Inside or Outside the Corporate Law Box? Shareholder Primacy and Corporate Social Responsibility in China

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Forthcoming *European Business Organization Law Review*,
[2016] *UNSWLRS* 48

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Abstract

When most of China's major cities are suffering from smog, people start to cry out for environmental improvement. The significance of Corporate Social Responsibility (CSR) has become one of the hottest topics in China. CSR and shareholder primacy are widely debated idiosyncratic areas of corporate legislation. China's approach has thus far been unclear in both areas.

This paper first consolidates all related provisions in Chinese commercial law in order to identify the approach (law on the books) from the legislative perspective. Then, based on this conclusion, this article further examines the enforcement of shareholder primacy and CSR laws using empirical methods (law in action). Finally, this article analyses and assesses the efficacy of the current approach from a political economy perspective. The article concludes that it would be efficient for China to follow existing statutory requirements and imperatives. Moreover, China must correct practitioners' modus operandi in order to improve rule of law. Social responsibility issues should be tackled outside the corporate law box for the time being rather than by meddling with already confusing director duties.

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I. INTRODUCTION

When most of China's major cities are suffering from smog, people start to cry out for environmental improvement.[1] Because there are few effective measures to be taken other than controlling pollutants, the State Council is therefore facing a trade-off between potential economic recession and continued environmental degradation.[2] Corporate Social Responsibility (CSR) has therefore become one of the hottest topics in China.[3] As a socialist and authoritarian country, China has already successfully incorporated many social responsibilities into various areas of law, for example environmental law.[4] Even if CSR is thoroughly discussed, however, people still sometimes confuse imposing social responsibilities against a firm with imposing them against management.[5] With this confusion, China's laws articulate neither how to apply CSR regulations in practice, nor the proper priorities when CSR is in conflict with shareholder interests. As a result, the implementation of social responsibility largely depends on the professionals who run firms. A long-disputed issue, therefore, reemerges: to whom are managers and directors responsible?

Shareholder primacy theory is a dominant principle in corporate law, and leads corporate decision-makers to focus on shareholders' interests.[6] As the counterpart to CSR in the theoretical battlefield, shareholder primacy theory exercises preeminent influence in many common law countries, such as the United States and the United Kingdom.[7] Meanwhile, CSR is mainly dominant in civil law jurisdictions, and requires management not only to work for shareholders but also to consider other corporate constituencies, such as creditors and employees.[8] The dispute between

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[1] *See* Euan McKirdy, *China looks for blue-sky solutions as smog worsen,* CNN (February 25, 2014), http://edition.cnn.com/2014/02/24/world/asia/beijing-smog-solutions/index.html.

[2] *See*, eg, Brian Spegele & Wayne Ma, *China Clean-Air Bid Faces Resistance,* The Wall Street Journal (January 22, 2014), www.wsj.com/Articles/SB10001424127887323301104578257484144272650.

[3] *See* 段丹峰 [Duan Danfeng], «企业要承担高要求社会责任» [*Enterprise Should Undertake High Level Social Responsibility*] 中国经济网 [China Economy] (March 23, 2013), Usually you use the English with pinyin for the translation but often journals have specific rules for foreign material. The editors will probably specify. http://www.ce.cn/cysc/newmain/yc/jsxw/201303/23/t20130323_21452431.shtml.

[4] *See* «中华人民共和国环境保护法» [Environmental Protection Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 22, promulgated December 26, 1989. Available at http://zfs.mep.gov.cn/fl/201404/t20140425_271040.htm.

[5] *See* 蒋建湘 [Jianxiang Jiang], '企业社会责任的法律化 [Legalization of Corporate Social Responsibility]' (2010) 5 中国法学 *China Legal Science* 123. This article gave examples of CSR in different countries, but when talking about China, the issue who should be responsible for the CSR is evaded; *see also* 王保树 [Baoshu Wang], '公司社会责任对公司法理论的影响 [The Influence of CSR on Corporate Law Theory]3 法学研究 [LEGAL RESEARCH] 80, 83 (2010). (Discussing the different opinions on how to enforce CSR).

[6] William W Bratton &Michael L Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation*34 J. Corp. L. 99 (2008).

[7] David Collison et al, *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence* (Association of Chartered Certified Accountants)18 (2011).

[8] Reinier Kraakman et al, The Anatomy of Corporate Law: A Comparative and Functional Approach (2nd ed. 2009) 104–5. (Talking about the constraint strategy protecting

Adolf Berle and Merrick Dodd is the beginning of the discussion on 'for whom the corporation is managed', even if the propositions of both parties might be wrongly deciphered.[9] The literature on the issue is particularly rich and comprehensive.

Chinese academia started focusing on this issue only recently, given that the first Chinese company law was promulgated in 1993.[10] Chinese researchers have achieved a great deal of success from the theoretical perspective.[11] Almost all of the past literature unilaterally leans to CSR and questions the applicability of shareholder primacy in China. The reason for opting to go this route might be the official public media's emphasis on socialist ideology and social value over the past 60 years. Supporters of shareholder primacy in China, of course, may be faced with choosing sides between socialism and capitalism, given that shareholder primacy means endorsing dividends, the prototype of capitalism. The predominance of shareholder primacy in corporate China is probably the reason for the abundance of CSR papers in Chinese academia. Just like in America, over the past 20 years Chinese corporate laws have been adapting to reality rather than shaping it.[12]

Given the rapid social and economic change in China, in order to promote a harmonious society, judges and professionals may sometimes deviate from law and creatively explain regulations.[13] Law in action in China, therefore, is equally important to the research. The article employs empirical methodology in part IV to tease out the enforcement principles in practice.

This article first discusses the traditional wisdom of shareholder primacy in order to furnish the reader with a basic knowledge of the issues in question in Part II. Parts III and IV tackle the following question: which approach, shareholder primacy or CSR, applies in China? Part V then explores the origin and rationale of the contemporary Chinese approach. Part VI analyzes the political economy of China as it relates to the application of shareholder primacy and CSR and examines which one is more efficient for contemporary China. Part VII offers the main conclusion of the Article. Part VIII, the appendix, showcases the statistical results of the research.

II. THEORIES OF SHAREHOLDER PRIMACY

As mentioned in the first section, the notion of shareholder primacy traces back to the scholarly debate between Berle and Dodd in the 1930s.[14] There is a widespread

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non-shareholder constituencies in corporate law.)

[9] Bratton & Wachter, *supra* note 6.

[10] *See* Companies Law of the People's Republic of China [Zhonghua Renmin Gonghe Guo Gongsi Fa] Order No 42, promulgated December 29, 1993 by the Standing Committee of the Nat'l People's Cong., art 122. Available at http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm.

[11] *See* Baoshu Wang *supra* note 5.

[12] Edward B Rock, *Adapting to the New Shareholder-Centric Reality*161 U. Pa. L. Rev. 1907 (2013).

[13] For example of the fact and the explanation to it, *See* Charlie Xiao-chuan Weng, *Lifting the Veil of Words: An Analysis of the Efficacy of Chinese Takeover Laws and the Road to the Harmonious Society* 25 Colum. J. Asian L. 180, 182 (2012).

[14] C A Harwell Wells, *The Cycles of Corporate Social Responsibility* 51 U. Kan. L. Rev. 77, 81–91 (2002) (discussing the Berle-Dodd debate in depth).

but mistaken belief that Berle is the flagman for shareholder primacy, while Dodd is the leading opponent and also a supporter of CSR.[15] In fact, at best we can say that their bifurcated views formed during the debate.[16] William Bratton and Michael Wachter find that Berle did not continuously stand on the shareholder primacy side, because his points of view shifted with the changing political economy. He also did not cage the discussion only inside the corporate law box.[17] Simply put, Berle and Dodd's debate did foment the deliberation regarding to whom managers and directors are responsible, but the dimensions of their discussion are broader and more idiosyncratic than today's shareholder primacy discussions.

In 1919, the Michigan Supreme Court turned shareholder primacy theory into law in the case of *Dodge v Ford Motor Corp*.[18] The court opined that '[a] business corporation is organized and carried on primarily for the profit of the stockholders'.[19] Obviously, the key point of the theory is to ensure that directors manage corporations for the purpose of maximizing shareholders' wealth. This rule does not, however, mean that management is left with no discretionary power to make business decisions. Due to collective action problems and other problems invited by 'the separation of ownership and control',[20] the focal point of modern corporate law is agency cost reduction. This cost reduction is achieved by imposing duties against management and allying their interests with those of shareholders.[21] Concentrating on the interests of shareholders leaves directors and managers with fewer excuses to shield themselves from the legal consequences of idle performance or self-interested conduct.[22]

To be sure, some scholars did conclude that shareholder primacy is superior to other corporate valuation systems.[23] Henry Hansmann and Reinier Kraakman argue that 'there is today a broad normative consensus that shareholders alone are the parties to whom corporate managers should be accountable.'[24] The shareholder primacy argument is not universally accepted in all jurisdictions, however. Although this argument may have gained acceptance in the Anglo-American countries, it faces compelling counterarguments that fundamentally challenge its universal applicability.[25] The theory of 'institutional complementarities' is the most convincing counterargument concretely supported by empirical data.[26] This line of

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[15] Bratton & Wachter, *supra* note 6.
[16] *Id*.
[17] *Id.* at 151–2.
[18] 204 Mich 459 (1919).
[19] *Id*. at 507.
[20] ADOLF A BERLE & GARDINER C MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932)
[21] *See* Kraakman et al, *supra* note 8.
[22] Roberta Romano, *A Guide to Takeovers: Theory, Evidence and Regulation* 9 Yale J. on Reg. 119 (1992).
[23] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law* 89 Geo L. J.439, 441 (2001).
[24] *Id*..
[25] Collison et al, *supra* notes 7, 10.
[26] Bruno Amable, *Institutional Complementarity and Diversity of Social Systems of Innovation*

counterargument shows that the attempt to shift corporations towards a shareholder orientation may be futile.[27] Furthermore, 'comparative institutional advantage' can mean that nations prosper 'not by becoming more similar but by building on their institutional differences.[28]

Variety in social institutions actually dampens the applicability of shareholder primacy in some cases. In other words, 'political economy' strongly affects the adoption of shareholder primacy. According to a widely cited paper by Hall and Soskice, Liberal Market Economy (LME) and Coordinated Market Economy (CME) form the major dichotomy in capitalist countries.[29] The former tends toward shareholder primacy, while the latter, due to less flexible labor markets and corporate control markets, tends in practice to emphasize CSR.[30] The United States and the United Kingdom are LMEs, for example. Meanwhile, Nordic capitalist countries, such as Denmark and Sweden, are representative of CME.[31] The distinguishing characteristics between LME and CME are the different ways in which corporations interact with their societies.[32] Therefore, it seems that neither shareholder primacy nor CSR are per se defective from the perspective of 'institutional complementarities'. One of the key points for a country swinging between shareholder primacy and CSR is probably how to choose a suitable approach based on that country's unique political economy.

Before analyzing the reality of Chinese shareholder primacy in detail, this Part will explain rationale of shareholder primacy. This rationale is the key to correctly decoding and explaining shareholder primacy and discussing its applicability in China. In order to explain shareholder primacy theory without bias, the following parts of this section canvass the arguments both for and against it. Based on mainstream literature on shareholder primacy, there are at least four major arguments in favor of it:

A *Shareholder Ownership: a Mundane View*

In discussions about the rationale of shareholder primacy, people without legal backgrounds tend to recognize that a shareholder is the owner of a firm. In contrast, legal professionals sometimes try to avoid the question of whether shareholders own firms or not. Instead, lawyers and law professors prefer to believe that a shareholder has proprietary interests in a firm that are akin to ownership. The idea of 'the

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*and Production*7 *Rev. Int'l Political Econ.* 645 (2000); Peter A Hall & Daniel W Gingerich, *Varieties of Capitalism and Institutional Complementarities in the Political Economy: An Empirical Analysis* 39 *British Journal of Political Science* 449 (2009).

[27] PETER A HALL & DAVID SOSKICE, VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE) 60 (2001); Beth Ahlering & Simon Deakin, *Labor Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?* 41 *Law and Society Review* 865 (2007).

[28] PETER A HALL & DAVID SOSKICE, VARIETIES OF CAPITALISM: THE INSTITUTIONAL FOUNDATIONS OF COMPARATIVE ADVANTAGE 60 (2001).

[29] Hall & Gingerich, *supra* note 26.

[30] *Id*.

[31] *Id* at 459.

[32] Hall & Soskice, *supra* notes 27, 6.

separation of ownership and control' is therefore widespread.[33] Shareholder ownership used to be the argument for shareholder primacy, because proprietary rights are enough to justify shareholders' superior legal position.[34]

Simply speaking, there is an important criterion for discerning ownership: whether the owner has a legally protected right of control.[35] The managers and directors supposedly work for the shareholders while exercising full control over the firm. This argument does not fit reality. In theory, the owner, the shareholder, vests control power in the hands of agents, the managers and directors.[36] Then, in 'the separation of ownership and control', control over stewardship is the symbol of having control over a firm. It is true that owners are exercising strong control over stewardship in small, closed corporations; often this type of firm is operated by the owners themselves. The degree of control in large, closed companies and listed public companies, however, is starkly different. It is not news that the costs of the shareholder franchise, namely exercising voting rights and removing directors, are formidable. For 99 per cent of shareholders, to exercise control over a firm is barely a fairy tale. In some jurisdictions, shareholders are not entitled to remove a director without legitimate cause.[37] It is more compelling that the law assigns some control power to the major interest groups: shareholders and managers. In the 1950s, George Goyder noted that technically, a firm is self-owning; the idea that it belongs to the shareholders is a legal fiction.[38] Shareholders are not the owners of the company's assets, but in substance are the owners by virtue of being the contributors of the company's capital.[39]

Given that shareholders have limited de facto control over management and that the ownership status is in dispute, the assumption that a company should be run in the interest of shareholders, on the basis of their ownership of company shares, 'is not a rational basis for organizing accountability and interest in companies.'[40]

B *Shareholder as Risk Bearer*

In the corporate law literature, a shareholder is usually referred to as a residual claimant.[41] This means that in bankruptcy, shareholders are the last stakeholders to get paid. The amount paid is the residual assets available after other stakeholders,

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[33] Berle & Means, *supra*note 20.
[34] *Id*.
[35] BRYAN HORRIGAN, CORPORATE SOCIAL RESPONSIBILITY IN THE 21ST CENTURY: DEBATES, MODELS AND PRACTICES ACROSS GOVERNMENT, LAW AND BUSINESS) 104 (2008).
[36] Berle & Means, *supra* note 20.
[37] REINIER KRAAKMAN ET AL, THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (2nd ed. 2009).
[38] GEORGE GOYDER, THE FUTURE OF PRIVATE ENTERPRISE: A STUDY IN RESPONSIBILITY (1951).
[39] J E PARKINSON, CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW 34 (1993).
[40] Janet Williamson, *A Trade Union Congress Perspective on the Company Law Review and Corporate Governance Reform Since 1997* 41 *British Journal of Industrial Relations* 511, 514 (2003).
[41] *See* Kraakman et al, *supra* note 8.

such as creditors and employees, have been fully compensated.[42] Therefore, shareholders as a whole bear greater risk than other stakeholders. When the firm is in good shape, shareholders may or may not get dividends. When the firm gets liquidated, shareholders' claims are a lower priority than those of any other stakeholders. It seems shareholders are taking the heaviest burden of anyone inside or outside the firm.

The issue in dispute is whether or not a shareholder is the only — as opposed to the major — risk bearer. If so, the above argument stands. Otherwise, the argument collapses. If we apply the theories of Frank Easterbrook and Daniel Fischel, the argument cannot stand. Easterbrook and Fischel believe that there is no such thing as a corporation, just an amalgamation of contracts connecting shareholders, managers and directors, creditors and suppliers, etc.[43] Following in this vein, we can safely conclude that a shareholder is no more unique than any other contractual party. Shareholders voluntarily enter into this web of contracts, even if the law does not articulate the shareholder primacy principle. In bankruptcy, other stakeholders face the peril of insufficient compensation, or even non-performance, as well. Indeed, the constituencies of corporations bear different sorts of risk all the time, with various expectations. For instance, employees face losing their jobs, and unsecured creditors may end up unpaid if there are many secured creditors. Additionally, shareholders' risk is limited and hence known in advance, whereas the other stakeholders' risk is often unknown and unforeseeable.[44] Investment portfolios and the liquidity of capital markets also significantly reduce the risk shareholders bear.[45]

Therefore, shareholders are *neither* the solo nor major risk bearers in a firm. Most important of all, if a firm is solvent, shareholders are not residual claimants. It might be a good, if imperfect, metaphor to liken shareholders with bankers in a gambling game. Bankers stand to lose more than any individual player. The qualifier to that is the lesser likelihood overall of the banker losing. The residual claimant argument is not a valid one for the time being.

C *Agency Theory*

Jensen and Meckling's influential work, 'Theory of the Firm: Managerial Behavior Agency Costs and Ownership Structure', changed the discussion context of shareholder primacy from 'separation of ownership and control' to 'managerial opportunism'.[46] In fact, agency theory is built upon 'the separation of ownership and

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[42] *Id.*

[43] FRANK H EASTERBROOK & DANIEL R FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1962).

[44] GEORGE GOYDER, *THE FUTURE OF PRIVATE ENTERPRISE: A STUDY IN RESPONSIBILITY* 17 (1951); *see also* MICHEL AGLIETTA & ANTOINE REBERIOUX, CORPORATE GOVERNANCE ADRIFT. A CRITIQUE OF SHAREHOLDER VALUE (2005).

[45] GEORGE GOYDER, THE FUTURE OF PRIVATE ENTERPRISE: A STUDY IN RESPONSIBILITY (1951); *see also* MICHEL AGLIETTA & ANTOINE REBERIOUX, CORPORATE GOVERNANCE ADRIFT. A CRITIQUE OF SHAREHOLDER VALUE (2005).

[46] Michael C Jensen & William H Meckling, *Theory of the Firm: Managerial Behavior Agency Costs and Ownership Structure* 3 *Journal of Financial Economics* 305 (1976).

control'.[47] Agency theory argues that managers and directors are agents hired by principals, namely the shareholders.[48] Access to information between the agent and the principal is asymmetric, of which managers can take advantage to their own benefit in order. Specifically, managers tend to work less (avoidance) and in a self-interested way (opportunism) in order to maximize their own utility. This behavior may have a negative effect on shareholders' interests. To mitigate the agency costs, the interests of managers and directors must be allied with those of shareholders. Essentially, agency theory suggests that managers and directors should be accountable to shareholders in order to reduce costs. Thus, agency theory supports shareholder primacy.

Given that the solution to the agency problem is based on property rights, this framework shares a theoretical weakness with the ownership argument.[49] Corporate law in most jurisdictions stipulates that the duties of managers and directors are owed to the firm, not to the shareholders directly.[50] From an incumbent law perspective, there is little support for the point of view that managers and directors are responsible to shareholders. Even if managers and directors did owe responsibilities to shareholders, these would not necessarily include taking care of shareholders' interests exclusively and in all matters. Additionally, an agency relationship exists when shareholders sign contracts with managers and directors. Contracts between the firm and the management are unlikely to expand the agency relationship to shareholders, who are third parties to the employment contract.

Traditional agency relationship theory fails to justify the agency cost argument. If there were strong evidence that creating a fictional agency relationship between shareholders and managers would maximize social wealth, we could still create such a relationship. In fact, some literature has tried to do so. This literature opines that 'companies contribute to the maximization of society's total wealth when they seek to maximize their own profits.'[51] This proposition, however, is groundless, because its intrinsic logic is not consistent. Maximizing shareholders' value may not be equal to maximizing social wealth. Consider some northwestern Chinese provinces with strong mining industries as examples. Owners of mining firms become extremely wealthy, while legions of laborers are severely exploited and struggle to make a living. Consequently, social welfare decreases because major populations are deprived. The nouveau riche transfer their wealth to other jurisdictions seeking a better quality of life, leaving their former provinces poorer than before.[52]

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[47] Rock, *supra*note 12; Aglietta &Reberioux, *supra* notes 43, 28.
[48] Jensen & Meckling *supra* note 45.
[49] Rock, *supra*note 12; Aglietta & Reberioux, *supra* notes 43, 28.
[50] David Collison et. al., *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence,* ACCA Research Report 125.
[51] J E PARKINSON, CORPORATE POWER AND RESPONSIBILITY: ISSUES IN THE THEORY OF COMPANY LAW 41 (1993).
[52] See 谌彦辉 [Yanhui Kan], «山西煤老板购房为外迁» [*Why did Mining Tycoons migrate?*] (September 5th, 2006) 腾讯新闻 [Tencent News] < http://news.qq.com/a/20061002/000372.htm>.

D *Efficiency*

Although improving a company's welfare is not equal to improving societal welfare, companies are vehicles that facilitate efficient resource allocation.[53] If a company runs inefficiently, it will eventually disappear. To ensure firms run efficiently, managers should work to maximize the value of the firm. There is a prerequisite to achieving this goal: management should be accountable for what they do. If the directors' mandate is amorphous, it is impossible to hold them accountable.

Considering only one set of interests, those of shareholders, ensures the efficiency of managers and directors.[54] The corporate constituencies' interests vary from group to group. Employees, for instance, ask for high salaries, while creditors demand corporations control costs. Individuals' interests may differ as well, even if they are in same group. Inter-creditor interest is heterogeneous rather than homogeneous, for example.[55] '[S]hareholders are the only stakeholders of a corporation who, in seeking to maximize their own claim, simultaneously maximize everyone's claim.'[56] Given their unique homogeneous interests, shareholders as a whole constitute the ideal group to which managers and directors should be accountable. Hence, shareholder primacy is an indispensable rule in corporate law.

The efficiency argument is not perfect. The shareholders' homogeneity of interests largely depends on the ownership structure of the firm. In a firm with a dispersed ownership structure, meaning no major or controlling shareholders, most shareholders' interests should be the same.[57] In a firm with a concentrated ownership structure, controlling shareholders' and minority shareholders' interests are in most cases heterogeneous.[58] Additionally, due to the incompleteness of contracts, even a firm with shareholder primacy may face efficiency problems.

Despite the above counterarguments against the efficiency argument, efficiency remains the most compelling theory in support of shareholder primacy. The theory also offers a critical guideline to directors, namely to focus on one goal: maximizing shareholders' profits.

III. LAW ON THE BOOKS: INSTITUTIONAL EVIDENCE FOR SHAREHOLDER PRIMACY

The theoretical debate about shareholder primacy cannot furnish any further information on China's shareholder primacy status quo. Even if Chinese corporate law scholars unanimously support CSR, it does not mean that the incumbent laws and

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[53] Easterbrook & Fischel, *supra* note 42.

[54] *See* William T Allen, *Our Schizophrenic Conception of the Business Corporation* 14 Cardozo L. Rev. 261 (1992).

[55] A bankruptcy scenario is a great illustration. In the Ford bankruptcy case, as an example, heterogeneous interests among different classes of creditors were the reason why the court (more accurately, the government) sketched out a bankruptcy-law-breaking plan to protect some 'important groups': DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2010).

[56] Allen, *supra* note 53.

[57] This might not be true in the case where some shareholders have public welfare pursuits while others want to maximize the value of the firm.

[58] THEODORE N MIRVIS, PAUL K ROWE & WILLIAM SAVITT, BEBCHUK'S 'CASE FOR INCREASING SHAREHOLDER POWER': AN OPPOSITION: DISCUSSION PAPER NO. 586 (2007).

judicial practice favor CSR.[59] It is possible that CSR and shareholder primacy can co-exist.[60] Schizophrenic corporate law is not an alien idea.[61] The co-existence of property conceptions and entity conceptions might be a surprise, but there are reasons for this type of arrangement.[62] William Allen ascribes this paradox to 'secularly rising prosperity, a lack of global competition, and the absence of powerful shareholders.'[63] This Part examines the laws linking shareholder primacy and CSR in order to explore legislatures' attitudes towards the dispute between shareholder primacy and CSR. To be sure, the Chinese judiciary does have difficulty exhaustively enforcing the law due to many normative and institutional obstacles.[64] This issue will be addressed in the next section, followed by an analysis of what causes the gap between the law on the books and the law in action.

A *Corporate Law*

Corporate law, of course, is the optimal area of law for legislatures to enact their intentions regarding shareholder primacy and CSR. In common law jurisdictions, scholars usually tend to find precedents with the strongest binding effect in order to discover what the law says on shareholder primacy.[65] China's legislation mode is in the civil law family, however.[66] Therefore, statutes are the major source of law in China, while case precedents are not binding.[67] If statutory materials specifically mandate shareholder primacy or CSR, the next step is to find the degree of conformity in practice. Indeed, Chinese commercial law, in some cases, is abstract and vague.[68] In cases where the statutes are ambiguous, the practitioners' views matter even more than in the clear mandate scenario.

There is strong statutory evidence in corporate law showing that the Chinese legislature did accord corporate control to shareholders. Compared with the manager-centric system in the United States,[69] Chinese shareholders have more

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[59] *See* Allen, *supra* notes 53, 266–72.

[60] *Id.* Also, in a very interesting recent article, Justice Jack Jacobs has pointed out the misalignment between the current model implicit in Delaware case law — that of passive, helpless, and ignorant shareholders — and the reality of concentrated shareholders. *See* Jack B Jacobs, *Does the New Corporate Shareholder Profile Call for a New Corporate Law Paradigm?*18 *Fordham J. of Corp. &Fin. Law* 19, 21 (2012). Another possibility of co-existence is that legislature tackles CRS outside the box of corporate law instead of integrating CSR inside the corporate law box.

[61] *See* Allen, *supra* note 53.

[62] Bratton & Wachter, *supra* note 6.

[63] *See* Allen, *supra* notes 53, 266.

[64] *See* Charlie Xiao-chuan Weng, *Chinese Unbridled Incorporation Competition: The Reality of Political Economy and Competition for Corporate Charters as a Replacement* 44 Hong Kong Law Journal 247 (2014).

[65] See e.g., Dodge v. Ford Motor Company, 170 NW 668 (Mich 1919).

[66] 沈宗灵 [Shen Zonglin], «比较法研究» [*Research On Comparative Law*] (Peking University Press, Beijing, 1st ed, 1998) 433–524.

[67] *Id.*

[68] *See* Weng, *supra* note 13.

[69] At least, it used to be true in the United States. *See* Rock, *supra* note 12.

comprehensive decision-making power.[70] They vote not only on dividend issuances but also on mergers and acquisitions.[71] Management merely has the right to provide explanations and plans.[72] Article 47 of China's company law stipulates that '[t]he board of directors shall be accountable to the shareholders assembly…'[73] Furthermore, art 108 says that '…[t]he provisions in Article 47 of this Law on the functions and powers of the board of directors of a company with limited liability shall be applicable to the board of directors of a company limited by shares.' Although the law states that managers and directors owe fiduciary duties to the firm, arts 47 and 108 are clear enough to demonstrate the legislature's position.[74] Further, there are no other provisions in Chinese corporate law requiring the board of directors to be responsible for non-shareholder subjects. Therefore, for corporate law, the Chinese legislature shows very strong preference for shareholder primacy. Theoretically, this does not supplant CSR. Chinese corporate law does not say that managers and directors should work for shareholders *only*, however. From an institutional perspective, it nevertheless makes incorporating CSR as a part of directors' duties impossible, as civil law jurisdiction judges usually need a statutory source (at least a principle articulated by law) to justify judgments. The detailed explanations on the reason why the Chinese legislature chose leaning towards shareholder primacy are in Part V.

Some might argue that Chinese corporate law has several CSR features, such as worker participation. Indeed, Chinese worker participation originates from German codetermination.[75] Nonetheless, it does not affect the omission of directors' CSR duties in corporate law. Given the fact that the mandatory requirement of worker participation on managerial boards is optional for non-state-owned firms, and the outnumbered worker directors are subject to the same duties as others on the board,

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[70] See generally «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993. Available at <http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm>.

[71] *Id.* at arts 37, 46, 99, 108.

[72] *Id.* at art 46.

[73] Chinese corporations, according to the incumbent corporate law, are categorized into two types: Limited Liability Company (LLC) and Company Limited by Shares (CLS). Article 3 is applicable to LLC, who's shareholders 'shall assume liability towards the company to the extent of the capital contributions subscribed respectively by them' rather than shares: *see* «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993, art 46. Available at <http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm>; *see also* «中华人民共和国企业破产法» [Law of the People's Republic of China on Enterprise Bankruptcy] (People's Republic of China) Standing Committee of the National People's Congress, Order No 54, 27 August 2006. Available at <http://www.gov.cn/flfg/2006-08/28/content_371296.htm>.

[74] See «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, December 29, 1993, art 147. Available at <http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm>.

[75] 江平，邓辉 [Jiang Ping & Deng Hui], «论公司内部监督机制的一元化» [*the Unification of Internal Supervision System In Corporation*], 2 «中国法学» [China Legal Science] 79 (2003).

merely requiring several directors to be selected from workers does not add CSR onto the agenda of the board.[76] To be sure, Chinese corporate law requires worker participation on supervisory boards, whose power and functions are very different from the German counterpart's.[77] The supervisory board only gets inquiry and inspection rights and can hardly supervise management properly, let alone make the managerial board socially responsible.[78]

Another possible counterargument is the recent corporate governance improvement efforts by the China Securities Regulatory Commission (CSRC). The CSRC urges listed companies, not directors, to improve their sense of social responsibility, and imposes disclosure requirements on major CSR related issues.[79] To be sure, the CSRC cannot touch the directors' duties by exercising its rule-making power when there is no direct expression in law. Further, there is a stark difference between imposing CSR on firms and incorporating it into directors' duties. The former barely increases the cost of being socially irresponsible, while the later fundamentally changes directors' decision-making methodologies. The CSRC's recent measures, therefore, are similar to other CSR solutions outside the box of corporate law.

B *Takeover Law*

One salient feature of Chinese company law is that the majority of China's takeover law is outside the company law statute.[80] The takeover-related provisions are scattered throughout securities law statutes and *Measures for the Administration*

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[76] See generally «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993. Available at <http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm>.

[77] 龙卫球，李清池 [Weiqiu Long & Qingchi Li], «公司内部治理机制的改进："董事会—监事会"二元结构模式的调整» [*Improving Corporate Internal Control：The Restructuring of Two-tier Board in Chinese Company Law*], 6 «比较法研究» [Comparative Legal Study] 58 (2005).

[78] *Id*.

[79] See 证监会公告[2011]41 号 [CSRC Gazette<2011>41], article 8 (requiring listed companies to take CSR), available at http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201112/t20111231_204430.htm (visited at 27, April 27, 2016) ; also see 深圳证券交易所关于发布«深圳证券交易所主板上市公司规范运作指引»、«深圳证券交易所中小企业板上市公司规范运作指引»的通知 [Notice of the Shenzhen Stock Exchange on Issuing the Guidelines of the Shenzhen Stock Exchange for Standardized Operation of Companies Listed on the Main Board and the Guidelines of the Shenzhen Stock Exchange for Standardized Operation of Companies Listed on the Small and Medium-Sized Enterprise Board], chapter 9, available at http://www.szse.cn/main/disclosure/bsgg_front/39754034.shtml (visited at 27, April 27, 2016).

[80] Most takeover-related regulations are promulgated by the Chinese Securities Regulatory Commission (CSRC) in the forms of Measures for the Administration of the Takeover of Listed Companies and other administrative rules. *See* «上市公司收购管理办法 2012» [Measures for the Administration of the Takeover of Listed Companies] (People's Republic of China) China Securities Regulatory Committee, Order No 35, 17 May 2006. ('the Measures'). They were amended according to the Decision on Amending Article 63 of the Administrative Measures for the Takeover of Listed Companies of the China Securities Regulatory of Committee on 27August 2008, and further amended according to the Decision on Amending Article 62 and Article 63 of the Administrative Measures for the Takeover of Listed Companies of the China Securities Regulatory of Committee on 14 February 2012. Available at <http://www.lawinfochina.com/display.aspx?id=7043&lib=law>.

of the Takeover of Listed Companies ('the Measures').[81] Takeover law can tell us the top priority that managers and directors should consider.[82] This is especially true in hostile takeover scenarios. The turnover rate of managers after hostile takeovers is high.[83] To keep their jobs, managers and directors have strong incentives to prevent takeovers, even if this means using measures that hurt shareholders.[84] In America, the judiciary has developed a series of precedents in order to ensure that managers and directors consider only, or at least primarily, the shareholders' interests.[85]

Article 8 of the Measures outlines to whom managers and directors in control transactions should be accountable.[86]

> The directors, supervisors and senior managers of a target company shall assume the obligation of fidelity and diligence, and shall equally treat all the purchasers that intend to take over the said company.
>
> The decisions made and the measures taken by the board of directors of a target company for the takeover shall be good for maintaining the rights of the company and its shareholders, and shall not erect any improper obstacle to the takeover by misusing its authorities, nor may it provide any means of financial aid to the purchaser by making use of the sources of the target company or damage the lawful rights and interests of the target company and its shareholders.

The language in this provision explicitly requires managers and directors to consider a corporation's and its shareholders' interests. The China Securities Regulatory Commission (CSRC), the legislative author of the Measures, does not give any explanation on what constitutes a corporation's interest.[87] Intuitively, it appears CSRC believes shareholders' interests and corporations' interests are homogeneous.

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[81] *Id.*
[82] *Id.*
[83] Anup Agrawal & Charles R Knoeber, Managerial Compensation and the Threat of Takeover 47 Journal of Financial Economics 219 (1998).
[84] *See* John Armour & David A Skeel Jr., *Who Writes the Rules for Hostile Takeovers, and Why? — The Peculiar Divergence of US and UK Takeover Regulation* 95 Geo.L.J, 1727 (2007).
[85] Although there is an attitude difference between the *Revlon* and *Unocal* cases (Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946(Del. 1985) & Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985)), the proposition of the judiciary is clear. *See* Armour & Skeel, *supra* note 78.
[86] *See* «上市公司收购管理办法 2012» [Measures for the Administration of the Takeover of Listed Companies] (People's Republic of China) China Securities Regulatory Committee, Order No 35, 17 May 2006. ('the Measures'). They were amended according to the Decision on Amending Article 63 of the Administrative Measures for the Takeover of Listed Companies of the China Securities Regulatory of Committee on 27August 2008, and further amended according to the Decision on Amending Article 62 and Article 63 of the Administrative Measures for the Takeover of Listed Companies of the China Securities Regulatory of Committee on 14 February 2012. Available at <http://www.lawinfochina.com/display.aspx?id=7043&lib=law>.
[87] *Id.*

Otherwise, CSRC would have provided a hierarchy to solve the potential conflict between these groups. In other words, it would identify whose interest should be the first one considered. This omission by and large obliterates the shareholder primacy stipulated in Chinese company law. Despite this vagueness, it is hard to imagine that the legislature chose CSR rather than shareholder primacy as the first priority for managers and directors. After all, the legislature never mentioned anything related to CSR in the statutes.

C *Other Areas of Law*

We now turn to other areas of law, such as labor law and environmental law, where managers and directors might be asked to take CSR into consideration. If the law imposes personal liability for non-compliance, managers and directors should at least consider CSR as an independent value instead of making a cost-benefit calculation. The results shows that all provisions directly related to social responsibility in Chinese law merely mention general duties, such as responsibilities to employees and the environment. The law does not introduce personal liability for managers and directors. If CSR violations invite liability, the legislature is dealing with the issue inside the corporate law box. This approach forces managers and directors to consider others interests. Otherwise, managers and directors tend to calculate costs and benefits and do what is ultimately good for shareholders.

IV. LAW IN ACTION: WHAT DO PROFESSIONALS BELIEVE?

It is not news that in China the law on the books is different from the law in action. From the incumbent law perspective, it seems that managers and directors are supposed to work for shareholders. The social and economic changes in the recent decade necessitate a reexamination of the law in action regarding for whom managers and directors work. In this part, data collected from questionnaires distributed to judges, lawyers and in-house counsel is analysed in order to find out what they believe and how they apply law in practice. Most questions are designed to ascertain if the subject favours shareholder primacy or CSR. They were developed with reference to the pros and cons on shareholder primacy and CSR, which have been discussed in the Part II.[88] This analysis will serve as a background for further discussion.

Some caveats seem warranted to give the methodological considerations a careful and sophisticated treatment. First, the questionnaire consists of two parts: A) the questions, such as the most important feature of a firm and the importance of resources, were conducted to find out, on the individual knowledge level, whether the interviewees endorse shareholder primacy; B) and the ones showcase the factors that

[88] Ian Ramsey and others' research on shareholder primacy also greatly informs the research methodology. *See* Malcolm Anderson et al, *Evaluating the Shareholder Primacy Theory: Evidence from a Survey of Australian Directors*, University of Melbourne Legal Studies Research Paper No. 302, available at http://www.law.unimelb.edu.au/files/dmfile/Evaluating_the_shareholder_primacy_theory_-__evievide_from_a_survey_of_Australian_directors__20_11_07_2.pdf.

would be considered properly fulfill a director's fiduciary duty in practice in order to measure the deviation of the law on book and the law in action.

Second, the interviewees in the research only include legal practitioners. To be sure, it would be sensible to include directors if the issue were whether China is dominated by shareholder primacy or CSR. Given the fact that the purpose of the research is to find out the inconsistency between law on book and law in action, legal practitioners are the major subjects to interview. Further, all the interviewees who participated in the research are corporate judges, lawyers and in-house counsels in Shanghai. There is selection bias of the method in term of the sample selection, therefore.[89]

Third, court rulings usually are more efficient resources to find out the conformity of law and practice. The research nevertheless has to choose a less direct way, interviewing legal practitioners, for following reasons: A) court rulings are not completely accessible, which will greatly affect data completeness. Further, given the fact that the judiciary firstly screens rulings for publication and withholds the selection criteria, selection bias may be out of control. B) In the drastically changing Chinese society, it is efficient, from the legal research perspective, to find out what people will do than what has been done. C) Questionnaire-based research can provide the information of subject's legal knowledge, which a survey of court rulings could not. D) Chinese court ruling represents the collective decision of a panel instead of individual judge's thoughts,[90] while questionnaire-based research generates accurate and individualized information. Therefore, for the research purpose, it is more efficient to employ questionnaire-based research than conduct court ruling empirical research.

A *Judges*

The first and most important subjects are adjudicators, because they make decisions regarding the application of the law. The values they cherish are crucial to the conformity between written law and actual practice. Around 50 questionnaires were sent out and 32 valid responses were collected. All the interviewees were in the commercial law adjudication section and had over three years of corporate law adjudication experience. In terms of the most important issue, the nature of corporations, 69% of judges believed that corporations are shareholders' assets, while 25% of judges regarded corporations as nexuses of contracts. Only two judges took corporations as principals with managerial agents.[91] Accordingly, 82% of judges opined that the most critical resource for corporations is capital, while only 6% of judges believed that labor is the most critical. Additionally, distribution network and

[89] Major cities, such as Shanghai and Beijing, usually have a more neutral and liberal judiciary and lawyers than the ones in less developed areas. If there is a law enforcement gap in major cities, the gap usually can be even wider in other cities. Therefore, we believe the selection bias does not fundamentally affect the conclusion of the research.

[90] Although some local courts in China are trying to incorporate dissenting opinions into court rules, generally speaking, there are no individual opinions in most corporate law hearing cases.

[91] *See* Chart One in Appendix.

policy each only got a 6% share of the votes.[92] This research also shows that 69% of judges considered shareholders' control over stewardship expensive and hard to exercise.[93] It seems the majority of judges are heavily influenced by property views on the shareholder-management relationship. Therefore, if there are no other strong interferences, it would be logical for judges to follow shareholder primacy.[94] They nevertheless realize that capital contributors, both creditors and shareholders, are the most significant factor for firms, while the control shareholders have over managers and directors is often weak.

When asked what interests executives must consider in order to fulfill their fiduciary duties, judges unanimously answered that all constituencies' interests are important and must be considered. The only divergence on fiduciary duty was the method of considering all constituencies' interests.[95] Furthermore, in terms of the significance of interests in litigation, judges firmly believed that the state's interest is most important.[96] Interestingly, although no one rated creditors' interests as the most significant, 75% of judges put it as one of the top three interests to be emphasized in litigation.[97] From the financial-market perspective, this emphasis is probably consistent with the absolute pro-state approach. Banks and other financial institutions, most of which are state-owned in China, do most of the financing in the market.[98] It is logical to put creditors, largely controlled by the state, among the top three interests, because most judges believe the law should favor the state. It is not hard to discover a huge discrepancy through analyzing the data, however. This discrepancy is the very gap between the law on the books and the law in action. Why are judges on the one hand aware that shareholders own firms and that equity finance is important, yet on the other hand inclined to protect all constituencies in applying the law? Parts VI and VII are dedicated to explaining this inconsistency.

B *Lawyers and in-house counsel*

Lawyers and in-house counsel are important in terms of how the law gets applied.[99] They provide legal opinions to clients and explain how companies can comply with the law. Given that lawyers and in-house counsels are less politically influenced than adjudicators, their answers, of course, differ in certain ways. Charts

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[92] *See* Chart Two in Appendix.
[93] *See* Chart Three in Appendix.
[94] *See* previous discussion on the pros and cons of shareholder primacy. Above, notes 32–8.
[95] *See* Chart Four in Appendix.
[96] *See* Chart Five in Appendix.
[97] *Id.*
[98] 平新乔 [Ping Xinqiao], «中国国有资产控制方式与控制力的现状» [China's Control over State Assets and Control Reality] 107 «经济社会体制比较» *Comparative Economic and Social Systems* 63 (2007). (talking about China's strong control over its financial system through state ownership).
[99] In China, in-house counsel is not regarded as a lawyer. Although some of them may be lawyers before working as in-house counsels, they generally do not enjoy any rights and take any obligations under Chinese Regulation of Legal Profession. These idiosyncratic characteristics are the reasons why we researched in-house counsel's points of view on shareholder primacy and CSR separately.

six to ten, infra, show the statistical results of the questionnaire for lawyers, while charts eleven to fifteen illustrate the in-house counsel's' opinions.[100] Around 20 commercial lawyers and 30 in-house counsels participated in this survey.

Lawyers' understandings of the nature of the firm are quite diverse. Almost equal numbers of participants believed that the firm is a nexus of contracts versus that the firm is the shareholders' asset.[101] Many lawyers also believed that the firm is a sole principal or one of the principals to managerial agents.[102] Because of this diversity, it is logical that the number of lawyers who choose capital as the most critical resource is lower than that among judges.[103] Meanwhile, in-house counsel, because of their employment status, gave more weight to companies per se. Almost half of the in-house counsel surveyed believed that a company is at best the same as its owners, the shareholders, in terms of the nature of the firm.[104] Answers to the third question, which related to shareholders' control over stewardship, mirrored reality. Most lawyers believed that such control is difficult to exercise and answers from in-house counsel agreed.[105] Unlike judges, hovering between shareholder primacy and CSR, most lawyers and in-house counsels agreed that the fiduciary should consider all constituencies.[106] The answers to the last question were quite straightforward. Lawyers rated the importance of all participants as roughly equal. In-house counsel favored the company, shareholders and employees, probably because they are company employees.

The statistical results are rich and academically valuable. This article nevertheless only uses them to show the gap in conformity between written law and actual practice. Other equally meaningful aspects of the data must wait for later analysis. Because lawyers and in-house counsel explain law to and control risks for clients, and judges decide such clients' cases, lawyers and in-house counsel are susceptible to judges' views. It is because judges lean towards CSR that other legal practitioners cannot help but follow this trend. In sum, legal practitioners are enforcing CSR inside the corporate law box, even if the laws say otherwise. There is nothing about CSR that should be inside the box of Chinese corporate law.

V. EXPLAINING THE INCONSISTENCY

It seems that practitioners' beliefs tend to deviate from the letter of company law.[107] The law explicitly demands that managers and directors work for shareholders as a whole. Nonetheless, many legal practitioners' responses to the issue of for whom

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[100] *See* Charts Six to Fifteen in Appendix.
[101] *See* Chart six in Appendix.
[102] *See* Chart Six in Appendix.
[103] *See* Chart Seven in Appendix.
[104] *See* Chart Eleven in Appendix.
[105] *See* Charts Eight and Thirteen in Appendix.
[106] *See* Charts Nine and fourteen in Appendix.
[107] See «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993, art 147. Available at <http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm>.

corporations are accountable went against shareholder primacy theory. At the very least, many legal practitioners are crossing the current legal boundary as CSR is not in the box of corporate law. The next question, therefore, is: what creates the gap between legal requirements and the modus operandi in practice? This part is devoted to addressing this question.

Given that China is an authoritarian country and had a planned economy for almost four decades, it is safe to conclude that the process of legal reform relies on government power.[108] This path dependency sheds light on the statute-practice gap. It is because of path dependency that political economy heavily affects China's corporate legislation and practice.[109]

A *Why does corporate law emphasize shareholder interest?*

China is a single-party state.[110] After three decades of massive campaigns for marketization, the government can no longer completely dominate society and the economy can no longer be classified as 'Leninist command'.[111] Gaps in party control over society have arisen and keep on widening. One of the options for the party to restore its control is to infuse its values and interests into legislation. That approach is the origin of instrumentalism, which regards law as a tool of the party.[112]

In 1978, President Deng launched the 'Open Gate Policy' and the 'Market Economy Reform'.[113] There were only two forms of business organisation in China at that time: State Owned Enterprises (SOE) and Collectively Owned Enterprises (COE). There was no need to dispute shareholder primacy, because SOEs' sole shareholder was the state and COEs were inferior in the national economy.[114]

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[108] 'Planned Economy' is an economic system in which the government controls the economy. Its most extensive form is referred to as a 'command economy', 'centrally planned economy', or 'command and control economy'. Under such a system, the resource prices are in many cases distorted; they fail to reflect the real value of the resource, as many types of resources are still priced by the state that operates on the inertia of the old planned economy. The central government decides what and how much should be produced. *See* Arnaldo Gonçalves, *China's Swing from a Planned Soviet-Type Economy to an Ingenious Socialist Market Economy: An Account of 50 Years* (Argentine Center of International Studies, Working Papers - Programa Asia & Pacífico, Paper No.019, 2006) (Arg.) 36 (discussing the details on transforming from planned economy to market economy in China). Available at http://ssrn.com/abstract=949371.

[109] *See* Weng, *supra* note 13. (Talking about takeover market regulator's legislation philosophy and evaluation of current Chinese takeover regulation from shareholder protection perspective).

[110] A single-party state is a jurisdiction in which a single political party has the right to form the government, usually based on the existing constitution. All other parties are either outlawed or allowed to take only a limited and controlled participation in political matters. *See*. Jonathan Unger & Anita Chan, *China, Corporatism, and the East Asian Model* 33 Australian Journal of Chinese Affairs 29 (1995).

[111] *Id*.

[112] 谢晖 [Xie Hui], '法律工具主义评析 [Analysis of Law Instrumentalism]' (1994) 1 «中国法学» *China Legal Science* 50.

[113] 袁剑[Jian Yuan], 中国证券市场批判 [Criticism on China's Capital Market] (China Social Science Press, Beijing, 1st ed, 2004).

[114] Charlie Xiao-chuan Weng, *Chinese Shareholder Protection and the Influence of the US Law: the Idiosyncratic Economic Realities and Mismatched Agency Problem Solutions* 40 Securities Regulation Law Journal 401 (2013). (Mentioned the ownership structure and its history).

Shareholder primacy was equal to state primacy. Approximately two years before the promulgation of the first Chinese company law, the marketization process was still stagnant due to the vagueness of the 'Open Gate Policy' and the 'Market Economy Reform'.[115] After the 'Southern Speech' in 1992, all levels of the bureaucracy received a clear signal that the Market Economy Reform was imperative and could be promoted more aggressively than before.[116] Nonetheless, 99% of the business organizations were still SOEs or controlled by the state. The first Chinese company law, in 1993, solidified the state shareholder's control by making management accountable to shareholders.[117] In 2007, literature showed that over 75% of the shares of listed companies were still in the state's hands.[118] It was also logical that the second version of the company law, enacted in 2005, remained closely aligned to shareholder primacy.[119] Or, more accurately in view of the practice of law, aligned to state shareholder primacy.

The company law revision in 2013 only touched the issue of registered capital.[120] Shareholder primacy is the central principle of Chinese company law. From a legislative perspective, it seems shareholder primacy is consistent with the state's interests and should be manifested in corporate law. To explain China's political economy, the argument could be: protecting the shareholder's interest is generally equal to improving social welfare because of the huge portion of state shareholding in the national economy. This approach sounds similar to the solution of creating a fictional agency relationship between managers and shareholders. This argument, of course, invites numerous criticisms from academics.[121]

B *Declining state owner's influence and legal practitioners' deviation from shareholder primacy*

If the presumption is true that protecting the shareholders' interest is generally equal to improving social welfare due to the dominance of state ownership, then legal practitioners should not significantly deviate from shareholder primacy. In fact, the landscape of Chinese companies' ownership underwent enormous change in the past three decades. Simply put, there were three major changes that reduced the dominant state-ownership: the advent of the joint venture, SOE reform and state-owned share

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[115] 袁剑[Jian Yuan], 中国证券市场批判 [Criticism on China's Capital Market] (China Social Science Press, Beijing, 1st ed, 2004).
[116] *Id*.
[117] *Id*.; before 1997, laws were drafted by the state council. If CSR represents the general good or the state interest, it would have been in the law,.
[118] Weng, *supra* note 106. (Discusses the ownership structure and its history).
[119] *See* «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993, art 147. Available at http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm.
[120] 张元 [Zhang Yuan], '《公司法》资本制度修改对执行程序的影响 [Modification of registered Capital Institution's Influence on Enforcement Procedure]' 10 法律适用 [*Application of Law*] 94 (2014).
[121] *See* notes 44–50 above.

reduction. These changes, taken together, drove legal practitioners' deviation from shareholder primacy.

The first wave of change began in the 1980s. In order to attract foreign investment, China permitted foreign investors to cooperate with Chinese SOEs and form joint ventures. The foreign ownership share, however, could not exceed 50%.[122] With the advent of tens of thousands of joint ventures, China said goodbye to the pure communist business organisation model. Because local governments were given incentives to entice investors to incorporate in their jurisdictions, local government investors were usually forced to sacrifice some advantages.[123] Additionally, in that period, state assets were managed by the state asset management authority, which is a bureaucratic agency.[124] Bureaucrats are not as active as private investors in maximizing a firm's value.[125] The foreign party often had greater control over the firm than they should have.[126] In the past, private parties in joint ventures tended to severely exploit laborers and abuse favorable government policies. Excessive control helped these parties to reap the benefits of exploitation and speculation.[127]

The second issue related to the change of Corporate China's landscape was SOE reform.[128] Because of problems with managerial incentive and the absence of proper supervision from owners, Chinese SOEs were floundering. These companies needed major restructuring to increase their internal governance.[129] The measures taken by the central government included increasing private share proportions, promulgating detailed supervision guidelines and introducing the Management Buyout (MBO).[130] Especially during the MBO process, many SOEs were transformed into private companies. This transition lowered the proportion of SOEs in Corporate China.

The third issue was the reduction of state shares, which complicated ownership structures. The Chinese state is criticized for simultaneously acting as a market player

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[122] There are regulations promulgated by the State Council stipulating that the investment from foreign investors should not exceed 50%. The most famous one is the Catalogue of Industries for Guiding Foreign Investment, available at http://en.pkulaw.cn/display.aspx?cgid=164578&lib=law#.

[123] Weng, *supra* note 63.

[124] The purposes and features of the state-owned Assets Supervision Administration Commission are available at: http://en.sasac.gov.cn/. Also, in my previous paper, the property of the authority was discussed; *see* Weng, *supra* note 13.

[125] Weng, *supra* note 106. (Discussed the ownership structure and its history).

[126] Local governments very often prioritize the incorporation for their own career consideration and are less interested in control power. As a consequence, non-local investors received more control and other benefits than their investment should have been entitled. Weng, *supra* note 63.

[127] Although there is no direct criticism on this issue, the relationship between foreign investors and local governments, and the blameworthiness on the government as market supervisor naturally incurs the association of above matters. *Id*.; *see also* 赵红梅 [Zhao Hongmei], '从"富士康事件"看我国劳动者权益保护机制的缺陷 [Analysis on 'the FoxCom Gate' and its Implications on Chinese Labor Protection Institutions]' (2010) «法学» [*Legal Science*] 3.

[128] 孙坚 [Sun Jian], '加速国企并购重组市场化 [The Ways of Expediting the Marketization of SOEs' M&A]' 11 董事会 [*Directors and Boards*] 63, 65 (2009).

[129] Weng, *Chinese Unbridled Incorporation Competition*, *supra* note 63.

[130] 袁剑[Jian Yuan], 中国证券市场批判 [Criticism on China's Capital Market] (China Social Science Press, Beijing, 1st ed, 2004).

(stakeholder of SOEs) and referee (rule maker of the market).[131] Reducing state shares is one method to reduce and change the state's stake in China's economy, but this method's future is far from clear due to the ambiguous attitude of the state.[132] Nowadays, it is easy to find a company in China with many types of shareholders (the state, local governments, private companies with state shares and individuals). Maximizing firm value, as a common goal, aligns idiosyncratic shareholders. Compared to pure state-owned SOEs in the planned economy era, Chinese companies today look more like organizations chasing profit for shareholders than social entities.

All the aforementioned issues call into question the dogma that protecting shareholder interest is generally equal to improving social welfare. Additionally, the state owner's slackness in corporate governance leaves SOEs vulnerable to exploitation by private shareholders and managers. This vulnerability arguably defeats arguments for the dogma. From the layman's perspective, it is hardly possible to argue that protecting shareholder interest improves social welfare after more than 13 workers exploited by a chip processing company committed suicide.[133] When hundreds of workers in southern China rose up and tried to defend their rights (or more properly express their feelings) against a profiteering boss, supporting the dogma became even more pointless in the face of vandalized township infrastructure.[134] It is not new to have citizens of coastal cities flood into city hall and block main highways in order to dissuade local bureaucrats from approving highly polluting projects.[135] As a consequence, the 'harmonious society' became the Party's most important social governance goal.[136] Obviously, the previously mentioned social disturbances are undesirable to the state in light of the 'harmonious society' propaganda. As a consequence, the legislature enacted laws imposing strict social responsibilities on corporations.[137] The Chinese judiciary, of course, must follow the

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[131] *Id.*

[132] 孙坚 [Sun Jian], *supra* notes 120, 65.

[133] 赵红梅 [Zhao Hongmei], *supra* notes 119.

[134] Even if the social disturbances happened a lot in the past ten years, there is very little information traceable on internet. This Chinese blog, written by a freelancer, might provide some flavor on the mentioned issue; Anonymous author, «广东群体性事件背后的思考？» [*Thoughts on the Group Activities in Guang Dong Province*] (June 16th, 2011) 新浪微博 [Sina Blog] http://blog.sina.com.cn/s/blog_54b2f99e0100v45f.html.

[135] The incidents that happened in Ningbo have been largely wiped out on the internet. For the complete Chinese narrative description of the social disturbance from a pro-government perspective (the blogger is representing the government) *see* «宁波镇海 PX 项目群众聚集事件舆情分析» [*Situation Analysis on the Group Activities Caused by PX Project in Zhen Hai, Ning Bo*] (December 27, 2012) 新浪微博 [Sina Blog] http://blog.sina.com.cn/s/blog_6988e07a0101dlv1.html.

[136] *See* Maureen Fan, *China's Party Leadership Declares New Priority: Harmonious Society,* Washington Post, A18 (12 Oct. 12 2006), http://www.washingtonpost.com/wp-dyn/content/article/2006/10/11/AR2006101101610_2.html. The construction of a 'harmonious society' is a socio-economic vision that is said to be the result of President Hu Jintao's signature Scientific Development ideology. In applying this vision, Chinese authorities have responded to social unrest by tightening controls and drafting laws to placate society's ire towards corrupt government and corporations.

[137] After the promulgation of the new labor law, for example, many enterprises found it too

government's step.[138] This judicial subservience is the source of the schizophrenia in Chinese corporate law.

VI. FURTHER ANALYSIS: POLITICAL ECONOMY AND INSTITUTIONAL CHOICE

The preceding discussion on Chinese shareholder primacy from both institutional and practice perspectives makes it clear that common practice is inconsistent with the language of the relevant statutes. This, of course, is not the only instance of such inconsistency in China. As mentioned before, it is because of the judiciary's enforcement of 'harmonious society' policy that practice deviates from written law. If this conclusion is correct, however, more questions follow. Why did the top leaders believe that harmony was the cure for social disturbances? Why did the judiciary voluntarily enforce this policy over legal principles? Should the laws be modified in order to react to the call for a harmonious society? Is policy-orientated corporate law enforcement a Pandora's Box which will dampen China's rule of law? Even if there are compelling justifications for CSR, how does it find its way into corporate law? This part is devoted to answering these questions.

A *Collectivism or Corporatism?*

There are three great 'isms' of the twentieth century: Marxism, Liberal Pluralism and Corporatism.[139] Pure version of each 'ism' might be difficult to find in the real world, because all of them are extreme examples. Liberal Pluralism advocates individualism and stands at the individualist extreme. In Liberal Pluralism, the political market place offers individuals a forum to express their political views, which eventually compete with each other and produce a winning policy outcome.[140] Unlike individuals, interest groups per se do not determine the policy outcomes.

As the essence of Marxism, Communism stands at the other end: collectivism.[141] Collectivism calls for a representative, a party, to speak for the state. The preferences of the party become the policies of the state. Interest groups in the society merely execute the party's decrees.

Compared to these two "isms", corporatism is more complex by nature. In terms of structure, corporatism stands in the middle of the spectrum between individualism and collectivism. In corporatism, both individuals and interest groups are involved in

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stringent and were planning to relocate their manufacturing lines. 张五常 [Zhang Wuchang],'张五常论新劳动法 [Zhang Wuchang Talking about New Labor Law]' (2009) 4 «法律和社会科学» [*Law and Social Science*] 1.

[138] My previous takeover papers introduced and explained the problems and independence of China judiciary: Weng, *Lifting the Veil of Words*, *supra* note 13. However, attention should be paid to recent judicial reform targeting the problems mentioned. The effects of the reform are yet to be observed. For more information see 魏胜强 [Wei Shengqiang], '法律方法视域下的人民法院改革 [Judicial Reform in the Framework of Law]' 5 中国法学 *China Legal Science* 95 (2014).

[139] HOWARD J WIARDA, CORPORATISM AND COMPARATIVE POLITICS: THE OTHER GREAT 'ISM 5 (1997).

[140] *Id*.

[141] *Id*

the decision-making process.[142] The mechanism of corporatism centres on the dynamics among interest groups, and between the groups and the state. Interest groups play a role as consultants in the process of rule-making, while the rules themselves are later articulated by the government. Once the government issues decrees, various interest groups are expected to abide by them and refrain from taking benefits beyond those allocated by the decrees.[143] To be sure, the number of interest groups with access to the state is limited. Selected groups serve as peak associations. Other groups are affiliated to the peak associations and arranged into hierarchies. Group discipline acts as an institutional cornerstone. Without this linchpin, support for national policies collapses and policy-making becomes dysfunctional.

In the United States, some social elites tried to promote corporatism during Roosevelt's New Deal period.[144] Corporatism supports government involvement in the national economy. This era of ambitious promotion nevertheless failed, because the peak associations did not exercise self-restraint in the execution stage.[145] In addition, the end of the National Industry Recovery Act (NIRA) also serves as evidence of the existence of corporatism in the United States[146]. Corporatism, of course, is conducive to productivity. It therefore came back into American policy during World War II in the form of the executive order.[147]

Jonathon Unger and Anita Chan opine that China is no longer a Party-state that directly dominates society, and that the economic mode is no longer 'Leninist command'.[148] To be sure, after three decades of economic reform in China, the social and political structures have become far more complicated than the founding fathers of reform would have envisioned. Even a layman in the Chinese street might agree that China is no longer a state that the Communist Party can comfortably control. Given the size of the economy and diversity of market interest groups, collectivism is no longer a viable political choice. In order to police China's drastically changing society, the Party has had to design an institution that can simultaneously reduce governance costs and deliver continuous economic growth.[149] Economic performance

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[142] ALAN CAWSON, CORPORATISM AND POLITICAL THEORY 145 (1986).
[143] HARMON ZIEGLER, PLURALISM, CORPORATISM AND CONFUCIANISM 22-3 (1988).
[144] JORDAN A SCHWARZ, LIBERAL: ADOLF A. BERLE AND THE VISION OF AN AMERICAN ERA 84-5 (1987).
[145] DONALD R BRAND, CORPORATISM AND THE RULE OF LAW: A STUDY OF THE NATIONAL RECOVERY ADMINISTRATION 94 (1988).
[146] National Industry Recovery Act, Pub L No 73-67 48 Stat 195, 196 (1933). The act was finally ruled unconstitutional by the Supreme Court in the case of *Schechter Poultry Corporation v. United States*, 295 US 495 (1935).
[147] BARTHOLOMEW H SPARROW, FROM OUTSIDE IN: WORLD WAR II AND THE AMERICAN STATE 73-4 (1996).
[148] Unger & Chan, *supra* note 102.
[149] 袁飞 [Yuan Fei] et al, '财政集权过程中的转移支付和财政供养人口规模膨胀) [The Transferring Payment in the Process of Fiscal Centralization and the Expansion of Fiscally Supported Population]' (2008) 5 «经济研究» [*Economic Research Journal*] 70. (Talking about the soaring fiscal budget on supporting expending public servants and the high cost of the administrative central and local controls).

justifies the governance of the Party.[150] It has been widely recognized by international scholars that China has become a corporatist state.[151] This situation assures the economic growth and Party governance of the world's second-largest economy.

Again, corporatism calls for self-discipline inside the interest groups.[152] There are established peak associations, such as big conglomerates and national labor unions. In modern China these entities facilitate the policy-making process and the enforcement of self-restraint. Therefore, the organizations in Chinese society are automatically saddled with a duty: once public policy is promulgated, the various groups are expected to adapt their own policies to support it. Rapid economic development creates and widens the gap between peak associations' internal discipline and the degree of conformity with the enacted policy. Some organizations, after calculating costs and benefits, may try to cross the institutional border and acquire abnormal returns. As a result, societal organizations need to carry certain non-value-maximizing obligations, such as considering environmental protection, in order to achieve social harmony, which is the catchword of corporatism.[153]

These obligations might or might not be consistent with the internal members' interests (which, in the corporate scenario, is shareholders' interests). The Chinese judiciary, working with other governance apparatuses, is the major power to restore harmony if organizations fail to restrain themselves. The corporatist state, as an apt description of modern China's political economy, is the major reason why the law in action goes beyond the literal dogma contained in the statutes. The mighty institutional resilience of China's political economy urges the judiciary to police society. Any literal interpretation of law to criticize judicial enforcement is powerless and naïve in the face of political economy. This also explains why judges believe corporations should be responsible for workers, even though the law says mangers should be answerable to shareholders only and nothing else.[154]

B *At the Crossroads: Shareholder primacy or CSR?*

1 *The Advantages of Shareholder Primacy*

It seems that protecting the state as shareholder is no longer a compelling justification for shareholder primacy in China, because there are now other shareholders in the market.[155] Political economy is also not conducive to considering

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[150] Jude Howell, *Civil society, Corporatism and Capitalism in China* 11 Journal of Comparative Asian Development 271 (2012).

[151] *See* Unger & Chan, *supra* note 102; Howell, *supra* note 142.

[152] Bratton & Wachter, *supra* note 6.

[153] Unger & Chan, *supra* note 102.

[154] See «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993, art 147. Available at http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm.

[155] Weng, *Chinese Shareholder Protection*, *supra* note 106. (Mentions the ownership structure and its history).

only shareholder interest by itself.[156] Nevertheless, these are insufficient reasons to incorporate CSR into corporate law and exclude shareholder primacy. It is debatable whether or not any argument for shareholder primacy can stand in the specific context of modern China. Which principle, CSR or shareholder primacy, is more efficient in China?

As mentioned before, laymen tend to believe that a firm is owned by shareholders. Therefore, the firm should be operated as a vehicle to maximize share value.[157] Furthermore, corporate law should be designed to reduce agency costs so that the principals' operating costs decrease.[158] Theoretically, this view is challenged by asking whether the firm is per se private property or an entity in which shareholders merely have a legitimate claim based on their capital contributions.[159] This debate on the most outstanding feature of a firm can be complicated and endless. We can, however, change perspective in order to examine the issue of ownership and agency costs. Chinese ownership structures are by and large concentrated.[160] This concentration means that in most Chinese firms there are controlling shareholders who make major calls, like decisions on mergers and acquisitions.[161] Another important feature of Chinese corporate law is that the law is shareholder-friendly. Shareholders as a whole have considerable discretionary power in their stewardship.[162] This discretion further weakens managerial power. Shareholders as a whole have strong control over the firm, which makes the institutional choice between shareholder primacy and CSR less relevant. It would be difficult for management to exercise discretionary power when shareholders' interests are in conflict with those of other constituencies. Both features, the nature of concentrated ownership and the shareholder-friendliness of Chinese corporate law, support shareholder primacy.

Of course, privately controlled firms should not be forgotten. Theoretically, managerial agency costs should be minimized by vigilant controlling shareholders.[163] This vigilance works only when the controlling shareholders actively supervise the executives, however. It is a long-standing issue that the state as a controlling shareholder is reluctant to be actively involved in corporate governance issues. The state is concerned more about politics than pecuniary gain.[164] Therefore, the nature of the agency problem could be starkly different depending on the characteristics of the controlling shareholders. CSR might give executives too much power in state ownership scenarios because in these scenarios the agency cost reduction effect can

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156 *See* above, notes 128–143.
157 *See* above, notes 32–38.
158 *See* above, notes 44–50.
159 *Id.*
160 Weng, *Chinese Shareholder Protection*, *supra* note 106.
161 *Id.*
162 *See* «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, December 29, 1993. Available at http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm.
163 *See* Kraakman et al, *supra* note 8.
164 Weng, *Chinese Shareholder Protection*, *supra* note 106.

be amplified. Still, it is quite hard to enforce in a scenario where private controlling shareholders seize stewardship power. In sum, CSR would not be a good fit under current Chinese ownership structures. The issue left unsolved, then, is whether CSR is a preferable, or perhaps the only, solution under current Chinese political economy.

2 *Is CSR the only solution, or at least better than shareholder primacy?*

To be sure, it is imperative that China reinforce social responsibility requirements, given that fast-expanding private entities and GDP-chasing SOEs are ruthlessly externalizing their costs to achieve their own goals. Emphasizing social responsibility can rein in this unbridled externalization so that societal welfare can be maximized. CSR nevertheless is not an absolutely preferable solution, because it is not viable under the current Chinese ownership and legal framework. At the very least, the application of CSR makes SOEs vulnerable to managerial exploitation and tends to prohibit managers and directors controlled by private shareholders from considering other constituencies.

Simplicity is crucial to Chinese corporate law, given that by many accounts the quality and independence of the judiciary are not satisfactory.[165] Taking into account more than just the externalization problem makes shareholder primacy a better approach. Shareholder primacy provides the most simplicity and leaves less leeway for the government to abuse. Unfortunately, the externalization problem nonetheless persists. It would be a better institutional choice to alleviate the problem without complicating the current corporate law framework.

Comparing CSR with shareholder primacy, the latter seems like a better fit for modern Corporate China from the ownership structure perspective, even ignoring the cost of changing the status quo. In the private controlling shareholder scenario, shareholder primacy merely reiterates the modus operandi, confirming the dominant status of controlling shareholders. Introducing CSR is not going to make managers and directors independent from controlling shareholders without changing multiple areas of corporate law, such as the criterion for disqualifying an executive.[166] In the state controlling shareholder scenario, it seems that in most cases managers and directors take advantage of the meager supervision from the controlling shareholder. Therefore, even though there is a controlling shareholder, the agency problem is still a managerial one.[167] Shareholder primacy is conducive to allying management's interests with the shareholders'. Shareholder primacy, therefore, is efficient when the state is a controlling shareholder.

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[165] To be sure, China has launched a round of juridical reform in 2014 in order to increase the efficiency and independence of the judiciary: *See* Weng, *Lifting the Veil of Words*, *supra* note 13. However, attention should be paid to recent judicial reform targeting the problems mentioned. The effects of the reform are yet to be observed. For more information, please read the Article: 魏胜强 [Wei Shengqiang], *supra* note 130.

[166] «中华人民共和国公司法» [Companies Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 29 December 1993, art 37. Available at http://www.gov.cn/ziliao/flfg/2005-10/28/content_85478.htm.

[167] Weng, *Chinese Shareholder Protection*, *supra* note 106.

If shareholder primacy is more efficient than CSR in China, how can we reduce the externalization of costs and make firms socially responsible? Luckily, Berle's discussion on shareholder primacy and CSR furnishes us with one more angle from which to examine this issue. The externalization problem need not necessarily be solved in the corporate law box. It is possible to keep the shareholder primacy requirement in corporate law, while still curbing externalization through increasing the firm-specific violation cost. Some jurisdictions have successfully incorporated stringent CSR requirements outside the corporate law box. Managers and directors therefore have to consider costs and benefits before making shareholders better off at the cost of other constituencies inside and outside the firm.

To be sure, imposing CSR outside the corporate law box without increasing executives' and controllers' duty to other constituencies works quite differently from directly incorporating CSR into corporate law. In the latter case, the management is going to automatically consider others' interests because they simply owe duties to other constituencies. The legal consequence of noncompliance, for instance, is fiduciary duty litigation, which will reduce executives' personal wealth as well as other benefits, executive liability insurance notwithstanding. Imposing CSR outside the corporate law box applies via an indirect and complex route. When there is a conflict of interest between shareholders and other constituencies, managers and directors are supposed to first calculate costs and benefits. Given that shareholder primacy requires shareholder interest maximization, management will only launch programs with positive gains after deducting the cost incurred for violating other interests. Therefore, without modifying the shareholder primacy principle, firms still can be more socially responsible.

When operating outside the corporate law, correctly reflecting the interests of other constituencies is the linchpin of the proposal. Accurate cost assessment not only includes fair compensation to others, but also is related to enforcement. These two elements happen to be the major areas in rule of law reform in China.[168] Therefore, an efficient choice in tackling social responsibility issues will be to improve social responsibility requirements in relevant areas of law and make sure these laws are enforced.[169] This solution seems consistent with the rule of law reform and incurs minimum cost compared with completely overturning the shareholder primacy principle on the statutory level.

VII. CONCLUSION

Shareholder primacy and CSR form a pair of crucial principles for deciding in whose interests managers and directors should be working. This topic, of course, has been thoroughly discussed in Chinese academia. Although Chinese corporate law stipulates that managers and directors should be responsible to shareholders and

[168] 魏胜强 [Wei Shengqiang], *supra* note 130.

[169] Once again, Chinese labor law can serve as an example. Although it is the most stringent labor law so far in China, the enforcement is still far from satisfactory. Of course, the applicability of the law is still significant: 张五常 [Zhang Wuchang], *supra* note 129.

corporations and there is no language mentioning other principals, this research discovers that in practice, a strong belief in corporate social responsibility exists. Not only judges but also other legal professionals are following CSR in legal practice and enforcing CSR inside the box of corporate law. From the history and political economy perspectives, it is no wonder that the Chinese legislature put shareholder primacy into corporate law. Furthermore, political economy explains the discrepancy between statutory requirements and legal enforcement. Given that Chinese society has undergone drastic changes and corporatism seems to have become one of the features of contemporary Chinese society, it is natural for people to associate idiosyncratic contemporary social utilities with shareholder primacy rule modification. The current judicial system, however, is not well prepared for the application of CSR in rulings on the liability of corporate management. Furthermore, judicial integrity and independence would be in jeopardy. Therefore, abolishing shareholder primacy is probably not an optimal and practical option. Instead, at the current stage, upgrading enforcement efficiency and increasing violation costs might be a cheap and immediate solution for China's urgent problems, such as environmental and labor issues. It is still premature to discuss whether CSR will be more efficient than shareholder primacy inside the corporate law box in China.

VIII. APPENDIX

Chart One[170]

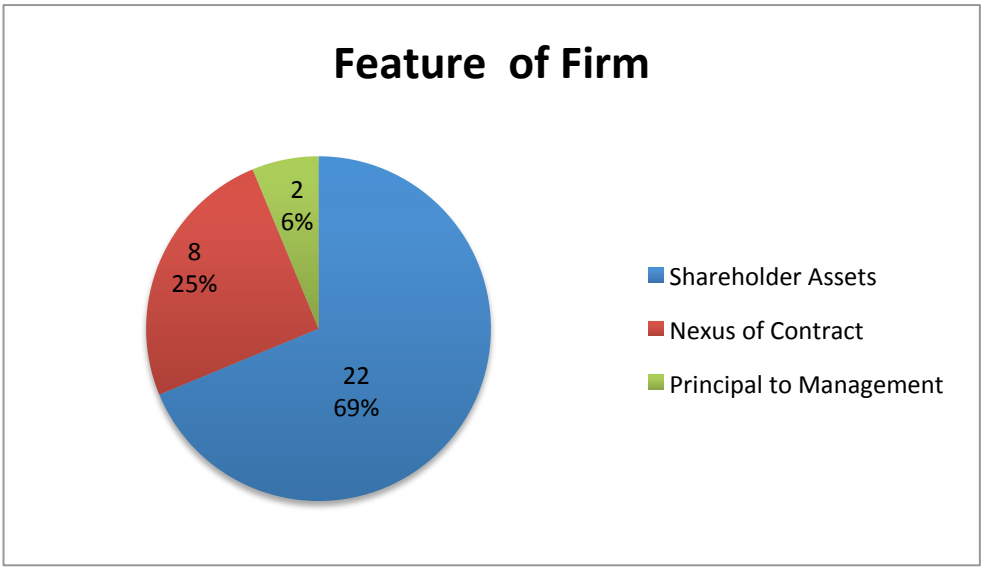
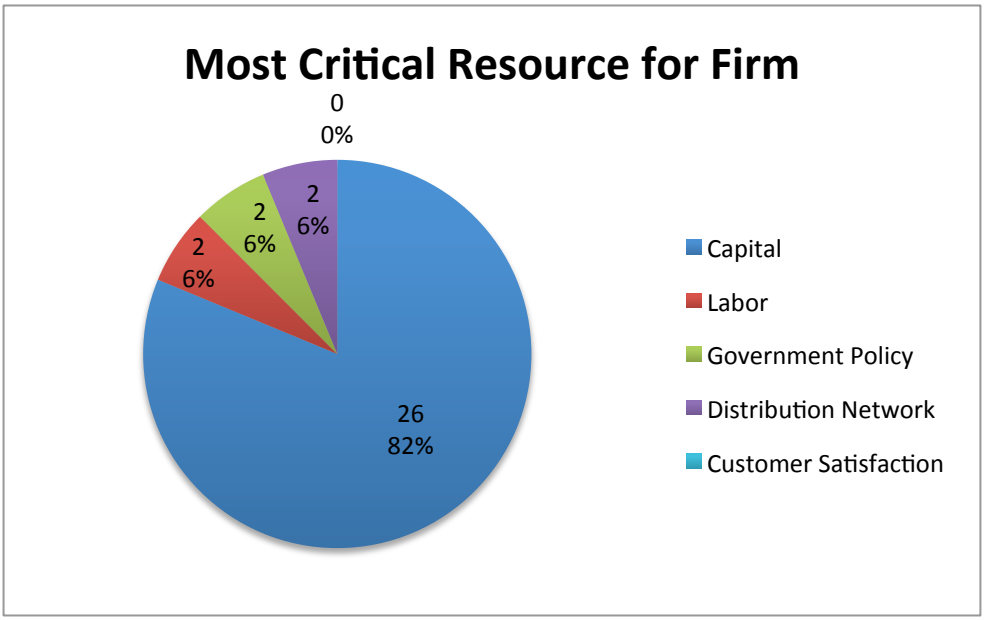


Chart Two[171]



[170] This question was designed to find out how the judges and other legal practitioners conceptualise the property of the firm. Legal practitioners that think the firm is an asset of the shareholders might be advocates of shareholder primacy. Otherwise, to some extent, they may agree that the firm is social entity carrying responsibilities to constituents other than shareholders.

[171] This question is a further step to test the results of the first question. If a legal practitioner is a proponent of shareholder primacy, they should list shareholders' contribution as the most critical resource. Of course, the empirical research reveals more legal issues, which are not directly relevant to this research.

Chart Three[172]

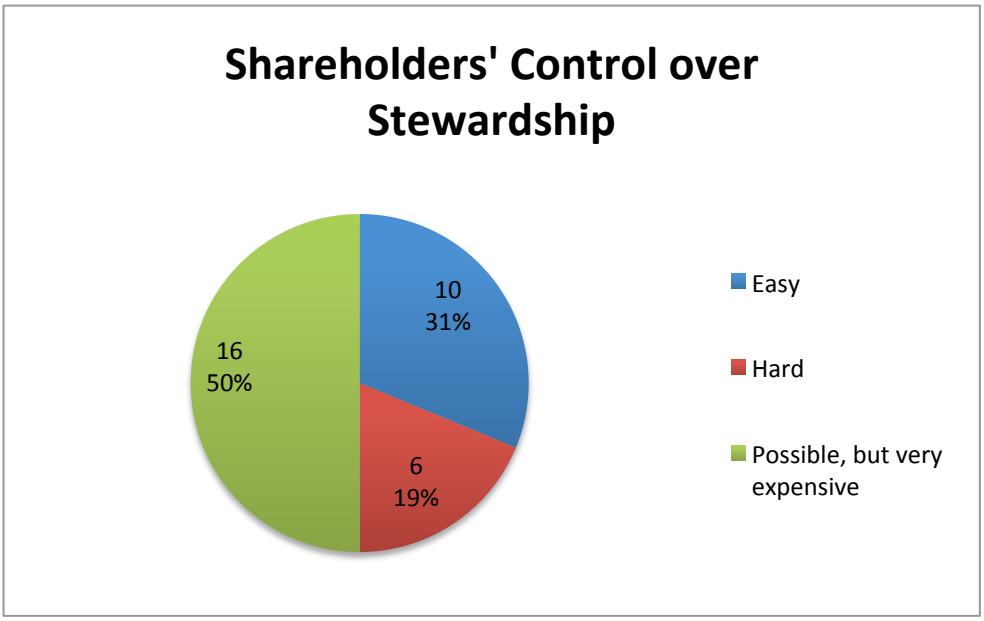
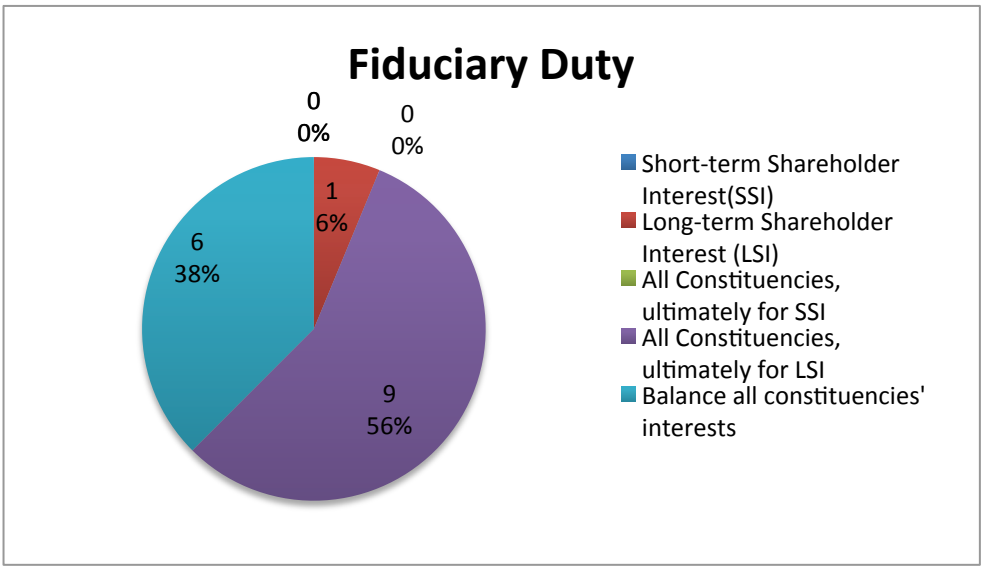


Chart Four[173]



[172] The results collected from the questionnaire showcase to what extent shareholders have control over the firm and how shareholders' control power is recognized by law and practice. As mentioned in the early part of the paper, if the owners' control is weakly protected, the recognition of shareholders' ownership right over firm is unwarranted.

[173] Through studying the responses to this question we expect to discover under what circumstances legal practitioners believe the fiduciary duty is fulfilled. This is the major evidence to show the discrepancy between law on book and law in action.

Chart Five[174]

Significance in Litigation			
Constituencies	**Average**	**TOP1 rate**	**TOP3 rate**
Shareholder	3.875	（2）12.5%	（5）31.25%
Company	4.625	（2）12.5%	（5）31.25%
Employee	4.5	（0）0	（5）31.25%
Consumer	6.25	（0）0	（3）18.75%
Supplier	6.9375	（0）0	（1）6.25%
Creditor	3.4375	（0）0	（12）75%
Community	6.875	（0）0	（0）0
Environment	5.1875	（3）18.75%	（5）31.25%
The State	2.25	（9）56.25%	（13）81.25%

[174] This chart shows the weights of different interests when legal practitioners are facing a case. The higher the average rating is, the more weight the interest receives.

Chart Six

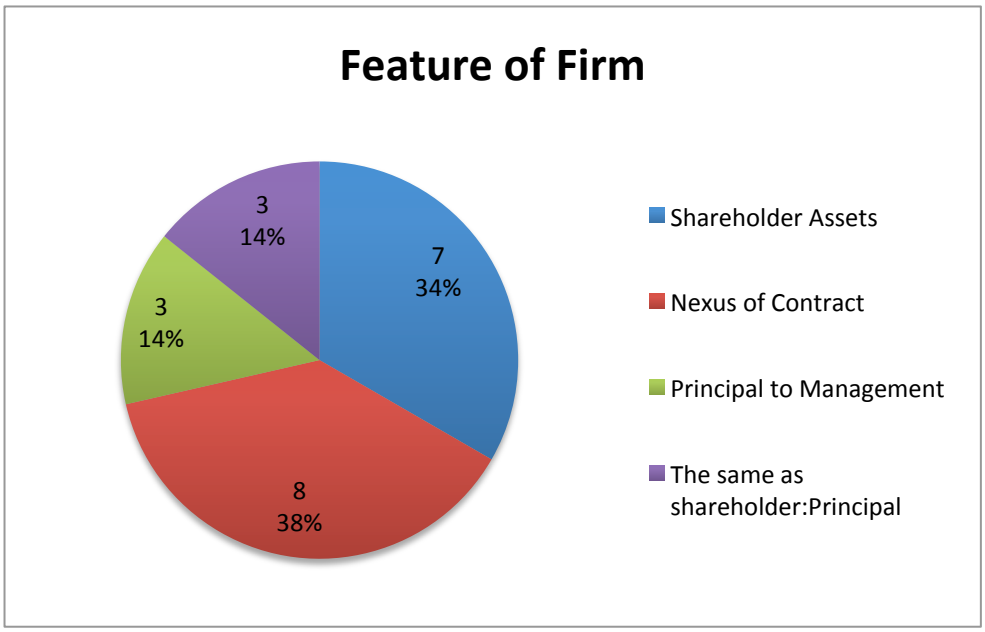


Chart Seven

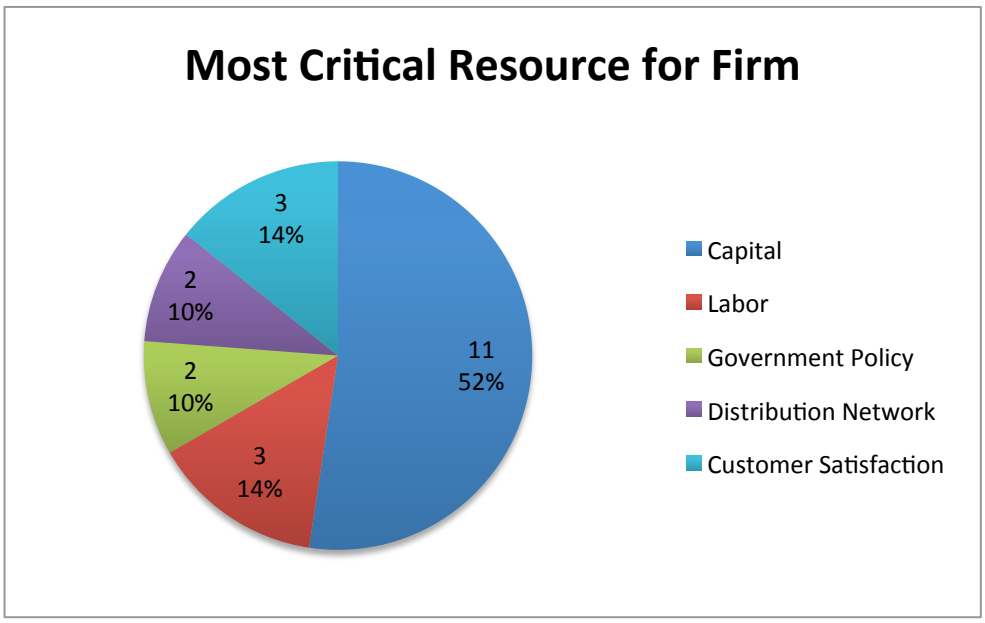


Chart Eight

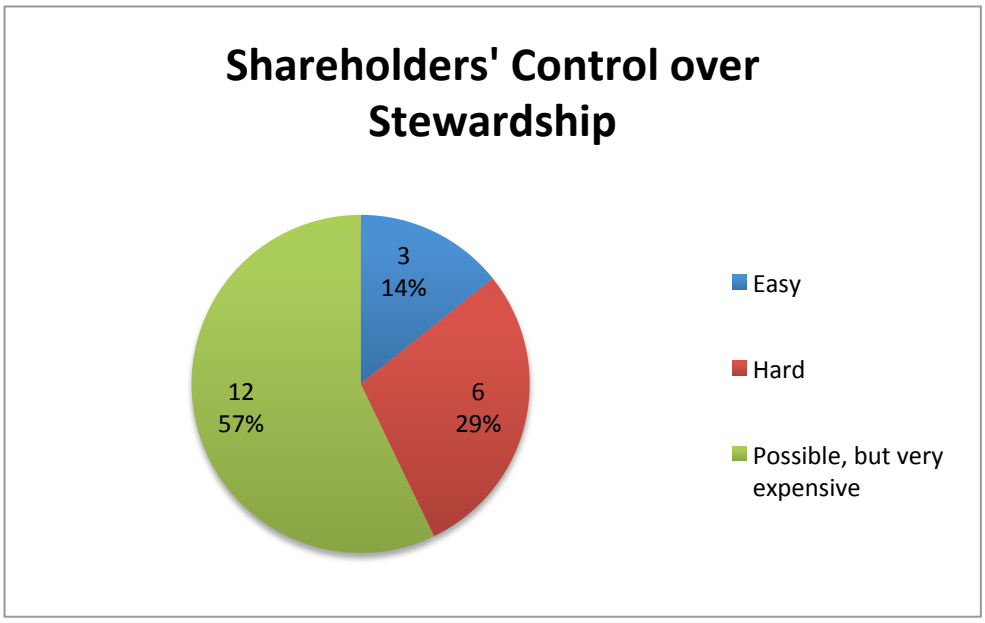


Chart Nine

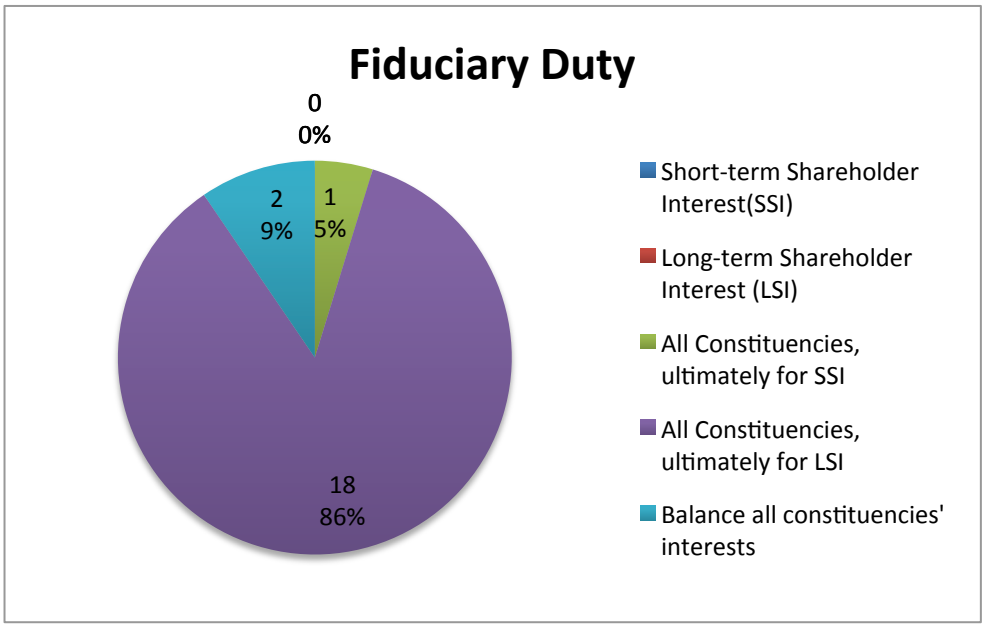


Chart Ten

Significance in Litigation			
Constituencies	**Average**	**TOP1 rate**	**TOP3 rate**
Shareholder	3.75	（5）25%	（10）50%
Company	4	（4）20%	（9）45%
Employee	3.9	（2）10%	（9）45%
Consumer	4.3	（3）15%	（8）40%
Supplier	6.05	（0）0	（4）20%
Creditor	4.6	（2）10%	（8）40%
Community	6.85	（0）0	（3）15%
Environment	5.65	（2）10%	（4）20%
The State	5.9	（2）10%	（5）25%

Chart Eleven

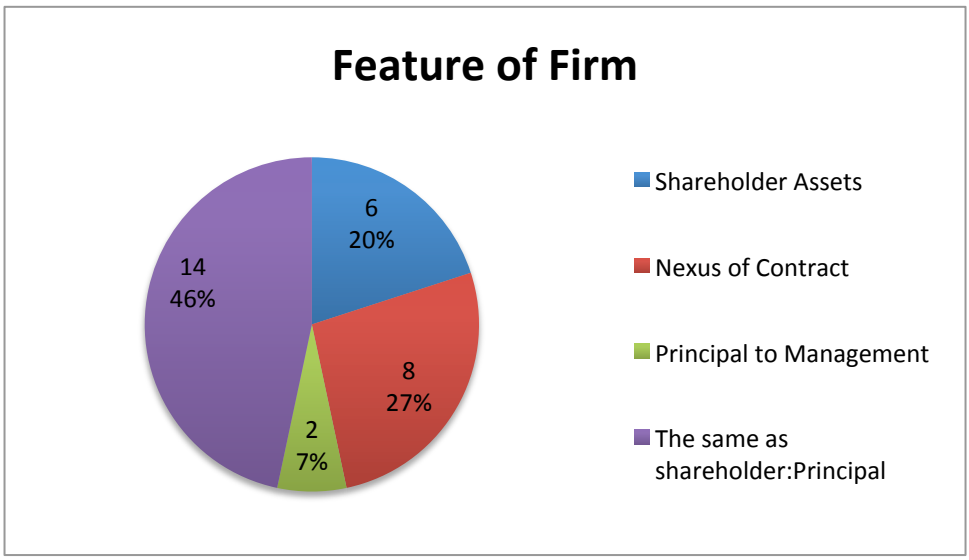


Chart Twelve

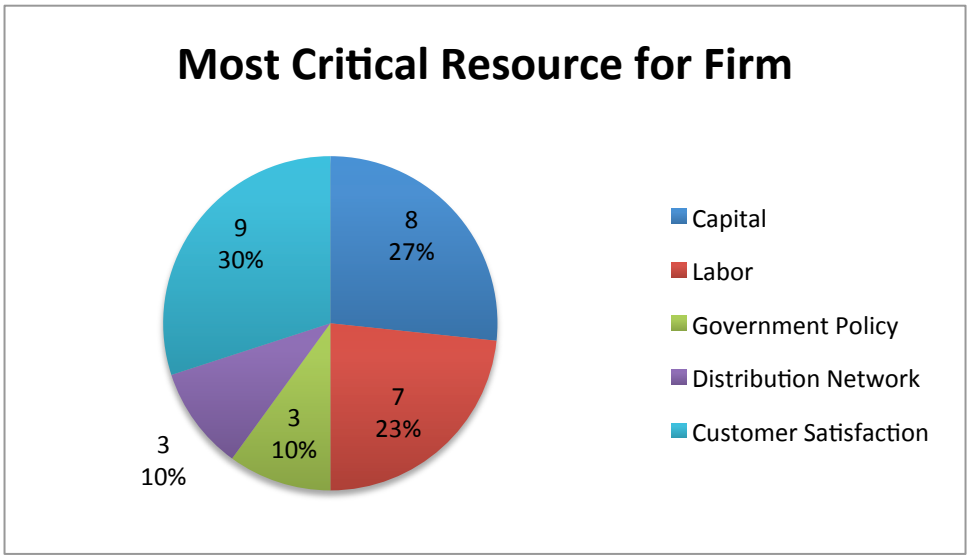


Chart Thirteen

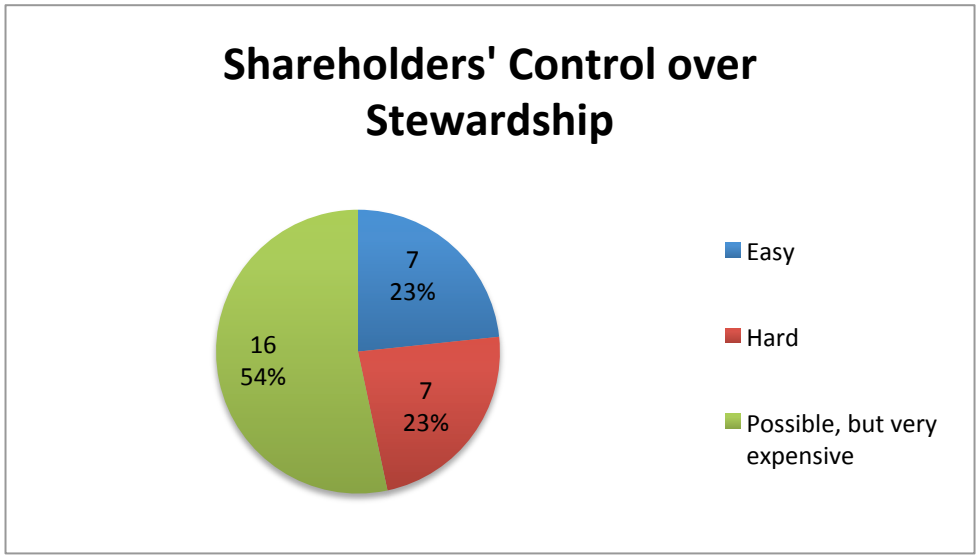


Chart Fourteen

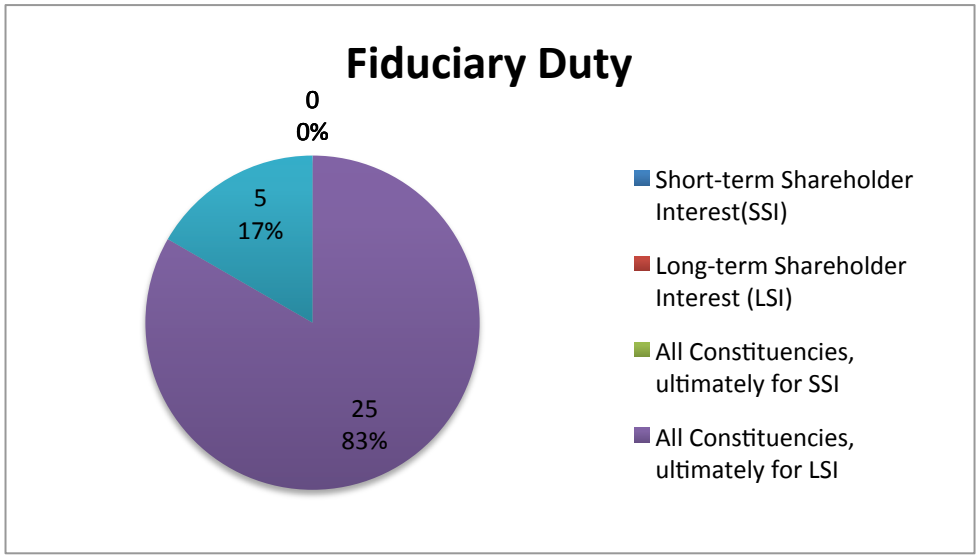


Chart Fifteen

Significance in Litigation			
Constituencies	**Average**	**TOP1 rate**	**TOP3 rate**
Shareholder	3.62	（10）34.49%	（18）62.07%
Company	3.86	（8）27.59%	（18）62.07%
Employee	3.69	（2）6.9%	（15）51.72%
Consumer	4.38	（1）3.45%	（6）20.69%
Supplier	6.14	（0）0	（2）6.9%
Creditor	4.76	（1）3.45%	（6）20.69%
Community	6.48	（0）0	（5）17.24%
Environment	5.45	（2）6.9%	（9）31.03%
The State	6.21	（5）17.24%	（8）27.59%