Stanford Law Review 1068 (2003).

Since both the in-house innovation and the external innovation contribute to the enhancement of adaptive efficiency, an ideal institutional environment should be compatible with each of them. When an institutional environment principally focuses on financing the in-house innovation, it actually strengthens the vested interest and the monopolistic position of large, well-established companies. It cannot simultaneously facilitate the booming of the external innovation which represents the competition and the challenge to large companies by entrepreneurs. However, when an institutional environment aims to sponsor the external innovation, in fact, it encourages increasing the magnitude of competition in its economy by bringing in new participants. In turn, the intensified competition provides incentives for large companies to more efficiently and more initiatively conduct the in-house innovation. Therefore, theoretically and logically, we can reach the conjecture that an institutional framework with the orientation to the external innovation should be the Holy Grail to promote adaptive efficiency.

The existing comparative study on the innovation patterns of the United States, Germany and Japan has provided persuasive evidence to support the above postulation. According to those studies, the overall adaptive efficiency of the United States which has been considered to typically promote the external innovation is fairly higher than those of Japan and Germany which have been thought to spotlight on the in-house innovation.[12] Furthermore, those studies have also indentified that a vibrant venture capital (VC) market is the cornerstone of America's success in fostering the external innovation. Therefore, an institutional structure facilitating VC is connected to the significant enhancement of adaptive efficiency.

In the last decade, western corporate law scholars drew a strong linkage between the corporate governance systems of large public companies and the institutional environments for the vitality of VC markets. For example, Black and Gilson analyzed the importance of a highly developed stock market for the exit of VC;[13] Milhaupt examined how VC failed to fit into the corporate governance system of Japanese large, well-established public companies.[14] These academic products have opened up a new insight to observe and estimate the corporate governance system of listed companies. The value of listed companies' governance framework is not just to minimize agency costs along the path set by Berle and Means.[15] It also imposes substantial influence on the legal and other institutional settings for the booming of VC and in turn the enhancement of adaptive efficiency. Therefore, any proposal for reforming the corporate governance of listed companies in a country must be on the basis of a thorough evaluation on that system from the perspectives of both agency theory and adaptive efficiency. Otherwise, it is probable to improve one value at the expense of damaging the other and to make the final result worse off**.** As I have mentioned before, there have been a lot of efforts to

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12 Milhaupt, *supra* note 8; Bernard S. Black & Ronald J. Gilson, *Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets*, 47 Journal of Financial Economics 243-77(1998).

13 *Ibid*., Black & Gilson

14 Milhaupt, *supra* note 8.

15 Adolf A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (1933), The MacMillan Company (New York).

explore the corporate governance of the SCLCs underpinned on agency theory. However, the attempt to examine it from the standard of VC and adaptive efficiency is still absent. It is the research gap which I try to fill with this article.

In China, "venture capital" burgeoned in the early 1980s. However, until 1998, the development of VC was just on the theoretical discussion and the pilot trial stage. In 1998, the Central Committee of Chinese National Democratic Constructive Association presented 'Proposal for Developing China's VC Industry' at the Ninth Chinese People's Political Consultative Conference (the CPPCC). Since then, VC has become a fast growing segment in China's financial system.[16] During the last ten years, China had made remarkable progress in the development of its venture capital market.[17] However, the striking expansion of China's VC market cannot disguise the embarrassing fact that the risk tolerance of Chinese domestic venture capitalists is still lower than their American counterparts. Given the strong linkage between the corporate governance of listed companies and the institutional environment for the vitality of VC markets, I assume that the corporate governance system of the SCLCs has substantially lowered the risk tolerance of Chinese domestic venture capitalists. In other words, I want to use the mirror of the high risk tolerance of American venture capitalists to reflect the negative effects of the corporate governance of the SCLCs on adaptive efficiency.

This article consists of five parts. Part II examines the status quo of corporate governance of the SCLCs to show that a control-based model is its feature. Part III compares the risk tolerance of American venture capitalists with that of their Chinese competitors in the light of the empirical evidence. Through this comparison, I have found that the risk tolerance of Chinese domestic venture capitalists is lower. Part IV aims to verify the connections between the lower risk tolerance of Chinese domestic venture capitalists and the negative effects of the control-based model. Conclusions follow in Part V.

II. The Status Quo of Corporate Governance in the SCLCs

The current SCLCs are the transformative results of traditional SOEs.[18] Therefore, their corporate governance cannot be understood thoroughly apart from their history. [19] Prior to the corporatization of SOEs after the first company law of the People's Republic of China (PRC) was enacted in 1993, the governance systems of SOEs had gone through two stages. First, from the establishment of the PRC to the middle of 1980s, the function of SOEs was merely satisfying the production plans made by government agencies and

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16 Rob Dixon, John Ritchie & Di Guo, The Impact of Governance Structure and Financial Constraints on Risk Tolerance of VCs: An Empirical Work on China's Venture Capital Industry, http://www.cass.city.ac.uk/emg/seminars/EMGpapers1stOct/Dixon_Guo_Ritchie.pdf (Aug 7, 2009).

17 In 2003, the total amount of VC in China was RMB 32.534 billion. Three years later, this number increased to RMB 58.385 billion. See China Venture Capital Research Institute Limited, China Venture Capital Yearbook 107 (2007), Democracy and Construction Press (Beijing).

18 Clarke, *supra* note 4.

19 Cindy A. Schipani & Junhai Liu, *Corporate Governance in China: Then and Now*, 1 Columbia Business Law Review 6 (2002).

guaranteeing social stability. Not only did the state own all the assets of SOEs, but it also completely held their managerial powers. The governance structure of SOEs was an integral layer of the governmental hierarchy.[20] Hence, SOEs were not real business entities from scratch and they were just a type of government affiliates. Second, from approximately 1984 to 1993 when the first Company Law of the PRC was promulgated, the contracting system was dominant in the movement of SOEs' reform. In accordance with the contracting model, the goal of reform was to grant SOEs the status of legal persons and to make them be responsible for their own profits and losses. [21]This strategy revealed that the Communist Party of China (CPC) and the Chinese government wanted the enterprises which they owned to be operated efficiently through authorizing them managerial autonomy to some degrees. However, the state's consideration behind the above expectation was not to render SOEs solely concerned with the maximization of wealth. Conversely, it just intended to implement its policies better with the support of robust SOEs.[22] Therefore, it meant that there were no possibilities for the state to abandon control on SOEs even if it had tactically authorized a share of power to them. The personnel power as the core component of the governance framework of SOEs was tightly held in the hands of the local CPC committees.[23]

The failure of the contracting model induced the national debate on the transformation and diversification of public ownership of SOEs into different forms at the end of the 1980s.[24] However, this move was halted by the Tiananmen Square protests in 1989. In the following three years after this demonstration, the speed of SOE reform was slowed down and the voice of restoring the centrally planned economy resurged.[25] Confronted with the circumstances, Mr. Deng Xiaoping called for the CPC and the whole nation to further emancipate their minds and put forward the economic reform with great courage during his inspection trip to South China in 1992.[26] Under his theory, the market economy did not solely belong to capitalism and it was compatible with the needs of socialist economic division and productions.[27] The support from Mr. Deng Xiaoping provided fresh political impetus to the transformation of SOEs in China. In late 1992, the Fourteenth National Congress of the CPC put the establishment of the market economy into its

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20 The Fifteenth CPC Central Committee, Decisions on SOEs Reform, http://cpc.people.com.cn/GB/64162/71380/71382/71386/4837883.html (Aug 7, 2009). In this Decision, the CPC Central Committee declared administrative ranks should not be granted to SOEs and their leaders any more. It demonstrated that leaders of SOEs used to be state cadres.

21 The Twelfth CPC Central Committee, The Decision of the CPC Central Committee on the Reform of the Economic System, http://news.xinhuanet.com/ziliao/2005-02/07/content_2558000.htm (Aug 7, 2009). After this Decision was published in 1984, the slogan of "separation between the state ownership and the SOE management authority" and the phrase "legal person" become popular among Chinese.

22 Clarke, *supra* note 4, at 494-95.

23 *Ibid.*

24 Shutang Gu & Siquan Xie, *Revisiting the Reform Process of SOEs*, 9 Economic Review 3 (2002).

25 Hongbo Xie, *From the Planned Economy to the Market Economy-The Transformation of the Economic Framework in China*, 5 Macroeconomic Management 24 (2008).

26 Xiaoping Deng, The Comments Made by Deng Xiaoping during His Inspection Tour to South China, http://cpc.people.com.cn/GB/33837/2535034.html (Aug 7, 2009).

27 *Ibid.*

charter.[28] Soon afterwards, the Fourteenth CPC Central Committee passed "Decisions on the Establishment of the Socialist Market Economy" in 1993 in which the setting up of a modern corporate system in SOEs was an urgent and important objective.[29] A series of policy signals for the corporatization of SOEs from the CPC and its paramount leaders promoted the enactment of the first Company Law of the PRC at the end of 1993 (Company Law 1993). After that, on the legal foundation laid by the Company Law 1993, two new approaches were put into practice for the reform of SOEs. First, small and less important SOEs were privatized and diversified into other business forms. The overall amount of SOEs has been drastically diminished.[30] Second, recapitalization with the governance system of modern corporations was encouraged for big and key SOEs instead of total privatization.[31] Some of them were listed on the emerging domestic stock markets in order to raise as much money as possible.[32] These listed companies whose predecessors were the traditional SOEs have constituted the cornerstone of the whole state-owned economy in China. On the basis of the traditional policy-implementation orientation to SOEs which has been analyzed above, I presume that the state must tightly control these pivotal listed companies through the specific governance institutions which have been stipulated by the Company Law of the PRC.[33] In other words, the corporate governance of the SCLCs in China is still the control-based model as traditional SOEs, which is the result of path dependence. Next, I will illustrate this model from the aspects of three principal corporate governance institutions applied in China-the shareholder meeting, the board of directors and the supervisory committee.

A. The Shareholder Meeting

In China, the shareholder meeting which is viewed as a supreme power organ of a corporation occupies the central position in corporate governance.[34] In terms of the latest Company Law of the PRC which came into effect in 2006 (Company Law 2006), the shareholder meeting holds the following comprehensive decision-making powers: (1) to determine corporate operation guidelines and investment plans; (2) to elect and replace directors and shareholder supervisors and determine their remuneration; (3) to review and approve the report submitted by the board of directors; (4) to review and approve the report submitted by the supervisory committee; (5) to review and approve the corporate fiscal

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28 Xinhuanet, Fourteenth National Delegate Conference of the CPC, Xinhuanet. Http://news.xinhuanet.com/ziliao/2003-01/20/content_697129.htm (Aug 7, 2009).

29 The Fourteenth CPC Central Committee, Decisions on the Establishment of the Socialist Market Economy, http://www.people.com.cn/GB/shizheng/252/5089/5106/5179/20010430/456592.html (Aug 7, 2009).

30 Bin Liang, The Changing Chinese Legal System, 1978-Present-Centralization of Power and Rationalization of The Legal System 30 (2008), Routledge (London).

31 *Ibid.*

32 Those enterprises are generally called "the SCLCs" in official documents and academic literature in China.

33 The Company Law 1993 was revised in 2005 and the latest Company Law came into effect in 2006. However, its overall structure with the three main sections of the shareholder meeting, the board of directors and the supervisory committee has remained in the new Company Law to which the author will make reference tin the following analysis.

34 Lin Ye, *The Distribution of Corporate Powers,* http://www.civillaw.com.cn/article/default.asp?id=37502 (Aug 8, 2009).

budgets and final account report on an annual basis; (6) to review and approve the corporate plans regarding allocating profits and making up for losses; (7) to determine the increase and decrease of the corporation's registered capital; (8) to determine the issuance of corporate bonds; (9) to make decisions regarding corporate mergers, divisions, dissolution and liquidation; and (10) to amend the Articles of Incorporation.[35] By this enumeration, we can find out that the shareholder meeting of a corporation in China keeps substantial managerial powers some of which are reserved to the board of directors in the United States and other western countries. This arrangement has given rise to the probability that the majority shareholder can control the operation of the corporation to considerable degrees through the governance institution of the shareholder meeting in China.

As I have mentioned above, the current SCLCs in China are the transformative results of traditional SOEs. Even if they have privatized a portion of shares to the public during the process of corporatization, the ownership structure of these enterprises still characterizes the substantial concentration of the state shares. Given the limits of available data, I am not able to show the ownership constitution of each SCLC in China to prove the above proposition. However, Table 1 provides the empirical evidence regarding the biggest shareholders of the SCLCs in the sector of steel. I believe that these enterprises can be used as a sample to reflect the concentrated state shares in this kind of listed companies in China to a large extent. In the light of the data in Table 1, all of the biggest shareholders of the twelve SCLCs producing steel and iron were state holding corporations which are solely held by the state.[36] The appointments to the top tier corporate leadership positions in these state holding corporations are made by state-owned asset management commissions and CPC committees.[37] Moreover, almost all of the candidates for these positions have the backgrounds of working in related government agencies. [38]Therefore, state holding corporation leaders are seldom held accountable for the economic performance of the enterprise and its subsidiaries as long as it does not deteriorate massively. [39] Their obligations are to guarantee the implementation of state and local policies in those entities. With the tier of state holding corporations as their biggest shareholders, the state has tightly gripped the SCLCs through the shareholder meeting. Even if the equity division reform in 2005 has made state shares tradable on the secondary market, it has not shaken the state's position in the SCLCs as the largest shareholders due to the impediments of vested interests groups.[40]

B. The board of directors

According to the stipulation of the Company Law 2006, the board of directors plays the role as the executive branch of the shareholder meeting in a corporation. It is mainly

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35 Article 100 of the Company Law 2006.

36 Christopher A. McNally, *Strange Bedfellows: Communist Party Institutions and New Governance Mechanisms in Chinese State Holding Corporations*, 4 Business and Politics 97(2002).

37 Can Yi & Yumin Zhang, *Research on the Corporate Governance of Wholly State-owned Corporations*, 7 Journal of Southwest University for Nationalities (Humanities and Social Science) 89 (2007).

38 *Ibid.*, at 104.

39 *Ibid*., at 102.

40 Ye, *supra* note 34.

Table 1: The Biggest Shareholders in the SCLCs in the Sector of Steel in China in 2009

Corporation Name	Name of the Biggest Shareholder	Amount of Shares Held by the Biggest Shareholder	Ratio to the Total Shares (%)
Anyang Iron and Steel Incorporated	Anyang Iron and Steel Group Corporation Limited	1,438,934,489	60.11
Baoshan Iron and Steel Incorporated	Bao Steel Group Corporation	12,953,517,441	73.97
Guangzhou Iron and Steel Incorporated	Guangzhou Iron and Steel Group Corporation Limited	291,104,974	38.18
Handan Iron and Steel Incorporated	Handan Iron and Steel Group Corporation Limited	1,060,810,380	37.66
Hangzhou Iron and Steel Incorporated	Hang Steel Group Corporation	545,892,750	65.07
Hongxing Iron and Steel Incorporated	Jiuquan Steel Group Corporation Limited	1,712,955,075	83.74
Laiwu Iron and Steel Incorporated	Laiwu Iron and Steel Group Corporation	688,503,152	74.65
Lingyuan Iron and Steel Incorporated	Lingyuan Group Corporation	431,473,247	53.67
Ma Anshan Iron and Steel Incorporated	Ma Steel (Group) Holding Corporation	3,886,423,927	50.47
Nanjing Iron and Steel Incorporated	Nanjing Iron and Steel Group Corporation Limited	1,056,120,000	62.69
Hebei Iron and Steel Incorporated	Tangshan Iron and Steel Group Corporation Limited	1,853,409,753	51.11
Wuhan Iron and Steel Incorporated	Wuhan Steel Group Corporation	5,072,021,816	64.71

Source: The Annual Reports of These Companies in 2009 [41]

responsible for the enforcement of the operation decisions made by the latter.[42] The state has controlled the board of directors by means of their personal arrangements. Generally speaking, the chairman and the vice chairman of the board of directors and the director who is concurrently the chief executive in a SCLC are actually determined by local

[41] China Stock Markets Web, Announcements of Listed Companies, http://static.sse.com.cn/sseportal/ps/zhs/ggts/ssgsggqw_full.shtml (Jan 17, 2014) .

[42] Article 109 of the Company Law 2006.

CPC committees.[43] After that, this decision is forwarded to local governments and their state-owned asset management commissions.[44] Next, state-owned asset management commissions require state holding corporations who are the biggest shareholders to convene the shareholding meeting of the SCLCs and appoint the candidates on the shortlist.[45] Moreover, in terms of local government regulations, it is a prevalent requirement that the chairman of the board of directors should act as vice CPC secretary and then the vice chairman should act as CPC secretary in this sort of listed companies.[46] In addition, a large portion of directors in a SCLC are former officials in disbanded component government departments.[47]

With regard to the independent directors in the SCLCs, they also represent the voice of the state. In the light of the "Guidelines on the Establishment of the Institution of Independent Directors in Listed Companies" (Guidelines on Independent Directors 2001) issued by the China Securities Regulatory Commission (CSRC) in 2001, independent directors are elected by the shareholding meeting.[48] Therefore, in the SCLCs, the state as the largest shareholders through the tier of state holding corporations actually dominates the selection of their independent directors.[49] Consequently, independent directors keep tight ties with governments and act on behalf of the state.

C. The supervisory committee

In China, the principal function of the supervisory committee in a corporation is to monitor the behaviors of directors and managers in the interests of shareholders.[50] The members of the supervisory committee in the SCLCs tend to be drawn from two sources. First, state holding corporations as the largest shareholders select external shareholder supervisors through the shareholder meeting.[51] Generally, these external shareholder

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43 Liaoning Securities Supervisory Bureau, Analysis on the Behavioral Changes of the Majority Shareholders and the De Facto Controllers of Listed Companies and the Corresponding Supervisory Approaches after the Equity Division Reform , http://www.csrc.gov.cn/n575458/n870331/n10217417/10264959.html (Aug 10, 2009); People's Daily Online, Behind the Dismissal of Qiao Hong: No Contest for the Successor of Maotai, http://finance.people.com.cn/GB/67815/71134/5870908.html (Aug 10, 2009). The appointment procedure is also applicable to the listed companies invested by the central government which are the minority of all of the SCLCs.

44 *Ibid.*

45 *Ibid.*

46 Yi & Zhang, supra note 37, at 105. In practice, it is also common that the chairman of the board of directors act as that corporation's party secretary.

47 Xinhuanet, Black Record of Chinese Listed Companies in 2005, http://news.xinhuanet.com/stock/2006-01/06/content_4015864.htm (Aug 10, 2009).

48 Article 4 of the Guidelines on Independent Directors 2001.

49 Jianmin Su, Yanbin Yao & Yuehui Su, *Analysis on the Problems of Independent Directors in China*, 14 Finance & Economy 79 (2007); Xiangping Cao, *Reasons for the Dysfunction of Independent Directors in China*, 1China National Conditions and Strength 47 (2008).

50 Article 118 of the Company Law 2006.

51 Jian Zhao, *Consideration on the Improvements of the Supervisory Committee of Chinese Listed Companies*, 11 China Economists 113 (2003); Jianwei Li, *On the Improvements of the Supervisory Committee of Chinese Listed Companies through the Perspective of Its Relationship with Independent Directors*, 2 Law Science 76 (2004).

supervisors are retired government officials, famous economists and accountants who have close relationship with the authorities. Second, within corporations, the secretaries of corporations' disciplinary committees of the CPC and worker representatives constitute internal shareholder supervisors.[52]

The two sources clearly convey the two main purposes of the supervisory committees of the SCLCs. First, the committee is applied to further internalize the oversight of competent government departments over how the SCLCs are operated, thus assuring the maintenance and increase of state assets and the implementation of state policies.[53] Second, the disciplinary committees of the CPC within corporations can play the traditional role as the primary organs of managerial discipline through their personnel overlap with the supervisory committees.[54] Therefore, this corporate institution in charge of management supervision in the SCLCs is also firmly held by the state. Even if it has not obviously taken effect in practice, it is another issue which is not essentially relevant with my analysis in this article.[55]

Just as Donald Clarke claimed, "China's legal system cannot be understood apart from its history and that history-whether imperial or modern- is overwhelmingly a story of centrality of the state."[56] It is also applicable to the corporate governance of the SCLCs. Through the retrospect to the governance structures of their predecessors, we are able to truly understand why the corporate governance of the SCLCs is a control-based model for the purpose of implementing state policies. In other words, without looking back to the historical path, it is not explicable that "the policy of corporatization does not involve a renunciation by the state of its ambition to remain the direct owner of enterprises in a number of sectors"[57] because "this ambition makes no sense if profits are the only objective."[58] Consequently, to a large extent, this control-based model has given rise to the lower risk tolerance of Chinese domestic venture capitalists, which I will demonstrate in the remaining parts of this article.

III. The Comparison of Risk Tolerance: Findings from Empirical Studies

As defined by Bernard Black and Ronald Gilson, VC refers to "investment by specialized venture capital organizations in high-growth, high-risk, often high-technology firms that need capital to finance product development or growth and must, by the nature of their business, obtain this capital largely in the form of equity rather than debt".[59] On the basis

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52 Linqing Wang, The Tragedy of the Supervisory Committee of Chinese Listed Companies: Curious Performance in the Past Eleven Years, http://www.civillaw.com.cn/article/default.asp?id=25935 (Aug 10, 2009).

53 Yi & Zhang, *supra* note 37, at 106.

54 *Ibid.*

55 Kaifu Li, *Brief Analysis on the Shortcomings and Improvements of the Supervisory Committee of Chinese Listed Companies*, 130 Law Review 123-27 (2005).

56 Donald Clarke, Lost in Translation? Corporate Legal Transplants in China, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=913784 (Aug 10, 2009).

57 Clarke, *supra* note 4, at 497.

58 *Ibid.*

59 Black & Gilson, *supra* note 12.

of the definition, it is clear that VC features two dimensions. One dimension is related to its affinity for investing in the early stage of firms as described by "to finance product development or growth".[60] The other dimension refers to its preference for investing in the high technology industry. On the basis of the two dimensions, I extract two indicators - financing stages and technological intensity, which will be used to measure the risk tolerance levels of Chinese domestic venture capitalists and their American counterparts in this article.

As for financing stages, I am principally concerned with the investment magnitudes of Chinese domestic VCs and American ones in the startup stage. In the VC sector, the development of a company is usually divided into four stages - the seed stage, the startup stage, the expansion stage and the pre-IPO stage.[61] The seed stage refers to the situation in which entrepreneurs only generate their ideas and are yet to convert those ideas into products.[62] The startup stage determines that trial production and early marketing has been carried out.[63] The expansion stage means that products have been recognized by consumers and have achieved a major share of the market.[64] The pre-IPO stage implicates that the VC-backed company is mature and possesses the scale to raise funds in the stock markets.[65] VCs, as the common practice, very rarely invest at the seed stage.[66] Instead, at this stage, entrepreneurs whose companies just have good ideas usually acquire equity investment from a group of wealthy individuals who are commonly called "angel investors".[67] Except the seed stage, VCs are willing to be involved in the other three stages. However, this kind of investment portfolio does not simply mean that the other three stages are equally important in the eyes of VCs. Theoretically, VCs ought to be much more interested in the startup stage because the returns from investing at this stage are fairly higher than those from investing at the expansion stage or the pre-IPO stage. But along with large profits, the risks in the startup stage are also much higher than those in the later two stages. Therefore, in order to disperse risks, VCs also put some money into enterprises at their expansion stages or pre-IPO stages, which are more secure than investing in early stage ones. From this analysis, I intend to convey two points. First, only the investment in the early stage can validly reflect the risk tolerance of venture capitalists. Maybe the expansion stage and the pre-IPO stage represent different risk levels. But both of them are means adopted by VCs to offset the high risks stemming from the early stage. In this sense, they are not directly related to the risk-neutrality character of VCs. Second, since the early stage represents a variable to measure the risk tolerance of venture capitalists, we ca n compare the risk tolerance of venture capitalists in different VCs by calculating the different weights of new investment in this stage by those VCs during a certain period.

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60 *Ibid.*

61 The four stages have already been recognized by the VC industry. For such an example, see Ingenious Haus Group, http://www.ingenioushaus.com/service_vc.htm (Jan 17, 2014).

62 *Ibid.*

63 *Ibid.*

64 *Ibid.*

65 *Ibid.*

66 Hank Heyming, Where Venture Capital Fits, http://www.kciinvesting.com/articles/9958/1/Where-Venture-Capital-Fits-Part-2/Page1.html (Jan 15, 2010).

67 *Ibid.*

Technology intensity is related to the fact that the risk levels of different high technologies are never identical although all of them are usually associated with high uncertainty and high risks. Theoretically, the determinant factor of the risk magnitudes of different high technology sectors is their different technology intensity.[68] The higher the technology intensity, the higher the risks a high technology sector has. Therefore, we are able to measure the degrees of risk tolerance of different venture capitalists if we know the technology intensity of various high technology sectors and the distribution of new investment among such sectors by the subject venture capitalists during a certain period.

In the aspect of investing in startup companies, the empirical evidence does not show any substantial differences between Chinese domestic venture capitalists and their American rivals. According to the data regarding the respective new investments by Chinese domestic VCs and foreign ones in China in 2005, among a total of 187 projects financed by Chinese domestic VCs, 80 were at the startup stage with a percentage of 42.8;[69] likewise, among 102 projects financed by foreign VCs, 44 were at the startup stage with a percentage of 43.1.[70] From this comparison, we can basically conclude that no obvious divergence exists between Chinese domestic venture capitalists and their foreign counterparts concerning their preference for startup companies. Even though this set of data did not specially measure the performance of American venture capitalists in this aspect, I think that the performance of foreign venture capitalists can be virtually applied to American ones because the latter plays a dominant role among all the members of the former in China.[71] Thus, I will use "American venture capitalists" in the following similar quotations instead of "foreign venture capitalists". Another piece of supplementary empirical proof to support my findings comes from the research collectively carried out by Rob Dixon, John Ritchie and Di Guo.[72] In their research, the three authors statistically compared the propensity of Chinese domestic venture capitalists and American ones to opt for different stages of companies in terms of their investment from 2002-2003 in China.[73] Finally, Dixon, Ritchie and Guo found that there was not a statistically significant difference between American venture capitalists and Chinese domestic ones in their preference to invest in projects at the startup stage.[74] On the basis of the above two pieces of empirical evidence, the risk tolerance of Chinese domestic venture capitalists and American ones toward startup companies is tight. The explanation for this phenomenon is that Chinese domestic VCs as learners have imitated the practice of seasoned American ones in the aspect of choosing investment stages. As Jianbiao Xiang who was the founder of the Holding VC said, our standards of selecting

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68 Dixon, Ritchie & Guo, *supra* note 16.

69 China Venture Capital Research Institute Limited, China Venture Capital Yearbook 277 (2006),.

70 *Ibid.*

71 Zero2ipo Group, "China Venture Capital & Private Equity Annual Ranking 2012" http://events.pedaily.cn/2012/vcranking/Ranking.asp (Jan 17, 2014)

72 Dixon, Ritchie & Guo, *supra* note 16.

73 *Ibid.*

74 *Ibid.*

projects were mainly transplanted from those of IDG which is a famous American VC.[75] In addition, my interviewee from a provincial government-backed VC (GVC) also held the same position on this matter.[76]

In the aspect of choosing high technology sectors, the empirical evidence indicates that there are clear differences between Chinese domestic venture capitalists and American ones. In 2006, 20.3% newly invested projects with a monetary injection of RMB812 million yuan by Chinese domestic VCs were in the fields of new energy and new materials.[77] Both of the data ranked No. 1 among all the projects financed by Chinese domestic VCs that year.[78] By contrast, in the same year, 51% newly invested Chinese projects with a monetary injection of RMB5,669 million yuan by American VCs were in the fields of IT.[79] Likewise, both of the data also ranked No. 1 among all the Chinese projects financed by American VCs that year.[80] From this comparison, Chinese domestic venture capitalists are more interested in new energy and new materials while American venture capitalists focus more on IT. At this point, my finding is supported by the above-mentioned research of Dixon, Ritchie and Guo as well. In their research, the three authors concluded that there was a statistically significant difference between American venture capitalists and Chinese domestic ones in their preference for high technology sectors - the former concentrated on IT-related technologies and the latter was attracted to new energy and new materials.[81] The explanation for American venture capitalists' favouring IT is that IT is their traditional advantage and they have accumulated rich experiences about making their fortune in this sector from their past successes and failures. Especially, many senior members of American VCs directly come from IT companies, which is why they are more willing to invest in their formerly specialized area.[82] The reasons for Chinese domestic venture capitalists' inclination towards new energy and new materials can be divided into two cases. For GVCs, this kind of inclination mainly results from the environmental policy of the State Council. In 2002, the State Council issued "The National Report of Sustainable Development" in which new energy and new materials were deemed the urgent fields for development.[83] In order to echo the calling from the central government, local governments subsequently made their own plans for rapidly developing the two fields.[84] In those plans, one common method is to finance the startup

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75 CEO & CIO Magazine, The Pain of Chinese Private Domestic VCs, http://tech.163.com/09/0722/10/5EQOCTER000915BF.html (Jan 15, 2010).

76 Interview with a venture capitalist from a provincial GVC. In China, Chinese domestic VCs consist of GVCs and private domestic VCs.

77 China Venture Capital Research Institute Limited, supra note 17, at 236.

78 *Ibid.*

79 *Ibid.*

80 *Ibid.*

81 Dixon, Ritchie & Guo , *supra* note 16.

82 IT Time Weekly, IT Experts Jump into the VC Sector, http://news.zero2ipo.com.cn/n/2009-11-14/20091114114800.shtml (Jan 16, 2010).

83 The State Council, The National Report of Sustainable Development (2002).

84 We are able to find that almost every province has issued its plan for developing new energy and new materials if we search for them through Google or Baidu.

companies with the technologies related to new energy and new materials.[85] Therefore, GVCs which are affiliated to local governments inevitably play the role of investor for those companies. For private domestic VCs, their partiality for new energy and new materials principally stems from the backgrounds of their VC investors. As Jiaqing Li who is the CEO of the Legend Capital Limited said, almost all VC investors of private domestic VCs in China are privately held companies in the manufacturing industry.[86] With the increasing prices of traditional energy and the more stringent environmental responsibilities, entrepreneurs of those privately held companies had realized that the profit room for their enterprises had been significantly narrowed.[87] Therefore, they put part of the retained profits of their companies into the VC industry in order to earn more money.[88] From Mr. Li's explanation, we are able to discover that one of the direct reasons for the participation of privately held enterprises in the VC industry is the pressure caused by the state policy of protecting traditional energy and the environment. Given their sufferings from this kind of pressure as well as the political advocacy from the Chinese central government, we have enough reason to believe that the entrepreneurs of those companies can definitely identify the big market potential of new energy and new materials in China, which means that they have more incentive to participate in the two fields. In addition, different from VC investors in America, they always require the status of decision makers,[89] which implicates that they possess the discretion to select their preferred areas. Thus, the combination of the two factors explains why private domestic VCs also show a preference for new energy and new materials.

Related to the technology intensity of different high technology sectors, little quantitative research has been conducted so far. In all likelihood, this inadequacy is attributed to the potential huge and complicated task of designing measurable indicators and collecting data across sectors and even across nations. Therefore, I can only qualitatively measure the technology intensity of the high technology sectors respectively preferred by American venture capitalists and Chinese domestic ones by conducting an interview. From the viewpoint of my interviewee from the provincial GVC, IT is more technological intense and riskier than new energy and new materials.[90] As he explained, the profits of IT projects mainly come from attracting and maintaining a huge number of users.[91] However, from an initial IT product to a widely-accepted one, this process usually takes several years during which almost all of the work is technology-based

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85 *Ibid.*

86 First Financial Daily, The Temperature of Private Domestic VC Needs to Be Cooled, http://www.china-cbn.com/s/n/000002/20080722/020000084359.shtml (Jan 16, 2010).

87 *Ibid.*

88 *Ibid.*

89 In China, venture capitalists in both GVCs and private domestic VCs are not independent in the process of selecting investment projects. They face serious intervention from their principal VC investors. See Lin Zhang, *Adaptive Efficiency and the Corporate Governance of Chinese State-controlled Listed Companies: Evidence from the Fundraising of Chinese Domestic Venture Capital*, 10 U.C.Davis Business Law Journal 151-81 (2010).

90 Interview with the venture capitalists from the provincial GVC.

91 *Ibid.*

because most IT products are intangible.[92] The longer growth period of IT products resulting from technology-intensity commonly means that they are not able to create money before maturing.[93] Moreover, nobody could guarantee that they can definitely build a huge client base within a few years' time.[94] Therefore, the uncertainty is fairly great.[95] By contrast, investing in technologies with tangible products, like new energy and new materials, is less technologically intense and risky because they are able to generate profits with a mature product in a much shorter period.[96] My interviewee's opinion has been supported by Qifa Liu who is the investment manager of the Fitch Crown Venture Capital Management Company. In a VC forum organized by the Net Ease Company, Mr. Li expressed the same position regarding the technology intensity and risks of IT, new energy and new materials.[97] In addition, in their research, Dixon, Ritchie and Guo mentioned that their interviewee who was a domestic venture capitalist also confirmed that IT was more technological intense and riskier than new energy and new materials.[98]

In terms of the aforementioned empirical evidence, we can basically arrive at the conclusion that the risk tolerance of American venture capitalists is higher than that of Chinese domestic venture capitalists. However, as analyzed elsewhere, venture capitalists in GVCs and private domestic VCs are not independent decision makers in the process of choosing investment projects.[99] And passive selection cannot authentically represent the risk tolerance of venture capitalists. Therefore, in order to truly reflect the risk tolerance of Chinese domestic venture capitalists, we must assess whether or not they would have been willing to catch up with or even overtake their American rivals in this aspect if we assume everything is the same except that they are able to independently make decisions.

For venture capitalists in GVCs, their answers to the above question are "No". In my interview with the venture capitalist in the provincial GVC, he expressed the view that even if they obtained the sufficient autonomy to make investment decisions, venture capitalists in GVCs were inclined to choose the projects favoured by governments, such as startup companies developing new energy or new materials.[100] As he explained, on the one hand, they could get rescued by governments when they are in trouble with the projects recommended by the authorities; on the other hand, they cannot earn more because of the fixed income system in GVCs but must be blamed for losses if they independently choose riskier projects like IT startups.[101] My interviewee's opinion has also been supported by the interview conducted by Dixon, Ritchie and Guo in their quoted research.[102] Therefore, in comparison with American venture capitalists, a lower

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92 *Ibid.*
93 *Ibid.*
94 *Ibid.*
95 *Ibid.*
96 *Ibid.*
97 The Net Ease, Chinese Domestic VCs Stay away With IT in the Three Years Ahead, http://tech.163.com/08/0117/00/42CCME3K000922QC.html (Jan 16, 2010).
98 Dixon, Ritchie & Guo, *supra* note 16.
99 Zhang, supra note 89.
100 Interview with the venture capitalist from the provincial GVC.
101 *Ibid.*
102 Dixon, Ritchie & Guo , *supra* note 16.

level of risk tolerance of venture capitalists in GVCs can be ascribed to the effects of risk absorption and incentive inadequacy.

For venture capitalists in private domestic VCs, their answer to the above question is "No" as well. As explicated before, the main funding source for private domestic VCs is the limited retained profits of privately held enterprises. Therefore, without alternative large funds, the failure of investment for a private domestic VC generally means that it has to leave the VC industry. Consequently, in order to survive, we have enough reason to believe that venture capitalists in private domestic venture capitalists do not invest in the areas riskier than those currently invested in by them if they have the discretion to select projects. My analysis has been testified by Fenglin Chen who is the vice CEO of the privately held Shanghai Huile Investment and Management Corporation. According to Mr. Chen's illustration, foreign VCs generally hold billions of dollars for investment.[103] If they fail in a project, they can also get compensated by other successful ones.[104] But for private domestic VCs, their funds are quite limited.[105] If they fail in a project, it usually means that all is lost.[106] Therefore, private domestic VCs pay more attention to risks while foreign VCs are more concerned with profits.[107] In addition, my interviewee in the GVC also agreed with my reasoning on this matter. As he said, even though neither GVCs nor private domestic VCs have as much money as American ones, the budgets of GVCs are much softer than that of private domestic VCs.[108] Hence, for private domestic VCs, project failure is almost the equivalent of their bankruptcy.[109] Consequently, they are more cautious in relation to risks.[110] From the above analysis, the lower level of risk tolerance of private domestic venture capitalists can be attributed to their shortage of funds.

To sum up, the empirical evidence has shown that the risk tolerance of American venture capitalists is higher than that of Chinese domestic venture capitalists. For GVCs, the difference is because of the effects of risk absorption and incentive inadequacy. For private domestic VCs, the difference results from their more limited fund sources. In the next section, I will try to prove that these reasons are linked to the control-based model.

IV. The Lower Risk Tolerance of Chinese Domestic Venture Capitalists: What the Control-based Model Explains

According to the empirical findings from the preceding section, in order to prove the linkage between the control-based model and the lower risk tolerance of Chinese domestic venture capitalists, I must testify the following two propositions in this section: (1) the effects of risk absorption and incentive inadequacy faced by GVCs largely result from the

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103 The CVCRI Online, The Differences between Chinese Domestic VCs and Foreign Ones, http://bbs.chinavcpe.com/topic.action?topicId=7004 (Jan 17, 2010).

104 *Ibid.*

105 *Ibid.*

106 *Ibid.*

107 *Ibid.*

108 Interview with the venture capitalists from the provincial GVC.

109 *Ibid.*

110 *Ibid.*

control-based model; (2) the more severe funding shortage suffered by private domestic VCs is mainly attributed to the control-based model as well. Next, I will attempt to verify them in sequence.

A. Risk Absorption and Incentive Inadequacy: The Reflection of Paternalism

In the second part, I have pointed out that the corporate governance of the SCLCs is the control-based model. This model has the effect to align the interests of governments with those of their controlled listed companies. Consequently, this kind of alignment has maintained the paternalism of governments which pervasively existed in traditional SOEs before their corporatization. With the paternalism, on the one hand, governments have the incentive to transfer as many resources as possible to the SCLCs, which I have empirically proved elsewhere; on the other hand, they are also willing to absorb any risks which threaten the operation and vested interests of those companies. As a result, when GVCs emerged since the end of the 1990s,[111] the behavioural inertia inevitably made governments apply the risk-absorption aspect of paternalism to this new type of firm which is homogeneous with the SCLCs. Naturally, when GVCs experience trouble after investing in projects recommended by governments, the authorities will try to bail them out by providing more money. Here, I believe that some may argue that the bailout of governments should have the effect of increasing the risk tolerance of venture capitalists in GVCs. Thus, is it inconsistent with its role as the reason to lower the risk tolerance level of venture capitalists of GVCs? My answer is "No". As the existing academic research has identified, the two factors that measure the risk tolerance level of venture capitalists are financing stages and technology preference as adopted in this chapter. The ability or willingness of venture capitalists to use risk-controlling mechanisms can only influence their risk tolerance at each level but cannot upgrade or downgrade their levels. For example, Professor Curtis Milhaupt once compared the risk tolerance levels of American venture capitalists and Japanese ones through the above two indicators.[112] Even though he also found that Japanese venture capitalists seldom made use of convertible securities or stock options, it did not change their lower risk tolerance level in comparison with their American rivals because they generally focus on late stage financing and traditional industries.[113] Therefore, based on this reasoning, we can understand that the bailout of governments lowers the risk tolerance level of venture capitalists in GVCs as the empirical evidence shows but may increase their risk tolerance at this lower level.

On the basis of the above analysis, what I ought to do next is prove that the practice of risk absorption maintained by the control-based model really exists in the SCLCs. In order to achieve this, I will explore the interaction between the control-based model and the risk absorption of governments in three situations which cause risks to the SCLCs. The three situations are fraudulent information disclosure, hostile takeovers and bankruptcy. Next, I will analyze them one by one.

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111 Dixon, Ritchie & Guo, *supra* note 16.
112 Milhaupt, *supra* note 8, at 894.
113 *Ibid.*, at 889.

a. Fraudulent Information Disclosure

Pursuant to the Securities Law of the PRC, when the fraudulent information disclosed by a state-controlled listed company is spotted by the CSRC, the company will suffer administrative fines and warnings.[114] In addition, according to the judicial interpretation entitled "Notice regarding Dealing with the Disputes Resulting from Fraudulent Information Disclosure" which was made by the Supreme Court of the PRC in 2002, the shareholders which fall victim are also entitled to file lawsuits against the company for compensation after the administrative penalty from the CSRC is imposed.[115] Therefore, for the SCLCs, fraudulent information disclosure theoretically means the loss of money and confidence from public investors.

With the risks of heavy punishments from the regulatory body, courts and market, the SCLCs should be dissuaded from issuing fraudulent information. But in reality, false information disclosed by them has been rampant in the Chinese stock markets. Professor Peixin Luo from the East China University of Political Science and Law once conducted an interview with a government official who was responsible for investigating securities crimes.[116] In this interview, the official admitted that it was common practice for the SCLCs to issue fraudulent information, but only a few of them had been punished by the CSRC or courts.[117] Likewise, Professor Liufang Fang from the China University of Political Science and Law also expressed the same opinion in an interview with an influential newspaper in China.[118] During this interview, Professor Fang even commented that the information frauds of the SCLCs had made accounting firms forget how to provide true auditing reports.[119] Facing the divergence between the punishment risks and the flooding of false information from the SCLCs, some may wonder why it happens. From my point of view, among others, the main reason is because governments absorb most risks from disclosing fraudulent information for the SCLCs, which was implicitly revealed by the official in his or her interview with Professor Luo.[120]

As I have analyzed in the second part, the underlying purpose of the control-based model is to ensure that the SCLCs are able to faithfully implement the policies of the CPC and governments. This fact determines that the administrative penalty made by the CSRC against the behaviour of information frauds of the SCLCs definitely impairs the interests of local governments or the SASAC. Therefore, when the fraudulent information from the SCLCs is identified by the CSRC, local governments and the State-owned Assets Supervision and Administration Commission (SASAC) inevitably wade in and prevent the CSRC from taking any punitive action. Moreover, this kind of intervention

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114 Article 193 of the Securities Law of the PRC.

115 The Supreme Court of the PRC, "Notice regarding Dealing with the Disputes Resulting from Fraudulent Information Disclosure", http://www.csrc.gov.cn/pub/newsite/flb/flfg/sfis_8249/200802/+20080227_191599.htm (Jan 17, 2014)

116 Peixin Luo, *The Establishment of Legal System for the Harmonized Ecology of Chinese Securities Markets*, 4 China Legal Science 101-02 (2005).

117 *Ibid.*

118 Fang, *supra* note 6.

119 *Ibid.*

120 Luo, *supra* note 116.

also deprives victim shareholders from the right to approach courts for remedies because the penalty decisions of the CSRC are the prerequisite for filing lawsuits in terms of the "Notice regarding Dealing with the Disputes Resulting from Fraudulent Information Disclosure". Consequently, the risks from issuing false information for the SCLCs have been substantially absorbed by governments.

Even though it is impossible to know how many the SCLCs governments have helped escape the administrative penalties after disclosing fraudulent information, we can still indirectly identify this kind of practice from some cases investigated and announced by the CSRC. Next, in order to further demonstrate my claim in this section, I will choose the Hongguang case as an example.[121]

Chengdu Hongguang Industrial Corporation (Hongguang) was a television manufacturer which was in the charge of Chengdu Municipal Government. In June 1997, upon the recommendation of Sichuan Provincial Government and the approval of the CSRC, Hongguang was listed on the Shanghai Stock Exchange. In its prospectus, Hongguang predicted that it could achieve profits of RMB70.55 million yuan by the end of 1997. However, according to its annual report of 1997, Hongguang eventually suffered net losses of RMB203 million yuan. Consequently, it became the first company to report losses in its listing year in China. The tremendous difference between the prospectus and the annual report aroused intensified criticism and skepticism among the media and public investors. Under this kind of pressure, the CSRC announced its intention to investigate Hongguang at the beginning of 1998. At the end of that year, the CSRC reported its investigation results to the public. According to the results, Hongguang provided fraudulent accounting information in its prospectus for the purpose of acquiring the listing quota. For example, in terms of its prospectus, Hongguang was continuously profitable from 1994 to 1996. But in fact, till 1996, it had suffered losses of RMB103 million yuan.

From this brief description of the Hongguang case, I intend to convey three points. First, as the SOE was located in its area and enjoyed its subsidy, Chengdu Municipal Government had no reason to say that they did not know about the losses of Hongguang before its listing. But they never declared any objection to the false financial data included in the prospectus when Hongguang sought to be listed. Therefore, it just means that the local government allowed the fraudulent practice of its enterprise. Second, ex ante conniving must be associated with ex post harbouring. From the almost one-year investigation, we have enough reason to imagine how much resistance from the local governments the CSRC went through. Hence, if Hongguang did not generate such huge negative influences in China, it may have escaped the punishments of the CSRC. Finally, the combination of the above two points can basically prove the risk absorption of governments for the SCLCs after they issue false information. More importantly, it is largely ascribed to the control-based model.

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[121] Yuming Zhang, The Red and Black of Chinese Stock Markets, http://www.guosen.com.cn/webd/eBook/redandblack/hongguan.html (Jan 21, 2010).

b. Hostile Takeovers

Hostile takeovers are an important and effective external governance mechanism to discipline the performance of the management of a listed company.[122] Along with the success of a hostile takeover, the controlling power of the target company will be transferred to the bidder; its incumbent managers will be probably replaced and its overall operation strategies will usually be changed. Therefore, for a listed company, hostile takeovers threaten the vested interests of the controlling shareholders and the management, and the established tactics of operation.

However, the prerequisite for the survival of hostile takeovers is the dispersed ownership structure of listed companies. In the case of concentrated ownership, a bidder can only negotiate in a friendly way with the controlling shareholders and the management if it intends to acquire the target company. Thus, with the control-based model, governments as the majority shareholders, not only guarantee the implementation of their policies in the SCLCs, but also discourage any hostile takeover attempts against those companies. In this sense, I think that governments absorb the risks from hostile takeovers for the SCLCs. Actually, in addition to hostile takeovers, friendly negotiations usually mean that a bidder is not able to ultimately control the target the SCLCs as well. According to the "Provisional Administration Regulation regarding the Transferring of State-owned Shares of Listed Companies" jointly enacted by the SASAC and the CSRC in 2007, the selling of state-owned shares of listed companies must obtain the approval of the SASAC or provincial governments[123] Given the vested interests from the control-based model, in most cases, those authorities are reluctant to hand over their identities as controlling shareholders to friendly bidders. Ultimately, such bidders at most become minority shareholders of the target state-controlled listed company. On this point, I think that the Tsingtao Beer case has provided persuasive empirical evidence.[124] Although this case occurred before the enactment of the "Provisional Administration Regulation regarding the Transferring of State-owned Shares of Listed Companies", governments also possessed the power to transfer state-owned shares of listed companies at that time. Therefore, time is not a factor to weaken the illustration ability of this case. Next, I will briefly analyze it so as to support my position in this section.

The Tsingtao Brewery Corporation (Tsingtao Beer) is a listed company which is controlled by Tsingtao Municipal Government. Given the popularity of Tsingtao Beer among Chinese consumers, the Anheuser-Busch Company (AB) which is the largest beer producer in the US once negotiated with Tsingtao Municipal Government to acquire the controlling shares of Tsingtao Beer at the very beginning of the 1990s. But Tsingtao Municipal Government refused its request. In 1993, Tsingtao Beer was listed on the Hong Kong Stock Exchange. Since then, it had begun to take over small beer producers in

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[122] Ronald J. Gilson, *The Political Ecology of Takeovers: Thoughts on Harmonizing the European Corporate Governance Environment*, 61 Fordham Law Review 169-71 (1992).

[123] Article 7 of "Provisional Administration Regulation regarding the Transferring of State-owned Shares of Listed Companies".

[124] China Business Newspaper, The Takeover Defense of the Tsingtao Beer in the Past Sixteen Years, http://finance.aweb.com.cn/2009/5/19/22520090519082155840.html (Jan 21, 2010).

China. Till 2001, this kind of takeover movement made Tsingtao Beer heavily burdened with debts. In order to enhance its financial liquidity, with the support and involvement of Shandong Provincial Government and Tsingtao Municipal Government, Tsingtao Beer approached AB with regard to equity investment. After almost one year of negotiations regarding the controlling power, Tsingtao Beer and AB eventually reached an agreement in 2002. According to the agreement, Tsingtao Beer issued 1.4 billion HK dollars worth of convertible bonds to AB, which meant that AB would hold 27% of the shares of Tsingtao Beer after the complete conversion of those bonds and the percentage owned by Tsingtao Municipal Government would be diluted from around 40 to 31 by then. In order to stabilize the status of Tsingtao Municipal Government as the controlling shareholder, the agreement also stipulated that AB only held the voting rights of 20% of the shares of Tsingtao Beer even though it actually owned 27%. The voting rights of the extra 7% shares had to be transferred to Tsingtao Municipal Government.

With the Tsingtao Beer case, I think I have empirically proved that governments are reluctant to hand over their controlling power of the SCLCs to outside bidders in friendly takeovers. In turn, it indirectly supports the fact that with the protection of governments through ownership concentration, hostile takeovers are not a threat to the SCLCs because bidders have to friendly negotiate with governments for their controlling blocks in the target SCLCs. Again, the root of the protection can be found in the control-based model as explicated above.

c. Bankruptcy

For a listed company, bankruptcy represents its demise as a legal person. With the completion of the bankruptcy procedures, the company does not legally and physically exist any longer. Therefore, in comparison with fraudulent information disclosure and hostile takeovers, the risks from bankruptcy look more severe.

Specifically referring to the SCLCs, as repeatedly mentioned above, they are the tools for governments to implement their policies. Thus, if they are announced to be bankrupt by courts, the vested interests of governments must be jeopardized. Consequently, this interest chain built by the control-based model determines that governments have the incentive to bail out the SCLCs which face the risk of bankruptcy.

In reality, the frequently used bail-out method by governments is to provide extra financial subsidies for the SCLCs which are in trouble. This method is commonly called "soft budget constraints".[125] Even though there are no statistics regarding the magnitude of "soft budget constraints" in the SCLCs, we can still easily find many cases involving this sort of practice from the mainstream media.[126] To some extent, it is fair to say that we can always find the figures of governments when the SCLCs are on the brink of bankruptcy. Next, I will use the Zheng Baiwen case to further justify this point.[127]

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[125] Donghua Chen, Tiesheng Zhang & Xiang Li, *Implicit Contract without Law - EmpiricalEvidence from China Capital Market*, (unpublished manuscript, on file with author).

[126] Such as the "Houwang" case Shuang Xu, "Examining the Houwang Case through the Perspective of Government", cenet http://web.cenet.org.cn/upfile/4992.doc (Jan 20, 2010).

[127] Yuhui Chen, *Innovation or Illegality?*, 23 Modern Economic Science 57-58 (2001).

Zhengzhou Baiwen Corporation (Zheng Baiwen) was listed on the Shanghai Stock Exchange in 1996. At that time, the biggest shareholder was Zhengzhou Baiwen Group Corporation which was wholly held by Zhengzhou Municipal Government. Therefore, Zhengzhou Municipal Government was the actual biggest shareholder of Zheng Baiwen. Because of bad operations, in 2000, Zheng Baiwen owed China Cinda Asset Management Corporation (Cinda) RMB2.1 billion yuan. Given Zheng Baiwen's inability to repay the debt, in the same year, Cinda filed a bankruptcy lawsuit against it. However, under the pressure of Zhengzhou Municipal Government and Henan Provincial Government, Zhengzhou Intermediate People's Court dismissed the application by Cinda. After that, in order to salvage Zheng Baiwen, Zhengzhou Municipal Government and Henan Provincial Government persuaded Shandong Sanlian Corporation which is a large SOE in Shandong province to restructure this moribund listed company with equity investment. In addition, with their efforts, Cinda which was wholly owned by the MOF also agreed to cancel Zheng Baiwen's debt worth 1.2 billion yuan out of the total 2.1 billion yuan payable to it. For the remaining 0.8 billion yuan debt, 0.3 billion was repaid by Shandong Sanlian Corporation and 0.5 billion was repaid by Zheng Baiwen Group Corporation with a guarantee from Zhengzhou Municipal Government. Finally, with the series of arrangements above, Zheng Baiwen successfully escaped the consequence of bankruptcy. Through this brief introduction to the Zheng Baiwen case, the efforts made by governments to save the the SCLCs on the brink of bankruptcy are clear. Thus, it empirically proves the existence of the soft budget constraints in reality.

I believe that I have proved that the risk absorption of governments really exists in the SCLCs due to the control-based model. In turn, the effect of risk absorption resulting from the control-based model inevitably leads to incentive inadequacy. As we know, incentive mechanisms are generally associated with discretion and risks.[128] Hence, it is not difficult to understand that incentive is not paid much attention to in an environment featuring control and protection. The long-term lack of a well-devised and regular system of stock options in both the SCLCs and GVCs is just a persuasive piece of evidence.[129]

To sum up, in this section, I have demonstrated that the risk absorption and incentive inadequacy faced by GVCs are the outcomes of the paternalism of governments. The culture of paternalism is in turn largely cultivated and maintained by the control-based model. Finally, on the basis of this correlation, I have verified the linkage between the lower risk tolerance of venture capitalists working for GVCs and the control-based model.

B. Severe Funding Shortage: An Old Problem

In another article, I illustrated that GVCs and private domestic VCs are commonly confronted with the problem of funding shortage because the control-based model hinders the huge amount of money held by various institutional investors flooding into the VC sector.[130] However, in terms of the empirical evidence in this article, it is clear that the

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[128] For example, stock options as an incentive mechanism connect the income of managers to their independent management performance. It is typically the combination of autonomy and risks.

[129] Lin Zhang, *Rethinking the Corporate Governance of Chinese State-controlled Listed Companies through the Perspective of Venture Capital*, (unpublished manuscript, on file with author).

[130] Zhang, *supra* note 89.

shortage suffered by private domestic VCs is much more pressing than that of GVCs in that it has become the main factor affecting the risk tolerance of venture capitalists in private domestic VCs. Therefore, more accurately speaking, the more severe funding shortage determines the lower risk tolerance of venture capitalists working for private domestic VCs.

The reason for the badly funding insufficiency plaguing private domestic VCs, is principally that privately held enterprises as their main VC investors lack financing channels in China. The fundraising difficulties of privately held enterprises are not a new problem. As I explicated in another article, it is largely ascribed to the interest-aligned effect of originating from the control-based model.[131] Consequently, the cash flows of privately held enterprises are very easy to dry up. Therefore, when they participate in the VC industry, they just put up a small amount of retained profits in order not to endanger the financial liquidity of their main business. For example, the biggest VC investor of Shunli VC which is a private domestic one in Foshan City only contributed RMB3.6 million yuan.[132] According to Zhiqiang Ouyang who is the CEO of Shunli VC, their VC investors were all privately held enterprises with limited fundraising sources.[133] Thus, for them, investing with small amounts of money would not risk their operations.[134] Next, in order to further illustrate the severe financing difficulties of privately held enterprises, I will make an analysis of the Sun Dawu case.[135]

Hebei Dawu Farming and Husbandry Group (Dawu Group) was established by Sun Dawu in 1985. Under the excellent management of Sun Dawu, Dawu Group developed very fast during its first ten years. By 1995, Dawu group was among the 500 biggest privately held enterprises in China. However, the expansion of enterprises is usually associated with the larger demand for cash. In order to enhance its cash flow, Dawu Group made loan applications with banks many times before 1996. But the banks almost refused all of those attempts because only SOEs were their traditional clients in this aspect. Under such circumstances, Sun Dawu decided to let Dawu Group take deposits from its employees and the residents living nearby. From 1996 to 2003, this kind of fundraising which is deemed a crime by the Criminal Law of the PRC significantly improved the financial liquidity of Dawu Group.[136] In addition, during the period, Dawu Group did not default on any borrowings. In 2003, Sun Dawu was arrested by the police with the charge of illegally taking deposits and then was sentenced to 3 years in prison by judges.

With reference to the Sun Dawu case, I do not mean to discuss whether or not the action of Sun Dawu is lawful per se. I just want to reflect the tough financing ecology of Chinese privately held enterprises under the gloom of the control-based model. In turn, this kind of negative effect of the control-based model has given rise to the lower risk tolerance of venture capitalists in private domestic VCs as the empirical evidence has shown above.

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131 *Ibid*.

132 Guangzhou Newspaper, VCs in Foshan Have Appeared, http://www.ezcap.cn/News/200815330.html (Jan 22, 2010).

133 *Ibid.*

134 *Ibid.*

135 Faren Magazine, Sun Dawu Fell before the Regulation of Chinese Financial Market, http://finance.sina.com.cn/leadership/crz/20080305/14364583433.shtml (Jan 23, 2010).

136 Article 176 of the Criminal Law of the PRC

V. Conclusion

The risk tolerance of venture capitalists directly influences the returns of VC investment.[137] With the existing empirical evidence, I have discovered that the risk tolerance of Chinese domestic venture capitalists is lower than that of their American counterparts. For GVCs, the reason for this disadvantage is because of risk absorption and incentive inadequacy; for private domestic VCs, the reason is because of severe funding shortage. Further, on the basis of the empirical findings, I have proved that those reasons are all linked to the negative effects of the control-based model. The implication from this study is that adaptive efficiency and agency costs are equally important factors which ought to be considered when we put forth any reform proposal for the corporate governance of the SCLCs. In case of neglecting either of them in this process, the overall efficiency must be jeopardized.

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An Analysis of 'the Law': Legal Positivism

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Abstract

The study of law is not just confined to accepting the rules as they are and applying them to factual circumstances. This article attempts to bring some contrast to the various legal theories from a legal positivism perspective in exploring, in broad terms, the justification for obedience to the law and whether such obedience is justified. One of the ever-pervading issues revolves around the interpretation and reception of what constitutes '(im)moral' and 'justice'. In this article, how the 'law' views '(im)morality' and 'justice' is examined in the light of Nazi Germany during World War II vis-à-vis legal positivism. Whilst it is never meant be a treatise, it is hoped that by examining the legal theories and eminent jurists alike here, there will be some clearer understanding of what is understood to be the 'law'.

Introduction

Legal positivism[2] is an approach of analysing law through description, viz. it is concerned with explaining what the law "is". This is distinct from the question of what the law "ought" to be, which approach is that of natural law. Hence, our question on legal positivism may also be approached descriptively. Nonetheless, to describe or think *about* positivism in clarifying thinking of/about law may be an external approach in evaluating positivism. Given that we are concerned with understanding positivism as a *whole* and to gauge the *extent* of its contribution towards the understanding of law, it is preferable to adopt an internal perspective towards it. More importantly, if we were to take the question from an external perspective, it seems that positivism is a subject in determining/affecting how we, an object, think of/about law. Instead, the internal perspective would be better as we, the subject, will be analysing positivism, the object, in thinking *of* law. Without adopting any particular reasons as with Hart's "internal point of view" of law, this approach is to show that the proper study of positivism itself would avail us a clearer understanding of law.

Besides, the word "clarify" necessitates clarification in our context. In relation to *explaining* law, positivism has put forward three renowned theses of separability, pedigree and discretion. Thus, all three theses will be explored to test their tenability. This article shall present some points to substantiate the theses, particularly the submission of an alternative way of looking at Hart's obligation to obey law. Additionally, this article will suggest the criteria to determine when a valid law becomes invalid. Secondly, the word is

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[2] Hereinafter substituted by the term "positivism". This is not to be taken to mean or include "logical positivism".

taken in another sense in the final section where the functions of law according to positivism are discussed. This serves to clarify why positivism stands firm on the theses in analysing law. Thirdly, semantically, the word is aptly used to *measure* the success of positivism in its approach of describing law for our *understanding* of it and the law analysed.

In this article, discussion will be made more on positivism as a whole, though less on individual positivist theories. Therefore, concentration is on the width rather than depth of this branch of legal philosophy. This will help to prove the general self-sufficiency of it without the contribution of morality. Finally, attempts will be made to answer the benefits of the stands taken in this piece of work, rather than presenting a debate over labelling or categorisation.[3]

Law as Rule & the Obligation to Obey Law

Besides the mention of the descriptive nature of positivism above, we may also distinguish that classical positivists like Austin, focus on the negative proposition of description in promulgating a command- or coercion- based theory – it concerns the consequence of the violation of law. Conversely, modern analytical positivists could be seen to be more interested in the positive proposition in describing the various possibilities inherent in the law, e.g. Hart's derivation of law from rule which in turn is derived from social practice.

Two objectives are intended in this section. Firstly, it is suggested that as an alternative dimension to comprehend Hart's assertion, that there is a general obligation to obey the law. Secondly, following the discussion, at attempt is made to answer "what is law?".

If we were to dissect Hart's thinking of law as rule and the resulting obligation to obey the same, we may arrive at three elements, namely (i) rule, (ii) obligation (to obey) and (iii) legality (attached to such rule). Rule is Hart's important concept as distinguished from habit.[4] Under this concept, the elements of the "internal aspect of law" and the "critical reflective attitude" are elaborated. There are also what are known as "primary rules" and "secondary rules", and the "rule of recognition" is an integral one of the latter and as a whole. Obligation, on the other hand, stems from the immense social pressure for its conformity. This is distinctive vis-à-vis Austin's command theory.[5] Obligation, as Hart claims, is important so as to maintain the social life and denotes that the required conduct may sometimes conflict with the wishes of individual(s), thus sacrifice is necessary for compliance. The final element of legality relates to the forms of *support* given to the rules by the society and its pressure. Normally, legal rules are supported by *physical* punishment.[6]

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3 This is inspired by the suggestion of James Allan in his recent article "A Modest Proposal" (2003) 23 (2) *O.J.L.S.* 197.

4 It suffices to mention here that according to Hart, deviation or attempts to deviate from a rule is itself a good reason for social criticism. Deviation from behaviour does not attract the same criticism.

5 Or more vividly described by Hart as "threats of the gun-man".

6 For a more detailed account on the aforementioned three elements, please see Oladosu, A., "H.L.A. Hart on Legal Obligation" (1991) 4 (2) *Ratio Juris* 152.

The three elements mentioned above may be seen in stages. The first and second stages relate to the contribution largely by the society in the later formation of a law. Relatively, officials play a larger role in the final stage which is resemblance of law-making by the legislature, the courts or the Executive with delegated authority. This stage may be seen as an endorsement of the prior "socio-formulation of law" by attaching sanction.

Therefore, it is submitted that there is a general obligation to obey law due to the social contribution in its making. Here, the obligation is to conform to the consensus of the majority, just as where one claims one is under social pressure not to deviate. This may serve to counter Raz's argument that there is no general obligation to obey law because such obligation is purely a moral one and consent or voluntariness is required for such obedience.[7] For, obligation is a result of a social phenomenon, rather than a moral gesture, and it is impossible to have a unanimous consensus to have a regulation in place, particularly in a complex society. It will equally be irrational to argue that one violates a law because one disagrees with the law.

Conversely, although Finnis states that there is an obligation to obey law, he justifies that on moral ground. As such, he claims that there is no general obligation to obey unjust laws.[8] It might be argued that the question of legal validity of law depends on the recognition and endorsement of officials, while the question of obligation and obedience rest on the subjects or society. Where there is a *total* absence of contribution by the society, the law is still valid but with no entailing obligation to obey it, not because it is immoral but the disregard of social circumstances.[9]

Moreover, the importance of social contribution as the determining factor for obedience could explain changes or reforms in law, for as the society changes the law has to be altered to reflect the needs and new perspectives of the society. This explains why slavery was legitimised some time ago in America but was later criminalised.

Besides, it has to be noted that sometimes social contribution in a sophisticated legal system may be unobvious, indirect or even trivial. This is particularly the case of laws on logistics regulations. But, generally speaking, the society would press for a governance or system to be well coordinated and efficient. Hence, the necessary regulatory frameworks, such as road traffic regulations, are made with such objectives in mind.

Here, analogy could be drawn with Rousseau's concept of law. Fundamentally, Rousseau sees the organisation of a state as a *social contract*. For him, the construction of such organisation is in two stages namely, first, a *unanimous social contract* and, second, law-making according to the *majority rule*. The link between the two stages may be explained using Hart's rule of recognition in that the society unanimously accepts or recognises the majority rule as the rule for law-making,[10] with the result that the rule replaces the principle of unanimity in law-making. His distinction between "legislator"

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7 Batnitzky, L., "A Seamless Web? John Finnis and Joseph Raz on Practical Reason and the Obligation to Obey the Law" (1995) 15 (2) *O.J.L.S.* 153.

8 Batnitzky, ibid.

9 e.g. practical impossibility or incapability of the subjects to meet certain standards stipulated by the law.

10 or they may recognise that it is generally impossible to have unanimity in law-making and so the majority rule is recognised to be the replacement.

and "legislative power" also correspond with the three stages mentioned above. His claim that the legislator determines the *content* of the law is akin to stages one and two wherein the *society* plays the larger part. Then, the law is sealed by the "legislative power", which resembles the point at stage three wherein the officials are predominant.[11]

On the above foundation, it is suggested that a concise answer to "what is law?" is *ideally* a legal rule of obligation. The word "ideal" is used for a law is valid when the rule of recognition endorses it with the necessary legality, while the obligation to obey it is another thing which is dependent on the part of the society, but is essential where the law is generally representative of the social practice.[12]

Legislative Intent vs. Judicial Discretion

In order to avoid misunderstanding of the contemporary perspective of modern positivists[13] as regards the discretion thesis, it has to be made clear at the outset that, first, the positivists' claim of the competence of the legislature in law-making is not absolute, viz. that the judiciary does have niches to do the same, although very much limited relatively[14], and, second, that even so, it does not mean that law is intertwined with morality[15].

To understand the room for judicial discretion under positivism, one could well see that through Hart's idea of the "open-texture" of law. It is argued[16] that such an idea stems from our relative ignorance of facts as well as indeterminacy of aim. Moreover, language is sometimes capable of different interpretations due to its ambiguity and uncertainty. Also, the legislature could not reasonably foresee all the empirical circumstances that the law is intended to regulate.

In reply to Dworkin's criticism, Hart[17] argued that judicial discretion in a limited scope is good on the ground of efficiency in avoiding the alternative of having to refer to the legislature whenever they are faced with unclear statutory provisions. He also argued that such mechanism is analogous to that of the delegation to the Executive and hence it is perfectly democratic. Moreover, the limited discretion would operate, most likely, outside the core of settled law.[18]

In the eyes of the positivists, judicial discretion is justifiable where a statute expressly provides for such discretion to be exercised[19] and/or where there is a "penumbra of

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11 Wintgens, L. J., "Law and Morality: A Critical Relation" (1991) 4 (2) *Ratio Juris* 177 at 183-184.

12 In other words, as positivists would claim, ascribing a law as valid is different from endorsing its content.

13 For instance, Hart and Kelsen rather than Austin and Bentham.

14 As a results, the judge "*makes new law*"; Hart, 1994, The Concept of Law, 2nd Ed., 1994, Clarendon Press, p. 272. This also explains the criticism by James Allan against Kramer's article wherein the latter seemed to attempt to exclude moral consideration altogether in judges' exercise of their discretion; see Allan, J., "A Modest Proposal" (2003) 23 (2) *O.J.L.S.* 197.

15 Hart, H.L.A., "Positivism and the Separation of Law and Morality", (1958) 71 *Harvard Law Review* 593 at 614-615.

16 Morrison W., *Jurisprudence : From the Greeks to Post-modernism* (1997, Cavendish) 381.

17 Hart, 1994, op. cit., at pp. 275-276.

18 Allan J, "A Modest Proposal", (2003) 23 (2) OJLS, at 198.

19 E.g. the use of phrases such as "good faith", "reasonableness"; see for instance s.11 of the Unfair Contract Terms Act 1977 where certain exclusion or limitation clauses in contracts might be valid if they satisfy the test of reasonableness.

doubts"[20] in the statute.[21] The former is rarely disputed by critics but the latter is criticised as unparallel with the positivist stance. It is thought that Freeman[22] provides a fine answer to this.

He suggests that the courts should be regarded as a *collaborator*[23] or partner to the legislature in achieving the democratic aim, as well as in reconstructing the society towards a more genuine democracy. The fact being that the legislature and judiciary have different characteristics[24] which allow the legislature to make law in general while the courts to do the necessary "*refinement*".[25] Following his argument, judges could make law by contemplating what the legislature would enact if seized with the same problem. Nonetheless, Bix is right in stating that the problem will then be how the courts are to discover the legislative intent.[26] Perhaps, the change in 1993[27] that allows consultation of *travaux preparatories* makes such discovery easier.

At any rate, we should be aware of the fact that even if the judiciary has exercised its limited discretion "wrongly" or inconsistent with the legislative intent, the legislature can "overrule" or "reverse" the ruling. It may be recalled that this was the effect of the passing of the War Damage Act 1965 on the House of Lords' decision in *Burmah Oil v Lord Advocate*.[28]

An alternative way,[29] which the positivists may claim, to see the role of judicial discretion in light of legislative supremacy is the use of Dworkin's model – that the basis of adjudication rests on *principle* rather than policy.[30] Principle, in short, justifies a decision by upholding that such decision respects or safeguards the right of individual(s) or group(s). Policy is concerned with the collective goal of a community as a whole. Given that principles can be found *within* the law and legal rules, judicial discretion could be justified in utilising principles which is within the confine of the legislative will.

Much has been said about the supremacy of the legislature. An obvious doubt against this is where the state is a member of a supra-national entity, like the case of the UK being a member of the European Union (EU).[31]

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20 The famous example given by Hart is where a judge is to interpret the rule "no vehicles in the park".

21 Where there is a penumbra of doubts, it does not necessarily follow that the judge will have the discretion to decide for a statute may provide otherwise. Hence the conjunctive "and".

22 Freeman, M., "Positivism and Statutory Construction: An Essay in the Retrieval of Democracy" in Guest S. (ed.), *Positivism Today* (1996, Dartmouth Publishing) 11.

23 This should be taken to mean as a "deputy to the legislature" rather than as a deputy legislature which denotes subordination.

24 The courts are reactive, they have to justify their reasons and maintain a level of consistency in their judgements. Conversely, the legislature can do all in the opposite, although it is constrained by time to legislate in detail.

25 Freeman, Positivism Today, (1996, Dartmouth Publishing), p. 16.

26 Bix B., *Jurisprudence: Theory and Context* (2nd ed 1999, Sweet & Maxwell) 42.

27 As a result of the case of *Pepper v Hart* [1993]1 All ER 42.

28 [1965] A.C. 75.

29 as suggested in Marshall, G., "Positivism, Adjudication and Democracy" in Hacker P.M.S. and Raz J. (eds), *Law, Morality and Society: Essays in Honour of H.L.A. Hart* (1977, Clarendon Press) 132 at 143-144.

30 Distinctions between principle and policy are well illustrated in Marshall, ibid., pp. 136-137.

31 This issue is of greater importance now since the EU Member States are in the midst of forming a "European Constitution".

Pursuant to the enactment of the European Communities Act 1972, the laws of the EU are now regarded as superior to the UK legislations.[32] Nonetheless, both Lord Denning[33] and Lord Diplock[34] explicitly noted that the UK parliament can at any time legislate to regain its supremacy in law-making. It is only evident that this is not done due to the benefits of membership.[35]

Apparently, the best case to prove the erosion of legislative supremacy is *ex parte Factortame*[36]. Nonetheless, it is important to note the statement made by the Solicitor-General in the course of the passing of a related amending legislation[37] which suggests that the "subordination" is consciously made and limited. He said:

> "*…this case involved no erosion of sovereignty over and above that which we accepted in 1972-73*"[38] (emphasis mine)

Therefore, voluntary membership of states in a supra-national body does not absolutely affect the positivists' view on legislative supremacy.

We now turn to the "collaboration" between the European Court of Justice and the EU. If the EU is regarded as a valid legal system,[39] it is surely an infant one in terms of its development. The observation on the operation of the ECJ is that it has been in the forefront in settling many matters not provided for by the EC Treaty and the Treaty is normally later amended to give "statutory effect" to these rulings.[40] This signifies the importance of the judiciary in giving prior effect to the intendment of the legislature where the latter has yet spelled out the same in authoritative form.

Additionally, positivists' emphasis on the supremacy of the legislative will greatly reflects empirical need, especially in a democratic system where "*legislation is almost always the exercise of moral or political judgement*".[41] This is because what is morally right or wrong is often a personal value judgement, and is thus mind-dependent. In a

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32 See for instance Art. 10 and Art. 234 of the EC Treaty and cases like *Costa v ENEL* (6/64) [1964] ECR 585, *Internationale Handelsgesellschaft* [1974] 2 CMLR 540 (Germany) and *Simmenthal v Commission* (92/78) [1979] ECR 777.

33 In *Macarthys Ltd. v Smith* [1981] 1 QB 180.

34 In *Garland v British Rail Engineering* [1982] 2 CMLR 174.

35 Hoffman J (as he was then) in *Stoke City Council and Norwich City Council v B & Q plc* [1993] 1 CMLR 426 stated that "*…partial surrender of sovereignty was seen as more than compensated by the advantages of membership*".

36 *R v Secretary of State for Transport, ex p Factortame Ltd.* (C-213/89) [1990] ECR I-2433.

37 Merchant Shipping Act 1988 (Amendment) Order 1989.

38 Turpin C., *British Government and The Constitution: Text, Cases and Materials* (5th ed 2002, Butterworth-LexisNexis) 384.

39 As Austinian legal practitioners would doubt.

40 See, for example, *Parliament v Council (Chernobyl)* case C-70/88 [1990] ECR I-2041; this case recognised the "semi-privileged" standing of the European Parliament in relation to bringing of action under Art. 230 of the EC Treaty. This was later written into the EC Treaty by the Maastricht Treaty 1992 and a full standing was recently granted by the Nice Treaty 2001.

41 Waldron, J., "*The Irrelevance of Moral Objectivity*" in George, R. (ed.), *Natural Law Theory*, Oxford: Claredon Press, 1992; quoted Allan, J., "Positively Fabulous: Why It Is Good To Be a Legal Positivist" (1997) 10 *Canadian Journal of Law & Jurisprudence* 231 at n. 42.

democratic system, diversity of views about moral value is just a norm. Therefore, it is justifiable that social policy-making and moral decision-making be assigned to the elected representative of the people and the role of judges in these respects is limited. Preference for legislative supremacy vis-à-vis judicial law-making also ensures greater certainty of outcome. It is noteworthy a fact that certainty is also a form of justice.[42]

Law & Immorality?

The reason for posing morality in the negative is twofold. Firstly, it describes better the common perception of idealists that positive law is prone of verging onto immorality without the use of morality as yardstick of its validity. Secondly, due to reason of space and the fact that discussions on "law and morality" are present in other parts of this article, this section will dwell rather into the instance of "bad times" to explore whether positivism does "survive" immoral or wicked legal regimes. Hence, some discussions will draw their points from those made elsewhere in this article.

It is perhaps banal but necessary to emphasise that Austin's claim that "*the existence of law is one thing; its merit and demerit is another*", which represents the central tenet of positivism, does not deny the importance and relevance of morality as an independent discipline. It is noted that law may even "*co-exist*"[43] with a belief in moral absolutes, but the central strand remains that morality is not to be involved in the analysis and study of positive law.[44]

The separability thesis draws a line between law and morality so that, on one hand, the law will not be value-laden, and, on the other hand, a law will not simply be regarded as (morally) right if morality is regarded as an integral part of law.[45] Being value-free means positivism introduces *relativism*, rather than absolutism, in our thinking of law and recognises *prudence*[46] in both the enforcement of and compliance with the law.

Relativism stems from the analysis of law from facts which in turn provides us with many options and alternatives to proceed henceforth, which benefits are considered further in this article below. On the other hand, prudence means that the enforcement of and compliance with morality is not an endorsement of the rightness of the law but may be due to other reasons such as self-interest, shared interest or even for the fear of punishment or ostracism. A case in point is the restitution laws passed in many Central European countries in the nineteen-nineties. However, the laws, especially those of

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42 See Kramer M., *In Defence of Legal Positivism: Law without Trimming* (1999, Oxford University Press) Chapter 1.

43 Cotterrell R., *The Politics of Jurisprudence: A Critical Introduction to Legal Philosophy* (1989, Butterworths) 143.

44 Of late, positivists like McCormick and idealists like Finnis concur that although law may be linked to morality, there is still a distinction between legal validity and moral obligation which means that an immoral law can still be law [Capps P., "Being Positive about Positivism" (2000) 63 (5) *MLR* 774 at 774]. Also, Hart himself acknowledges a "minimum content of natural law" in *The Concept of Law* [Hart H. L. A, *The Concept of Law* (2nd ed 1994, Clarendon Press), pp. 193-200].

45 This was indeed a claim made by Nazi writers that the fusion of law and morality had been achieved by the German National Socialism. See Cotterrell, loc. cit., p.143.

46 Kramer, 1999, op. cit., p.3.

the Czech Republic,[47] which are supposedly "moral" laws to "undo" past injustices, are discriminatory towards the Jews and Germans. Pogany stated that such policy was "*essentially for political and ideological reasons*"[48] and condemnations on such laws come from various commentators[49]. But, such are still the laws of the day and so to claim that justice and the rule of law are essentially concepts of morality *per se* may not be factually true.

The discussion on law and immorality will deal mainly with the case of Nazi Germany during World War Two (WWII), coupled with the conversion of Gustav Radbruch and his subsequent concept of justice. Additionally, some focus will go to similar issues arising from the 1989 Velvet Revolution.

The immeasurable atrocities committed by the Nazis led Radbruch to subsequently comment that "*legal positivism has in fact rendered the German legal profession defenceless against statutes that are arbitrary and criminal*".[50] It is claimed that Radbruch was very much pro-positivism in his pre-WWII writings wherein he emphasised greatly on legal certainty as compared to justice and utility of law[51]. His post-WWII writings[52] signify "shifting [of] the accent", as he claimed, with the focus now on justice rather than legal certainty. Nonetheless, such a "shift" was claimed to be a correction of his earlier overemphasis on legal certainty.[53] Be that as it may, one has to see his theory in the light of "*ordinary times*" and "*extraordinary times*".[54]

In brief, legal certainty should prevail in "ordinary times" and morality should not be the determinant of the validity of law. It is only in times of the extraordinary that *collective* morality is allowed to determine the validity of law. However, it must be noted that he confined his "extraordinary times" to situations where there is an "*intolerable*" deviation from justice or where there is not "*even an attempt at justice*".[55] In a 1947 writing, he further qualified that legal certainty "*may be relaxed only in altogether exceptional, indeed, unique cases, only in cases rivalling what we have experienced in the Nazi period – and hope never to experience again*".[56]

It may be deduced from the above that morality is only pertinent in deciding the validity of law in cases of *gross* injustices. A conclusion at this point may be that there

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47 The Law on the Mitigation of the Consequences of Certain Property Losses (October 1990), The Law on Extrajudicial Rehabilitation (February 1991) and The Law on the Revision of Ownership Relations to Land and other Agricultural Property (May 1991).

48 Pogany I., *Righting Wrongs in Eastern Europe* (1997, Manchester University Press) 150.

49 See e.g. Pogany. Ibid., Conclusion; Elster, J., "On Doing What One Can", *East European Constitutional Review*, Summer 1992, pp. 15-17; "Forum on Restitution" in *East European Constitutional Review*, Summer 1993, pp. 30-39.

50 Leawoods H., "Gustav Radbruch: An Extraordinary Legal Philosopher" (2000) 2 *Washington University Journal of Law and Policy* 489 at 497. also available at <http://law.wustl.edu/journal/2/p489leawoods.pdf>

51 Note that the latter two concepts are also within his "idea of law".

52 Most notably his *Five Minutes of Legal Philosophy* and *Statutory Non-Law and Suprastatutory Law.*

53 See Paulson, S. L., "Radbruch on Unjust Laws: Competing Earlier and Later Views?" (1995) 15 (3) *O.J.L.S.* 489 at 493-494.

54 See generally Leawoods, op. cit.

55 "Gesetzliches Unrecht und ubergesetzliches Recht", *Suddeutsch Juristen-Zeitung* 1 (1946) 105-8 at 107; in Paulson, op. cit., p.491.

56 Radbruch, "Gesetz und Recht", *Stuttgarter Rundschau* 2 (1947) 5-6 at 6; in Paulson, op. cit., p. 497.

is a link between law and morality but to say that it is a necessary connection might be flimsy because the application of morality is subject to numerous qualifications. Here, it is submitted that our discussion on why and when obligation to obey law may cease corresponds with Radbruch's explanation of "extraordinary time" and his firm emphasis on *collective* rather than individual morality in such time. Particularly, Rousseau's majority rule and Hart's rule of recognition denote that there would unlikely to be gross injustices if the law is duly *representative* of the people.[57] There might be injustices to some quarters but, still, that might fall under "ordinary times". Nonetheless, gross injustices in "hard cases" and as a result of arbitrary law-making are acknowledged and considered below[58].

Furthermore, it must be considered whether positivism was indeed present in and practised by the wicked regimes so that the idealists' claim that positivism is an accessory to the atrocities is justifiable. In relation to Nazi Germany, Rottleuthner[59] suggests that the right question to ask is *why* the judiciary functioned since the Weimar Republic. Ott and Buob[60] state that after Bismarck was appointed Chancellor in 1878, he introduced radical judicial reform[61] which led to the instrumentalisation of the courts according to the political needs. This was exacerbated by Hitler after 1933 by his amalgamation of all German judges into the Association of the German National Socialist Jurists. These themselves crippled the independence of the judiciary and, to answer Rottleuthner's "why", the judiciary was in effect made a *tool* to further the political aims of the ruling party rather than to dispense justice.[62] Hence, there arose principles like the Fuhrer-principle and Volkische Rechtsidee (the popular notion of law), and "laws" were drafted in unclear terms e.g. "*healthy popular sentiment*".[63] All the autocratic, anti-democratic and anti-liberal stance towards law and the interventionist approach adopted by the Fuhrer and Nazi officials in judicial decision-making point astray of positivism. Fundamentally, for positivism we speak of the hierarchy of formal sources of law, but for the wicked regime, they conveniently subordinate the law and put themselves above the law.

Similar arguments apply to the communist regimes in Central Europe pre-1989. The Communist Party exercised legislative functions without the necessary legitimisation in issuing directives. They even went beyond their constitution. As Morawski stated, free elections and political rights were provided for in the Polish Constitution but were never

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57 It may generally be inferred from the two rules that justice is inherent in law, irrespective of their content, as it is based on the consensus of the majority.

58 Please see the discussions on the former in the section of "*Law & Justice*" and the latter in "*What makes Positivism – a Science of Law – Special*?".

59 as noted in Ott, W. and Buob, F, "Did Legal Positivism Render German Jurists Defenceless during the Third Reich" (1993) 2(1) *Social and Legal Studies* 91 at 92.

60 Ibid.

61 it has to be noted that the qualifications to be a judge was imposed onerous requirements e.g. the lengthy training period of at least 12 years without pay and the need to deposit a considerable amount of money. These made the selection of judges confined to the upper-middle class and the thinking of judges moulded to the ideology of the ruling party. See Ott and Buod, op. cit., pp. 92-94.

62 Similar claims were made by Neumann and Kirchheimer. Neumann stated that "*the National Socialist Legal System is nothing but a technique of mass manipulation by terror*" and Kirchheimer stated that the aim of adjudication was to execute given commands "*so as to have the maximum effect in the shortest possible time*"; both quoted in Cotterrell, op. cit., pp. 133 and 134 respectively.

63 In s. 2 of the Penal Code in the version of 28th June 1935.

practised. Nor was there a constitutional court as a check and balance on the legislature and executive vis-à-vis the constitution.[64]

Moreover, there is a forgotten dimension when positivism is linked to wicked regimes. All the forgoing sections would have obviously suggested the importance of democracy in the minds of the positivists. The insistence on the obligation to obey law is in fact only one side of the coin. The reverse side is the insistence for the sovereign to enact good laws. However, the former is a pure matter of law while the latter concerns also with that of politics. As such, legal philosophers are promulgating only the legal duty of the governed rather than the political duty of the legislature. These explain Bentham's "division of labour"[65] on the respective duty of the society and legislature, and his staunch support for democracy.[66] Besides, the social nature of the above-mentioned rules of Hart and Rousseau should connote that democracy is not a presumption in positivist theories but a necessary *by-product* or *goal*.

Law & Justice

Having discussed the relationship between law and (im)morality, the notion of justice cannot be left unattended. In fact, this notion is one that really pushes positivism to verge on morality. The questions that require attention are whether justice is a concept of morality, therefore there is a connection between law and morality in this respect, and whether it could affect the validity of positive law.[67]

In Hart's opinion,[68] justice is not a concept of morality. In brief, his explanation is that whether something is just or otherwise is not *equivalent* to whether that thing is morally right or wrong. The concept of justice lies on fairness or equality. His claim is that equality "*is plainly not coextensive with morality in general*".[69] Equality is concerned with proportionality and balance, hence the principle of "treating like cases alike and different cases differently". The problem, as he stated, is to determine the pivotal or fundamental resemblances or differences. There are clear-cut cases that pose little difficulty but some others do and in such instances, there might be a "shifting or varying criterion"[70] used in the determination. He further claimed that morality may sometimes make such "distinction" that is discriminatory.[71]

Guest,[72] conversely, brilliantly points out that the positivists' stance on justice would fail in "*genuine situations of injustice*".[73] He noted that the principle of promissory

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64 Morawski, L., "Positivist or Non-Positivist Rule of Law?: Polish Experience of a General Dilemma" in Krygier M. and Czarnota A. (eds), *The Rule of Law after Communism* (1999, Ashgate Publishing) 39 at 43-44.

65 That, it is submitted, also explains Raz's distinction between the "*deliberative*" and "*executive*" stages of law which is discussed below.

66 See generally Lee K., *The Positivist Science of Law* (1989, Avebury) 185-186.

67 i.e. the concept of *lex iniusta non est lex*.

68 See Hart, The Concept of Law, 2nd Ed., 1994 Clarendon Press, at pp. 153-167.

69 Ibid., p. 158.

70 Ibid., p. 160.

71 Ibid, at p. 162; he gave the example where a society may have the moral perception that human are naturally of different classes, which therefore justifies slavery of certain groups of men.

72 Guest, S., "Why the Law is Just?" (2000) 53 *Current Legal Problems* 31.

73 Ibid., p. 35.

estoppel,[74] the law of restitution etc. are products of judicial activism when confronted by injustice. These are also what Dworkin described as "hard cases". Guest claims that real equality is a concept of morality[75] and, more insightfully, that the pivotal or fundamental common ground for treatment lies on *humanity*.[76] He emphasised on equality of *treatment* and asserts that the positivists, more particularly Hart, are only concerned with equality of outcome.

As such, real equality means "*first person equality*"[77] for what is just is to be determined in the specific by putting oneself in the other's shoes.[78] That said, Hart's assertion that Apartheid is "formally" just and Kramer's[79] claim of justice as constancy (of outcome) seem unconvincing here.

It is submitted that equality could be seen either in the general or specific. General equality applies to clear-cut cases so that judges can take into account not only the interests of the litigants, but also those of the community as a whole – say, in imposing more severe punishments in order to deter certain crimes. As regards hard cases, specific equality of treatment must be upheld on the common ground of humanity. Given that hard cases are normally where there are no legal rules or principles requiring, or constraining, the judge to decide either way, he could thus exercise his discretion. So, justice (both general and specific) falls with the embrace of the limited judicial discretion.

A point of disagreement with Guest's model is that if justice means equality of treatment solely on the common value of humanity, then justice seems unable to justify positive discrimination in favour of certain disadvantaged groups.[80] It is submitted that prudence may play a part in determining what is just as well, as the prudence for positive discrimination may well be to avoid the possibility of social conflict due to social, economic or educational gaps.[81]

In sum, Guest's proposal in relation to hard cases, coupled with the fact that positivists, Hart himself at least, do not seem to provide any good solution to them, should lead positive law to give way to moral value of equality (or justice) in these instances. It seems that in hard cases *per se* and within the confine of limited judicial discretion, there is a clear relationship between law and morality. Arguably, this relationship is constrained

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74 As established by Lord Denning in *Central London Property Trust Ltd. v High Trees House Ltd*. [1947] KB 130.

75 It is submitted that Hart does not seem to deny this *absolutely* by merely stating that equality is not "*coextensive with morality*", as mentioned above.

76 Op. cit., p. 39.

77 Op. cit., p. 40.

78 This could also serve to criticise Hart's internal aspect of law which claims that one could comment or criticise the practice of a participant by assuming his perspective. If one really understands the perspective of the participant, it is doubtful that one would claim it as being irrational.

79 Kramer, 1999, op. cit., at footnote 42, Chapter 1.

80 For example positive discrimination in favour of Roma/Gypsy in many European countries.

81 An empirical case was the social conflict in Indonesia after the Asian economic crisis in 1998. Atrocious crimes were committed by the native Indonesians on the Indonesian Chinese due to the vast economic gap between them which caused resentment in the former. Note also that Aquinas and Finnis also acknowledge the obligation to obey unjust law for "common good" i.e. where greater injustice or disorder is avoided by such compliance.

as it falls within the scope of judicial discretion. It follows that in such cases, the judge *could*, in exercising his discretion, disapply the unjust law.

What makes Positivism – a Science[82] of Law – Special?

In this section, the very fundamental issue of legal positivism as a science of law is dwelled upon. It is submitted that many merits, and demerits if any, of positivism can be "derived"[83] from the scientific understanding of law conferred by this school of thought. Discussion will be made in regards to the advantages in thinking of law with a positivistic mindset.

Of positivism in general, Lee stated that:

> *"... for the positivists, to study [law] philosophically is to study exclusively its logic, and to ignore all other aspects of it which cannot be fitted into the deductive structure or which cannot be expressed in terms of the relationship of derivability or deducibility."*[84] *(emphasis mine)*

The concept of (logical) derivability or deducibility is taken to mean that such study would involve the presence of three requisite elements, namely prediction, explanation and conclusion.[85] Amongst them, the first element of prediction is of the utmost importance as most positivists[86] infer this to offer the possibility of control. Noting these similar points, Halfpenny[87] described positivism as a science grounded on *observation* and stated that it "*progresses by conjecturing hypotheses and attempting to refute them, so that false conjectures are eliminated and corroborated ones retained"*.[88] (emphasis mine)

Given the need for derivability or deducibility, the validity of laws must be capable of being reduced to some basic source and as such the ultimate source of all law-making is the legislative will. Also following the above premise, valid laws must be capable of being subject to empirical observation and verification. It seems, therefore, that law-making by the legislature qualifies best under the above tests. The most obvious advantage of this is that such law-making is open to public scrutiny as it is a "*declaration of public event*"[89] and, thus, "mind-independent".[90]

This positivist's pedigree thesis is particularly prone to attack by the naturalists by mentioning wicked regimes like Nazi Germany. Nevertheless, positivists like Austin and Bentham in fact encapsulated, as expressly quoted and discussed by Fuller in the Hart-

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82 Therefore, legal positivism is to be contrasted with Aristotlean metaphysical and Tomist theological approaches towards law.

83 This in fact is a word of scientific importance which will be used more commonly hereafter.

84 Lee K, The Positivist Science of Law, (1989, Avery), p. 76.

85 The word "conclusion" is better described as "testable conclusion" by Lee, op. cit., p.76.

86 e.g. Comte as noted by Lee, op. cit., pp. 43-52.

87 *Positivism and Sociology: Explaining Social Life* (1982, Allen and Unwin, London); quoted by Lee, op. cit., p. 36.

88 Ibid.

89 Op. cit., p.144.

90 see generally Allan, 2003, op. cit, pp. 197-210. The author even went as far as to describe moral evaluation of law as being similar to "*ice-cream flavour valuing*", at p. 204.

Fuller debate that "*when a law is sufficiently evil, it ceases to be law*".[91] Fuller claimed that they did not provide sufficient clarification to the statement and it was in fact a "running away" from the problem.

It is submitted that the criterion for determining when a law is "sufficiently evil" so as to be devoid of validity is whether such a law is capable of being subject to "scientific undertakings" viz. whether it is capable of being logically and reasonably predicted, explained or justified and concluded. The decrees under the Third Reich might be validly passed, but would likely fail under these scientific undertakings – the law and its operation will be difficult to be predicted as they are determined by the whims and fancies or arbitrariness of the Fuhrer or Nazi officials and discriminatory law could hardly be capable of reasonable explanation or justification, especially when it is based on ethnicity, not to mention whether all these decrees are capable of being concluded. Even if they are alleged to be, the conclusions would likely to be *non-sequiturs* for the elements of logic and reasons, both being omnipresent elements in science, are likely to be absent.[92]

This suggestion seems redundant where laws are duly representative of the social norms. Therefore, perhaps this second "test" should be used in addition to the positivist criterion of validity only when a wicked law is in question. The assumption that goes along with the suggestion is that wicked laws are rare and therefore the "test" will only be vital in "extraordinary times", in Radbruch's sense.[93] While this test may not determine whether the content of a law is just, it helps to determine whether the law is made, and practised, arbitrarily and without proper exercise of legislative authority.

It is noted that Fuller's criticism against positivism in relation to Nazi Germany is stronger, that positivism led to the silence and passivity of the legal profession which in turn enabled the rise of Nazism. Also, positivism did not encourage resistance against the regime. All these, he claimed, were due to the "black-letter law mindset" inculcated by positivism as it promotes rule-following without reason.[94]

The reason the discussion on Fuller's criticism is presented last is to prove in advance that positivist was in fact not *directly* culpable for Nazi's atrocities. So, we now have to consider Fuller's assertion that positivism contributed *indirectly* to the crimes.[95]

Having dwelled into the scientific nature of positivism, it could be said that Fuller's claim is unreasonable because the very *intendment* of it is to promote reason in the analysis and understanding of law. The *result* is that all the positivist theories assert claims with tenable reasons attached. The claim[96] of the obligation to obey law is clearly

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91 Fuller, L. L., "Positivism and Fidelity to Law – A Reply to Professor Hart" (1958) 71 *Harvard Law Review* 630 at 655.

92 Also, applying our discussion on the obligation to obey law, we could say that the regime "leapfrogged" to "stage three" in law-making without going through the process of "socio-formation of law".

93 see *supra*. This in no way suggests that moral values, even the notion of justice, should be applied in such circumstances but that in such times, the second "test" could well be used to determine whether the law is devoid of validity or not.

94 See generally Cotterrell R, The Politics of Jurisprudence: A Critical Introduction to Legal Philosophy (1989, Butterworths), pp.143-144.

95 Fuller's famous eight principles of legality are accepted as tenable but often criticised as being merely amoral. This line of criticism will not be expanded in this essay. For a structured criticism of Fuller's eight principles, see Kramer, 1999, op. cit., pp. 53-71.

96 Especially those of Hart's and Rousseau's.

based on reasons, viz. for one is obligated to do so premising upon a norm that is legally determinable or recognisable. No obligation is claimed where such norm is absent. Where one is acting under such circumstance, he may likely be acting under coercion instead. Conversely, when one acts under a legal authority (vis-à-vis power), he is acting under a similar legally determinable norm, thus he is authorised to determine the conduct of others.[97] In sum, there is an "obligation" to obey law because it is passed by an "authority".

It is merely true that positivism does not positively emphasise that an unjust law must be disobeyed. However, it has gone a long way in reasoning why and when the obligation to obey arises, persists and ceases. As regards Nazi Germany, positivism would say that the (legal) obligation to obey law had ceased but there is no (moral) obligation to disobey the law. Additionally, it may be argued that the Germans actually followed Nazi laws with reason, rather than according to their herd instinct of solely taking the law it was. Perhaps, for the fact that millions had been massacred, it was reasonable to submit obedience. Fuller's idealism suggests the possibility of toppling the regime through assertiveness or revolt, but it was another use of force, thanks to the Allied force,[98] that ended the regime. Thus, for reasoning why and when the obligation to obey ceases *and* acknowledging prudence for rule-following after that point, positivism at least helped to mitigate the death toll in Germany.

On the other hand, the advantages of having a positivist mindset in the understanding of law are numerous. The most vital one being pragmatism in that one will be "clear-headed"[99] in one's evaluation of legal issues. One would see a legal problem more clearly, and even more "honestly",[100] when s/he can dissect a problem into distinct issues and have each of them settled in steps. It also begs the critical thinking in us as to how an unjust law could be reformed or abolished.

On the other hand, merely holding that an unjust law simply is not law leads, at worst, to anarchy,[101] or, at best, to an oversimplification of certain complex moral conundrums. Being pre-occupied with moral judgements of law blinds one towards hard reality. It is perhaps more important to accept the ugly reality that besets us and then contemplate means to remedy it. The advantage is that one then knows well the terrain on which he is to proceed from, and thus all efforts and resources can be channelled and altered to suit the circumstances. As for law, positivism is handy as it provides the best description it can of the legal problem for our further action. As a strong advocate for a more just Central Europe, Elster[102] provides an insightful point in saying that,

> "*To abstain, as some did, is morally admirable-but can one really say that it is morally required? .... Perhaps in the end, they did more harm to themselves than to anyone else*."[103] (emphasis mine)

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97 see generally Kramer, 1999, op. cit., pp. 75-76.
98 i.e. the alliance of the American, British and Russian forces.
99 Hart, The Concept of Law, (2nd Ed., 1994 Clarendon Press), p. 210.
100 Hart, The Concept of Law, (2nd Ed., 1994 Clarendon Press), p. 207.
101 As feared particularly by Austin and Bentham.
102 In his arguments against restitution and retribution in the post-communist Central Eastern European countries.
103 Elster, J., "*On Doing What One Can*", East European Constitutional Review, Summer 1992, p.16.

It is not that positivism helps to ensure that one survives longer but it encourages rationalism so that a rational thing is done at an appropriate time.

Furthermore, it is submitted that the descriptive nature of positivism, as compared to the prescriptive nature of natural law, is itself a strength. In a modern and pluralistic society, there ought to be constant reconfigurations of human community and as such these configurations cannot be premeditated. Hence, it is unrealistic to prescribe something "good" in advance. Positivism is distinctive for it lays down the current state of affairs and therefrom we project our way to the *general* goods or goals of the society. Premeditation implies that some standards are to be achieved but descriptive approach emphasises on *relativism* and focuses on the present capabilities and resources to advance, thus it does not attempt the impossible. It follows that the latter requires constant reflections and alterations of its value and allows more, and even better, possibilities of achieving human goods to flourish.[104]

Concluding Remarks: Positivism – Coordination, Order & Reform

Perhaps, to speak of positivism wholly in an essay is ambitious. But, it is at least vital to note what positivists generally regard the functions of law as because that shall clarify why positivism takes the stands as described, and as distinct from other philosophies, especially those of natural law and Dworkin.[105] In short, the functions are social coordination, order and reform.[106]

The first function of law explains why positivists stress extensively on the supremacy of law and the legislature. Following this line, individuals in a society do not relate to each other personally, but law stands between them to regulate their conducts. This, strictly speaking, means that a man is not accountable to another but to the law, which in turn is accountable to the other man. Amongst the positivists, Raz promulgates most clearly the role of law in social coordination. He opines that the law or the legislature knows best what is right to be done by an individual and the society as a whole. In simplistic terms, he claims that the legislature "decides" (by issuing authoritative decisions i.e. laws) and the society "performs"[107]. The rules of Hart and Rousseau could be handy here in explaining that the society, in the first place, acknowledges the impossibility of organising itself without having a restricted group of people to whom they confer authority to. And, this is the group of people chosen because of their (or expected) higher level of knowledge, expertise and understanding of what is the best for the people.[108]

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104 I derived some of the ideas in this paragraph from Leora Batnitzky's discussion on the exchange between Finnis and Raz on the obligation to obey law in Batnitzky, ibid.

105 note that Dworkinian idea of the function of law is the settlement of disputes (in courts).

106 Although Fuller also sees the law as a means of social coordination when he describes law as "*the enterprise of subjecting human conduct to the governance of rules*" [Fuller L. L., *The Morality of Law* (revised ed 1969, Yale University Press) 39], positivism has two other distinctive functions in mind which cause the differences in their stands.

107 More accurately in his words are the two distinct stages of "*deliberative*" and "*executive*".

108 Raz explains the need for coordination in society by drawing the analogy with the coordination of a large and complex society; Raz J., *Ethics in the Public Domain* (1994, Clarendon Press) 203.

The second function, namely order,[109] is in fact the underpinning reason for the birth of positivism. Instead of promoting order by non-reasons, like the theologists and metaphysicians, positivists press for the thinking of law through scientific reasoning. It follows that positivism is able to control and coordinate the society through the study of the behaviours of law and the society, and their intertwinement. It may be recalled that one of the tenets of positivism is that law is posited by men solely,[110] and with that in mind it is a *means* to achieve and further social goals, of which a fundamental one is social order.

As for the function of reform, Bentham put it aptly that, "*obey punctually; censure freely*".[111] This is synonymous to Hart's claim that by taking law as it is and having our own evaluation of it ensure a real examination of and progress in law. Where the officials and society understand the need to obey law as essential and that the need to progress through planned reform is no less vital, a transition will be successful. It is submitted that this was the case of the 1989 Velvet Revolution. The reasons being the reformers could have declared the wicked regimes "void" for being unjust and wrestled the governing power easily with the support of the people. But that would make them no less wicked than the wicked regime. Instead and rightly, extensive "round-table talks"[112] took place between the reformers and the communists. Compromises were made and resolution reached, most importantly, on the new constitutions which led to a "velvet" transition to social democracy.

In this article, discussion on positivism and some positivist theories have been made but the latter in rather general terms due to the aim of providing a larger picture of the former. More crucially, it has been shown that the individual theories can complement each other to perfect positivism as a philosophy. Also, as observed, the submissions on why and when the obligation to obey law ceases and a valid law may become invalid are consistent with the pedigree thesis. Since both submissions are derived from the analysis of positivism and if they are plausible, then they show that positivism is self-contained to develop more analyses from within itself. It is submitted that the question on the extent positivism clarifies thinking about law could thus be answered as *infinite*. There may be flaws in individual theories, but positivism as a whole have provided equally good, if not better, clarification in thinking of law vis-à-vis non-positivists. Unlike other schools of thought which underlying theme may only be one, positivism is all-embracing as it contemplates coordination and order of society and reform in law, plus endeavouring towards more democratic law-making. It matters little which function is the most fundamental one for most of the important ones are pursued after *together* by positivism, and that is its beauty.

Finally, it may be observed that this essay is "regressive" in description as it touches more preliminary points about positivism as it flows, especially in discussing the very

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[109] see generally Lee, op. cit., Chapter IV.

[110] i.e. laws are commands of human being.

[111] As quoted in Lee, op. cit., p. 185.

[112] For an account of the "round-table talks", please see Elster, J., "Constitutionalism in Eastern Europe: An Introduction" (1991) 58 (447) *The University of Chicago Law Review* 447.

scientific nature of positivism at the end. The objective is to prove that many criticisms against positivism miss the ideas of it, which, respectfully, seem to be miscomprehension of its thoughts. A holistic understanding would have prevented that, so it is hoped that this article has provided a clearer description of positivism in clarifying thinking of law.

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Public-Private Partnership Initiative in Nigeria and Its Dispute Resolution Mechanism: An Appraisal

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Abstract

In the African countries, the provision and supply of infrastructural facilities and the procurement of other public utilities were, until recently, absolutely under the sole control of the government. However, due to corruption, leakage and wastage in the public procurement process, coupled with the lackadaisical attitude of the government officials towards the same, and more importantly, with the realisation and acknowledgment of the skills and competencies of the private sector in building infrastructure, the governments all over the world including those in Africa have begun to divest themselves of their monopoly in the field of infrastructural supplies and development. This rising trend has led to a more resourceful, efficient and smart partnership between the public and private sectors in the matter of infrastructural development, and this recent phenomenon or trend is popularly propagated as Public-Private-Partnership (PPP). It has now come to stay and will intensify over time. This article seeks to examine the definition, ambit, as well as the practical operation of PPPs in the economic development of contemporary states. It has a bias towards dispute resolution covering the various ADR mechanisms with a particular preference for arbitration. It postulates that since disputes are inevitable in all business transactions, and since PPP practitioners are usually sponsored by banks and other financial institutions, there is an urgent need to devise a faster and more efficient mechanism of dispute resolution aside from conventional litigation so that shareholders' funds are not unnecessarily bogged down by prolonged litigation in the courts.

Keywords: Public-Private Partnerships and Dispute Resolution.

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1. Introduction

Governments all over the world have sought for the active participation of private sector in the provision of public infrastructure and services which were traditionally within the exclusive domain of the public authorities. There are various levels of involvement ranging from privatization of erstwhile public enterprises to contracting out of services and, of late, the use of Public-Private Partnership[1] in the provision of social and economic infrastructure necessary for the development of a nation.[2] Privatisation is the commonest of these initiatives and it has been adopted by several countries especially in Europe, Asia and Latin America.[3] Contracting out of government services has also been widespread. Recently, Public-Private Partnerships in infrastructure development have increasingly been of special interest to most developing countries as a sound alternative to traditional public procurement system.

Nigeria and few other African nations[4] have also embraced the Public-Private Partnership initiative as a means of addressing their huge infrastructure deficits and challenges. It is pertinent to point out that in these countries, the provision, management and control of infrastructure used to be within the exclusive competence of the governments, be they central or provincial.[5] This explains the apparent lack of disputes between the private and the public sector since the government was the alpha and omega in the procurement of goods and services.

Unlike the case under the traditional procurement system, the proclivity for disputes arising in PPP projects is now very high. The reason for this is not far-fetched. PPP is a contract or business venture between the public and private sectors. Due to the complexity of PPP contracts, this arrangement involves several other parties like the financiers, operators, construction contractors, the public sector authorities and others who together form a consortium in order to provide the necessary infrastructure development through PPPs. The interests of each party to these mega contracts are seldom adequately protected in the contracts. Thus, conflicts are bound to arise. Effective resolution of these conflicts in PPP contracts is therefore very cardinal. There is, therefore, an urgent need to look beyond the conventional litigious way of resolving disputes in the courts when considering options for PPP dispute resolution because of the copious shortcomings associated with conventional litigation.

This article therefore seeks to explore the newly-imbibed PPP initiative in Nigeria's infrastructure base by looking at its nature, practical application, the SPV as a one-stop shop for PPP operation, risk sharing and management, the various models, the statutory/regulatory framework and its practical application. Of equal importance, this article also

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1 Or "PPPs", as the case may be, if it denotes plurality.

2 B Li and A Akingboye, An Overview of Public Private Partnership, in A Akintoye, M Beck, and C Hardcastle (eds) Public Private Partnerships: Managing Risks and Opportunities (Blackwell Publishing Company: Oxford, 2008), at p. 29.

3 There are several countries that have adopted this politico-economic policy. Prominent among them are China, Brazil, India, Russia, Poland, Argentina, Thailand, Indonesia and Malaysia.

4 These are South Africa, Ghana, Zimbabwe and Mozambique among others.

5 For example, in Nigeria, government had the monopoly of infrastructure provision and control. However, the government has recently started divesting itself of the powers through privatisation and PPPs.

focuses on the aptness, relevance and importance of some of the ADR processes, to wit, negotiation, mediation and arbitration in resolving PPP disputes with a particular bias or slant towards arbitration. It also draws useful lessons from the South African PPP framework and alludes to the rapidly expanding arbitration landscape in Asia to reflect the international best practices with regard thereto. Finally, this article concludes by making suggestions which, if applied by all nations that have adopted the PPP initiative or mantra, will point and lead towards better and brighter development prospects in the sense of reaping more success stories in the near future from PPP practitioners across Africa and elsewhere.

2. The Nature of Public-Private Partnership (PPP) Contracts

Public Private Partnership refers to a contractual relationship in which a government service or a private business venture is funded and operated through a smart partnership between a public authority and one or more private sector companies.[6]

In such an arrangement, the government and the private sector come together to provide and strengthen the infrastructure needs of a country. While the duty of the government is to provide an enabling environment for PPPs to thrive, the private sector in return brings the much needed capital, skills and core competencies which are the prerequisites to a viable and successful PPP project.

The public authority or public sector party to a PPP contract could be a federal, central, regional, state, municipal, local governmental institution or any other entity which is under the public-sector control. However, in Nigeria, it is only the ministries, departments and agencies (MDAs)[7] of these public sector authorities that can enter into PPP contracts with the private sector.[8] While the private sector party is normally a Special-Purpose Company which includes investors, lenders, and companies providing construction and operational services. According to Yescombe, the relationship between the parties is not really a partnership in the legal sense, but it is contractual, being based on the terms of the PPP Contract.[9]

In the words of the Institute of PPP (IP3),[10] PPP is a partnership between the government and an appropriate qualified private sector entity, or group of entities, for the purpose of financing, designing, constructing and or operating an infrastructure or service which would traditionally have been provided via the traditional public delivery system of public procurement.[11] Thus, PPP is a medium whereby both the private and public sectors

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6 See a paper delivered titled "Public Private Partnership: Infrastructure Development As a Vehicle for Economic Development" by Wale Babalakin at the 2nd Mustapha Akanbi Public Lecture delivered at the University of Ilorin Auditorium on July 13, 2009 at p. 6.

7 Their acronym.

8 See s.1 of the Infrastructure Concession and Regulatory Establishment Act of 2005.

9 E.R.Yescombe, Public-Private Partnerships Principles of Policy and Finance', (Oxford: Elsevier Publishing Ltd, 2007), at p. 2.

10 IP3 is a leading global capacity building firm based in Arlington, Virginia, USA.

11 A Emide, 'The Influence of the Infrastructure Concession Regulatory Commission Act on the Public-Private Partnership in Nigeria'. Retrieved from http://law.lexisnexis.com/practiceareas/International/The-Influence-of-the-Infrastructure-Concession-Regulatory-Commission-Act-on-the-Public-Private-Partnership-in-Nigeria. Accessed on the 15th August 2009.

pool their resources for the ultimate purpose of providing the ever increasing infrastructure needs or deficits for the nation. This is particularly so in the case of developing countries where funding and expertise are lacking.

The advantages inherent in this type of business arrangement are multifarious. The leading ones include the provision of an off-budget mechanism to government for infrastructure development, relieving the public sector of the onerous responsibility for paying for the costs of designing, constructing and the transferring of certain risks to the private sector.

PPPs in the matter and area of infrastructure development by most countries have been justified *inter alia*, on the following grounds:

a. The availability of private capital and other resources to meet the increasing needs for investment in infrastructure services;
b. Efficiency of the private sector in project delivery and operation;
c. The private sector has more access to advanced technology;
d. Sustainable development in infrastructure facilities and services; and
e. The policy shift towards a market economy driven by free enterprise and capitalism.[12]

Consequently, PPP is now gaining more popularity particularly in the developing world whereby it is viewed as a relatively new business relationship that is evolving between both the public and private sectors. In the writers' view, it is not an overstatement to argue that PPPs are here to stay and develop.

3. Stages in PPP Contracts

A complete life cycle of a PPP arrangement is said to be made up of three different phases, to wit, the procurement phase, the construction phase and the operation and maintenance phase. The procurement phase is the period when the concessionaire bids for the project to be executed under a PPP arrangement. The construction stage entails the execution of the contract awarded in conjunction with a cornucopia of other sub-contractors and sub-sub-contractors; while the operation and management stage covers from the period of use of the project for public good up to when the project will be handed back to the public authority.

In practice, a typical PPP arrangement may be quite complex. Usually, it involves various contractual arrangements between a number of parties including the public authority, financier, contractors, project sponsor, project operator, engineers, suppliers, third parties and customers. The partners, through various legally binding contracts or some other mechanisms, agree to share their respective responsibilities arising from financing, implementation, operation and management of a project. This collaboration or partnership is built on the expertise of each partner that meets clearly-defined public needs through the appropriate allocation of risks, resources, rewards and responsibilities. The allocation of these elements and other aspects of PPP projects such as the details of implementation, termination, obligations, dispute resolutions and payment arrangements

[12] Public-Private Partnerships in Infrastructure Development: An Introduction to Issues from Different Perspectives, *supra*, n 6, page 2.

are negotiated among the various parties or partners involved and are documented in a written contract as agreed to by the parties.

It is pertinent to note with regard to the multiple contracts resulting from the above arrangement that amongst the agreements entered into between the concessionaire and the other parties, there are two most important ones out of all the agreements. These are the contract agreement[13] with the financiers and the contract agreement with the government. In fact, the contract agreement with the government forms the basis for the subsequent agreements with the other parties.[14]

Basically, the head contract comprises of an agreement between the public authority,[15] on one hand, and a consortium whose task is to design, finance, operate and maintain the project, on the other. This consortium, in more advanced environments, will be an embodiment of financiers, Construction Company and a facilities management company and, more often than not, the consortium itself will be in the form of a limited company referred to as a Special Purpose Vehicle/Venture (SPV) formed solely for the purpose of carrying out the PPP project.[16]

However, under the Nigerian PPP regime, as shown from the few experiences so far,[17] the SPV is yet to be seen in use. Rather, once the government advertises a certain pivotal infrastructure for concessioning, the interested qualified private sector companies will then submit their applications for consideration. Thereafter, the government will get in touch with the emerging concessionaire after a competitive bidding. A winner will emerge from the process and the government will then execute a proper agreement with the private party. The SPV system and its accompanying advantages are yet to be put to use in Nigeria. Of course, it is a matter of time that the SPV system will be adopted.

4. The Special Purpose Vehicle (SPV)

A Special Purpose Vehicle (SPV) is a separate commercial venture which is a key feature of most PPPs. It is a legal entity which is established between or among the parties undertaking a PPP project. The Special Purpose Vehicle is usually set up by the private party(s) to a PPP transaction. Where the government is interested in the SPV, it may also participate and contribute to the long term equity capital in exchange for shares. Where this is the case, it means that the SPV serves as a joint venture company between the public and private sectors whereby the government, too, would acquire equal rights to the assets within the SPV as other private sector shareholders. The justification for this type of arrangement, from the viewpoint of the government, is that by this, the government's continued interests in the management and operations of the asset will be assured. This may augur well for the business venture.

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13 Before the complex nature of the PPP transaction and the final conclusion of the PPP contracts, different other agreements are also needed. These are sub-contracts under the main PPP agreement and together they form the PPP agreement.

14 Note 12, *op cit*, at p. 67.

15 The name given to this body may vary from country to country.

16 Peter Sheridan, 'PPP In-depth: PFI/PPP Disputes' at p. 1. Retrieved from: http://www.sheridangold.co.uk/articles/pfi_ppp_disputes.pdf. Accessed on 15th March, 2013.

17 The leading ones being the MMA2 and the Lagos-Ibadan Express road amongst others.

It is vital to note that apart from the public and private sectors, a foreign company may equally constitute a part of a joint venture if permitted by the law of the land.[18] Also, an SPV, either solely constituted by the private sector or in alliance with the government/ public sector, will have a contract regulating the relationship between its members. This is referred to as a shareholder's agreement.

If and when this mode is used, the duty is on the consortium which makes up the SPV to deal directly with the authority concerned. It will then enter into various sub-contracts for the performance of the PPP project, usually including a sub-contract with its contractor members for the construction and management of the project, usually for duration of between 25 – 35 years.[19] The SPV's member contractors will also enter into sub-sub-contracts with others, thus making the occurrence of disputes more probable.

In addition, the SPV bears other shoulder-breaking tasks such as approaching commercial bankers for the provision of funding for the project; absorbing the costs of bidding for and winning the project and designing and constructing it; and receiving fixed payments for the duration of the project (mostly between 25-30 years). Such payments received will cover all the bidding costs, capital costs, operating costs, financing costs and the profits of all the PPP players. Although, the SPV mechanism is not always applicable, where it is, it provides a one-stop shop for a proper organisation and execution of the PPP contracts.

5. Risk Sharing and Management in PPP Contracts

Going by the intricacy and sensitivity of the subject-matter of most PPP agreements, risk sharing and management of risks by the participating parties become ineluctable. Should this be a source of discouragement to the various actors? No. Rather, a sound mechanism for effective sharing and management of risks in PPP contracts should be put in place. Where this is accomplished, it will go a long way to checkmate and obviate the unsavoury effects of the likelihood or the existence of risks on the various players in the field of PPP.

The risks inherent in PPP arrangements are multi-faceted. They include political risk (this may arise as a result of change in government policy), technology risk (this arises when technology is not a proven one), construction risk (arises mainly as a result of delays in construction), environmental risk (this may be in form of pollution and other environmental hazards to the society), commercial risk (lower than expected demand for services produced by the project), legal risk (change in law), regulatory risk (change in regulatory regimes), sponsor risk (inability of the sponsor to deliver the project), operating risk (inefficiency in operation leading to higher operating costs) and *force majeure* (risks due to unpredictable natural and man-made events such as flood, earthquake, civil war, etc).[20] Since these are all inevitable risks, it has become an important strategy of PPPs to

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[18] This is permitted in Nigeria. S.54 of the Companies and Allied Matters Act (CAMA) applicable in Nigeria allows an alien that has satisfied the necessary requirements to participate in business in Nigeria.

[19] Peter Sheridan, *supra* n 16 at p.1.

[20] Public-Private Partnerships In Infrastructure Development: An Introduction to Issues from Different Perspectives, *supra* n 6 at p. 57.

make adequate provision for an eventuality in order to share the resultant risks between or among the parties involved.

6. The PPP Models

A wide variety of PPP models have emerged in an attempt to encourage private sector's participation in the provision of infrastructure facilities and services. The compartmentalisation into one model or another is done after an exquisite consideration of the existence of one or all of the following factors:

a. Ownership of capital assets;
b. Responsibility for investment;
c. Assumption of risks; and
d. Duration of contract.

Using the above parameters, PPP models can be classified into four broad categories, namely, *the supply and management contract*, *turnkey projects*, *affermage/lease* and *concessions*. Each of these categories is discussed below.

a. Supply and Management Contract

This is a contractual arrangement for effective management of a part or whole of a public enterprise by the private sector. By so doing, the private sector skills are employed for the effective design and delivery of service, operational control, labour management and equipment procurement. The distinctive feature of this model is that the public sector retains the ownership of facility and equipment. The responsibilities assigned to the private sector are limited as it is not expected to assume commercial risks. In terms of reward, the private contractor is remunerated by the payment of a fee known as the management and services operation fees. This payment is normally performance-based. Although the contract period for this model is usually short (2-5 years),[21] longer period may be used at times for large and complex operational facilities such as a port or airport. Also, this model is common for existing assets in the water and transport sectors.

b. Turnkey Project

Turnkey Project is one of the traditional procurement sources of infrastructure facilities. Under this model, a private contractor will emerge at the end of a highly competitive bidding process to design and build a facility at a fixed fee, rate or total cost. This condition often determines who emerges at the end of the bidding process. The risk involved in the design and construction phases is entirely heaped on the contractor, and for this reason, the scale of investment by the private sector under this model is extremely low and short-termed.

Similarly, the completion of project is unnecessarily delayed since there is no strong incentive on the part of the government for early completion of project by the contractor. This type of private sector participation (PSP) is known as Design-Build.

[21] Perhaps, an example could be cited from Malaysia *albeit* the subject matter is on Nigerian law. The initial management contract for Port Klang in Malaysia with a foreign company was only for three years. The main purpose was to set-up the system so that eventually a local company could take over for a longer period.

c. Affermage/Lease

Under this model, an operator (often referred to as the leaseholder) is exclusively saddled with a somewhat demanding responsibility of maintaining and operating the infrastructure facility and services, though he is not required to make any monumental investment.

However, going by the nature of this model, for more efficacy, it is often combined with other models such as Build-Rehabilitate-Operate-Transfer (BROT). Where this is done, the contract period becomes elongated and, contrary to the known practice, the private sector will be required to make a significant level of investment.

Although the arrangements under affermage and lease are strikingly similar, some minute disparity exists. For instance, while an operator retains the revenue he realises from the customers/users of the facility but makes a specified lease fee payment to the contracting authority under a lease, the arrangement under an affermage is different. In an affermage, an operator and the contracting authority share the resulting revenue from the customers/users of the facility. Usually, the investment risk is borne by the government while the operator bears the operational risk involved in the transaction.

d. Concessions

There is no other model that is as widely used for PPP projects as concessions. Here, the government defines and grants specific rights to an entity (usually a private company) to build and operate a facility for a fixed period of time after which it is expected to transfer same back to government.

In most concessions, government often retains ownership of the facility and or right to supply the services. A concession may be granted to a concessionaire under any of the following two types of contractual arrangement viz., franchise and BOT. These are explained hereunder.

i. Franchise

Under this arrangement, the concessionaire provides services that are fully specified by the franchising authority. The commercial risk is borne by the private sector which may also be required to make investments.

ii. Build-Operate-Transfer (BOT)

In BOT and its other variants (e.g., Build-Transfer-Operate (BTO), Build-Rehabilitate-Operate-Transfer (BROT), Build-Lease-Transfer (BLT), Design-Build-Operate-Transfer (DBOT), Design-Rehabilitate-Operate-Transfer (DROT) and Build-Own-Operate-Transfer (BOOT)), the concessionaire undertakes investments and operates the facility for a fixed period of time after which the ownership reverts back to the public sector.

7. PPPs in Nigeria

The unexampled success records of PPP in other climes have served as a catalyst for its adoption in Nigeria.[22] This is, no doubt, a welcomed development going by the

[22] For example, South Africa has adopted the PPP initiative to develop critical infrastructure since the mid 1990s.

innumerable achievements of PPP in infrastructure developments in those climes. It is, however, important to note that even though the application of PPP in infrastructure development in Nigeria is a relatively recent and novel concept, traces of arrangements similar to PPP could be found in some sectors of Nigerian economy. There exists, either expressly or impliedly, arrangements similar to PPP in the oil and gas industry through the joint venture operations of the Nigerian National Petroleum Corporation (NNPC) and the oil majors such as SPDC, TOTAL ELF, Chevron, NAOC, Addax Petroleum which are being administered by NAPIMS among several others.[23]

The above notwithstanding, the first known project that was executed in Nigeria under PPP arrangement is the Murtala Muhammed Airport II project (MMA2) in Lagos which was designed, financed, built and being operated by Bi-Courtney Aviation Services Ltd (BASL). The magnificent success recorded by this project has triggered off more consciousness on the part of both public and private sectors as to the feat a partnership between the private and public sectors is capable of achieving.

With the glistening hope being brought by the MMA2, the federal government has penned down more airports for concessioning among which are the Murtala Muhammed Airport, Lagos; the Port Harcourt International Airport, Margaret Ekpo; and the Mallam Aminu Kano International Airport, Kano; with the belief that this measure will bring about more efficiency and positive results in the aviation industry. The recent concessioning of some seaports in Lagos, Warri and Port Harcourt by the National Council on Privatization under PPP arrangement is further testimony as to the rate and pace at which the country is embracing this kind of infrastructure development initiative.

The achievements highlighted above are not limited to the Federal Government as some state governments, too, are also pursuing various projects under the PPP scheme. For instance, the Lagos State government, which is the leading actor in this regard, has established a special office to coordinate activities of PPP under the state Ministry of Finance. PPP has been used in Lagos for power generation, management of waste disposal, highway and street cleaning and maintenance. In addition, the state has employed PPP for cooperating with the private sector entities for the development, upgrading, rehabilitation, operation and management of state roads, bridges and highway and other infrastructure projects.[24] A leading example in this regard is the Lekki Concessioning Company (LCC) which is to undertake the construction of major roads (Lekki-Epe Expressway) under BOT for a term of 30 years.[25] It is worthy of mention that the Lekki-Eppe Expressway has since been commissioned.

In Rivers State, the state government is employing PPP to address the Public Health and Housing Programmes. Particular mention must be made of the ClinoRiv Hospital built under PPP, transportation (in partnership with Skye Bank), Housing and Entertainment (in conjunction with Silverbird). In Cross River State, the government has just signed a N100 billion project with the American firm, Jack Rouse of Cincinnati for designing a master plan for their theme park project to attract tourism.

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[23] Engr. Saidu Njidda, 'PPP in Nigeria: How Far?' Retrieved from http://www.fpppn.org/pppnigeria.html. Accessed on 17 August, 2009.

[24] *Ibid*.

[25] *Ibid*.

All the foregoing discussion points to a single conclusion-- the use of PPP in infrastructure development in Nigeria has come to stay and will intensify in the years ahead.

8. Statutory/Regulatory Framework for PPPs in Nigeria

Until very recently, there was no national law for controlling PPP contracts in Nigeria. During this period, projects with arrangements similar to those under PPPs came under the control of the Budget Monitoring and Price Intelligence Unit (BMPIU) which was set up in June 2003 to ensure full compliance with prescribed guidelines and procedures for the procurement of capital projects. Although BMPIU did not directly control PPPs, it could be said to be the pioneer unit set up to oversee PPPs at the federal level with regard to contracts that come within its jurisdiction.

With the expansion in the use of PPPs in Nigeria, the Federal Government realised the real need to come up with a separate legal/regulatory framework which will be primarily responsible for controlling and regulating PPP projects in the country. Following this realisation, the government of the late President Musa Yar'Adua set up the Infrastructure Concession Regulatory Commission (ICRC) pursuant to the ICRC Act of 2005 to develop policy and provide institutional and regulatory framework for an effective regulation of PPP programme in Nigeria.

In further response to the ever-growing demands for more effective PPP regulation, the federal government further inaugurated the Project Steering Committee (PSC) for the Nigeria's PPPs in July, 2009.[26] This Committee is entrusted with the task of ensuring greater participation of the private sector in financing infrastructure services in the country. Coupled with this is the task of undertaking a regular review of the policy guidelines and operating procedures issued by the ICRC to ensure that they are coherent and consistent with evolving development strategies and policy thrusts of the Federal Government. The move towards to a statutory regime in regulating PPP undertakings is a most welcoming news to the PPP players. In terms of legal enforceability, guidelines are discouraged because they are far too inferior than an enforceable statutory scheme.

At the state level, too, for example, Lagos state enacted the Lagos State Roads, Bridges and Highway Infrastructure (Private Sector Participation) Development Board Law in 2004. This law provides for a legal and regulatory framework for private sector participation in the development, rehabilitation, upgrading and construction of infrastructure within the state.[27]

Even though most of these laws have been criticised as being insufficient, they nonetheless provide a ready springboard upon which further development, refinement and improvement could be made. After all, the process for continuous improvement never stops in ISO lingo.

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[26] See Idris, Ahmed, "Nigeria: FG Inaugurates Project Committee For PPP" in the Daily Trust, 21 July 2009 at p. 44 retrieved from http://allafrica.com/stories/200907210083.html. Accessed on August 16, 2009.

[27] See "PFI/PPP Projects 2007" published by Global Legal Group with contributions from: A Practical Insight to Cross-border PFI / PPP Projects work www.ICLG.co.uk. Retrieved from http://www.iclg.co.uk/khadmin/Publications/pdf/1027.pdf. Accessed on September 7th, 2009.

9. Dispute Resolution in PPP Contracts

The discussion on the dispute resolution in PPP contracts will now be looked into. The legal framework for the settlement of disputes is an important consideration in the implementation of the PPP projects. Parties especially the private partners will feel safe and secured where there is a guarantee that disputes arising therefrom can be efficiently resolved.[28] Disputes may arise in all phases of the PPP projects, namely, construction, operation and even at the stage of final handing over of the projects to the public authority.

The legal framework for dispute resolution may be found in a number of statutes and in different rules and procedures of the country concerned. The legal instrument may include tax law, competition law, consumer protection law, laws relating to public procurement, company law, property law, Arbitration and Conciliation law, foreign investment law, acquisition and appropriation law and various other relevant statutes which can aid in the resolution of disputes between or among the parties.

It is important to bear in mind that the settlement mechanisms contemplated in the contract or agreement is in line with the best practices, particularly when large-scale investments from foreign private partners are involved. The commonly used dispute resolution methods include: facilitated negotiation, conciliation and mediation, adjudication by regulatory authority, arbitration and litigation proceedings in the courts. Of all these methods, litigation is the most unsuitable method for settling disputes arising from PPP arrangement except in extreme circumstances. This is because litigation is time consuming, costly and neither of the parties may even be satisfied with the outcome of the proceedings.

The contractual relationships of PPP arrangements suggest that parties to the agreement will be involved in performing various roles in the execution of the project. Undoubtedly, this situation will create a changing and dynamic environment. Moreover, uncertainty of contractual terms and the bearing of risk are bound to create disputes. Irrespective of the degree of complexity of the contractual structures, there are four major identifiable levels of dispute which the SPV partners may likely be faced with. These are-- upstream, intra-parties, downstream and third-party disputes.[29]

Upstream disputes are those disputes between the private sector and the public authority/government. These may involve unilateral actions of the government which may likely affect the policy or the legal and regulatory framework i.e. the issuance of ministerial decisions which result in project cancellations and variations. This change will impact upon the consistency of the PPP network of contracts: it will cause the project company to restructure the downstream substantive contracts, as well as its loan agreements with third-party financiers. These will give rise to disputes.

The second category is the intra-parties disputes. These are the ones which relate to the project performance agreement. Partners may disagree over each partner's financial

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[28] United Nations ESCAP, A Guidebook on Public-Private Partnership in Infrastructure, (United Nations, Bangkok) 2011, *supra* at p 74.

[29] Dimitrious Athanasakis, Effective Dispute Regimes for Large Infrastructure Projects in Greece; paper delivered at the 3rd Hellenic Observatory PhD Symposium on June 14 & 15, 2007.

contributions to the financing of the SPV, or, one partner may go insolvent, and the financial burden falls on the shoulders of the remaining partners.

Downstream disputes may occur from the defaults of the contractors, e.g. where sectional completion is not certified for reasons of the contractors using materials that are substandard or the ones different from the ones specified in the contracts.

Risks in the PPP scheme may also occur by the actions of third parties to the scheme. Financiers often resort to overburden unilateral change of interest rates affecting the process of repayment loans. This kind of financial burden brings along a specific risk. Refinancing the project will amount to pursuance of further deals which may be negotiated on much more burdensome terms than the previous agreements. Clearly, time overruns will amount to lower levels of profitability as returns will be at less percentages and start at a later stage.

Whatever the level of dispute arising, these will have a domino effect upon the progress of the parties' contracts and lead to some interfacing level of liability. But, there is a common decisional thread-- the determination of causation and liability.

Therefore, the existence of a viable and adequate legal framework for the settlement of these disputes which are likely to arise in PPP contracts is vital in the effective implementation of the PPP projects. Private parties (including the concessionaire, financiers and contractors) feel encouraged to participate in PPP projects when they have confidence that any dispute arising between the contracting authority or other governmental agencies and the concessionaire; or between the private parties themselves can be resolved fairly and efficiently without time wasting and incurring of financial losses.

Each PPP contract usually provides for the acceptable modes of settling disputes which must, of course, not be antithetical or obnoxious to the allowed dispute resolution system under the legal framework of the country concerned. The commonly used methods for dispute resolution in PPP contracts include facilitated negotiation, conciliation and mediation, non-binding expert appraisal, review of technical disputes by independent experts, arbitration, and legal proceedings.

Even though most dispute resolution clauses often start with negotiation, as far as the court is concerned, an agreement to negotiate between the parties is unenforceable as it is void for uncertainty.[30] The only advantage of negotiation is that it is believed that tiered dispute resolution provisions (which include negotiation) assist in providing parties with flexibility to try and resolve low value or less important problems/disputes more swiftly and with lower costs and management time than those common under more traditional forms of contract.

Additionally, the pressures created by the security package required by the lenders and banks frequently act as a stimulus to settlement or early resolution of disputes using negotiation. Its failure is, however, that those parties are not legally bound by it and as such if either of the parties is discontented with the outcome of the negotiation, the fact that the contract provides for an agreement to negotiate cannot stop such party from approaching the court.

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[30] Peter Sheridan, *supra* n 16 at p. 8.

Mediation is another dispute resolution option. The only difference between negotiation and mediation is that in the case of the latter there is the involvement of an independent third party known as a mediator. A mediator is a person entrusted with the responsibility of assisting the parties in concluding a settlement which may or may not be binding on the parties. Mediation is, therefore, an advanced negotiation. The effect of a mediation clause in PPP contract is not significantly different from that of a negotiation clause. The determining factor lies in the existence or otherwise of a special procedure to be followed in carrying out the negotiation.

In mediation, the main objective is to resolve the differences between the parties through a negotiated agreement. The mediator does not have the authority to make a binding decision on the parties.[31] The only situation where such decision would be binding is where all the parties have agreed to such outcome. This is because, the mediator has no authority or power except the one given to him by the parties involved. If any of the parties withdraws the authority or power so given, that ends the mediation process. Therefore, if the parties are unable to settle their dispute through this means, they will be at liberty to have their issues dealt with in another way. It is as a result of this that mediation may not be suitable for disputes involving big commercial transactions like PPP contracts because either of the parties may decide to opt out of the mediation process if he or she thinks that the outcome may not be favourable.

Where a contract provides for mediation as a means of resolving disputes without specifying a procedure to be followed, such mediation clause will have the same effect as a negotiation clause. On the other hand, where the parties have not only agreed to negotiate in good faith (assisted by a mediator) but have gone further to identify a particular procedure (such as the CEDR[32] mediation procedure), the effect will be different. In the latter case, there will be a sufficient certainty for a court to ascertain whether the parties' obligations have been complied with or not.[33]

This distinction is pivotal in that where there is a clear procedure as opposed simply to an agreement to negotiate with no specific procedure; the court can investigate and see whether the specific steps the parties agree to take have or have not been undertaken. Be that as it may, since a mediation is conducted on a without prejudice basis, if the parties are not successful in concluding a settlement, the mediation will be of no effect and cannot be referred to in a court action.

From the above cursory examination of both negotiation and mediation, it is obvious that they are both ridden with problems which go a long way to puncture a hole in their appropriateness to resolving PPP disputes. Litigation is equally not apposite for its time-wasting and cost-gulping propensity. Owing to this, the need to consider other viable options, such as arbitration, becomes necessary. The usefulness and effectiveness of arbitration *vis-à-vis* PPP dispute resolution is considered below.

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31 H Brown and A Marriott, ADR Principles and Practice 2nd Edition, (Sweet & Maxwell, 1999) at Page 129.

32 This is the Centre for Effective Dispute Resolution.

33 See *Cable & Wireless Plc v. IBM United Kingdom Ltd* [2002] EWHC 2059 (Comm), [2003] B.L.R. 89.

10. Resolving PPP Disputes through Arbitration

Arbitration is a mechanism whereby two or more parties agree that their dispute will be decided confidentially by an independent tribunal. To be binding, it is a requirement of the law[34] that the parties must agree that the dispute will be resolved by arbitration. Parties are also at liberty to include any specific requirement they deem fit within the agreement to arbitrate. For instance, the parties may agree that the dispute is to be determined by a single arbitrator, or by a panel of three arbitrators, or indeed fifteen arbitrators,[35] so long as they are agreed on this. It is also within the exclusive discretion of the parties to specify the procedural rules to be applicable, the national law to be used, the language of arbitration[36] and even the country in which the arbitration is to be held.[37]

In Nigeria, Infrastructure Concession and Regulatory Commission Act of 2005 which is the principal law that governs PPP contracts in Nigeria does not provide for how dispute arising from the contract will be resolved. It must be pointed out that there is nowhere in the Act where the procedure for the settlement of disputes is mentioned. The Act merely provides that:

> *"No agreement reached in respect of this Act shall be arbitrarily suspended, stopped, cancelled or changed except in accordance with the provisions of this Act."*[38]

Recourse would, therefore, have to be made to the Arbitration and Conciliation Act[39] which is the main statute applicable for purposes of resolution of disputes arising from PPP contracts in Nigeria. That arbitration provides for a veritable platform for resolving emerging disputes in PPP is a widely conceded fact as shown in its global application in PPP dispute resolution. Its advantages are well documented and this further underscores its appropriateness to PPP dispute resolution. For instance, one of the numerous advantages of arbitration is the ability of parties to have their disputes determined by an independent arbitrator knowledgeable in a particular and relevant specialist area. This will go a long way in ensuring quick disposition of cases before the arbitral tribunal; it is more so when PPP projects encapsulate multifarious technical and specialised subjects.

By so doing, the parties will not need to spend so much time "educating" the arbitrator upon a particular specialised area; comparing with a court which may have no experience in such area and may need considerable assistance from the parties. Invariably, the dispute is resolved more quickly and at a lower cost than equivalent proceedings in the court thereby bringing to the fore another invaluable advantage of arbitration, viz., time saving and lower cost of dispute resolution.

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34 In Nigeria, arbitration is governed by the Arbitration and Conciliation Act 2004 (ACA), Cap 19, Laws of the Federation of Nigeria.

35 See Section 6, ACA, LFN 2004.

36 See Section 18, ACA, LFN 2004.

37 See Section 16, ACA, LFN 2004.

38 Section 11 of the ICRC Act, 2005.

39 *Supra*, n 34.

The fact that a huge sum of investment is often committed to a PPP project makes litigation undesirable. For example, in Nigeria, the MMA2 project gulped a whopping sum of ₦20 billion.[40] Assuming that when some government agencies flout the contractual terms of the agreement between the Federal Government and BASL, the latter has to engage in extensive negotiations to resolve the issue not because its rights have not been violated but because of the fear of protracted litigation that may ensue if those rights are to be pursued and litigated in a court of law.

Another salient feature of arbitration that makes it apt for PPP disputes is that the award issued by an arbitrator or an arbitral tribunal is both binding and final, and may be enforced through the court.[41] Even though the Arbitration and Conciliation Act[42] allows for the setting aside of arbitral awards, it may appear to pose some irreconcilable drawback. However, upon closer perusal and examination of the provisions of the Act, however, this is not in any way a problem. That law does specifically provide for when an arbitral award can be set aside in the following words:

> *A party who is aggrieved by an arbitral award may within 3 months by way of an application for setting aside, request the court to set aside the award in accordance with subsection 2 of this section.*[43]

On the authority of the above subsection, the court will only intervene to set aside an arbitral award on the proof of the party making the application that the award contains decisions on matters which are beyond the scope of submission to arbitration.[44] Even where this is the case, in order to prohibit facetious complaint against arbitral awards, the subsection further provides that only the part of the award which contains decisions on matters not submitted to the arbitral tribunal may be set aside.[45]

The above provision, no doubt, goes a long way in limiting the jurisdiction of the court in off-setting arbitral awards and in discouraging parties from approaching the court for setting aside of such awards since proof is required. This makes it more appropriate to PPP disputes where parties cannot afford the luxury of time wasting.

In other climes, in recognition of the over-burdening effects of risks on the concessionaire, there are statutory provisions making the inclusion of arbitration clause in PPP contracts a non-negotiable. In Greece, for instance, any dispute regarding the implementation, interpretation or status of a PPP contract or ancillary agreement is settled exclusively by means of arbitration.[46] In addition, the arbitration decision is final, irrevocable, not subject to appeal and is a legally executable title.[47] In Russia, the

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40 See the Presentation by Wale Babalakin, *supra* n 6 at p. 11. See also the Guardian Article by Wole Shadare, *supra*, at p. 46.

41 See Section 31, ACA, LFN 2004 and also the case of *Ebokan v. Ekwenibe & Sons. Trading Company* (2001) 2 NWLR (PT 696) 44 paragraph F.

42 Cap 19, LFN 2004.

43 See Section 29(1) ACA, LFN 2004.

44 See Section 29(2) ACA, LFN 2004.

45 *Ibid*.

46 Article 31(1) the "PPP Law", Law 3389/2005 applicable in Greece.

47 Article 31(2) of the Greece PPP Law.

Concession Law[48] clearly allows the inclusion of arbitration clauses providing for dispute resolution by an arbitration tribunal or international commercial arbitration.

Provisions such as these are essential to checkmate what may at times be the excesses of the government. Since the government knows that the concessionaire will usually be unwilling to go court because of the fear of time-wasting, and in the absence of arbitration clause in such contract, government tends to contravene the contractual terms with impunity.

Added to the above is the fact that PPP projects are capital-intensive with most parts of the risks involved being shouldered by the concessionaire who is expected to build, design, finance, operate and then transfer the project back to the government within the stipulated number of years. The concessionaire undertakes the construction risk, operational risk, commercial risk, and other forms of risks and, therefore, deserves to be protected against protracted litigation which may delay the recoupment of its invested loaned capital and prejudice its profit earning. The only available effective insulation to the concessionaire is the inclusion of an arbitration clause in the PPP contracts.

11. Dispute Resolution in PPPs in South Africa

Perhaps, it would also be pertinent to survey the ADR landscape in South Africa and Asia.

South Africa has a number of arbitration institutions.[49] One of the most renowned is the Association of Arbitrators (Southern Africa) which was established in 1979 through the initiative of professionals in the construction, legal and other sectors. The association has standard rules which have been amended and modified over time in line with international best practices.[50] The rules have also been adopted by arbitration institutions in Botswana and Namibia for their use[51] in those countries which indicates a degree of regional acceptability of those rules.

The Arbitration Act[52] of South Africa, Module 6 of the National Treasury PPP Manual and the Standardized provision[53] prescribe a detailed procedure for resolving PPP disputes. It is, therefore, important for the parties to incorporate this in the PPP Agreement. It is the requirements of these provisions that all disputes should first be referred to the respective liaison/project officers in order to proffer solutions thereto. If these officers are unable to resolve the dispute within time, then the dispute should then be referred to both the accounting officer of the institution and the Chief Executive of the private party.

If the dispute could still not be settled at this stage, then it has to be referred to an independent mediator appointed by the two parties to the dispute.[54] Where, however, the

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48 No. 115 FZ of 21 July 2005.

49 D W Buttler, 'Development and Practice of Arbitration and ADR in South Africa' in Arbitration and Alternative Dispute Resolution in Africa, C.J Amasike, ed., (Yaliam Press Ltd, Abuja, 2007) at page 84.

50 There were series of amendments to the rules since its 1st draft in 1979. It has undergone not less than five amendments the last of which was in 2005.

51 These are the Botswana Institute of Arbitrators in Botswana and PAMAN (the Professional Arbitration and Mediation Association of Namibia which is based in Windhoek.

52 Act No 42 of 1965.

53 See Part 86 of the Standardised Provision.

54 See also section 11 (1) of the Arbitration Act of 1945 as amended by Act No 49 of 1996.

dispute could still not be settled by the independent mediator, then as a last resort the deadlock will have to be referred to the courts for adjudication and settlement.

12. Arbitration Landscape in Asia

The arbitration landscape in Asia has changed dramatically in recent years with the active involvement of China International Economic and Trade Arbitration Commission (CIETAC). It is one of the leading arbitral institutions particularly in Asia.[55] However, rapid growth in international arbitration in the region has also gravitated very strongly towards Singapore and Hong Kong.[56] The competition between Hong Kong and Singapore is very intense with each trying to outdo the other as the leading international arbitration centre in Asia. The China International Economic and Trade Arbitration Commission together with other arbitration institutions in the region are being increasingly used in cases involving commercial disputes instead of litigation, which is often viewed as time consuming, expensive and inefficient.

Moreover, court judgments are not enforceable across borders to the same extent as awards in international arbitration cases. Aside from common law jurisdictions such as Malaysia, India and Hong Kong, litigation is considerably less prevalent than in the Europe and Africa.[57] But with disagreements or disputes in business and commerce on the rise, arbitration has been considered as an acceptable and popular mechanism for settling commercial disputes.

The increased use of international arbitration has been aided and spurred by the growth of a well-developed cadre of international arbitral specialists who act as counsel and arbitrators, and the increasing acceptance of arbitral awards by domestic legislators and courts. Also, the recognition and enforcement of Foreign Arbitral Awards by all the 148 member states who are signatories to the 1958 New York Convention have also rendered arbitration to be increasingly acceptable and popular in recent years. The increased use of arbitration in Asia has reached a point where statistics suggest that key arbitral institutions in the region now could easily rival some of the main London or European counterparts in terms of case loads and value.[58] For example, according to reports collated by the Singapore's Ministry of Law, after London and Geneva, Singapore

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55 The China International Economic and Trade Arbitration Commission (CIETAC) is one of the major permanent arbitration institutions in the world. It was formerly known as the Foreign Trade Arbitration Commission, CIETAC was set up in April 1956 under the China Council for the Promotion of International Trade (CCPIT) in accordance with the Decision Concerning the Establishment of A Foreign Trade Arbitration Commission Within the China Council For the Promotion of International Trade adopted on May 6, 1954 at the 215th session of the Government Administration Council.

56 The Singapore International Arbitration Centre (SIAC) and The Hong Kong International Arbitration Centre (HKIAC) are the principal arbitration venues in the Asia Pacific with many disputes successfully resolved yearly.

57 Asia's Arbitration Explosion. Retrieved from http://www.ibanet.org/Article/Detail.aspx?ArticleUid=C55383E1-519F-4CD9-8822-BE34CC748D2F. Accessed on 28th June, 2013.

58 In Singapore, for example, the government has been promoting the country as a regional arbitration hub, while the courts have continued to adopt a pro-arbitration, minimal intervention approach. The government has opened Maxwell Chambers in 2010, a purpose built integrated arbitration centre to provide offices for arbitral institutions, arbitrators and counsel, as well as hearing rooms and work spaces for conducting arbitrations.

together with Paris and Tokyo are the most popular venues for arbitration.[59] The Singapore International Arbitration Centre (SIAC) has also been ranked as the fourth most popular global arbitration institution, after ICC-ICA,[60] London Court of International Arbitration, and the American Arbitration Association/International Centre for Dispute Resolution.[61]

Seoul, Sydney and Kuala Lumpur are just three of the other locations in the Asia-Pacific region where the authorities are keenly attempting to draw in lucrative arbitration cases.[62] The global arbitration map is littered with ambitious new international arbitral centres that could not manage to develop a sustainable business. However, it is greatly anticipated that the Asian arbitration landscape will continue to flourish and consolidate in the years ahead with increased trade, investment and population in the region.

From the foregoing account, it can be said that the establishment of arbitral institutions in Asia together with the recognition of their awards will really help in the quick resolution of disputes within the region. PPP disputes are no exception to this trend. Parties to a PPP transaction, particularly the private sector will be most interested in knowing in advance what dispute resolution mechanism has been put in place before committing themselves to providing infrastructures and services through the PPP initiatives. This awareness and development with regard to dispute resolution will augur well for the rapid rise of arbitration of commercial disputes in Asia. And reverting to the future ADR landscape on the African continent adverted to earlier, the writers will also like to speculate that South Africa will lead and set the pace on the African continent with her robust laws and institutional set-up.

13. Recommendations

1) The practice in the advanced nations[63] should be emulated to ensure a further snowball in PPP achievements in Nigeria and other African countries.[64] In England, Greece, America and Australia, amongst others, the government shoulders a bulk of the risks involved. They equally provide guarantees on behalf of the concessionaire whenever the latter attempts to raise funds for the project.
2) It is the duty of the governments to create an enabling environment for PPPs to thrive. Sound legal and institutional frameworks are very cardinal. In some countries,[65] the concessionaires enjoy some forms of tax reliefs or tax breaks in addition to the existence of a sound legal and regulatory framework that has been put in place for PPPs to flourish.

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59 See Asia Arbitration Explosion, *supra*, n 57.

60 International Court of Arbitration of the International Chamber of Commerce.

61 Arbitration Procedures and Practice in Singapore: Overview. Retrieved from http://uk.practicallaw.com/3-381-2028?source=relatedcontent#. Accessed on 16th July, 2013.

62 The Kuala Lumpur Regional Centre for Arbitration established in Malaysia in 1978 is an internationally recognised arbitration centre in the South East Asia. It has a panel of experienced domestic and international arbitrators from diverse fields of expertise.

63 These are the United Kingdom, Australia, Chile, South Africa and a few other countries that have adopted PPPs.

64 Needless to say, South Africa is always the leader of the African countries in terms of any legal and economic development.

65 Examples are United Kingdom, Australia, etc.

3) There should be certainty in the law on PPPs in order to clarify and define the obligations of the contracting parties and the regulatory agencies. Private concessionaires will be most interested and would want to invest more in an environment where there is legal certainty and regulatory stability.
4) Parties to a PPP contract especially the governments should respect and honour agreements voluntarily entered into. Where parties fully respect the agreement, there is likely to be less disputes arising from the transaction.
5) A sound dispute resolution mechanism should be put in place to ensure an effective and quick resolution of disputes that may arise between or among the participating parties.
6) There is an urgent need for a complete overhaul of both the legal and regulatory regimes for PPPs in Nigeria. In respect of dispute resolution, the few existing laws hardly address the problem. The ICRC established under the ICRC (Establishment, etc) Act 2005 has been criticised by a leading Nigerian PPP practitioner:

> "*as having very little effective powers and might end up being largely a monitoring and policy making entity without the capacity to enforce compliances, particularly on the side of the* government."[66]

There is, therefore, an urgent need for a law or laws which will adequately address all the various aspects of PPP including dispute resolution. There is also a need for all the controlling bodies in the field of PPPs to learn the nitty-gritty of the concept as practised in other advanced jurisdictions. It is high-time for the government to realise that PPP is not all about generating funds for the government, it is all about providing infrastructure development for the nation through a formidable alliance with the private sector which in turn will stimulate more economic development for the country, and this is what the government should be more interested in. Since it is called an alliance, there is a presupposition that both parties to the partnership must assume risks and responsibilities.

The overall spin-off effects of the existence of all those measures as discussed in the foregoing in any country is not hard to speculate. For instance, in Greece about 28 projects (worth £2.4 billion) were submitted for evaluation to the PPP Secretariat by public entities. About 16 projects have been approved since March 2007 by the Inter-Ministerial PPP Committee in the education sector, public buildings, justice and culture.[67] The triggered response from the private sector was as a result of the great incentives provided by the government.

14. Conclusion

The on-going wind of change that is blowing across the globe especially in the provision of infrastructures through the PPPs undoubtedly is a most welcomed development. It

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[66] In the words of Mr. Tola Oshobi of BOB & Co, a leading legal practitioner in the field of PPP, in Lagos State, Nigeria in an interview conducted by Mubarak (co-author of this article) on 27th September, 2012.

[67] See Marily Paralika, "PPP Law Brings Positive Change to Public, Private Sectors in Greece" in International Disputes Quarterly Winter 2008 at p. 2. Retrieved from http://www.whitecase.com/idq/winter_2008_6/. Accessed on 16th August 2009.

could easily be touted as the contemporary mantra for socio-economic development. Nonetheless, a lot of commitments are still required especially on the part of the governments in the developing world. If the governments see PPPs as a profit-making enterprise; if guarantees are provided for the concessionaires by the governments; if tax reliefs or incentives are made available to the concessionaires; if the existing legal and regulatory regimes are built upon and constantly consolidated; if a level playing field and an enabling environment are provided; and if arbitration clause is made a compulsory part of PPP contracts, then Nigeria and other African nations can reap and boast of unprecedented economic development in their infrastructure base and achieve the Millennium Development Goals in the not-too-distant future. The same is also true of other regions of the globe with particular reference to the common law countries.[68]

[68] The authors will like to express their sincere gratitude to Grace Xavier for her generous comments on a few aspects of arbitration law covered in this article.

Establishment of Judicial Commissions in Malaysia and Bangladesh to Strengthen the Constitutional Process of Appointment of Judges of the Higher Judiciary: A Comparative Study

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Abstract

In order to strengthen the constitutional process of appointment of judges in Superior Courts, Malaysia by enacting an Act in 2009 established the Judicial Appointments Commission and Bangladesh established a Supreme Judicial Commission in 2008 by promulgating an Ordinance. This Act/Ordinance was neither passed/ promulgated in pursuance of any provisions of the Constitution nor by introducing any amendment to the provisions of the Constitution. The recommendations of the both the Commissions were not given binding force on the executive. The power of the executive to accept or reject the candidates recommended by the Judicial Appointments Commission/Supreme Judicial Commission at his pleasure defeats the very objective of establishing the Commission for appointing the most competent and suitable persons as judges of the superior courts in Malaysia and Bangladesh.

I. Introduction

Despite the fact that the question of performing judicial functions independently by judges comes after their appointment, the method of appointment of judges is the crucial and dominant factor to ensure their substantive independence, the independence which means the independence of judges to arrive at their decisions in accordance with their oath of office without submitting to any kind of pressures- internal and external- but only to their own sense of justice and the dictates of law. For, the appointment of a judge on account of political allegiance in utter disregard to the questions of his qualifications, merit, ability, competency, integrity and earlier performance as an advocate or judicial officer may bring in, to use the words of President Roosevelt, "Spineless" Judges who can hardly be expected to dispense justice independently according to law and their own sense of justice without regard whatsoever to the wishes and desire of the government of the day. There is a great possibility that such a judge may remain "indebted to those responsible for his designation... the beneficiary is exposed to the human temptation to repay his debt by a pliable conduct of his office"[1] especially when the executive itself is

[1] Karl Loewenstein, *Political Power and the Governmental Process* (University of Chicago Press, 1957), at page 231.

the largest single litigant before the courts. As H. J. Laski aptly said, '[i]t is not necessary to suggest that there will be conscious unfairness; but it is ....possible that such judges will, particularly in cases where the liberty of the subject is concerned, find themselves unconsciously biased through over-appreciation of executive difficulty."[2]

Of the four methods of appointment of judges[3], appointment by the head of the state is followed in most of the countries of the world, particularly in most of the common law countries, with striking variations, regarding consulting, recommending or confirming entities. As common law countries, Malaysia and Bangladesh have adopted the method of appointing judges of superior courts by the Head of the State involving the scope for intrusion of politics in the selection process.

The prime objective of this paper is to examine as to what extent the establishment of the Judicial Appointments Commission/ the Supreme Judicial Commission in Malaysia and Bangladesh respectively through enactment of an Act/promulgation of an Ordinance has strengthened the constitutional process of appointment in both the countries. The constitutionality of the relevant Act/Ordinance shall also be examined. Furthermore, the independence of the Malaysian Judicial Appointments Commission shall be considered.

II. Constitutional Process of Appointment of Judges of the Superior Courts in Malaysia

The original provisions of the Constitution of the Federation of Malaya, 1957, concerning the method of appointment of judges of the superior courts have been amended first by the Constitution (Amendment) Act, 1960 and then by the Constitution (Amendment) Act, 1963. The existing procedure for the appointment of judges of superior courts in Malaysia resembled the British practice obtaining prior to the enactment of the Constitutional Reform Act, 2005.[4] The Constitutional head of Malaysia is circumscribed to exercise his power of appointing the heads and other judges of the three courts- the Federal Court, the Court of Appeal and the two High Courts- on the advice of the Prime Minister. The Prime Minister is always required to consult before giving his advise to the Head of the State, the Conference of Rulers[5] and in respect of the appointment of the judges of three superior courts, the respective heads of the courts i.e. the Chief Justice of the Federal Court, the President of the Court of Appeal and the Chief Judge of the High Court concerned.[6] Furthermore, in appointing the judges of the High Court in Sabah and Sarawak[7] the Head of the State is obligated to consult the Chief Minister of each of the two states.[8] It should be stressed here that each of the functionaries has a distinct and valuable role to play:

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2 H. J. Laski, *Studies in Law and Politics* (Transaction Publishers, 2009), at page 170.

3 The four methods of appointment of judges are: 1) appointment by the executive, 2) election by the legislative, 3) election by the people, and 4) appointment by the judicial service commission.

4 *See* O Hood Phillips and Jackson, *Constitutional and Administrative Law* (Sweet and Maxwell, 2001), at page 431; R.M. Jackson, *The Machinery of Justice in England* (Cambridge University Press, 1960), at page 232.

5 The Federal Constitution of Malaysia, 1963, Art 122B(1).

6 *Ibid.* Art 122B(4).

7 Sabah and Sarawak are two Malaysian States on the island of Borneo.

8 Supra note 5, Art 122B(3).

the Conference of Rulers as to the antecedents of the candidates and heads of the three superior courts as to the legal suitability of candidates for appointment. However, after consultation with the constitutional functionaries, the final word in respect of the sensitive subject of the appointment of judges of superior courts belongs to the Prime Minister on whose advice the head of the state is obliged to make the judicial appointment. Thus it appears that there is a scope of considering those with the right political patronage and right beliefs as the most suitable for appointment.

III. Judicial Appointments Commission Act, 2009

A. Background of Enacting the Act

The 1988 judicial crisis, which is an unprecedented upheaval and turmoil in the Malaysian Judiciary, witnessed the unceremonious dismissal of the then Lord President[9] and two Supreme Court Judges[10] and their vacant posts were filled in allegedly with the favourites of the regime. For example, the then Chief Justice of Malaya and acting Lord President of the Supreme Court Abdul Hamid Omar, who chaired the First Tribunal that recommended the removal of Tun Salleh Abbas as Lord President, was appointed as the Lord President to succeed Tun Salleh Abbas on 10 November 1988 and Tun Eusoff Chin, who chaired the Second Tribunal which injudiciously recommended the removal of two of the five Judges of the then Supreme Court, was first appointed as the Chief Justice of the High Court of Malaya on 21 May 1994 and eventually as the Chief Justice of Malaysia on 23 September of the same year (and remained in that office till December 2000).[11] Both the justices, particularly Tun Eusoff Chin, were confronted with grave allegations[12] during their terms of office which had the dreadful impact of eroding the public confidence in impartiality and independence of the Malaysian Judiciary.[13] These kinds of improprieties in the state of affairs of the judiciary had the effect of seriously undermining and eroding the integrity and impartiality of the judges to such an extent that a reputed former Chief Justice, Tun Mohamed Suffian, deplored: "When I am asked what I thought, my usual reply is that I wouldn't like to be tried by today's judges especially if I am innocent."[14] The Human Rights Commission of Malaysia, which was set up on 20 April 2000, recommended in 2005 for the establishment of an independent Judicial Appointments Commission to ensure transparency in the appointment process and enhance public confidence in the

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9 Tun Salleh Abas.

10 Tan Sri Wan Suleiman and Datuk George Seah.

11 Datuk George Seah, "Crisis in the Judiciary- Part 4 & 5, the Suspension of the Supreme Court", *INFOLINE,* 1 May 2004, at pages 46-49.

12 For details of these allegations see Wu Min Aun, "The Malaysian Judiciary: Erosion of Confidence", (1999) 1(2) *Australian Journal of Asian Law* 124. *New Strait Times*, 30 May 2000. Roger Mitton, "A Flurry of Questions about Malaysian Justice", *Asiaweek*, July 1996.

13 *See* Wu Min Aun, "The Malaysian Judiciary: Erosion of Confidence", (1999) 1(2) *Australian Journal of Asian Law* 124 and *New Strait Times*, 30 May 2000.

14 Centre for Public Policy Studies (CPPS), Policy Factsheet: Judiciary, available at < http://www.cpps.org.my/downloads/factsheets/Judiciary%20factsheet.pdf> (visited 2 February 2010).

judiciary.[15] But the proposal for the formation of such a Commission received a hostile and unfavourable response from a person none other than the Chief Justice of Malaysia, Tun *Dato* Seri Ahmad Fairuz Bin *Dato* Sheikh Abdul Halim (who became CJ in 2003), first in November 2005 in an International Conference held in Philippines[16] and then in an interview with the New Straits Times in February 2007 in Kota Baru after chairing a meeting with the Kelantan Judges.[17] The reasons for this antagonistic attitude of the Chief Justice towards the establishment of a Commission became distinct and crystal clear on 19 September 2007 when a video clip, recorded in 2002, showing senior lawyer V.K. Lingam's telephonic conversation with the then Chief Judge of Malaya (the Judiciary's third ranked post) Ahmad Fairuz Sheikh Abdul Halim on the urgency to get the latter appointed to the position of the President of the Court of Appeal (second in rank) and then the Chief Justice of Malaysia- the highest judicial post in the country- was made public by the People's Justice Party. The fact that the incumbent Chief Justice had been an overt beneficiary of the prevailing system of appointment was substantiated in the Report of the Royal Commission of Enquiry submitted to the *Yang di-Pertuan Agong* on 9 May 2008.[18] Perhaps taking into account the seriousness of the matter and its far-reaching implications on the judiciary, the then Prime Minister *Datuk* Seri Abdullah Ahmad Badawi in April 2008, one month before the submission of Report by the Royal Commission of Enquiry's on the V.K. Lingam affair, announced the decision of the Government to set up a Judicial Appointments Commission.[19] In order to ensure transparency in the method of judicial appointment to the superior courts, much expected Judicial Appointments Commission Bill was placed before the Parliament on 10 December 2008. The passing of the Bill by the House of Representatives within eight days of its initiation and approval by the Senate within two days of its introduction demonstrate that the Bill, concerning the establishment of an important body to ensure transparency in the judicial appointments, was not passed after adequate deliberation, thoughtful debate or meaningful discussion to maximize reasons and minimize the defects of the Bill. The Judicial Appointments

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15 Report for the Universal Periodic Review on Malaysia, 4th Session, February 2009, from the Human Rights Commission of Malaysia, p 13.

16 Honourable Tun Dato Sri Ahmad Fairuz Bin Dato Sheikh Abdul Halim, 'Judicial Independence, Accountability, Integrity and Competence- Some Aspects of the Malaysian Position', presented during the International Conference and Showcase on Judicial Reforms held at the Shangri-La Hotel, Makati City, Philippines from 28-30 November 2005.

17 *New Straits Times*, 21 February 2007; Lim Kit Siang, "CJ Fairuz's poor taste in equating Judicial Appointments Commission to 'nudity'", 22 February 2007, available at < http://www.malaysianbar.org.my/general_opinions/comments/cj_fairuzs_poor_taste_in_equating_judicial_appointments_commission_to_nudity.html> (visited 10 November 2010).

18 The Royal Commission of Enquiry on the Video Clip Recording of Images of a Person Purported to be an Advocate and Solicitor Speaking on the Telephone on Matters Regarding the Appointment of Judges (2008) Report, Vol.1, pp 75-76. The Commission found evidence that several individuals, including the former Prime Minister and two former Chief Justices, were involved in the fixing of judicial appointments and judicial decisions. Other judges accepted gifts and bribes from Lingam and other key individuals. Shockingly, in one case, a judge's judgment was completely written by Lingam himself, who was a counsel for the plaintiff, Vincent Tan.

19 Cabinet approves Judicial Appointments Commission, available at < http://www.themalaysiainsider.com/index.php/malaysia/12957_cabinet_approves_judicial_appointments_commission> (visited 10 November 2009).

Commission Act, 2009 which came into force on 2 February 2009[20] provides, inter alia, "for the establishment of the Judicial Appointments Commission in relation to the appointment of judges of the superior courts…."[21]

B. Composition of the Commission

The Judicial Appointments Commission Act, 2009 provides for the establishment of a nine-member Judicial Appointments Commission to be comprised of two types of members: ex-officio and non ex-officio.[22] The number of ex-officio members from the three superior courts- the Chief Justice of the Federal Court, the President of the Court of Appeal, the Chief Judge of the High Court in Malaya and the Chief Judge of the High Court in Sabah and Sarawak- is four, whereas the number of non ex-officio members is five to be appointed by the Prime Minister. Of the five non ex-officio members, one is to be a judge of the Federal Court to be appointed by the Prime Minister at his sole discretion without consulting any relevant person or authority while other four non ex-officio members are to be 'eminent persons', not being 'members of the executive or other public service', who are to be appointed by the Prime Minister after consultation, not concurrence, with various stakeholders in the administration of justice, namely, (i) the Bar Council of Malaysia, the Sabah Law Association, the Advocates Association of Sarawak, the Attorney General of the Federation, the Attorney General of a State legal service or any other relevant bodies.[23] Thus the Prime Minister appoints the majority of the members of the Commission- five out of nine- and in doing so he is more likely to be swayed by political allegiance of the persons concerned. This leaves the door wide open for selecting candidates by the Judicial Appointments Commission in deference to the Prime Minister's covert wishes for vacancies in the superior courts and, as such, the very purpose of setting up of the Commission, independent of the Prime Minister, for a fair, independent and impartial selection tends to be defeated. The position may eventually go from bad to worse if the Prime Minister exercises, under the Act, the power of appointing "any person he deems fit to fill the vacancy ... created [out of death, conviction, bankruptcy, insanity, resignation, absence from three consecutive meetings of the Commission without leave of the Prime Minister] for the remainder of the term vacated by the member or for the interim period until a new person is appointed to the office or the position held by that member prior to his vacating the office or position."[24] It seems that in order to exclude political bias in filling casual vacancy in the Commission, the Chairman of the Judicial Appointments Commission should have been given the power (of filling in casual vacancy in the Commission) as the Chief Justice of Namibia has been empowered by the Constitution to fill in any casual vacancy in the Judicial Service Commission.[25]

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20 P. U. (B) 43/2009.

21 The Judicial Appointments Commission Act, 2009, s 1(3).

22 *Ibid.* s 5(1).

23 *Ibid.*

24 *Ibid.* s 10(2).

25 The Constitution of Namibia, 1990, in Art 85(4) provides that "Any casual vacancy in the Judicial Service Commission may be filled by the Chief Justice or in his or her absence by the Judge appointed by the President."

C. Selection Criteria

A candidate is qualified for selection as a judge of the High Court, if he fulfils the requirements (i.e. citizenship, ten years experience as an advocate of the High Courts or as a member of the judicial and legal service of the Federation or of the legal service of a state) laid down in Article 123 of the Federal Constitution.[26] The Judicial Appointments Commission Act, though not required by the Constitution, has spelled out certain criteria to take into account by the Commission in selecting candidates for appointment.[27]

The enumeration of certain important criteria of honesty, fairness, good health, strong achievement, aptitude, knowledge and the ability to write judgments in time is a positive development in line with the modern trend of specifying certain benchmarks to be found in some of the constitutions of the world for selecting in a holistic manner the best candidates as judges. For example, the Constitution of the Islamic Republic of Comoros provides that the members of the Supreme Court shall be chosen on the basis of their competence, their integrity and their knowledge of law.[28] Jurist like Chief Justice Dickson (of Canada) also looks for in a good judge the five qualities of: integrity, equanimity, legal knowledge, patience and common sense.[29]

However, a serving judge or judicial commissioner must be disqualified for appointment if he has three or more pending judgments or unwritten grounds of judgments that are overdue by sixty days or more from the date they are deemed to be due.[30] Such a provision is also to be found in the 1994 Code of Ethics, adopted by the *Yang di-Pertuan Agong* on the recommendation of the Chief Justice of the Federal Court, the President of the Court of Appeal and the Chief Judges of the High Court, after consulting the Prime Minister in pursuance of the Constitution (Amendment) Act, 1994, which provides that judges should not inordinately and without reasonable explanation delay in the disposal of cases, the delivery of decisions and the writing of grounds of judgments. Despite these provisions, the justification of incorporating similar provisions into the Judicial Appointments Commission Act demonstrates Government's seriousness to address past public criticisms regarding the appointment/promotion of a High Court Judge to the Federal Court in August 2007 "who had not submitted written judgments in 33 cases"[31], of which in three cases, death sentences were passed against the accused.

D. Initiation of the Proposal for Selecting the Candidates

It is a very rare arrangement that the initiations of the proposals for selecting the candidates for vacancies in the offices of the Chief Justice of Malaysia (i.e. head of the Federal Court), President of the Court of Appeal, Chief Judge of the High Court in Malaya and Chief Judge of the High Court in Sabah and Sarawak have been given to the retiring, not retired, heads of three superior courts respectively- the retiring Chief Justice, the President and Chief Judges- who are, through their long association with the respective

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26 The Federal Constitution of Malaysia, 1963, Art 123.

27 The Judicial Appointments Commission Act, 2009, s 23(2).

28 The Constitution of the Islamic Federal Republic of the Comoros, 1978, Art 32(6).

29 George Sturgess and Phillips Chubb, *Judging the World Law and Politics in the World's Leading Courts* (Butterworths, 1988), at page 148.

30 Supra note 21, s 23(3).

31 SUARAM, Overview of the Malaysian Civil and Political Rights (Kuala Lumpur, December 2007), at page 15.

court, conversant and best equipped to assess objectively the attributes of their fellow colleagues for proposing the names of their successors in office.

But the Chief Justice of Malaysia, the head of the Malaysian Judiciary and *paterfamilias* of the judicial fraternity, has also been given, following the constitutional scheme, the role of proposing names to the Commission for selection against the vacancies of the President of the Court of Appeal, and the Chief Judges of the two High Courts. Furthermore, he has been empowered, not only to propose the names against vacancies in the office of the judges of the Federal Court, but also, along with the President of the Court of Appeal, for the vacant posts of judges of the Court of Appeal. For, he is in a better position to know the functional suitability of the candidates in terms of experience or knowledge of law, ability to handle cases, firmness and fearlessness requisite for appointment as the superior court judges for ensuring dispassionate and objective adjudication. It is expected that the incumbent Chief Justice of Malaysia, President of the Court of Appeal and retiring heads of the three superior courts shall not be imperceptibly influenced by extraneous or irrelevant considerations and shall be free from bias, predilection or inclination in proposing names of the suitable candidates for appointment on the bench. Perhaps taking into account the nature and importance of judicial appointment, plurality of sources of proposing competent candidates from outside judiciary has also been provided for. Thus eminent persons having knowledge of the legal profession or achieved distinction in the legal profession have been empowered to propose names for the consideration of the Judicial Appointments Commission in respect of vacancies in the Federal Court and the Court of Appeal. Hence there is the scope for the stalwarts in legal profession to be associated with the selection process for judicial appointment.

E. Selection Procedure

The transparent process of selection involves two parts, namely the screening of the antecedent or background of the candidates and ascertaining the suitability of the candidates for judicial appointment on the basis of fitness and competence. The initial investigation of potential judicial candidates by the four agencies of (a) Malaysian Anti Corruption Commission, (b) Royal Malaysia Police, (c) Companies Commission of Malaysia, and (d) Department of Insolvency Malaysia to verify their educational qualification, financial position statement, tax payment record and credit history as to arrest and conviction may be compared with the crucial investigation of the prospective judicial candidates done by the US Federal Bureau of Investigation (FBI) on receipt of three names from the Office of Policy Development (OPD) of the Department of Justice (supervised and directed by the Attorney General) after its positive preliminary evaluation.[32] However, the Secretary to the Commission prepares a deliberation paper on each of the candidates, about whom the relevant agencies have given satisfactory and positive reports, for the consideration of selection by the Commission.

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[32] The names of the candidates are also sent to the American Bar Association (ABA) for assessing their qualifications including temperament. The ABA's informal piece of advice to the Department of Justice on the rating of the candidates' states: "well qualified", "qualified" or "not qualified." If the ABA rating is positive, the FBI report is satisfactory and the Department of Justice's evaluation is favourable, then the Attorney General formally recommends the nomination to the President.

F. Consideration of Report by the Prime Minister

After receiving the report of the Commission as to the selection of the candidates for the appointment to the office concerned containing reasons for selection and necessary information[33], the Prime Minister may "request" for two more names to be selected and recommended for his consideration with respect to any vacancy to the office of the Chief Justice of the Federal Court, the President of the Court of Appeal, the Chief Judge of the High Court in Malaya, the Chief Judge of the High Court in Sabah and Sarawak, judges of the Federal Court and the Court of Appeal, and the Commission [which maintains reserve candidates for this purpose] shall, as soon as may be practicable, comply with the request in accordance with the selection process as prescribed in the regulations made under this Act.

Thus the Judicial Appointments Commission, which has been given the authority to vet and select the best candidates taking into account the selection criteria as laid down in Article 123 of the Federal Constitution and Section 23 of the Judicial Appointments Commission Act, 2009, requires unjustifiably to propose varying number of minimum candidates: not less than three candidates for each vacancy of the High Court Judge and not less than two persons for each vacancy of the Federal Court Judge and the Court of Appeal Judge. Again the Prime Minister may require the Commission to select and recommend two more names for his consideration, not for an appointment against a vacant post of the High Court, but only for appointment to an office bearer position of the three superior courts- the Chief Justice of the Federal Court, the President of the Court of Appeal, the Chief Judge of the High Court in Malaya and the Chief Judge of the High Court in Sabah and Sarawak- and judges of the Federal Court and the Court of Appeal. The Commission is required to comply with such a request from its reserve candidates as soon as may be practicable. Thus the Prime Minister is empowered to reject the well considered selection of two candidates by the Commission for vacant positions of the office bearers of three superior courts and judges of the Federal Court and the Court of Appeal without any obligation to make his reasons for such a rejection known to the Commission and request for two additional names without assigning any reasons whatsoever. Generally, it is expected that the Commission will recommend the best two suitably candidates available for the first instance against those vacant posts and being requested for two additional names, it shall comply with the request from the 'reserve candidates'[34] who may be of comparatively less appropriate candidates. The provision for providing the Prime Minister with the multiple choices of four candidates for appointment to the each office bearer position of the Federal Court, the Court of Appeal and two High Courts and each vacant post of judges of the Federal Court and the Court of Appeal is

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33 Supra note 21, s 26(1).

34 As Reg 9, the Judicial Appointments Commission (Selection Process and Method of Appointment of Judges of the Superior Courts) Regulations, 2009 provides that "1) In selecting candidates to be recommended for appointment to the superior courts, the Commission shall ensure that reserve candidates are available for purposes of complying with any request that may be made by the Prime Minister under s 27 of the Act. 2) Upon receiving a request from the Prime Minister under s 27 of the Act, the Commission shall submit the names of the reserve candidates and its report under s 26 of the Act."

incompatible and inconsistent with the very purpose of establishing the Commission as an effective and meaningful selection body.

G. Tender of Advice

As to the acceptance of the candidates recommended by the Commission for Prime Minister's consideration, the Judicial Appointments Commission Act provides that: "Where the Prime Minister has accepted any of the persons recommended by the Commission, he may proceed to tender his advice in accordance with Article 122B of the Federal Constitution."[35]

Thus it is not explicitly and unequivocally stated that the Prime Minister must accept only those candidates recommended by the Commission for proceeding to tender his advice to the *Yang Di Pertuan Agong* under Article 122B of the Federal Constitution. Because of the using of vague and imprecise words of "where the Prime Minister has accepted any of the persons recommended by the Commission", it appears that the Prime Minister is not bound to recommend to the Head of the State after consulting the Conference of Rulers from among those candidates shortlisted by the Judicial Appointments Commission for appointment in the vacant posts of judges of the Superior Courts. If the Prime Minister is free to accept or reject the recommendation of the Commission, then there is little point and justification in having such a "toothless tiger."

H. Independence of the Commission

The kernel and success of the Judicial Appointments Commission lie in its independence. The member of the Judicial Appointments Commission is expected to perform their function of selecting and recommending suitable persons for judicial appointment without submitting to their personal likeness or dislikeness and improper influences, inducements or pressures from any quarter except toeing the line with the constitutional and legal criteria and the commands of their conscience. The Commission will only be as independent as the members of which it is composed. The question of independence of the Commission is inextricably linked with, apart from the method of appointment, its members' security of tenure, salaries and other terms and conditions of service.

The conferring on the Prime Minister the power to appoint majority of the members of the Judicial Appointments Commission (five out of nine) is, as it seems, deliberately designed to staff the Commission with pro-Government people to retain his control over the judicial selection and recommendation process. Furthermore, the four out of five appointed (except appointed Federal Court Judge) members of the Commission from the category of "eminent persons" have not been given the security of tenure, the most fundamental of the guarantees of independence of the members of the Commission for enabling them to perform their functions without fear of the consequences regardless of whether their job or actions do not please the Prime Minister or some other person. For, the appointment of any of the four eminent persons as members "may at any time be

[35] Supra note 21, s 28.

revoked by the Prime Minister without assigning any reason."[36] Thus the four non ex-officio members of the Commission (indeed eminent persons), who are appointed "for a period of two years and are eligible for reappointment"[37] for another term only, cannot be expected to acquire that habit of independence in discharging their duties without fear or favour requisite in their office if their grounds of removal are not clearly specified and their removal procedure is not made a difficult process involving careful consideration by an independent body other than the Prime Minister.

Furthermore, all the members of the Commission have not been given the security of providing them with adequate allowances and appropriate privileges during their terms of office. For, the "members of the Commission shall be paid such allowances as the Prime Minister may determine"[38] which implies that the Prime Minister has not only given the absolute and unfettered power to determine the amount of allowances for the Commissioners but also to alter the amount of allowances to their disadvantages. Taking these realities into account, the Constitution of the Sovereign Democratic Republic of Fiji, 1990 has aptly vested the power with the Parliament to fix allowances for the members to the Judicial Service Commission.[39]

On top of it, the Judicial Appointments Commission Act contains a very unusual stipulation as to the amendment of its provisions in Section 37. the Parliament, which has passed the Judicial Commissions Act, has been deprived of its inherent power of modifications, including "amendments, alteration and non-application of any provisions of this Act," to remove the defects of the Act after its coming into force with a view to improve the existing arrangement keeping pace with changing needs of time. The power of modifications has been completely given to the Prime Minister in the two years of the coming into operation of the Act by ministerial order usurping the power of the Parliament.

Therefore, it appears that the provisions of the Judicial Appointments have been carefully crafted to incapacitate the members of the Commission, particularly the members appointed from the category of eminent persons, from performing their functions of selecting and recommending candidates for appointment as judges of the superior courts independently and "to uphold the continued independence of the judiciary" without paying any attentions to the wishes and desires of the Prime Minister.

IV Validity of the Judicial Appointments Commission Act

The Federal Constitution of Malaysia provides for a detailed procedure in Articles 122B and 122AB for the appointment judges of three superior courts, and appointment of Judicial Commissioners in the High Court in Malaya and the High Court in Sabah and Sarawak respectively by the *Yang di-Pertuan Agong* acting on the advice of, and, after consulting the designated constitutional functionaries. The qualifications for the appointment of judges in the superior courts of the Federal Court, Court of Appeal and of High Courts have been, as stated earlier, outlined in Article 123 of the Constitution.

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36 *Ibid*. s 9(1).
37 *Ibid.* s 6(1).
38 *Ibid.* s 37.
39 The Constitution of the Sovereign Democratic Republic of Fiji, 1990, Art 131(3).

The Federal Constitution neither contemplates of establishing any Judicial Appointments Commission for selecting candidates for the consideration of the Prime Minister with respect to judicial appointment in superior courts nor does it empower the Parliament to enact law determining the organization, powers and functioning of the Commission, a power which has been given to the Parliament in the Constitution of Algeria, 1989, the Constitution of France, 1958, the Constitution of Italy, 1947, the Constitution of Namibia, 1990, the Constitution of Sudan, 1998 and the Constitution of Rwanda, 2003.[40] The Constitution of Malaysia has also not empowered the Parliament to pass any law prescribing additional qualifications for the appointment of judges of superior courts as it is to be found in Article 95(2) of the 1972 Constitution of Bangladesh.[41] Furthermore, the Constitution has given the Prime Minister unfettered prerogative of exploring any number of candidates for each judicial vacancy. Therefore, it can be strongly argued that the enactment of the Judicial Appointments Commission Act, 2009 providing for the establishment of a Judicial Appointments Commission, prescribing selection criteria and limiting Prime Minister's choice to three candidates for the appointment of judges in the High Courts and ultimately four candidates for appointment as judges of the Federal Court and the Court of Appeal is unconstitutional. For, the Parliament cannot assume a power which has not been conferred on it by the Constitution itself. Furthermore, the establishment of the Judicial Appointments Commission under an ordinary Act of the Parliament consisting of, *inter alia*, the Chief Justice of the Federal Court, the President of the Court of Appeal, the Chief Judge of the High Court in Malaya and the Chief Judge of the High Court in Sabah and Sarawak as ex-officio members, has given rise to an over-lapping exercising of power under the Federal Constitution regarding judicial appointment in superior courts. For, after receiving the names of the candidates recommended by the Commission, the Prime Minister is required under the Constitution to consult again the Chief Justice of the Federal Court before tendering his advice to the *Yang di-Pertuan Agong* for the appointment of all the judges of the superior court (Federal Court), consult the President of the Court of Appeal for the appointment of judges to the Court of Appeal and consult each of the Chief Judges of the two High Courts for appointing puisne judges to the High Court concerned. This will enable the heads of the superior courts, particularly the Chief Justice of Malaysia who is a common consultee in appointing all judges of superior courts, to express their personal impression and point of view for the second time as to the suitability of the candidates having disagreed with the Commission's decision taken in the selection meeting.

In very recent times, the Constitutions of some of the countries of the world, e.g. the Constitution of Pakistan in 2010[42] and the Constitution of the UK in 2005[43], have been amended to provide for the establishment of an independent body for selection

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40 The Constitution of Algeria, 1989, Art 155; the Constitution of France, 1958, Art 65; the Constitution of Italy, 1947, Art 105; the Constitution of Sudan, 1998, Art 102(2); and the Constitution of Rwanda, 2003, Art 158.

41 After laying down the criteria of citizenship and 10 years of experience as an Advocate of the Supreme or Court or holding judicial office for 10 years, Art 95(2)(c) as an alternative requirement speaks of "such other qualifications as may be prescribed by law for appointment as a Judge of the Supreme Court."

42 Hasan-Askari Rizvi, "Constitutional Amendment and Judicial Appointments", *The Daily Times*, 16 May 2010.

43 *See* the Constitutional Reform Act, 2005.

and recommendation of duly qualified persons for appointment of judges in the superior courts in order to ensure that neither political bias nor personal favouritism and animosity play any part in judicial appointment. Therefore, it may be suggested that the Federal Constitution of Malaysia should be amended providing for the establishment of an independent, effective and meaningful body for vetting and selecting best candidates for the consideration of the Prime Minister excluding the present overlapping process which enables the office bearers of the superior courts, to have a "first bite at the cherry" as the ex-officio members of the Commission under the Act and to have a "second bite at the cherry", while expressing their personal views about the candidates under the Constitutional selection procedure if they disagreed earlier with Commission's choice.

V. Constitutional Process of Appointment of Judges of the Superior Courts in Bangladesh

The 1972 Constitution of Bangladesh originally provided that the judges of the Supreme Court "shall be appointed by the President, in consultation with the Chief Justice."[44] For, the Chief Justice of Bangladesh was in a better position to know about the competence, legal practice, seniority and integrity of the members of the bar and bench. The consultation with the Chief Justice in the selection of other judges was, indeed, a major safeguard against political and expedient appointments. The Chief Justice could reasonably be expected not to be guided by any parochial considerations and, as such, would nominate objectively names of such advocates or judicial officers who would be most suitable for appointment as judges of the Supreme Court. But the Constitution (Fourth Amendment) Act, passed on 25 January 1975, dispensed with President's obligation to consult the Chief Justice in appointing puisne judges of the Supreme Court. This left the door wide open for the President to measure fitness in terms of political eminence rather than judicial quality. But the first Martial Law Regime of Bangladesh restored on 28 May 1976 the Constitutional provision of consultation with the Chief Justice by the President in making appointment of the judges to the Supreme Court. The President's obligation to consult the Chief Justice in appointing the judges of the Supreme Court was again dispensed with on 27 November 1977 by the new President and Chief Martial Law Administrator Major General Ziaur Rahman. However, it is claimed that he himself developed the convention of consulting the Chief Justice of Bangladesh in appointing the puisne judges of the Supreme Court.[45] Thus the power to appoint the judges of the Supreme Court is an executive power vested in the President who is duty bound, as a constitutional head, to exercise this power under Article 48(3) "in accordance with the advice of the Prime Minister" after consulting the Chief Justice of Bangladesh.

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[44] The Constitution of the People's Republic of Bangladesh, 1972, original Art 95(1).

[45] Justice Kemal Uddin Hossain, "Independent Judiciary in Developing Countries" (Speech delivered at the Justice Ibrahim Memorial Lecture Series, University of Dhaka, 1986), at page 45.

VI. The Supreme Judicial Commission of Bangladesh

A. Background

Since the number of judges to be appointed in the High Court Division and Appellate Division of the Supreme Court of Bangladesh has been kept indeterminate,[46] it is to be determined by the President on the advice of the Prime Minister. Although the Appellate Division of the Supreme Court has the strength of judges determined by the President from time to time, there is no such strength for the High Court Division fixed by the President. Thus the number of judges varies at the pleasure of the executive. If the President is satisfied that the number of judges of a Division should for the time being be increased then the President may under Article 98 of the Constitution appoint Additional Judges to the said Division for a period of two years. The successive governments have taken advantage of this lacuna to pack the Supreme Court with judges of political allegiance with the hope that they would support their action, omission and legislation if challenged. When the Government of the *Awami* League succeeded the Bangladesh Nationalist Party (BNP) Government in 1996, there were 37 judges in the High Court Division and five judges in the Appellate Division including the Chief Justice of Bangladesh. During their five year rule, the number of judges in the High Court Division was increased from 37 to 56 although the number of judges in the Appellate Division remained the same. The *Awami* League Government altogether appointed 40 additional judges to the High Court Division.[47] In October 2001, the Bangladesh Nationalist Party came to power and next year it raised the number of judges in the Appellate Division from five to seven (on 9 July 2009, President Zillur Rahman raised the number of posts of Judges in the Appellate Division of the Supreme Court from seven to 11 under Article 94(2) of the Constitution[48]). When the BNP Government relinquished power in October 2006 the number of judges in the High Court Division was 72 and it appointed altogether 45 judges.[49] In order to prevent politically motivated appointments that took place allegedly during the previous two regimes and 'to select and recommend competent persons for appointment as judges of the Supreme Court',[50] the President Iajuddin Ahmad issued on 16 March 2008 the Supreme Judicial Commission Ordinance providing for the establishment of a Supreme Judicial Commission for selection and recommendation of names to the President for appointment as additional judges and regular judges of the High Court Division and

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46 As Art 94(2) of the Constitution of Bangladesh provides that the Supreme Court shall consist of the Chief Justice, to be known as the Chief Justice of Bangladesh, and such number of other Judges as the President may deem it necessary to appoint to each division.

47 Staff Correspondent, "HC verdict on judges' appointment stayed for three weeks", *New Age*, 30 July 2008, available at < http://newagebd.com/2008/jul/30/front.html#12> (visited 10 December 2010).

48 Ashutosh Sarkar, "Appellate Division: Number of posts of judges raised to 11", *The Daily Star*, 10 July 2009, available at < http://www.thedailystar.net/story.php?nid=96265> (visited 10 December 2010).

49 Staff Correspondent, "10 new HC judges to be appointed", 31 October 2008, available at < http://www.thedailystar.net/newDesign/news-details.php?nid=61184> (visited 10 December 2010). After 2004, the B.N.P Government did not appoint any additional judges to the High Court Division.

50 First preambular para to the Supreme Judicial Commission Ordinance, 2008.

judges of the Appellate Division of the Supreme Court. The Ordinance was issued during the regime of the Non-Party Care-taker Government (consisting of the Chief Advisor and ten other nominated Advisors) which is an interim government established within 15 days of dissolution of the Parliament[51] having only the mandate to carry on ordinarily the routine functions of the government and is destined to "give to Election Commission all possible aid and assistance for holding the general elections of members of parliament peacefully, fairly and impartially."[52]

B. Composition of the Supreme Judicial Commission

The original Supreme Judicial Commission Ordinance, 2008, issued in March 2008, provided that the Commission would consist of nine members with the Chief Justice as its Chairman and the Minister of Law, Justice and Parliamentary Affairs, two senior most judges of the Appellate Division, Attorney General, two Members of Parliament- one should be nominated by the Leader of the House and the other by the Leader of the Opposition in Parliament, President of the Supreme Court Bar Association and Secretary, Ministry of Law, Justice and Parliamentary Affairs as the members of the Commission.[53] Thus among the members of the Commission the six non-judicial members constituted the majority. Since the Commission was established for a cautious, professional and non-political search for the best persons for the judgeship of the Supreme Court, based on first-hand knowledge about each of the candidate's keen intellect, legal acumen, integrity and suitability of character and temperament as an advocate and a judicial officer, the provisions for inclusion into it two members of a political body like the Parliament, and a Minister (a politician) and the Secretary (a loyal civil servant) of the Ministry of Law, Justice and Parliamentary Affairs as its members could hardly serve the purpose of selecting and recommending for appointment as judges of the Supreme Court the best potential candidate for maintaining the quality of the Bench. Although both the President of the Supreme Court Bar Association and the Attorney General (principal and Constitutional Law Officer of the Government) are pre-eminently suited to evaluate the advocates of the Supreme Court for appointment as judges, their inclusion into the Commission might not be conducive to check patronage appointment. For, they are under the distressing influence of either party in power or opposition political parties and, as such, are highly politically charged. Furthermore, out of the nine members of the Commission, the provision for including only three judges of the Supreme Court- the Chief Justice and two senior most judges of the Appellate Division- into the Commission evinced the domination of six non-judicial members in the selection process. Since the composition of the Supreme Judicial Commission was diluted, the purpose of establishing the Commission for selecting and recommending the most qualified and appropriate persons for appointment as judges of the Supreme Court was destined to be frustrated.

But only three months after the promulgation of the Ordinance, on 16 June 2008, the Supreme Judicial Commission (Amendment) Ordinance, 2008 was issued to introduce

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51 The Constitution of the People's Republic of Bangladesh, 1972, Art 58C(2).

52 *Ibid*. Art 58D (2).

53 The Supreme Judicial Commission Ordinance, 2008, s 3(2).

changes in the composition of the Commission by which the provision of appointing two members of Parliament (one from the ruling party and other from the opposition) and the Secretary of the Ministry of Law as the Commission's members were deleted and provision was made to include two senior most judges of the High Court Division of the Supreme Court as the members of the Commission. Thus under the new arrangement, the Commission would consist of the Chief Justice as its ex-officio Chairman and the Minister of Law, three senior most judges of the Appellate Division (previously it was two), two senior most judges of the High Court Division, the Attorney General and the President of the Supreme Court Bar Association, altogether eight, as the ex-officio members.

Thus unlike Malaysia, the Prime Minister or President of Bangladesh was not given any authority to appoint any imminent person, jurist or supreme court judge, close to the regime, as members of the Commission. It is noticeable that the majority of the members of the Commission- six out of nine- are ex-officio members of the Commission from the Judges of the High Court Division and Appellate Division of the Supreme Court. Thus the majority judicial members having expert knowledge about the candidate's acumen and suitability dominate the selection process of judges for appointment to the highest judicial office. The other three members- the Law Minister, the Attorney General and the President of the Supreme Court Bar Association (if the Bar President has political allegiance to the party in power)- could make an abortive attempt in the meeting of the Commission in deference to the wishes of the Prime Minister/President for filling in the vacancies in the Supreme Court. However, the inclusion of the two senior most judges of the High Court Division into the Supreme Judicial Commission may be considered as a positive development in the sense that the large number of lawyers appear before them and only a small fraction of the lawyers having a good length of practice and better reputation and standing (generally not interested to become a judge) appear before the Appellate Division of the Supreme Court.

Unlike the Judicial Appointments Act of Malaysia, 2009, there is no provision in the Supreme Judicial Commission Ordinance, 2008 to fill in casual vacancies as all the members of the Commission were ex-officio members.

C. Selection Process

Unlike the Judicial Appointments Commission of Malaysia, the Supreme Judicial Commission of Bangladesh was not given any discretion to advertise in the Commission's website or in any other medium the Commission deems appropriate, to fill in any vacancy in the office of a judge of the Supreme Court. Thus any citizen having the experience of practising before the Supreme Court for a period not less than 10 years or a judicial officer having not less than ten years experience could not apply directly for selection as a judge of the High Court Division of the Supreme Court. The Commission was required to consider the names of the candidates proposed by the Law, Justice and Parliamentary Affairs Ministry.[54] The Law Ministry could propose minimum three and maximum five names for each vacancy to the Commission for its consideration to recommend for

[54] *Ibid.* s 6(1).

appointment by the President as additional judges and judges of the High Court Division and the judges of the Appellate Division.[55] It is obvious that candidates sharing ideological views of the party in power would have better prospects of getting nomination from the Law, Justice and Parliamentary Affairs Ministry for the consideration of the Supreme Judicial Commission of Bangladesh. However, if the Commission considered it necessary to take into account the names of the additional candidates, it could make such a request to the Law, Justice and Parliamentary Affairs Ministry or it could select any competent person outside the names proposed by the Law, Justice and Parliamentary Ministry.[56] Of course, such a candidate, if selected and recommended, would have the least chance of getting appointment for not having political patronage.

Thus non-recognition of plurality of sources of proposing candidates from outside the Ministry of Law, Justice and Parliamentary Affairs for judicial appointment was a serious drawback of the system. However, the Supreme Judicial Commission was allowed to follow a transparent process in selecting the candidates by taking interviews of the candidates at its discretion[57] as against the previous system of appointing judges of the Supreme Court which had been cloaked with secrecy and devoid of any transparency. But unlike the Malaysian Judicial Appointments Commission Act, the Supreme Judicial Commission Ordinance of Bangladesh did not contain any provision as to screening of the antecedents of the candidates by the Independent Anti-Corruption Commission, Police Forces or Tax Ombudsman of Bangladesh in respect of their educational qualification, tax payment record, credit history as to arrest and conviction, integrity etc.

D. Functions and Selection Criteria

The authority of the Commission was confined only to select and recommend candidates for appointment as regular and additional judges to the High Court Division and of regular judges to the Appellate Division of the Supreme Court. But, unlike the Judicial Appointments Commission of Malaysia, it was not given the jurisdiction to recommend candidates for appointment as the Chief Justice of Bangladesh. It was also not given any authority to discuss about the disposal of cases and improving the performance of the Supreme Court Judges. The Supreme Judicial Commission Ordinance provided for different sets of criteria for the consideration of candidate's by the Commission for the appointment of additional judges in the High Court Division and Judges in the Appellate Division of the Supreme Court. The Commission was required to consider the candidates' educational qualifications, professional skills (efficiency), seniority, honesty and reputation (along with other ancillary matters) in recommending for appointment as additional judges of the High Court Division.[58] On other hand, for recommending any judge of the High Court Division of the Supreme Court for appointment to the Appellate Division, his seniority, judicial skill, integrity and reputation (along with other subsidiary matters) were to be taken into account by the Commission.[59]

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55 *Ibid*. s 6(2).
56 *Ibid.* s 6(3).
57 *Ibid.* s 5(7).
58 *Ibid.* s 5(6).
59 *Ibid.* s 5(5).

E. Selection Meeting of the Commission

The Supreme Judicial Commission of Bangladesh was required to sit at least once in six months.[60] But the Chairman of the Supreme Judicial Commission, the Chief Justice, would immediately convene the meeting of the Commission if he was requested to do so for selecting and recommending the names by the President or by the competent authority (i.e. Ministry of Law, Justice and Parliamentary Affairs under the Rules of Business) for the appointment of judges of the Supreme Court.[61] It was stressed that the Commission first would strive at to take a unanimous decision, perhaps taking into account the importance of appointing the most qualified and suitable persons as judges, for maintaining the quality of the Bench. If that was not possible, the decision was to be taken by a majority of the members present.[62] The presence of five members, out of nine, would constitute quorum of the meeting and a decision to recommend names for appointment could be taken by a majority of the members present which implied that a decision of the Commission might be taken by the support of three members if only five members attended the meeting.[63] Unlike the Malaysian Judicial Appointments Commission, it did not say that the quorum would include the Chairman. But like the Malaysian Judicial Appointments Commission, it was provided that when there was an equality of votes, the Chairman of the Commission or the person presiding over the meeting could exercise a casting vote.[64] It is to be stressed here that the three non-judicial members of the Commission (the Law Minister, Attorney General and President of the Supreme Court Bar Association) were allowed to attend its meeting as members of the Commission for selecting and recommending the High Court Division judges for appointment to the vacant posts in the Appellate Division. But the senior most judges of the High Court Division as the Members of the Commission were precluded from taking part in its meeting without assigning any reason whatsoever (for example, if he was being considered for selection).[65] However, the Commission was required to select and recommend two candidates for each vacancy of the Supreme Court judge (that was the usual practice) without the requirement of any mention of the order of preference[66], perhaps to give a free hand to the appointing authority in selecting any of the two candidates proposed.

F. Consideration of Report by the President

The Supreme Judicial Commission of Bangladesh was required to send its recommendation to the Ministry Law, Justice and Parliamentary Affairs for forwarding it to the President.[67] Ordinarily the President would appoint the judges of the Supreme Court in accordance with the recommendation of the Commission.[68] In case of differing with the recommendation of

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60 *Ibid.* s 4(5).
61 *Ibid.* s 4(6).
62 *Ibid.* s 4(7).
63 *Ibid.* Proviso to sub-section (4) to Section 4.
64 Supra note 61.
65 *Ibid.* s 4(9). Added by the Supreme Judicial Commission (Amendment) Ordinance, 2008.
66 *Ibid.* s 5(2).
67 *Ibid.* s 7.
68 *Ibid.* s 9(1).

the Commission, the President would send the recommendation back to the Commission for its reconsideration.[69] After receipt of any request from the President for reviewing any recommendation, the Commission would promptly reconsider the recommendation and would send either its modified recommendation or earlier recommendation with recorded reasonable grounds to the President.[70] The President was given the right to ignore and reject the recommendation of the Commission by recording appropriate reasons.[71]

Thus the power of the President to accept or reject the candidates recommended by the Commission at his pleasure defeated the very objective of establishing the Commission for appointing persons of highest calibre, character, professional skill and integrity as judges (i.e. right type of judges) to the Supreme Court.

VII. Validity of the Supreme Judicial Commission Ordinance

The Ordinance making power of the President of Bangladesh, conferred on him by Article 93 of the Constitution as a legislative function, is a relic of the Government of India Act, 1935[72] which is of the nature of an emergency power, to meet "circumstances" that "render immediate action necessary" when "Parliament stands dissolved or is not in session"[73] to secure the enactment of necessary legislation instantly. Apart from the time and circumstances, there are other limitations on the ordinance making power of the President, who is the sole judge of the necessity of issuing an ordinance (as Article 93 contains the words "if the President is satisfied"); he cannot promulgate an ordinance making any provision i) which could not lawfully be made under this [the Bangladesh] Constitution by Act of Parliament; ii) for altering or repealing any provision of this Constitution.[74] Although the ordinance making power of the President should be exercised sparingly, there has always been a tendency on the part of the successive Governments to resort to such a power frequently than seems necessary and desirable. However, the Supreme Judicial Commission Ordinance was issued in March 2008 during the regime of the third Non-Party Care-taker Government established after the dissolution of the Parliament in 2007 as a stopgap arrangement for holding free and fair General Elections. This Government was required to discharge its function as an interim government and, as such, to carry on routine day to day works of the Government in addition to their main function of assisting and aiding the Election Commission. Hence it could not make any policy decision except in the case of necessity for the discharge of such routine functions.[75] The promulgation of the Supreme Judicial Commission Ordinance cannot be accepted as a valid piece of legislation within the framework of the Constitution due to the following grounds:

Unlike Article 115 of the Constitution of Bangladesh, which empowers the President to make rules in accordance with which he is required to exercise his power

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69 *Ibid.* s 9(2).
70 *Ibid.* s 9(3).
71 *Ibid.* s 9(4).
72 The Government of India Act, 1935, s 42.
73 The Constitution of the People's Republic of Bangladesh, 1972, Art 93(1).
74 *Ibid.* Proviso to Art 93(1).
75 *Ibid.* Art 58D (1).

of appointing subordinate judicial officers and magistrates exercising judicial functions, Articles 95(1) and 98 (which deal with appointment of regular and additional judges of the Supreme Court respectively) do not at all provide for the enactment of any law setting up a mechanism, like the Supreme Judicial Commission, for selecting candidates in the matter of appointment of judges to the Supreme Court by the President. Unlike the Constitutions of Algeria, France, Italy, Namibia, Sudan and Rwanda,[76] the Constitution of Bangladesh does not even empower the legislative authorities to enact law/promulgate ordinance regulating the organization, powers and functioning of the Commission. Article 95(2)(c) of the Constitution of Bangladesh empowers the Parliament only to pass law providing for an alternative requisite qualification (e.g. a distinguished jurist) for the appointment of judges to the Supreme Court and, as such, an ordinance if at all necessary, could only be promulgated in this regard. Instead, the Supreme Judicial Commission Ordinance, apart from providing for detailed provisions concerning the composition, functions and procedure of the Commission, laid down different selection criteria (educational qualification, professional skill, seniority, honesty and reputation for High Court Division judgeship and seniority, judicial skill, integrity and reputation for Appellate Division judgeship) for the appointment of the High Court Division as well as the Appellate Division Judges. Therefore, it can be argued that the Supreme Judicial Commission Ordinance, 2008, was not promulgated within the parameters of Articles 95, 98 and 65[77] of the Constitution of Bangladesh and, as such, is *ultra vires* of the Constitution of Bangladesh.

VIII. Functioning of the Supreme Judicial Commission

For the first time in the history of Bangladesh, the President on 12 November 2008 appointed the seven new additional judges to the High Court Division for two years on the recommendation of the Supreme Judicial Commission[78] of which one regretted to accept the offer of judgeship due to his ill-health. The Commission also recommended in its first meeting, held on 16 October 2008, four senior most judges of the High Court Division for the two vacant posts of the Appellate Division.[79]

IX. Natural Death of the Supreme Judicial Commission

It is ironical that the Bangladesh *Awami* Lawyers Association, a platform of pro-*Awami* League lawyers, demanded on 26 July 2008 that the Supreme Judicial Commission Ordinance, 2008 be repealed.[80] After coming to power by obtaining a landslide victory

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76 Supra note 40.

77 Art 65(1) of the Constitution of Bangladesh, 1972 provides that 'There shall be a Parliament for Bangladesh (to be known as the House of the Nation) in which subject to the provisions of this Constitution, shall be vested the legislative powers of the Republic.'

78 Ashutosh Sarkar, "Appellate Division running with few judges for long", *The Daily Star*, 18 December 2008, 1.

79 *Ibid*.

80 Staff Correspondent, "No UZ elections before JS polls: AL Awami Ainjibi Parishad to form human chains Aug 7", *The Daily Star,* 27 July 2008, available at < http://www.thedailystar.net/story.php?nid=47643> (visited 10 December 2010).

in the General Elections, held on 29 December 2008, the *Awami* League regime placed 54 out of 122 Ordinances promulgated by the Non- Party Care-taker Government for the approval of the Parliament. But, as expected, the Supreme Judicial Commission Ordinance was not placed before the newly elected House of the Nation (the Parliament) for its passing into law. Therefore it met a natural death[81] as the life of an ordinance is always subject to the approval of the Parliament. Since it is the same political party which deleted from the Constitution on 25 January 1975 the provision concerning consultation with the Chief Justice by the President in appointing judges of the Supreme Court, it is only natural that it (the *Awami* League) cannot afford to experience the luxury of seeing the embargo of following a detailed and time-consuming procedure under the auspices of the Supreme Judicial Commission by the executive in the appointment of judges to the highest court of the land.

X. Conclusion

The foregoing discussion reveals that keeping the Constitutional selection procedure of appointing judges of the Federal Court, the Court of Appeal and the High Courts untouched, the Parliament of Malaysia passed in December 2008 the Judicial Appointments Commission Act providing for the establishment of a Judicial Appointments Commission. The Commission, established in February 2009, is comprised of four ex-officio judicial members and five non ex-officio members to be appointed by the Prime Minister, for selecting candidates for the consideration of the Prime Minister in the matter of the appointment of judges including heads of the superior courts.

Unlike Malaysia, the President of Bangladesh, during the regime of third Non-Party Care-taker Government, set up as an interim Government for about four months mainly to assist the Election Commission in conducting the General Elections in a free, fair and impartial manner, promulgated the Supreme Judicial Commission Ordinance, 2008 providing for the establishment of a Supreme Judicial Commission. Unlike the Malaysian Judicial Appointments Commission, which is nine-member Commission where the non ex-officio members appointed by the Prime Minister are in a majority (i.e. five in number), the Supreme Judicial Commission of Bangladesh was entirely composed of nine ex-officio members and among the ex-officio members six were from the judiciary- the Chief Justice of Bangladesh, the three senior most judges of the Appellate Division and two senior most judges of the High Court Division of the Supreme Court- who did constitute the majority. This domination of the Commission by the judicial members was more conducive to select and recommend candidates objectively keeping in mind the needs of the office in view. Although the Supreme Judicial Commission was able to recommend the best candidates to the President for appointment of judges to the Supreme Court, unlike the Judicial Appointments Commission of Malaysia it was not empowered to recommend candidates for appointment as the Chief Justice of Bangladesh. However, the recommendations of both the Commissions were not given binding force on the

[81] Rakib Hasnet Suman, "Public interest ignored in picking CG's ordinances", *The Daily Star,* 24 February 2009, 1.

executive taking into account the scheme of the Constitutions and the establishments of the Commissions in both the countries were provided for neither in pursuance of any provision of the Constitutions nor by amending them (the Constitutions). Therefore, the Judicial Appointments Commission Act of Malaysia, 2009 and the Supreme Judicial Commission Ordinance of Bangladesh, 2008 cannot be considered as valid pieces of legislations.

It seems that the present method for selection and appointment of judges to the superior courts in Malaysia and Bangladesh should be given a "decent burial" for excluding patronage appointment of judgeship or appointment on extraneous consideration. In order to strengthen the independence and impartiality of the judiciary, an independent, effective and meaningful judicial commission, representing various interests with pre-eminent position in favour of the judiciary with the power of selecting and recommending best candidates to the Head of the State for judicial appointment, is the demand of modern times.

In order to ensure that the matter of appointment in the superior courts of Malaysia and Bangladesh does not result in politically biased judges or judges who are or feel beholden to the appointing authority, an independent Judicial Appointments Commission/ Supreme Judicial Commission is to be set up through constitutional amendments. The power of appointment of judges of the superior courts by the Head of the State is to be exercised on the recommendation of such a commission. The recommendation of the Commission should be binding upon the Constitutional Head but it shall be open to the *Yang di-Pertuan Agong*/President to refer the recommendation back to the Commission in any given case along with the information in his possession regarding the suitability of the candidates. If, however, after reconsideration the Commission reiterates its recommendation, then the President/*Yang di-Pertuan Agong* shall be bound to make the appointment. Preferably the Judicial Appointments Commission/Supreme Judicial Commission should consist of ex-officio members from the higher judiciary (e.g. the Chief Justice and the six senior most judges), last retired Chief Justice or Judge, and a Professor of Law on the basis of seniority from public universities by rotation. However, it should be added that, "no procedure will be effective if the will to appoint only the best is lacking" "among the politicians of all the parties."[82] (Australian Chief Justice Harry Gibbs)

[82] Harry Gibbs, "The Appointment of Judges" (1987) 61 *Australian Law Journal* 7, at page 11.