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Competition, Corporate Responsibility, and the China Question

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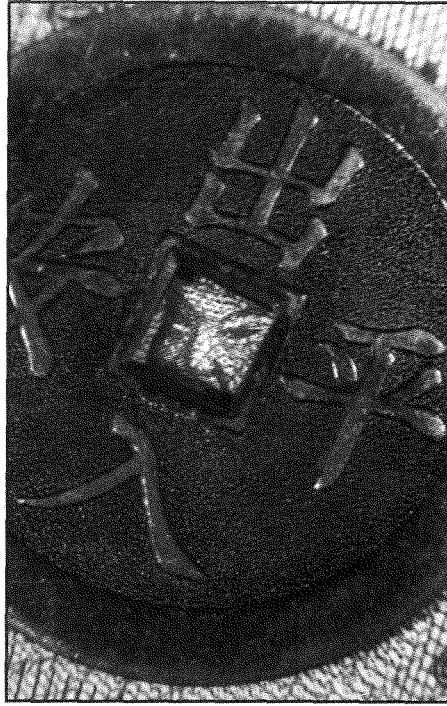
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COMPETITION, CORPORATE RESPONSIBILITY, AND THE CHINA QUESTION

The following essay is based on a talk presented in June while the author was serving as the Sir Edward Youde Distinguished Visiting Professor at Hong Kong University of Science and Technology. The presentation was co-sponsored by the university, the Yale Club of Hong Kong, the Harvard Club of Hong Kong, and the Oxford & Cambridge Society of Hong Kong.

By Joseph Vining

The subject I have been asked to address is the impact of China's WTO [World Trade Organization] accession on "the question of corporate responsibility." We might begin by asking why corporate responsibility should ever be a question at all.

We do not ask such a question about you or me. You might say of me that I'm not a responsible person, or I'm being irresponsible in the circumstances, but your assumption is that I should be responsible or try to be. You and I look out for and care about the consequences of our actions. There is tort law out there with its threat of damages, and we pay premiums for insurance against liability, for being held "responsible" for what happens to someone else. But that is

not the reason why we are careful if we are responsible people. We actually don't want someone else to be hurt, and if we really don't care, and really are indifferent to the consequences of our actions, we are viewed as a bit of a psychiatric case and a threat — certainly not someone who can be dealt with in ordinary affairs.

But "business," it is urged, is different, and that is why corporate responsibility is something that has to be argued about and is often pictured as an interference in business, an imposition on it and on its central institution, the business corporation. I should quickly say that the legal profession, or the legal business if you will, also wants to be set apart as not responsible for consequences of its actions, despite Justice Brandeis' oft-quoted remark that the lawyer's pen does more harm than the burglar's tool. Our, lawyers', claim is that we do not have to be concerned about the consequences of what we do. Our clients may, and our clients' other agents may, but we do not. This is a pulling of what lawyers do under the umbrella of immunity that applied from ancient times to the lawyer in adversary litigation, who was in a form of war. And we might note, speaking of war, that the military, as a profession and a field of human endeavor, wants to be exempt

from the ordinary criminal law, indeed from the ordinary law governing human experimentation. I think of what has come to light in the United States about radiation or biological weapons experiments on soldiers, or vaccines in the Gulf War. And institutional science, too, if you come to think about it. What would be assault, or homicide, or criminal cruelty to animals, is not, it is claimed, if it is done by a scientist engaged in scientific research following the rules of research. These exemptions, parallel to the exemptions sometimes claimed for business, are matters of lively debate now in the United States and internationally. Actually, so is the lawyer's claim that the lawyer is not his brother's keeper a matter of increasing debate. So this I think is what we are talking about when we say that corporate responsibility is a debatable question worth having a discussion about — exemption and difference from the norm. There is necessarily the implication of the alternative, corporate non-responsibility or, some would like to say, irresponsibility.

What are the issues? It used to be thought that the context for talking about corporate responsibility was charitable contributions. There was famous litigation over contributions by business corporations from corporate funds to, for example, Princeton, arguing this was using the shareholders' money, wasting it, taking it from them since the corporation was receiving nothing back. But corporate charitable contributions were everywhere upheld, partly on the ground that if they were not too large they could be viewed as public relations moves, as appearing to be a good citizen, but equally on the ground that a corporation was a citizen, that regardless of its particular circumstances it had a stake in the country, the social fabric, the arts, the relief of poverty. And we all know that business corporations now are major patrons. A refusal to take Philip Morris' grants, on moral grounds relating to smoking, meant a substantial loss for Canadian arts organizations.

But charity is not where the question of corporate responsibility really bites, or becomes what our topic calls a "China question." The question really bites at the deepest level of everyday business decision making. The question is presented over and over and over again, and presented also to lawyers advising corporate decision makers — what is the attitude to take toward the consequences of a business decision and the action that follows it? In discussion this often becomes a question of attitude toward identifiable groups in China and America and beyond on whom the consequences fall: workers, retirees, long-term middle management,

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customers, suppliers, creditors, local and national communities, even committed long-term equity investors. In economic theory these effects are called "externalities" but that assumes an answer to the question [of] what is internal and what is external to a business corporation, an answer that economics itself cannot give and only the law can provide.

Is one's attitude to be that one attends to adverse consequences or attends to these groups only insofar as one is forced to, and one uses one's ingenuity and imagination to avoid doing even that?

Or is one's attitude to be that one takes into account, for their own sake, these interests or the values these interests represent? If one does attend to them as values that are in some sense one's own and not merely someone else's, imagination is fired, as it always is by what one holds dear, to find new ways and more efficient ways of realizing them or reducing hurt to them.

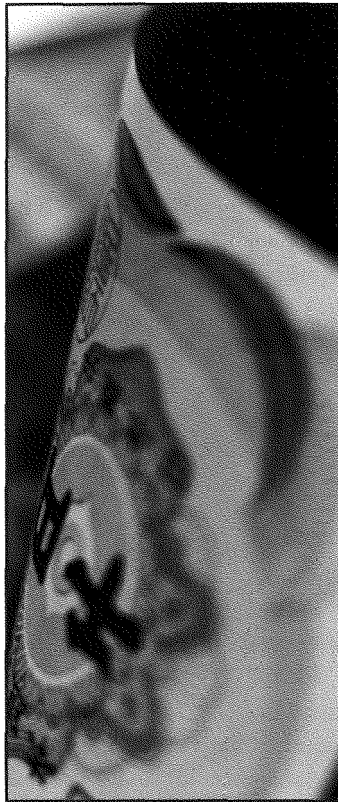
Corporate leaders sometimes say their company is like a family, and the example of the head of a family trying to take into account the various interests of its various members, while keeping an eye on the growth and prosperity of the whole, is as good an example as any, and a contrast to the opposite attitude, a military general's for example, for whom the enemy's interests have no weight at all, and appear in his thought only as costs his organization would be forced to bear and would seek to minimize. The question is whether the corporate attitude, the duty really, conceived and mandated by business law, is to be like the general's, or like that of the family head. Realistically, I think the alternative possibilities are the general, on the one hand, and on the other, something on a range between the general and the family head.

Let me give some examples of actual cases.

- The Ford Motor Company is designing a car, and it appears that the gas tank is so situated and attached that there is a high likelihood of explosions and fires in relatively mild rear-end collisions. At Ford, what is your attitude and reaction to be? Is it to work at the governmental level for the theoretical calculation of a low dollar figure for the value of a human life, use that figure in a static cost-benefit equation, and decide that the cost in human lives lost to fiery deaths and any damages Ford might be required to pay is less than the gain that could be obtained by going ahead with the design as it is? Or do you internalize the value of human life, and work with it as such in your decision? This has to do with customers.
- The Chisso Chemical Company in Japan notices that fishermen's families around the Bay of Minamata where its plant is located are giving birth to horribly deformed

children. A company scientist samples the plant's chemical discharge into the bay and discovers that his laboratory animals fed it show all the signs of mercury poisoning. At Chisso, what is your attitude to be? The discharge satisfies the environmental standards then in effect. Your wastewater is cleaner than the wastewater of your competitors. In making decisions on what to do on behalf of the corporation, do you follow up this suspicion and warning, or do you stop the company scientist's investigations and leave it to others to be concerned about the rising number of deformed babies? This question has to do with the environment and the local community.

- A Chicago company called Film Recovery Systems extracts silver from used photographic film by dissolving it in vats of cyanide solution. The question arises whether to spend money on ventilation equipment for the cyanide vats and whether to provide training, impermeable gloves, and goggles for the non-union immigrant labor steadily available and anxious to have jobs in the plant. Profits would be higher if these costs were not incurred — safety inspectors tell you that ventilation and safety equipment are inadequate, but inspections are few and the penalties are light for not observing safety regulations. Public relations problems are not an issue for you. In making these daily decisions on equipment purchases, do you take the value of human health itself into account? This has to do with workers and their interests.
- The Dow Chemical Company in my own state of Michigan made napalm under contract with the Department of Defense, and in the Vietnam War the dropping of napalm was injuring civilians and especially children. A group of shareholders seeks to raise at the shareholder meeting the question whether the company should continue to manufacture napalm. In response, and in making decisions on behalf of the company, do you seek to prevent discussion of the issue on the ground that the concern motivating the shareholders is not a concern for profit? Or do you let the discussion go forward and lead where it may? Then this contract for napalm with the Defense Department becomes unprofitable in part by its own terms and in part because of adverse publicity from napalm affecting the recruitment of good chemical engineers from engineering schools. Do you go forward with the manufacture of napalm anyway because of your commitment to the national interest? These questions have to do with humanity in general and patriotic duty.



In each of these decisional problems which eventually came to a court, there were arguments made that the values involved were of no concern to the business decision making of the corporation, and that the groups affected — workers, customers, residents, the nation — ought to look out for themselves, and I emphasize the word “ought” or “should” because, remember, this was argument about the way corporations ought to make their decisions and an argument about what those affected by the consequences legitimately ought to expect. The question was corporate responsibility, put in operational terms.

I think of the way the question has been raised frequently in the Enron case we are in the midst of in the United States. California, as you know, recently suffered power blackouts, about which a good many non-Californians were not so terribly unhappy. But it has been discovered that Enron traders were using schemes named Fat Boy,

Death Star, Ricochet, and Get Shorty, to profit hugely from manipulation of the rules desperately put into place in response to the blackouts. An internal Enron memo noted that the strategy “appears not to present any problems, other than a public relations risk,” arising from the fact that “it may have contributed to California’s declaration of a Stage 2 Emergency yesterday.” The public relations risks were something to be costed out, but the Stage 2 Emergency was not Enron’s concern. On the other hand, the very fact that Enron’s decisions ran a public relations risk and that the memo was not one they wanted anyone to see points to the problem of corporate responsibility. There would be no public relations risk if this were what it was agreed business corporations should do.

We do not know what the outcome will be at Enron, whether the verdict of the market will be the only verdict. I can say what happened in the other cases involving customers, workers, and other groups. Some of you may know these cases. In the Ford case, Ford did the cost-benefit analysis and went ahead with the gas tank unchanged. The corporation itself was indicted for manslaughter in the deaths of customers who bought a Pinto and were burnt to death. Ford’s cost-benefit calculation in the circumstances was relevant to its criminal intent, which was, for purposes of manslaughter, “indifference to the value of human life.” There was no resolution of the case at trial because of evidentiary problems with regard to the particular Pinto involved. A good many books appeared about the case with titles like *Reckless Homicide*, and it became a staple in professional studies of organizational behavior.

In the Japanese case, with regard to what came later to be known as Minimata disease, Chisso stopped its scientist's investigations. The deformities were eventually linked to Chisso, and the victims sued. The Japanese court ruled that "the defendant's plant discharged acetaldehyde wastewater with negligence at all times, and even though the quality and content of the wastewater of the defendant's plants satisfied statutory limitations and administrative standards, and even if the treatment methods it employed were superior to those taken at the work yards of other companies in the same industry, these are not enough. . . . No plant can be permitted to infringe on and run at the sacrifice of the lives and health of the regional residents." Over time Chisso paid out indemnity of tens of millions of dollars.

In the case of the silver recovery company in Chicago, workers sickened and were blinded from cyanide, and one died. The company itself was prosecuted under the general criminal law and convicted of negligent homicide, and the company's officials were convicted of murder, convictions that were eventually reduced to manslaughter.

In the Dow Chemical case, in which I was the shareholders' counsel for a time, management lost its argument in federal court that concerns other than profit had no place in discussion at a shareholder meeting, though it was supported by the Securities and Exchange Commission. The shareholder proposal with respect to napalm was defeated, the management inconsistently introducing the national interest into the argument. Eventually Dow ceased manufacturing napalm.

These of course are examples that have become public. Questions whether values are going to be taken into account for their own sake and whether corporate managers are to think themselves in any way responsible for the consequences of the decisions they make arise in myriad milder ways every day.

Some of these example cases involve the criminal law, and I should emphasize how much that has entered the debate over corporate responsibility in the United States in the last 15 years, really since the Reagan revolution reduced administrative regulation and it simultaneously became clear that in any case the regulated could often effectively "capture" the regulators. The general criminal law in the United States, the common law of crime, is now directed at corporations themselves as persons and supplements specific provisions directed at corporations as such. As you know, the accounting firm [Arthur] Andersen was recently indicted and convicted. There was much surprise that only one Andersen partner was indicted individually; in fact this is a common pattern.

But there is opposition to the application of the criminal law to corporations, not just because they are corporations and not individuals, but because they are business corporations. It surfaced with force in 2000 in the widespread debate over the Ford-Firestone vehicle rollover

problem, which ended with Congress introducing criminal sanctions into auto safety regulation, one of the few remaining regulatory fields where there had been only civil fines. Of interest to us here is the distinctive feature of criminal law, that the values it protects, life, safety, environmental integrity, and competitive markets, are to be internalized. You are generally not convicted for breaking a rule: the very rule is that you are not to be indifferent to the value. You cannot define criminal homicide, for instance, in any more definite way than a showing of indifference to the value of human life.

This reaches deep into business decision making. Even if there is a quite specific administrative rule forbidding on pain of criminal sanction the trucking of explosives through New York's tunnels, it is standard law that a trucking company may be convicted for such trucking of explosives though it does not know about the rule. "Ignorance of the law is no defense" is the awkward way it is put, awkward because a sane defendant is not thought to be ignorant of what counts in criminal law. It's not a "rule" that limits your choice of routes, it's a value. The criminal mind, the mental element that makes such trucking a crime, is precisely indifference to the possibility of explosion in the tunnel, not indifference to "rule-breaking."

What will develop in China in this respect will depend upon the nature and processes of Chinese criminal law, and one can imagine some period of contraction in its application. The expanding application of the criminal law in a business setting in the United States produces continuing, strong opposition. But I think we can see that what is really being argued about is much more general, the nature of the decision making within business corporations that we as a community want to have, or that we as the world want to have now that we are in a globalized business setting.

The other major development that bears on corporate responsibility, other than the recent turn to the criminal law, is a new focus on the functioning and responsibility of corporate lawyers. Professional ethics, or the law applying to lawyers, is sometimes thought of as set apart from questions of substantive law, or the law governing what lawyers' clients should do, and its remedies as also set apart from the remedies of substantive law. But ethics and substantive law are not so separate where the corporation is the client and the lawyer is counsel to the corporate entity and not to particular individuals associated with the entity.

The fusion occurs in two ways. The corporation can't speak for itself. What its interests are has to be decided in order to say whether lawyers have fulfilled their duty to it. You can't simply ask it directly what its interests are. The other fusion of ethics and substance, where the corporation is the client, is in the fact that a lawyer is not merely advisor, negotiator, and defender, but an actor deeply involved in the doing of what corporations do.

Corporate lawyers' recent experience in the United States reflects this fusion.

Government agencies, such as the Securities and Exchange Commission and the Office of Thrift Supervision overseeing banking institutions, have disciplinary authority and can bar lawyers from whole fields of practice, and they have done so, on the ground that, given substantive corporate law, the lawyer has violated his or her fiduciary duty to the client, which is clearly the entity. Management representatives of the entity may be arguing on behalf of the accused lawyer, that she did what they told her to do, but they too have been deemed to be speaking for themselves and not for the entity.

Very large damage awards have been paid to bondholders, minority stockholders, and government agencies representing the customers of bankrupt savings and loan institutions, by law firms that are among our best known. When I say large, I mean large. The partners of Kaye Scholer in New York were sued for \$275 million by the government on behalf of depositors and settled for \$41 million. Jones Day settled for \$24 million with investors in one savings and loan, and settled with the government for \$51 million after facing possible damages of \$500 million. Paul, Weiss settled for \$45 million. Implicit in these rulings and settlements is a determination that the interests of the business entity include to some degree the interests of these groups and the values they represent, bondholders, depositors, small shareholders. And — here is the second aspect of the blending I mentioned — lawyers were held personally responsible for losses that were caused (as a matter of fact) by their actions and failure to act, where these actions could not be protected or defended by a claim that they were fulfilling a duty to their client, the entity as a whole.

This means that the inevitable presence of lawyers, inevitable because organizations cannot do without them, acts as an independent check on the business decision making going on under the corporation's authority and on its behalf. Introduce as a client a creature that cannot speak for itself, an entity that is not an individual human being, and the most interesting things occur, among them that the lawyer herself is seen as an actor in the world with responsibility for consequences.

Most recently, just a few months ago, the American Bar Association changed its Model Rules of Professional Responsibility to provide that a lawyer was authorized to reveal client confidences, without the consent of other representatives of the client — and here I quote the new rule — “to the extent the lawyer reasonably believes necessary to prevent reasonably certain death or substantial bodily harm.” This change was not effected without a considerable fight;

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indeed in February there was a reconsideration and a reaffirmation of this change. Before, the confidentiality rules required that the client be committing a criminal act and that the danger be “imminent.” Now there is no requirement of criminality and the danger of death or substantial bodily harm need only be reasonably certain. The lawyer is not required to warn and prevent harm, not yet. But he has no longer a defense that his responsibility to his client absolves him from being concerned about the consequences of his silence. In the same way others, accountants, even someday engineers perhaps, may have no defense that their responsibility to the business corporate entity absolves them from responsibility for consequences. Again, as the corporate bar

and professional regulation in China develop along with the reorganization of Chinese industry after accession to the WTO, lawyers and other professionals may begin to have something of a similar role in China.

In the largest view, the “China question” as it relates particularly to corporate responsibility seems to me to have two parts or sides.

One concerns the decision making and the constituents of the emerging private corporations in the People's Republic [of China (PRC)], whose guiding purposes as defined in the Company Law of 1993 and 1999 are not put in terms of exclusive profit “maximization.” Chinese statutory language is not unlike the law's language of business corporate purpose in America. My English translation of the corporate purpose clauses in the People's Republic Company Act contemplates operation “with a view to improving economic return.” The American Law Institute contemplates making corporate decisions “with a view to enhancing corporate profit,” and this parallel language was chosen by the Institute after a proposal to describe the purpose of an American business corporation as “long-term profit maximization” was specifically rejected.

The PRC Company Act provides further that “in conducting its business, a company must . . . strengthen the development of socialist spiritual civilization,” again, in my English translation. Perhaps someone during discussion will say how this reads in Chinese and what alternative translations would be. And the Act requires consultation with workers before making decisions affecting them, giving them a status somewhat less definite than in European companies where workers elect part of the Board of Directors, or even in British corporations, where British law instructs directors to take into account the interests of the employees in general as well as the interests of the shareholders. But, as one might expect in China, the interests of workers are at least

introduced explicitly into the decision-making process even if they are not given specific weight. However enforced or enforceable these company law provisions may be at the moment, they do define the standard and the shape of the present ideal.

Then there are the state-owned enterprises, which have quite definite obligations to a variety of the groups that I listed as examples earlier. The question there will be how far those responsibilities will be legally modified and whether, indeed, competition and rigorous financial accounting will make some or many of those obligations impossible. I might say that such modifications or shedding would fall far short of moving to a position in law or in fact of corporation irresponsibility, the mode of thought in which all substantive value is external, none is internalized, and all mental activity is calculation.

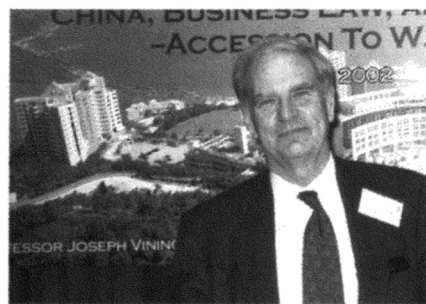
This, the Chinese side of the question, is matched by the question raised for the United States and other Western economies by China's looming presence in the business of the world. As competition from Chinese industry increases, advantaged presumably for some time by lower labor costs, market constraints on corporate decision-making processes in the United States may increase. I say may increase. We do not know how competition is going to play out, what the relative advantages are going to be or how large a factor labor costs will be. We do know that there has historically almost never been a perfect market in the ideal sense of economic theory that takes away all discretion. Business decisions will not become virtually automatic, with bankruptcy and disappearance attending any incorrect decision in the way extinction attends any incorrect "decision" of the genes in evolutionary competition. We know that the market itself will not answer our question. The question of corporate responsibility, as a question of real responsibility for the consequences of a corporation's actions in the world, will remain as far as we can see.

Nor will it do in the future, in China, America, or the world as a whole, to say the responsibility is the customer's and the corporation is the slave or tool of the customer, who can name a price for the protection of a value and protect it by paying the price to a seller who offers to protect it, "vote" as it were, put his money where his mouth is. Values do not work that way, choices are not presented that way, time does not work that way. Around the world we organize and are organized in order to live together, and the business corporation may already be the major form of human organization that surrounds decision making through governmental organization. We no more present ourselves with a choice whether to respond to and sustain the activities of a sociopathic mentality in business, utterly indifferent to value, than we present ourselves with the choice whether to sustain a sociopathic person at large on the street. "Business" is not a set of value-free machines. "Business" is a set of living human organizations allowing us as individuals to live in a

way we can stand to live — to have lives as individuals we can justify to ourselves and each other.

But we should not forget, in the debate over corporate responsibility, that there is no intrinsic conflict between markets and competition on the one hand and the protection of substantive value on the other. Competition may be necessary to keep action and care and attention and energy up to the mark when the absence of such care, attention, and energy does violence to others. It is tragic, but love and concern are not enough, as I think all of us know. Passengers burn to death in a train whose emergency doors will not open in a crash. The train crash itself is produced in part by scheduling breakdowns and chronic delays in starting. All of this, including the violent and fiery deaths and unimaginable pain and loss that occur, might have been avoided by one or another individual going further to check and repair despite his fatigue, or taking risks to avoid delay, or worrying about scheduling when that was not precisely within her instructions. Competition, nagging fear of losing and of exclusion from property and employment, may sometimes be the only way of avoiding the daily assaults on life and health and fair expectation with which corporate responsibility is concerned. There can certainly be a lively dispute about "ruthless competition," its virtues and its vices, but the truth is that competition as such can be in the service of what human beings hold most dear.

Joseph Vining is a graduate of Yale University and Harvard Law School and holds a degree in history from Cambridge University. He practiced in Washington, D.C., and served with the Department of Justice and with the President's Commission on Law Enforcement and the Administration of



Justice. In 1983 he was a Senior Fellow of the National Endowment for the Humanities and in 1997 a Rockefeller Foundation Bellagio Fellow, and is a member

of the American Academy of Arts and Sciences. Professor Vining has lectured and written in the fields of legal philosophy, administrative law, corporate law, comparative law, and criminal law, and he is the author of *Legal Identity* (1978), a book on the nature of the person recognized and constituted by law; *The Authoritative and the Authoritarian* (1986, 1988), on the nature of the person speaking for law and the relation between institutional structure and the real presence of authority; and *From Newton's Sleep* (1995, 1997), on the legal form of thought and its general implications. He began his academic career at Michigan in 1969 and is now the Harry Burns Hutchins Professor of Law.