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China, Business Law, and Finance –
Accession to the World Trade
Organization

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Sir Edward Youde Memorial Fund Council
Distinguished Visiting Professor Lecture
Hong Kong University of Science and Technology

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Mr. Arculli, Vice President Lin, Dean Biddle, Professor Lee, members of the University and guests:

I am honored to come and speak as the Sir Edward Youde Professor in Hong Kong. Those of you who have traveled recently in the United States know how many Americans at all levels and in all walks of life are glancing at China -- looking toward China -- even, as it were, staring at China. China's moving into full economic communion with the Western world is an enormous event. It will have enormous consequences. It will affect not only how we live and how well we live, both in China and in the West, our eating and drinking and clothing and medical care and hopes for our children, not only these tangible things. It will affect how we think as well.

I.

China. Business Law. Finance. Since ancient times, business has been entwined with law. Some would say that business has been a driving source of what we call a system of law: local and national law -- Chinese law, United States law -- or supranational, international, the law emerging from the World Trade Organization and other international institutions. Others would say that business is a creature of law, that without human law we do not have and would not have anything we could recognize at all as joint enterprise.

Some degree of trading may be a "natural" process. Symbiosis, which you may remember from your middle school biology, involves benign parasites, systems linked to one another, with one trading something the other needs in return for something it needs. But anything human that goes beyond primitive exchange depends upon the life and structures of human law, what we now call

business law, and depends also upon finance which is a child of business law. Two human beings trading or exchanging is natural. Money is not natural. Two human beings working together to lift a rock is natural. Thousands and hundreds of thousands working together, in what we call joint enterprise, is not natural. Predictions about another's behavior in the future may be natural. Contracts or promises about the future are not natural. Money, markets, and organizations depend upon law. Which arises first, which is the source of the other, makes no difference. They arise together.

I make this obvious point (what to me is obvious and I hope is obvious to you) to make the point that human purpose is involved in all this. Natural processes have no purpose, at least in a scientific view of them. Whatever we may think of the laws of nature and a scientific view of how the world works, human law does introduce and does express human purpose. Human purpose and human decision making, human purpose and human choice, human purpose and human responsibility, they are tied together, two sides of the same coin -- or, I should say, two sides of the same foundation rock on which law is built. And operationally, human purposes are values, protected or advanced or and achieved. The hard work of decision and the responsibility that goes with decision -- by everyone involved in business, business organization, business law, and business finance -- are guided by value. No decision is automatic. Decisions involve human values, inescapably. This is what the fundamental involvement of business with law comes to, a fundamental involvement with human value.

The event we mark here is China's accession to the World Trade Organization. The purpose of the World Trade Organization is to make the world better off, measured by values that determine what is better and what is worse. China's choice and China's decision -- and it was not inevitable; it was a choice and a decision -- is looking forward fifty years, after things have settled out, to a point where people looking back to this choice will say, "Yes, we are better off for it." This was the hope fifty or more years ago for the move to socialism in China. In America, it was the hope of the American Revolution, the hope of the American Civil War. My thesis here will be that, just as China's engagement with the West will affect it, hopefully in a good way, the West's and America's engagement with China will affect America, and in a good way. Most importantly it will affect the way we think.

II.

Let me turn from law generally to business law. What I want to do this afternoon is proceed from law to business law, then to the business entity and the financing that nourishes it, then to business decision making and the business

purpose that guides it. In the end, I hope we will be focused on that guiding purpose of the business entity, and how China's accession will affect it and our mutual understanding of it.

We call business law in the United States corporate law, the law of organizations and joint enterprise, to distinguish it from law that has its origin and much of its application in individuals' lives. While there are single proprietors who work as individuals with the law of property, contract, and agency or employment, business is overwhelmingly a matter of joint enterprise. But I might say that in important parts of business law in the United States a single individual with employees may be treated as what we call an "entity" because the arrangement has a structure and a continuity that is not just the individual's own. Certainly the moment more than one individual enters the picture, we have as you know the law of partnership or joint venture recognizing a separate entity, and we move from there into a range of ways of organizing joint enterprise whose product is not the product of one but of many. The range runs on to the new "limited liability companies" and to partnerships in which some have limited liability and there are marketed shares, to what we call "close corporations" in which individual participants all may know one another, to large corporations in which participants typically do not, to corporate groups which can be treated as a single entities, to multinational corporations, and then, even in the United States, to state-owned corporations.

In American business or corporate law we look to statutes like the People's Republic Company Law of 1993, at the level of each of the fifty American states, and to the judicial interpretation of them. But we include also as sources of corporate law, and for understanding what business is and what a business entity is, many other fields of law which are often treated as specialties unto themselves. Antitrust law, securities law, tax law, and the ordinary law of crime, environmental law, labor law, and the law of lawyers' and accountants' professional responsibility, are all clustered around organizations and the financial arrangements that sustain them.

In the United States this field, corporate law, is second only to constitutional law in basic importance. It is the law of private government, having much in common with the law governing public bureaucracies we in the United States call administrative law. The language of private contract cannot begin to describe it. It is so basic to material and mental life that virtually all American law students take courses in it even if their future practice may not involve business or corporate entities. It has been central to my own thinking and writing since I began. Some of my colleagues, practicing and academic, surprise me when they

say an interest in the problems of corporate law must be a distraction from thinking about really important things. Corporate law is at the center of life.

III.

Corporate law, corporate finance. When we turn to corporate finance, we turn to the creation and expression of claims on joint enterprise and the product of joint enterprise which no one person has caused or produced by himself or herself. We can think of these claims as little machines for the allocation of flows of money and allocation of power to participate in, influence, or direct corporate decisions made on behalf of everyone. We are dealing in finance with social profit, and social power.

Then there is the third feature of these machines -- we call them securities -- which everyone wants to forget, and of which the Enron case in the United States has made us vividly aware. They also allocate the losses caused by joint enterprise, losses and liabilities which may be larger than the amounts put into the enterprise or received back from it, and which rest on some shoulders somewhere and must be either left there or put somewhere else.

In redistributing losses, securities govern who loses first in a limited liability situation, and therefore how much, but as you know they also work beyond the limit of the value of an investment. If you hold an American limited partnership share, for example, and you exercise control over the day-to-day affairs of the limited partnership, you may find that despite your partnership agreement you are personally liable like the general partners for losses caused by the joint enterprise, and that the amount you invested is no limit. In ordinary corporate law, the doctrine we call piercing the corporate veil, which is very much alive in the United States, can fold the personal assets of equity shareholders into the assets of the corporation for the payment of losses, if equity shareholders have treated the assets of the corporation as their own rather than as those of an entity separate from themselves. So called piercing can pool the assets of a corporation with another corporation in which it owns shares, and dominates. Under modern securities laws, controlling shareholders may find themselves similarly liable: the securities they hold are a connection between them and the business organization across which large losses can flow to them.

Finance, the way capital investment "works," is inevitably a branch of corporate law. These created claims to positive flows of profit and to decision-making power and these connections and exposures to negative flows of losses are claims and connections to a corporate entity. The securities involved in the "capitalization" of an enterprise seem to be commodities, like automobiles or

grain, things that can be traded, bought, sold, borrowed, used as collateral. But their reality, their substance, spirals down to the corporate entity, what it does and the decisions it makes, much as the elaborate instruments of finance called "derivatives" spiral down in their substance to the ordinary securities from which they are derived.

Even cash, that ultimate haven of finance, is a security in the United States and Hong Kong. So many Americans have never looked closely at a dollar bill, but if you do, you see in two places on it that it is a "note", a "Federal Reserve Note." As a note it falls within the definition of a "security" in the American Securities Acts. Go look at the beginning of those foundational pieces of American financial legislation. They begin, "The term security means any note, stock, ... bond, ... investment contract." Only in a later section it is provided that the Act "shall not apply to the following classes of securities," among them interests in or obligations of a federal reserve bank. The Hong Kong twenty dollar "bill" I have here states that "by order of the Board of Directors" the "Hong Kong and Shanghai Banking Corporation Limited promises to pay the bearer on demand at its office here Twenty Hong Kong Dollars."

Now I know the nature of money is almost as mysterious as the nature of love. What the dollar bill, which is in the end only a claim on a corporate organization, is a claim for, after it ceased to be a claim for gold or silver, we shouldn't explore. The price of bread is how many dollars it takes to buy it, but, equally, the price of a dollar is how much bread someone will give you for it. Like an equity shareholder, you have to go a secondary market to realize the value of what you have, which is only what someone else thinks he can get for it in the future. The U.S. dollar bill does say on it "In God We Trust," but that shouldn't set off alarms. We trust someone human too, making decisions, who, we trust, is taking into account the interests of those who purchase and hold these securities -- just as in any organization. National banks can of course always make more of these securities and decrease their value. But then corporations can also decide to manufacture more equity stock, and, depending on what they get for it, dilute the claims to power and profit held by the existing security holders.

A dramatic way, I think, of seeing the focus of finance and the instruments of finance on the decision-making of the productive entity is to consider an arrangement my own undergraduate university, Yale University (which is legally the "Yale Corporation"), made with students whose education it wanted to support, and, as it said, "invest in." The University transferred varying amounts of cash to students in the entering class of students, and I should say that at Yale each entering class takes on a character and organization of its own, as I imagine it does

here too. The individual students in the class receiving the cash used it to pay their tuition, and they each gave to the University in return -- "issued" to the University is the technical term -- a security. This security was not the usual note giving the university a right to its principal on a certain date and to interest for specified time, as a corporation might issue a note in return for cash, giving the noteholder a right to interest and repayment of principal at a specified time. Instead, the security which the university bought from the students with its cash gave the university a right to four-tenths of a percent of their future net income for thirty-five years, virtually their whole working life, unless the whole class paid off the total loan made to them all before that, which, if many students taking loans became very rich, might happen rather soon. High lifetime earners would subsidize low lifetime earners in public service.

But it did not happen rather soon, or at all. The aggregate transfer to members of the class was not paid back. The university's "investment" was a very good one. One typical student who had sold these rights to his future earnings for one thousand seven hundred dollars, had paid seven thousand dollars before the whole thing was stopped, I might say in considerable embarrassment. He was linked to the payments of others, who had not paid enough because they were not rich enough.

This security, which he, loosely but sufficiently organized with other members of his class, had issued, is covered by the securities law of the United States applicable to issuers of securities. I will quote it -- "The term 'issuer' means every person who issues any security... The term 'person' means an individual, a corporation.... The term 'security' means any ... investment contract ..."

And what this security was, was something of an equity security, in an individual human being. Add to it the elements of control over diet, study, and sleep typically found in American scholarship arrangements with university athletes, and you can see how much it can resemble and match a typical voting share of equity or common stock. An exemption actually has to be found for it in the securities laws, or the students would have had to register as an issuer. That exemption is generally taken to be the exemption of securities which are not issued in a "public offering." The students were not selling shares in themselves just to anyone, but to a very sophisticated buyer, Yale University.

These are extremes, the dollar bill, the hapless student selling common stock in himself. But they focus attention on what is basic, fundamental, central to law and finance -- the business entity, its life and decision making. They may also help us resist any temptation to separate finance in a market economy from the

basic questions of corporate law. These basic questions have to do with the nature of the corporate entity -- how real it is, how like the student, how ongoing and separate it is from any one or another individual who is connected to it, what its purposes are and what values are to guide decisions that individuals make on its behalf. Basic questions also have to do just as much -- because the corporate entity and corporate law are so linked -- with the nature of corporate law itself, the degree to which it is a set of objective, mechanical rules, or, instead, a structure of guiding values.

It may be said, it is said, that the instruments of finance are rights. They are property. They are contracts. Basic questions of the purpose of business entities and the nature of corporate law must be merely academic where world financial markets are concerned -- those that China is now fully entering.

But not only is it obvious that financial instruments are simply claims on the decision-making processes of a corporate entity and what that entity will produce. They themselves, these rights, these contracts, can be changed by corporation decision-making without the consent of the owner of them. They are property, but they are a very peculiar form of property, which can transform itself in your hands as you look at it: change, not through government decree, but through a part of corporate law often forgotten in discussion.

The state-owned enterprises of China themselves are being "securitized" through the processes of what we call "corporate reorganization," which is the establishment of new entities and the merging of existing entities into them, and other such creation and recreation of entities. The changing of the terms of securities despite protests by their owners is achieved through the law of corporate reorganization -- through the redefinition of what the corporate entities are -- and is an on-going and lively process in the financial capitals of the world. The terms of securities can be modified. Securities can be completely replaced with other kinds of securities or with securities in other unknown corporate entities, or they can be replaced with cash or some particular property, say a set of pots and pans, eliminating the security holder from future participation in the joint enterprise. I need only read you from a typical American corporation law. "The shares of each corporation that is party to the merger," and, remember a second corporation can be created solely for the purpose of doing this, "that are to be converted under the plan of merger into ... other securities, cash, other property,... are converted, and the former holders of such shares... are entitled only to the rights provided to them in the plan of merger."

This can extend to debt instruments as well as equity stock, to bonds and debentures, and not just in bankruptcy. The Delaware Corporation Law, governing the largest number of large American corporations, allows a corporation to include in its charter a provision for amendment of creditors' rights by a "majority in number representing three-fourths in value of the creditors or class of creditors," if the corporation asks a court to order a meeting of that class of creditors.

Sophisticated practitioners thus know that the central focus is always on the decision making of the entity and the purposes or criteria that guide it, and not on stocks, bonds, debentures, options and derivatives themselves as if they had a marketable existence apart from that decision making.

IV.

Now we can turn back to China's accession to the World Trade Organization and its effects, and I will go at once to an example involving the decision-making processes of Chinese business entities. Article XVII of the General Agreement on Tariffs and Trade requires that purchases and sales of covered enterprises be made "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation, and other conditions of purchases or sales." The clause says "solely," and then says "commercial." The term "considerations" points to decision making, those factors that are taken into account and given weight in making a decision. The language of the clause perfectly reflects the centrality of active decision making in business law and finance.

"Commercial" is an English word. How should it be translated into the Chinese language? Though an English word, it is an international English word. How would "commercial" in the phrase "solely commercial considerations" be translated into American? How, indeed, would it be translated into British, or French, or German?

Would it mean, in America, that no consideration can be taken into account that is not a means of advancing the money profit of the enterprise? Would "commercial" mean, in the American language, that the value of human life, the value of human health, even the value of maintaining good markets that we in America call the "antitrust" value, cannot be taken into account for their own sakes? Is protecting human life, or worker safety, only a cost like any other cost, and except as it is imposed by others is of no concern as such to the decision maker? So, for example, if life is cheap, then a decision maker confined "solely" to "commercial" considerations should use more of it to save money elsewhere?

There is an answer to this question in the United States. Neither "commercial" nor "business" as legal terms or as words in ordinary speech means indifference to human value as such. An individual in commerce, a businessman or businesswoman, is not, by American legal definition, solely a calculator. Nor is a business corporation by legal definition solely a calculator. Business entities are not the entities of biology I referred to and contrasted at the beginning this afternoon, ultimately manipulative and self-aggrandizing, and blind to value. Nor in American law is the business corporation the similar theoretical construct of Western economics, the "firm," which is a profit-maximizing mechanism operating within a set of objective rules or external constraints. Business law does not produce such creatures, biological or mechanical.

It produces a human organization, the business entity or company or corporation, and the separateness of it from any individuals associated with it cannot be overstressed. It is separate, autonomous, in the sense which is true in fact, and in the vision which is the law in fact, that the corporation has a purpose which is not the purpose of any individual or other entity associated with it, a purpose that individuals faithful to it determine in their thought and carry out in their action. It is clear that corporate lawyers are lawyers for it, not for shareholders, or employees, or directors, or managers. "A lawyer employed or retained by an organization represents the organization," begins Rule 1:13 of the American Bar Association's Rules of Professional Responsibility. "In dealing with an organization's directors, officers, employees, members, shareholders, or other constituents, a lawyer shall explain the identity of the client." This is crystal clear. The corporation is not reducible to any of these but may include them all. Large and distinguished law firms in the United States have paid damages in hundreds of millions of dollars in recent years for forgetting who their client is, and there is now a question in the Enron scandal whether lawyers will pay many more millions.

V.

How the purpose of this separate entity with a purpose of its own is to be stated now has a long history in the United States. The outcome of the story is important, perhaps critical, to the security of finance and to what China will be dealing with and joining after accession. The story itself may be of particular interest to Chinese observers because it has always proceeded against a background of concern about granting business managers too broad a discretion and leaving them unaccountable to any but themselves.

The word "profit" appears in any definition or statement of the guiding purpose of a business corporation. The word "profit" even appears in the legal definition of a partnership in the United States, which requires a "business for profit," and as you know the business form of the partnership has been typical in the business and practice of medicine, law, architecture, and engineering, where it is well understood that values of life and health, to name only two, are taken into account as such and for their own sake in decisions made on behalf of the partnership, and not just insofar as and no more than they can be means to money profit for it.

Of course profit appears in any definition: if you ask yourself or I ask myself what my own object is, what I seek, profit is certainly there, as it is not, for instance, in those in religious orders who have taken a vow of poverty. (I was fascinated, incidentally, to read the questions on the application form for Social Security benefits in the United States: one of the questions was, "Have you taken a vow of poverty?"). The question is not profit but the status and weight of profit in the guiding object or objects of one's own overall decision making, and the question is the same for any organization, including any business entity.

My colleague Henry P.C. Hu, at the University of Texas as the Shivers Professor of Banking and Finance and a distinguished contemporary commentator, has tried a summary statement: "The most basic principle of corporate law," he wrote not long ago, "is that a corporation is to be primarily run for the pecuniary benefit of its shareholders." But he notes the rising conflict between the interests of those shareholders -- like some of you, and me, perhaps? -- who diversify away their own risk of loss by holding a structured portfolio of stocks in different companies, and the interests of what he calls "the company itself -- and its managers and employees," for whom risky investments such self-protected shareholders might prefer would be devastating. And he notes the increasing attempt, accompanying this rising conflict in the United States, to persuade corporate managers to take shareholder wealth "maximization" as their goal and only goal. If shareholder wealth maximization were the legal purpose of a business corporation, there would be, as he says, "no focus on measures of corporate performance like accounting earnings and no concern of the corporation independent of the welfare of its shareholders."

Then Henry Hu quite correctly says, "Most academics now believe that shareholder wealth maximization is the basic pecuniary objective of the modern publicly held corporation. Judges have typically subscribed to this standard only in the most limited of circumstances, typically in the context of a sale of the entire company."

This last is a good statement of the situation in the United States, and of the strength of the effort to deny what the legal facts are. Hu's initial definition of the most basic principle of corporate law, that a corporation is to be primarily run for the pecuniary benefit of its shareholders (and, he says, "few would disagree with this principle as a general matter") rests, in its language, on the language of a leading case, in my own state of Michigan, in litigation between Henry Ford and the founders of the Dodge Motor Company, who were also substantial shareholders in the Ford Motor Company at the time. Ford was paying a 10,000% a year dividend on the Dodges' investment. They wanted more, and claimed that Ford was selling automobiles at a below market price, and paying wage labor above market wages. The court did not stop Ford, though it required him to pay out some more dividends. But it was moved to declare, and this has been quoted ever since, "A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end and does not extend to a change in the end itself.... [I]t is not within the lawful powers of a board of directors to shape and conduct the affairs of a corporation for the merely incidental benefit of shareholders and for the primary purpose of benefiting others."

The legal powers of the directors, the court says, do not extend to a "change in the end itself." What is that end? It is "primarily the profit of the stockholders." What would a different end or purpose be? "The primary purpose of benefiting others." The court's question is what is primary.

Nowhere in this language of purpose is there the critical word "maximization" we often hear, which has a special meaning. "Maximization" is taken over from biology and a branch of economic theory, in which a firm in a perfectly competitive market seeks profit "maximization" because it must, seeks profit and takes nothing into account but profit because it has no choice, lives only for profit because any more complicated choice than that is a choice to disappear and die in a perfectly competitive market. Similarly in biology organisms must maximize their chance of survival or die. But though maximization is not a part of American business law, is a concept in economic or biological theory but not in the human law of human decision making, pressures increased in the second half of the 20th Century to make it the legal purpose of business corporations -- a chosen norm, mandated by law rather than circumstance.

These were pressures that in part were a response to the power exercised by managers of increasingly large corporations who effectively elected themselves.

And these pressures were in part what I may call ideological, a matter to which I will return at the end.

The American Law Institute eventually decided to take this matter up, as the first question in a general project to state the principles of corporate governance in the United States. The Institute is the organization of some 3,000 judges, practicing lawyers, and legal scholars that is the source of much of the authoritative statement and restatement of American law. It is the central integrating source of statements of American law perhaps most prominent after the United States Supreme Court. In the Institute's processes, appointed drafters present what is called a "black letter" statement of the law to the large governing body of the Institute, the Council. When the Council is satisfied, a draft is presented for discussion, redrafting, and voting by the Institute at large. The project to state the principles of corporate law took over a decade, from the early 1980s to the early 1990s, and was preceded by a National Conference on Corporate Governance and Accountability sponsored by the Institute, the New York Stock Exchange, and the American Bar Association.

It is important to note and to know just how precisely the question of "maximization" was addressed. Whether maximization was described as short-term, medium-term, or long-term, what was at stake was a proposed mentality, an approach to decision making, in which every consideration is translated into monetary terms. This was also, and is, as much a proposed approach to and attitude toward corporate law and law in general as it is to any other consideration that is to enter a decision.

Profit maximization did not appear in the first draft of the American Law Institute's "Restatement and Recommendations of the Principles of Corporate Governance and Structure." That first draft provided that the objective of the business corporation is to produce and distribute goods and services, and make investments, "for profit," as in the partnership law I mentioned. But "for profit" became "profit maximization" in a second draft, which stated that the objective of the business corporation is to conduct business activities "with a view to the maximization of long-run corporate profit and shareholder gain." This version then went to the Institute's Council with this specific issue to be debated on the agenda, stated in these terms: Did the draft of this section "properly state that the objective of the corporation is to maximize corporate profit and shareholder gain?"

There were formal submissions from many quarters, including major business leaders. They were all relevant to the question of what China is really acceding to when it enters the World Trade Organization and undertakes to

harmonize its business laws with those of the Western world. I was involved in this discussion as a member of the Institute, though not as a member of the Council. To give you a taste I will quote from my own submission to the Council. It used strong terms, but neither I today nor others think they were too strong given what was at stake for public respect for business:

"As the reference to maximization of profit and various of the explanatory comments make evident, a particular construct of economic theory, devised for purposes of simplification and prediction in certain kinds of ideal situations, and without any necessary connection to normative and empirical concerns, is being taken into law and thereby transformed into a norm. This is a misuse of economics. It is a development which many economists, who perhaps know better the constructs with which they work, would be loath to take. When reflecting on their own method, sophisticated economists frequently point out that, insofar as profit maximization is a reflection of anything real, it embodies a very special and indeed peculiar form of psychology. ... This is of no concern to economic science. It is of the greatest concern to law... Such a view is not true to law, either in this country or in other developed industrial countries...

After the Council's deliberations the late Paul Freund, then the dean of American legal scholars, wrote to me that "Even some of the more conservative members of our generally conservative group were unhappy with the draft both intrinsically and for the light in which it would place the Institute." He reported that the draft was "subjected to a lengthy and intensive review, centering on the term 'maximization,'" and that it "was remanded for redrafting, to avoid 'maximization' and to elevate the concept of ethical purposes so that it does not appear as an indulgent exception."

What then occurred was in fact the elimination of "maximization," even in its so-called long-term form that would still maintain a separation of the decision-maker from value and ask him to look at it from others' eyes and not his own, ask him to focus on their attention span and interest in it and not on his own -- to minimize it always rather than allow it to fire his imagination as it would if it were his own, and to act a part, inauthentic, whenever he speaks of it.

"Maximization" was replaced in the draft statement by the term "enhancement." This carried through to the end and was endorsed and adopted by the Institute at large. The objective of the corporation was characterized as "the

conduct of business activities with a view to enhancing corporate profit and shareholder gain" -- meaning survival, growth, efficiency; realism about a tough and competitive world; enhancement day by day, step by step -- economic progress; but not the loss of the very reason why we want economic progress, to give more and more human beings around the world the chance to live reasoning, choosing, responsible lives.

Now take up the Company Law of the People's Republic of China, as adopted in 1993 and amended in 1999. Under Article 5 in my English translation -- or should I say my American translation? -- "The company shall... organize its production and operation... with a view to improving economic return and productivity, and accomplishing the preservation and increase of the value of its assets." "With a view to improving": where have I heard a comparable phrase? "With a view to enhancing," of course, in the American Law Institute's Principles of Corporate Governance. Under Article 59 of the PRC Company Law, company directors shall "faithfully perform their duties, and safeguard the interests of the company." What are those interests? They are Article 5's "improving economic return and productivity, and accomplishing the preservation and increase of the value of its assets," and Article 14 adds that "In conducting its business, a company must... observe industry ethics [and] strengthen the development of socialist spiritual civilization." These legal interests to which directors are to be faithful would have been acceptable to the American Law Institute, though the reference to civilization would not have been one they would have made, in at least those terms.

VI.

Let me expand a moment on why the Council of the American Law Institute was unhappy with the thought, the proposal, that instead of having interests described in this way in both China and in America, the corporation should be directed to profit maximize whether long term or short term. The Council was, as Paul Freund reported, unhappy with the proposal not just intrinsically but "for the light in which it would place the Institute." What that fear was is starkly illustrated by Philip Morris Tobacco Company's project, widely discussed last summer, to demonstrate to Eastern European governments that encouraging smoking was advantageous to them. "The negative financial effects of smoking (such as increased healthcare costs)," Philip Morris's project said, "are more than offset by positive effects.... Among the positive effects, excise tax, VAT and healthcare cost savings due to early mortality are the most important." In response to the firestorm of criticism when this was publicized, the Chairman of Philip Morris wrote the Senator from California that this view of agonized human death

in positive financial terms "exhibited terrible judgment as well as a complete and unacceptable disregard of basic human values."

There was apology here. But the effort to make this mentality part of the legal conception of business has not been given up, and I will mention this afternoon three other important chapters in this continuing history.

During the economic restructuring in the United States in the 1980s, there was a prediction that if a market in managerial control itself could be established, managers representing the corporation as a whole would be forced to profit maximize to protect themselves, because otherwise shareholders in sufficient number would sell for a premium their voting stock to so-called corporate raiders who specialized in "unfriendly takeovers" and in paying for them out of the corporate assets. Management found ways to defend themselves, often by turning back to finance and designing special financing instruments, securities called "poison pills" or "shark repellants." These defenses were then challenged as unauthorized under corporate law because not in the maximizing interests of shareholders. The Delaware Supreme Court responded that under Delaware corporate law, directors analyzing the effect of a takeover on the corporate enterprise might take into account its "impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)," and that directors might distinguish between shareholders who were "short term speculators" and those who were "long term investors." The majority of state legislatures in the United States passed what are called "constituency statutes." The important New York Corporation Law is typical, providing that in taking any action, a director shall be entitled to consider, without limitation, the "interests of the corporation and its shareholders" and "the effects that the corporation's actions may have in the short term or in the long term" upon "current employees," "retired employees," "customers," "creditors," and "the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business." Nothing in these typical American corporate statutes would be out of place in the Chinese Company Law of 1993.

On another front, the federal Securities and Exchange Commission introduced a definition of a shareholder as one who was single-mindedly interested in profit. A shareholder proposal for action by shareholders at a shareholder meeting might be excluded from the corporate materials presented to the meeting, if, in the words of the Commission's rule, the proposal was submitted "primarily for the purpose of promoting general economic, political, racial, religious, social, or similar causes." The Securities Commission applied its rule to

permit exclusion of a proposal by a group of shareholders of the Dow Chemical Company during the Vietnam War questioning Dow Chemical's manufacture of napalm then being used in Vietnam -- the shareholders were doctors treating civilians burned by napalm in Vietnam. The Commission argued that these shareholders were not acting as shareholders if they had such concerns as these. But a shareholder is, by definition, only what the law says a shareholder is. The shareholders challenged the legality of this rule -- and I should say I was their counsel for a time -- and the Federal Court of Appeals overruled the Securities Commission, holding that shareholders, acting in their capacity as shareholders, might properly debate "whether they wish to have their assets used in a manner which they believe more socially responsible but possibly less profitable than that which is dictated by present company policy." This has since been confirmed in other federal decisions.

Third, most recently and most tellingly, there was a considered effort during the reformation of federal criminal sentencing in the United States to separate the business corporation convicted under the federal criminal law from other convicts, and to view it as solely a cost-benefit calculating mechanism. Rules were published that provided only for money fines for corporations, and calibrated fines on the assumption that business corporations would only be calculating whether they would get caught and what the fine would be, treating it like any other risk or cost of doing business. There was widespread criticism like that of the early profit maximization proposal in the American Law Institute. Indifference to human values in themselves, the essence of the mental element in criminal law, was also the essence of the purely calculating and manipulating mentality contemplated for the profit maximizer, with again, emphasis on that special term "maximization." The rules were withdrawn and over the last ten years replaced with sentencing rules that envision the corporation as a responsible actor with a capacity even for remorse, of the kind Korea or China has been demanding from Japan for what occurred during the Second World War. American criminal sanctions for corporations now include a form of receivership, and what is measured in sentencing is degrees of corporate culpability, defined throughout the substantive law of corporate crime as the degree of indifference to a protected value.

VII.

But shareholders remain in a special relation to the business corporation, among all those who contribute to the product of the joint enterprise. Shareholders' interest in wealth can remain primary. Some have gone so far as to ask why should shareholders be special? Why not leave it to directors to balance everyone's interest, governed only by the market and by shareholders' ability, if any, to replace directors? And, indeed, some American "constituency statutes" are

written in this way. Why make the special position of shareholders a matter of duty, an instruction from the law to those exercising decision-making power given to them by law?

The reason is not that shareholders own the corporation. In suggesting they do, I fear much insightful and useful financial theory misstates the law. Shareholders do not own the corporation's property, they do not own the corporation's managers. The corporation's managers are not their employees or agents, but the corporation's employees and agents, which is why the corporation has no limited liability under the law of "respondeat superior," but the shareholders ordinarily do. What shareholders own is a particular financial instrument, and here we return to corporate finance. "Owning" a corporation is at best a colloquialism -- the Democrats "own the Senate" -- and is used especially by economists searching in law for the equivalent of the "firm" in economic theory. Shareholders do not establish a corporation. Incorporators or "promoters" establish a corporation, a legal person, which then creates and sells, usually for cash, securities of various kinds including equity securities with various terms, just as it later sells various manufactured commodities or services for cash. Who does own the corporation then? One can ask who owns Yale or Harvard University. The answer is the Yale or Harvard Corporation, but who owns the Yale or Harvard Corporation? The answer for the business corporation is the same as for Yale and Harvard. The corporation "owns" itself, as do other legal persons.

The initial reason for putting shareholders first is that the financial instrument they hold puts them last among those who have claims upon the income of the joint enterprise, after creditors, the tax authorities, workers, even management. Equity shareholders take what is left over, which may be a very great deal, but, other the other hand, may be very little or nothing. Shareholder gain can be viewed as the best proxy for the gain of all. Their welfare is welfare and security for those who come before them in line -- so long as, of course, those other securities we call money hold their value. If there is something for shareholders, there will be something for others.

A second reason in American law for giving special weight to common shareholders in corporate decision-making is that shareholders are especially vulnerable. They cannot demand their money back. They have what they bought, their financial instrument, which, we said at the beginning, is nothing more than a claim. But for them it is a claim that does not come due until the corporation ends its life, which may be generations. Under American law they have no right to a dividend if directors of the corporation wish to put the money to a corporate

purpose. Their very vulnerability evokes a fiduciary duty under American business law (just as the vulnerability of the passive partner evokes a duty in a managing partner), odd though that may seem to those who imagine that concern for vulnerability has no place in business.

Beyond shareholders' claim to special attention from corporate decision makers, their only recourse to obtain current income from the enterprise is in a market for their stock, the "secondary" or "used stock" market. There they again become a proxy for a general wealth and welfare, just as they are for the general welfare of all within the enterprise. It is a truism that the stock market serves not just the interest of shareholders in realizing something on their investments, but is, we think, a swift, flexible allocator of capital to its most highly demanded uses. Attention to shareholder interests is attention also to the working of that capital allocating system, in which China after its accession to the World Trade Organization is sure to play a larger and larger part.

VIII.

We spoke at the beginning about the ever present question when great public events occur like China's accession: Will those who come after us look back fifty years from now and say "We are better off because of this?" I put the question fifty years hence because one cannot look forward much further than that. Fifty years ago China became the People's Republic, and I can remember it. Fifty years hence a new generation, molded by the great events of today, will be fully in charge and taking care of the rising twenty- and thirty-year-olds of today.

The answer to "better" or "worse" is not simply a matter of statistical measurement. How our successors will think, what their minds will be like, is very much part of the answer too, because every day what anyone has at the moment is decaying and fading and every day human beings are creating their future, creating it by thinking and action, and thinking, of course, in the way they think. Business law has a very great deal to do with how we think. The pressure I have described in the United States, to make business and corporate decision making entirely manipulative and calculating and to eliminate the force of human value from it, will continue, and not just in the United States. Individuals can of course adopt such a stance in their own lives, and individual corporate managers can do so. What they cannot claim today is that this mentality, this approach, this attitude is mandated by business law or justified by business law. There is no authority for any statement that this is what "business" is -- the meaning of "business." Legal authority is otherwise.

But the future of the meaning of the term "business" is an open question. Books in corporate finance, from which I teach because of their insights, often begin with statements about corporate purpose and the nature of corporate law that, again, misstate what the law is. But they are there, influencing as well as reflecting the struggle over the way we think. Part of the source of the pressure is a real concern about the discretion and accountability of corporate managers -- let their decisions, it is said, be quantitative, fully measurable, as automatic as possible. But cold calculation as an ideal solution immediately comes up against the very nature of corporate law, which must enter decision and which cannot be manipulated and calculated about because it is not a set of rules of a quasi-mathematical kind. At every turn in the structure of corporate law, in statute, rule, and common law, you find the term "good faith" or "bona fide," meaning "hsin" perhaps, meaning authenticity, meaning trustworthiness, the opposite of manipulation and making things appear to be what one knows they are not. Over and over again what is found not to be in good faith, whatever its appearance and form, is held by courts not to be authorized by corporate law, to be empty of force and therefore need not be responded to. And good faith itself, like evasion, cannot be defined in a way that allows calculation and manipulation. When I first began teaching jurisprudence my students and I kept the Chinese proverb in front of us, Li i fa, Sêng i pi -- "for each new rule a way of circumventing it will arise" -- as we explored why good faith was so often expressly written into a rule, as a condition of legality, or implied, and why good faith itself could not be reduced to a definition or a set of rules.

But if the nature of business law stands squarely in the way of a wholly profit-maximizing approach to law or to the world in general, the strong effort to make the mentality I have described legal and the norm, rather than the exception, can try to eliminate the law's foundational requirements of good faith and the personal responsibility for which it stands. This would fit, in fact, a much wider thrust in Western thought, that positively wants to see each of us and each of our institutions as only systems responding to the actions of other systems, rather than as responsible and choosing creatures with purposes and hopes. Systems, not us, determine what happens and are, as it were, "responsible" for it. Our concern for another's life or another's health or another's security or trust is, we are urged, only apparent, an illusion. There is no idealism in this thrust of Western thought. It is ultimately cynical, about human nature and the world. *Its* attraction is evident. Responsibility is hard, even anguishing. Weighing and balancing interests and values is hard. Of course we want something easier and more fun, something like a game.

Here is where China's accession seems to me to have its deepest significance. The development of China's economic institutions may blunt and even save the West from this tendency and thrust in its own thought, and make the way we all think fifty years from now better than it would have been. As trade and production become worldwide, so do ways of thinking. The People's Republic had idealism in its founding, a vision of relief of suffering. More and more in the West will come to admit this with the passage of time. This idealism and this purposeful vision may have been tempered by experience, and there may be enthusiasm for trying new ways. But it is not gone utterly without trace, and its traces will appear in the enterprises emerging in China to engage in the world's business.

A single nation's business enterprise may be a tool or weapon in military or cultural competition, where winning, as in a game, is itself an object and reward. The world's business enterprise is different. Its object is the ultimate relief of suffering and the hope of a good life for all. How much worse off human beings would be, what an irony it would be, if in joining in worldwide business their minds became hardened to suffering because of the way they were taught they should think. Could the human mind be hardened to suffering, rather than driven by it? It might -- without the great event of China's accession.

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