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# PetroChina Syndrome: Regulating Capital Markets in the Anti-Globalization Era

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# The PetroChina Syndrome: Regulating Capital Markets in the Anti-Globalization Era

Stephen F. Diamond\*

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## I. INTRODUCTION

As one of her last acts as Acting Chairman of the Securities and Exchange

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Commission, in the spring of 2001, Laura Unger threw what the *Financial Times* called a “bombshell” into the global capital markets.<sup>1</sup> Responding to pressure from Congress and an emerging independent political campaign, Chairman Unger issued a letter that acknowledged that the human rights violations by issuers of securities can be considered “material” to investors, and, therefore, foreign issuers of securities in the United States will now be required to provide disclosure of the risks associated with any investments by these issuers in countries where the United States has imposed sanctions for human rights or other legal violations.<sup>2</sup> The Unger Letter followed the unprecedented effort over the previous year by a range of labor, religious, human rights, and anti-slavery groups to change American securities law in part by attempting to derail the initial public offering (IPO) of common stock by PetroChina Company Ltd. (PetroChina), a large oil-producing company controlled by the government of the People’s Republic of China (PRC).

For decades, the U.S. capital markets have been considered relatively free of the risk and uncertainty of political interventions that are common in many other jurisdictions. Thus, issuers have been thought to benefit from a lower cost of capital and greater transparency and predictability about regulatory action. Because of these apparent advantages, it is argued that, in recent years, a larger number of foreign issuers have tapped into the deep and liquid U.S. capital markets by listing their securities on a U.S. exchange. In the words of Federal Reserve Chairman Alan Greenspan:

[T]he openness and the lack of political pressures within the [American financial] system . . . has made it such an effective component of our economy and, indeed, has drawn foreigners generally to the American markets for financing as being the most efficient place in many cases where they can raise funds.<sup>3</sup>

Thus, the Unger Letter on the U.S. capital markets represents a significant break with the hands-off tradition in the United States. Indeed, perhaps not surprisingly, its impact was felt almost immediately. Soon after the release of the Unger Letter, Lukoil, a large Russian oil company that was considered a crown jewel in that country’s privatization and economic reform process, announced that it would withdraw a planned listing of its common stock on the New York Stock Exchange in order to list its shares instead on the United Kingdom’s London Stock Exchange. In a brief statement, Lukoil said that it wanted to avoid what it called the “political risk” now associated with a U.S. listing.<sup>4</sup> This followed a decision some weeks before by the PRC to withdraw a planned sovereign debt offering in the United States.<sup>5</sup> These were precisely the kinds of developments that

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1. Edward Alden, *SEC Chief Inherits Disclosure Bombshell*, FIN. TIMES, May 11, 2001, at 1. Note that the SEC continues to use the word “Chairman” despite widespread usage of gender-neutral titles in other parts of the government.

2. Letter from Laura Unger, Acting Chairman, Securities and Exchange Commission, to Frank P. Wolf, Congressman, U.S. House of Representatives (May 8, 2001) (on file with author) [hereinafter Unger Letter].

3. *The Federal Reserve’s Second Monetary Policy Report for 2000: Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs*, 106TH CONG. 13 (2000) (statement of Alan Greenspan, Chairman, Board of Governors, Federal Reserve System) [hereinafter Greenspan].

4. Alison Beard, *Russia’s Lukoil Disappoints US Investors with London Listing*, FIN. TIMES, July 2, 2001, at 23.

5. Joe Leahy & Aline Van Duyn, *Spy Plane Incident Hits Bond Sale in US*, FIN. TIMES, May 16, 2001, at 31 (“Recent changes to SEC procedures regarding the amount of documentation required from foreign

critics of the approach taken by Unger had feared.<sup>6</sup> Nonetheless, this reaction to the Unger Letter did not stop those who argue that the capital markets are now an appropriate, and indeed, crucial arena for advocacy of certain political goals. The AFL-CIO, for example, the thirteen million-member umbrella body for America's trade union movement that had played a key role in the protests about PetroChina's IPO, followed that effort with a campaign to block the proposed tender offer by integrated oil giant Amerada Hess (AHC) for the publicly traded shares of the exploration and production specialist Triton Oil (Triton).<sup>7</sup> AHC had a twenty-five percent stake in the British oil company Premier, one of the last major multinational companies to maintain an active investment in Burma, or Myanmar, a country laboring under a brutal military dictatorship.<sup>8</sup> In addition, Triton has operations in Equatorial Guinea, on the west coast of Africa, and in Colombia. Both countries have severe internal political strife and are the locale of concerns about human rights violations. The AFL-CIO has also been conducting an aggressive shareholder campaign to force Unocal, the California oil producer, to change its investment policy in Burma in light of accusations that the company, among other allegations of human rights violations, engaged military forces there to use forced labor to help build a natural gas pipeline.<sup>9</sup>

This unprecedented development in the capital markets, I will argue, can only be understood in the context of the broader debate about globalization<sup>10</sup> that has emerged over the last several years. A problem is emerging in the global economy that may indeed

borrowers might also have delayed the process of issuing a bond into the US market . . .").

6. Greenspan, *supra* note 3 ("[T]o the extent that we block foreigners from investing, from raising funds in the United States, we probably undercut the viability of our own system.").

7. *Union Peak Body Calls for Amerada Hess Vote on Triton*, OIL & GAS TODAY, Aug. 8, 2001, available at <http://www.ogtoday.com/archives/0108/010506/010808b37.html> (last visited Nov. 16, 2003).

8. In late 2002, AHC and Premier Oil gave in to shareholder and public pressure and sold off their Burmese assets to a Malaysian company friendlier to the dictatorial regime. Terry Macalister, *Premier Oil Gets Out of Burma*, THE GUARDIAN, Sept. 17, 2002, available at <http://www.guardian.co.uk> (last visited Nov. 4, 2003); Press Release, *The Burma Campaign UK, Campaigners Celebrate as Premier Oil Pulls Out of Burma* (Sept. 16, 2002), available at <http://www.burmacampaign.org.uk/pressreleases/160902.html> (last visited Sept. 17, 2003).

9. Press Release, *AFL-CIO, Worker Shareholders Challenge Unocal's Plans for New Investment in Burma and Ask for Commitment to Global Labor Standards* (May 20, 2002), available at [www.aflcio.org/mediacenter/pr05202002.cfm](http://www.aflcio.org/mediacenter/pr05202002.cfm) (last visited Nov. 16, 2003).

10. The concept "globalization" remains controversial and difficult to pinpoint. For the purposes of this Article, I consider globalization to represent the attempt to spread the Anglo-American model of capitalism, particularly seen in the expansion of cross-border flows of capital in both its fictitious and physical forms (i.e., investment and trade) that has been so marked in the last twenty years. In addition to the increase in flows, the ability to locate first-class production facilities in low cost areas around the globe, a process facilitated by financial and technological developments, gives a new significance to capital mobility and threatens long-standing social and economic arrangements together with the political and institutional frameworks that accompanied those arrangements. For a generally favorable view of the impact of globalization, see THOMAS L. FRIEDMAN, *THE LEXUS AND THE OLIVE TREE* (1999). For critical views from the left, see JOSEPH E. STIGLITZ, *GLOBALIZATION AND ITS DISCONTENTS* (2002); PETER GOWAN, *THE GLOBAL GAMBLE: WASHINGTON'S FAUSTIAN BID FOR WORLD DOMINANCE* (1999); and WILLIAM GREIDER, *ONE WORLD READY OR NOT: THE MANIC LOGIC OF GLOBAL CAPITALISM* (1998). For a critical assessment from the right, see JOHN GRAY, *FALSE DAWN: THE DELUSIONS OF GLOBAL CAPITALISM* (1998). On the WTO protests in Seattle, see Stephen F. Diamond, *Bridging the Divide: An Alternative Approach to International Labor Rights after the Battle of Seattle*, 29 PEPP. L. REV. 115 (2002) [hereinafter Diamond, *Bridging the Divide*].

prove to be fatal for Anglo-American capitalism<sup>11</sup> as we now know it. This model of capitalism has evolved and survived for some two hundred years or more in significant part because of its ability to generate legitimacy, understood as a sense inculcated in the general population that the system is not only the best that can be achieved under the circumstances, no matter how unjust or unequal actual social outcomes, but that these outcomes are reached in a manner that reflects the needs or desires of a substantial majority of the population.<sup>12</sup> The ability of capitalism to generate this legitimacy depends crucially on certain compromises crafted with the general population through ideology, institutions, and mass organizations. This was true, for example, throughout the four decades of the Cold War, for both contending parties. The bureaucratic regimes of the east justified their existence by appealing to the alleged material improvements they provided for the bulk of their populations. This apparent achievement helped those regimes generate an attractive ideological agenda that appealed to hundreds of millions of desperately poor people around the world, and thus posed a serious political challenge to the traditional capitalist regimes of the West. Stalinism made (and, in the case of a handful of countries like Cuba, China, and North Korea, continues to make) this appeal not just through the exercise of mindless propaganda, but also through the active efforts of mass organizations controlled rigidly from above by the government or a Communist party.<sup>13</sup>

A variation of this legitimation process was also found in the West in tripartite and corporatist institutions that, for example, brokered wage and productivity deals between workers, employers, and the government. In the West, of course, the strength of the system's legitimacy was not found largely in arguments about the material conditions of the working class, though such arguments were certainly made, but rather in the argument that basic civil liberties guaranteed freedom for all its citizens. The existence of process acting as a check on the arbitrary exercise of power, through institutions like free trade unions and collective bargaining, helped western capitalism win the hearts and minds of its working class.<sup>14</sup>

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11. I write of the Anglo-American model in distinction from the European and Asian models. The Anglo-American model, as will be clear from discussion below, relies heavily on arms-length capital markets, as opposed to friendly creditors, as a source of capital for, and as a device for the discipline of, corporations. The core principles (and principals!) of this model have become central to the globalization process of the last twenty years. See MICHEL ALBERT, *CAPITALISM AGAINST CAPITALISM* (1993) (arguing that a "new phase of capitalism" emerged with the rise to power of Margaret Thatcher in 1979 and Ronald Reagan in 1980); RONALD DORE, *STOCK MARKET CAPITALISM: WELFARE CAPITALISM—JAPAN AND GERMANY VERSUS THE ANGLO-SAXONS* (2000) (discussing emergence of new model of capitalism where "firms run primarily, even exclusively, for the benefit of their shareholders").

12. On legitimacy and capitalism generally, see JÜRGEN HABERMAS, *LEGITIMATION CRISIS* 19 (1973) ("[P]rivate ownership of the means of production . . . in the long run threatens social integration [but] within the framework of a legitimate order of authority, the opposition of interests can be kept latent and integrated for a certain time. This is the achievement of legitimating world-views or ideologies."); 1 MAX WEBER, *ECONOMY AND SOCIETY* 213 (1968) ("Experience shows that in no instance does domination voluntarily limit itself to the appeal to material or affectual or ideal motives as a basis for its continuance. In addition every such system attempts to establish and to cultivate the belief in its legitimacy."), cited in HABERMAS, *supra*, at 97.

13. For an exploration of the internal political dynamics of the Stalinist and neo-Stalinist regimes, see Stephen F. Diamond, *Class and Power in Revolutionary Nicaragua: The Rise and Decline of the Sandinista Movement* (1991) (unpublished Ph.D. dissertation, University of London) (on file with author).

14. See E.P. THOMPSON, *WHIGS & HUNTERS* 265 (1977) ("[T]he notion of the regulation and

The result, in both East and West, was the widespread social acceptance, at least for several decades, of what can be thought of as a social variation of Pareto optimality: the working class would not revolt no matter how much better off the wealthiest or politically connected became, as long as the participatory institutions available to the working class generated steady improvement in their welfare.<sup>15</sup> With the collapse of the Soviet Union and its subsidiary regimes in Eastern Europe, the Stalinist variation of the legitimization process disappeared. No ideology has since emerged which attempts to justify its existence on the basis of widespread material improvement of the population. In fact, to the extent that coherent ideologies advertising a general explanation of the world's ills have emerged, such as Islamic fundamentalism or racist nationalism, they actually aim to take the world back to a pre-capitalist, if not primitive, era.<sup>16</sup> While the absence on the world stage of the Stalinist approach has been widely remarked upon, particularly in the West during the heady triumphalist period of the 1990s, what has been less well understood is the change in the kind of appeal that that same western, or Anglo-American, capitalism now makes, whether consciously or not, to the billions of the world's desperate, poor, and hungry. Western capitalism has, in fact, also broken with its approach to legitimacy, thus opening up an ideological and institutional vacuum in the global economy.

While the Cold War forced both East and West to legitimate their respective systems, now that a more aggressively neo-liberal form of capitalism has emerged from that period, its advocates no longer feel the same social or political pressure to craft the institutions that were once relied upon to generate legitimacy. Thus, in the new global,

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reconciliation of conflicts through the rule of law—and the elaboration of rules and procedures which, on occasion, made some approximate approach towards the ideal—seems to me a cultural achievement of universal significance.”).

15. In the West, the general acceptance of this view was signaled by the emergence of the “difference principle” arguments of John Rawls in *A THEORY OF JUSTICE* 75 (1971) (“The intuitive idea [of the difference principle] is that that social order is not to establish and secure the most attractive prospects of those better off unless doing so is to the advantage of those less fortunate.”). As Philip Selznick summarized this view:

In a doctrine he calls the ‘difference principle,’ Rawls asserts that social and economic inequalities may be necessary and desirable, but their moral worth must be judged by what they contribute to the welfare of the least advantaged . . . . The difference principle is founded in rationality and reciprocal advantage, not in sympathy and benevolence . . . . Yet the difference principle, as Rawls understands it, is an expression of human solidarity. Within his theory of justice, the abstract ideal of fraternity takes on a new and more specific meaning. What began as a shrewd calculation—a hedge against unfavorable outcomes—generates a spirit of brotherhood and is a building block of community . . . . Rawls imagines a social contract in which free, equal, and rational persons agree on the terms of their future cooperation by choosing principles of justice. Behind a veil of ignorance about their individual circumstances, they choose the least bad or safest alternatives. No one can be sure of not ending up highly vulnerable to loss of liberty or at the bottom of the social ladder. Therefore he or she wants to insure against the worst alternative. The outcome is a set of principles—compelled by rationality—that protect the interests of the least advantaged and the basic liberties of all.

Philip Selznick, *The Idea of a Communitarian Morality*, 75 CAL. L. REV. 445, 446 (1987) (citations omitted). This was expressed more cynically and with pointed humor in the eastern bloc. Russian workers in the Soviet era were heard to quip: “They pretend to pay us, we pretend to work.” On games that workers in the Stalinist world played to survive, see MIKLOS HARASZTI, *A WORKER IN A WORKER’S STATE* (1978).

16. John Lloyd, *Radical Islam Sees Itself Just as Communism Did—In a Battle With a Hostile World*, FIN. TIMES, Jan. 11-12, 2003, at 1.

post-Cold War environment, Western capital has joined hands with a new post-Communist elite to forge new corporations, markets, and, indeed, entire countries. This process is taking place largely from above with less and less consideration of its impact on the general population. At the same time, however, an independent response is being crafted from below through new social movements and also through variations in activity by those older institutions, such as trade unions, that once participated actively, if not always willingly or enthusiastically, in the legitimation process of the Cold War era.<sup>17</sup> A new kind of global fracture is emerging, not on a geographical basis, not between east and west, as in the Cold War, but on a social basis, between those, on the one hand, who control dominant institutions from above and, on the other hand, from below by those who are impacted by these institutions.<sup>18</sup> This fracture signals the emergence of a legitimation deficit created by the globalization process. The anti-globalization protests against the World Trade Organization in Seattle in November 1999 are the most visible evidence of this phenomenon.<sup>19</sup>

To explore this new social fracture and its challenge to the legitimacy of Anglo-American capitalism, this Article presents a case study of the attempt by the Chinese government and major Wall Street investment banks to complete an initial public offering by a major Chinese corporation. Their efforts represented a classic example of the effort to build a new global capitalist order from above without significant concern for the legitimation question. And, as we shall see, the effort was met from below with a vigorous social response. Thus, I suggest that a kind of syndrome, the *PetroChina*

17. In the case of the trade unions, this is much more the case in the West where the labor movement retained some level of independence from the system throughout the Cold War. In the east, the so-called trade unions were merely party appendages unable, for the most part, to generate any independent life after the collapse of the regimes.

18. This Article signals the existence of a deeper concern about the nature of law itself. The author belongs to a tradition marked by the work of E.P. Thompson who noted that law is not simply "another mask for the rule of a class," rather law is the outcome of complex social conflict: "What was often at issue [in Thompson's examination of 18<sup>th</sup> century battles between independent hunters and royal land-owners] was not property, supported by law, against no-property; it was alternative definitions of property-rights . . ." THOMPSON, *supra* note 14, at 259-61. In a word, men and women make law, but not just as they please. Thus, an important challenge for legal scholarship in the twenty-first century is to expose the unique social conflicts emerging in a new global environment, a new form of what Justice Holmes called "experience," and examine and debate the appropriate legal forms and institutions necessary to resolve those conflicts. This intellectual challenge is similar to the one that confronted legal thought in the late nineteenth century as the emerging era of industrial capitalism posed a new intellectual challenge. As Justice Holmes wrote of his approach to the problem: "The life of the law has not been logic: it has been *experience*." OLIVER WENDELL HOLMES, *THE COMMON LAW* 1 (1991) (emphasis added). See also his dissent in *Lochner v. New York*, 198 U.S. 45, 76 (1905) where with his memorable comment, "[g]eneral propositions do not decide concrete cases," Holmes signaled the emergence of a battle against "Mr. Herbert Spencer's Social Statistics." A valuable reprise of Holmes' thinking, particularly his approach to "experience," is found in LOUIS MENAND, *THE METAPHYSICAL CLUB* 337-47 (2001). Thompson, much like Holmes, believed in the importance of reason, noting in the foreword to one of his most important works: "I commenced to reason in my thirty-third year, and, despite my best efforts, I have never been able to shake the habit off." E.P. THOMPSON, *THE POVERTY OF THEORY AND OTHER ESSAYS* i (1978). Both Holmes and Thompson, can "be distinguished . . . from . . . skeptics, who question . . . the power of legal reasoning of any kind." Robert Brauneis, "The Foundation of Our 'Regulatory Takings' Jurisprudence": The Myth and Meaning of Justice Holmes's Opinion in *Pennsylvania Coal Co. v. Mahon*, 106 YALE L.J. 613, 644 (1996).

19. Diamond, *supra* note 10.

*Syndrome* if you will, is emerging that reflects the failure to resolve new conflicts caused by the globalization process. Part II of the Article examines the PetroChina IPO itself, explaining the reasons why the stock offering occasioned such controversy and demonstrating the unwillingness of the Chinese regime, the company and its advisors to consider its associated social and political problems. Part III discusses the unprecedented campaign against the IPO itself so that the political forces generating the PetroChina Syndrome are better understood. Part IV describes the key features of the resulting Unger Letter.<sup>20</sup> Part V reviews conventional explanations and arguments that help, in part, to explain the Unger Letter and the PetroChina Campaign, including traditional securities law concerns, a change in the political climate represented by the anti-globalization movement and structural changes in the global capital markets. Part VI begins the discussion of the emergence of the legitimization deficit by exploring the work of economic historian Massimo De Angelis. De Angelis' innovative reconsideration of the work of two archetypal economists of the twentieth century—John Maynard Keynes and Milton Friedman—helps us come to a deeper understanding of the issues raised by what can be called the PetroChina Syndrome. I will argue, in Part VII, that this understanding is incomplete without a deeper exploration of the role of process in generating legitimacy in the modern industrial era. Without that concern for process, the PetroChina Syndrome cannot be correctly diagnosed. The legitimization deficit this Syndrome signals can only be filled by the design of new institutions that respond constructively to the problems of the new era.

## II. THE PETROCHINA OFFERING

In early 2000, an international consortium of investment banks, law firms, consulting groups, and accounting firms, led by the American investment bank Goldman Sachs launched an initial public offering of the common stock of the newly-formed mainland Chinese oil company PetroChina Company Limited, popularly known as "PetroChina."<sup>21</sup> When plans for the IPO first surfaced, the company and its advisors hoped that it would mark the largest ever public offering of stock in a Chinese state-owned enterprise (SOE) and represent a watershed event for pro-free market reform elements currently in power in China. But the transaction also meant potential devastation for the workforce of the Chinese oil industry, as more than one million workers at the restructured company were to be dismissed as "redundant" with only minimal social protections and, at best, uncertain prospects for alternative employment.<sup>22</sup>

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20. The Unger Letter is a hybrid instrument, most similar to the more standardized "Interpretive Releases" that the SEC issues regularly. It combines an interpretation of existing rules with a proposal for modification of those rules and also relays to Congress a staff memorandum that discusses the Commission's research and investigation of the issues involved.

21. See Final Prospectus, PetroChina Company Limited (March 27, 2000) (on file with author) [hereinafter PetroChina Prospectus].

22. Indeed, the frustrations of the laid off workers boiled over into open protest in the Spring of 2002, as part of what one close observer has called a "veritable labor insurgency" now underway in the PRC. Ching Kwan Lee, *From the Specter of Mao to the Spirit of the Law: Labor Insurgency in China*, 31 THEORY & SOC'Y 189, Apr. 2002. Conflict was particularly acute in the Daqing oilfields now owned by PetroChina. See Stephen F. Diamond, *The Chinese Market: An Enigma Unraveled*, DISSENT 95 (Summer 2002). These strikes were widely expected, yet PetroChina told potential investors that its relationship with its employees was "good" and



In accord with longstanding plans, the PetroChina IPO was to be the first of several that the Chinese government planned to bring to the global capital markets in the following year. In each case, the workforces of major industrial companies would face unemployment as downsizing and restructuring were forced upon them. These transactions were not to be subjected to the widely accepted checks and balances found in the developed world. China remains without the basic democratic institutions that investors and the wider public outside of China take for granted. There are no legislatively established, transparent, and accountable regulatory agencies to oversee the social impact of major economic changes. There is no independent trade union movement or a collective bargaining process to provide some form of representation for the tens of millions of workers whose lives are being severely impacted by economic reform.<sup>23</sup> In addition, there are no open, efficient, and regulated capital markets to provide investors and companies with a viable pricing mechanism for their assets. Further, investors in the proposed IPOs were to be sold only minority stakes and serve as junior partners of the Chinese state that planned to retain for itself majority control and effective influence over the future of these entities.<sup>24</sup> This first section explores each of these key areas in greater depth, including the new corporate structure at PetroChina, the changing Chinese economic context in which the IPO took place, the human rights concerns raised by the offering and an assessment of the offering from the standpoint of traditional investor concerns about corporate governance.

#### A. The New Structure

PetroChina was formed in November of 1999 as a result of months, perhaps years, of planning by the government of the People's Republic of China (PRC).<sup>25</sup> PetroChina was initially established as a wholly-owned subsidiary of its parent company—China National Petroleum Corporation (CNPC). CNPC is one of several Chinese state-owned oil companies. The three largest of these are CNPC, the China Petrochemical Corporation (Sinopec), and the Chinese National Offshore Oil Corporation (CNOOC). CNPC and Sinopec divide among themselves the assets of all of China's domestic oil extraction, refining, and distribution. Roughly, CNPC operates in northern and western China, and Sinopec in the eastern and coastal regions of the country.<sup>26</sup> Meanwhile, CNOOC, as its name suggests, is responsible for offshore production and distribution, including the strategically important oil reserves in the South China Sea.<sup>27</sup>

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provided no information or background on the potential for worker unrest. PetroChina Prospectus, *supra* note 21, at 143.

23. Though beyond the scope of this Article, it is important to note that while the lack of basic civil liberties and trade union rights are extreme in the PRC, a variation on these conditions is increasingly the norm in the newly-industrializing areas of the so-called emerging market countries, thus feeding into the "legitimation deficit" discussed here.

24. See PetroChina Prospectus, *supra* note 21, at 31-33 (stating that PetroChina "will be controlled by CNPC, whose interests may differ from those of our other shareholders").

25. Many details of the IPO remain confidential to this day. For example, there were reports that the entire restructuring of the oil industry was planned by the Chinese regime secretly with the World Bank. However, neither the Bank nor the PRC have made a report or other form of public accounting of this process.

26. On the restructuring, see PetroChina Prospectus, *supra* note 21, at 73.

27. *Id.* CNPC and Sinopec do engage in foreign investments to supplement shortfalls in domestic oil production. In particular, CNPC is a joint venture partner in an oil production effort underway in the Sudan.

PetroChina emerged from within the much larger CNPC as an attempt to create a business that could attract foreign capital. PetroChina is viewed by the Chinese and its foreign advisors as holding the “crown jewels” of the assets of CNPC, including the key Daqing oil fields and the pipelines that move eighty-four percent of China’s natural gas. It has five business units: oil and gas exploration and production, oil refining and petrochemical production, oil sales and pipeline operations, foreign joint ventures, and research and development. It controls more than two-thirds of China’s oil and gas production and ranks among the world’s largest oil companies.<sup>28</sup> It contributes a substantial portion of the total profits earned by China’s largest SOEs. PetroChina took with it from CNPC close to 500,000 of the total 1.5 million workers employed by CNPC. The 1 million who remain are considered largely redundant and are now in the process of being dismissed with minimal severance payments.<sup>29</sup> With government plans to lay-off tens of millions of workers throughout China in the next several years as restructuring of other SOEs moves forward, Chinese oil workers are unlikely to find alternative employment easily. Industry analysts even argue that the 500,000 workers that will go to work for PetroChina are far more than necessary. Exxon employs only one-fourth as many people.<sup>30</sup> The oil industry generally considers China’s oil companies to be “grossly overstaffed, even by the bloated standards of other national oil companies.”<sup>31</sup>

A small army consisting of more than two thousand investment bankers, consultants, accountants, and lawyers, designed the new PetroChina structure. The lead manager of the IPO was the American investment bank, Goldman Sachs. The key co-manager was the China International Capital Corp., a joint venture of the PRC’s China Construction Bank and Morgan Stanley Dean Witter. PricewaterhouseCoopers (accounting), McKinsey & Co. (consultancy), and seven foreign law firms rounded out the foreign team advising the Chinese company.<sup>32</sup>

The new company attempted to lure several key business leaders in the oil industry and elsewhere to serve as outside directors. Of the three names that surfaced during the

This triggered the opposition of several human rights and religious groups to the PetroChina IPO. Peter Wonacott & Ian Johnson, *PetroChina Hopes to Shake Off Its Past*, WALL ST. J., Jan. 14, 2000, at A13. As we will see below, the Sudan link is a major factor in the process that led to the Unger Letter.

28. Mark L. Clifford & Dexter Roberts, *Can this Giant Fly: China’s Oil Company Hopes for \$5 Billion from Wall Street*, BUS. WK., Feb. 7, 2000, at 94B [hereinafter Clifford, *Can this Giant Fly*].

29. Wang Xiangwei, *PetroChina in Pledge to Slash Costs*, S. CHINA MORNING POST, Jan. 31, 2000, at 1 (stating “about one million workers . . . have been made redundant through the restructuring”); Michael Forsythe, *Chinese Minister Says More Must Be Done to Help Fired Workers*, BLOOMBERG NEWS, Apr. 12, 2002 (explaining that in 2001 CNPC and Sinopec “fired 600,000 workers between them”).

30. In fact, since the IPO, PetroChina has engaged in a series of layoffs, despite reported profitability and aggressive expansion plans, in response to investor expectations. See *Petrochina to Invest 2.2 bln Yuan in 1,500 Petrol Stations this Year*, AFX ASIA, Aug. 29, 2002 (“The company will continue to lay off employees to further improve operating efficiencies”); J.V. Cruz, Jr., *Hither and Thither—The Chinese Way*, BUS. WORLD (Philippines), Aug. 30, 2002, at 5, stating:

Exxon Mobil, with revenues almost six times bigger than PetroChina’s, has about 123,000 employees. PetroChina’s employee headcount is about 1.4 million. Each employee of Exxon Mobil thus accounts for US\$1.5 million of revenues, while each employee of PetroChina accounts for US\$21,000 . . . . PetroChina seems overstaffed. If it is, it’s only because China is trying to minimize the pain of a program that has already brought on considerable anguish.

31. Clifford, *Can this Giant Fly*, *supra* note 28, at 94B.

32. *Id.* See also PetroChina Prospectus, *supra* note 21, at 55-59.

marketing of the deal, only two accepted: Chee-chen Tung, the brother of the Chief Executive of Hong Kong, and Wu Jinglian, a leading PRC economist and an advisor to Premier Zhu Rongji.<sup>33</sup> Another senior government economist, Liu Hongru, who received his academic training at the University of Moscow in 1959, replaced Wu Jinglian in late 2002.<sup>34</sup> Franco Bernabe, former head of the Italian oil conglomerate ENI, initially turned down the opportunity but later became the sole non-Chinese member of the Board.<sup>35</sup> The two “outside” Chinese directors were likely, in fact, to act as proxies for the Beijing regime given their close ties to the government.<sup>36</sup> To appear more like companies familiar to the international investment community, several Board committees were established as well, including an audit committee; a health, safety and environmental protection committee; an examination and salary committee; and an investment and development committee.<sup>37</sup> However, without a competitive market for corporate control or an independent judiciary, there were no clear guarantees that these bodies would operate in a manner comparable to their counterparts in developed market economies.

Initially, it was reported that PetroChina hoped to raise as much as US \$10 billion in the IPO. This figure was then scaled back several times as bankers ran into severe political and financial headwinds.<sup>38</sup> When the dust settled, the company was only able to raise US \$2.9 billion, and much of that was provided at the very last minute by friendly Hong Kong investors and BP, the large UK oil company, in side deals negotiated by the underwriters. All told, this represented an approximate ten percent stake in PetroChina. The parent company, CNPC, retained majority control of PetroChina as owners of the remaining ninety percent of the common stock. In addition, PetroChina put in place a dividend distribution policy that obligated the company to share half of its future earnings with CNPC. One leading oil industry source stated: “CNPC remains in total control of the new entity.”<sup>39</sup>

As state-owned enterprises, CNPC, Sinopec, and CNOOC are controlled, in turn, by the government of the People’s Republic and, hence, by the Chinese Communist Party. Corporate officers of the SOEs are appointed by the government and serve at its whim. In fact, at one point during the IPO process, Dow Jones reported that the President of Sinopec, Li Yizhong, had been reassigned to become “governor or the communist party secretary” of the Gansu province in northwest China.<sup>40</sup> Replacing Li at Sinopec would be the current President and Chairman of CNPC, Ma Fucai. Ma Fucai had been slated to serve as Chairman of PetroChina and, hence, lead the planned “road show” to Hong

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33. PetroChina Prospectus, *supra* note 21, at 139.

34. Liu Hongru, *Executive Profiles*, PetroChina.com, available at <http://www.petrochina.com.cn/english/gsj/s/21119.htm> (last visited Sept. 17, 2003).

35. Franco Bernabe, *Executive Profiles*, PetroChina.com, available at <http://www.petrochina.com.cn/english/gsj/s/1231.htm> (last visited Sept. 17, 2003).

36. Sang Xu & Mary Ho, *PetroChina: International Corporate Governance with Chinese Characteristics*, Center for Asian Business Cases, School of Business, The University of Hong Kong, HKU183, Feb. 15, 2002, at 8.

37. *Id.* at 17.

38. See *infra* text accompanying notes 105-107.

39. Lawrence Basapa, *China Launches “World Class” Petro Giant*, CHEMICAL NEWS & INTELLIGENCE, Nov. 10, 1999.

40. Xu Yihe, *China’s Petroleum Industries Undergoing Major Management Overhaul*, Jan. 19, 2000, available at <http://integrate.factiva.com/search/article.asp> (last visited Nov. 16, 2003).

Kong, London, and New York—a crucial corporate step in the effort to sell an IPO to major institutional investors. The new President of CNPC, replacing Ma Fucai, was to be Yan Sanzhong, a former deputy director of the government agency that oversees the oil and petrochemical industry. He did not have extensive experience, however, in the oil extraction operations that are key to PetroChina and he had only been a vice president of CNPC for six months.

This move was very unpopular with potential investors and was eventually reversed. “Analysts doubt if Ma and Yan are qualified for their new positions,” Dow Jones reported. “[T]he managerial overhaul sends a confusing signal to the oil industry as it comes just before the two companies launch their initial public offerings.”<sup>41</sup> The motivation for these changes appeared to be domestic political considerations. They were “seen as part of the government’s strategy to accelerate the development of northwestern China.”<sup>42</sup>

To impose such a significant change in corporate leadership in the middle of an IPO would be considered a disaster in the United States or Europe. In fact, it would be unthinkable because no government diktat could force a company to move its CEO around in such a manner. Although many state-owned companies in Western Europe have been privatized through public share offerings in the last decade, this kind of move has never been made. It was no surprise that this change was cancelled, but the mere reporting of such a possibility made potential investors very nervous about the governance structure in place at the new entity. Evidence of the political connection between the company and the regime has continued since the IPO. In early 2002, PetroChina announced it was conducting exploratory discussions with Husky Energy, a Canadian oil company controlled by Hong Kong-based billionaire Li Ka Shing. However, when the discussions fell apart, the public announcement by PetroChina that it was withdrawing from the negotiations was made by the PRC’s State Development Planning Commission vice-minister Zhang Guobao, with PetroChina Chairman Ma Fucai sitting silently beside him.<sup>43</sup> Commenting on the nature of the announcement, a writer in the *South China Morning Post* noted that “[w]hat this PetroChina cameo illustrates is that Beijing has yet to recognise the sanctity of listed private companies . . . shareholders have to add on a new level of risk if politicians, with their different set of priorities, can waltz in and turn things upside down.”<sup>44</sup> Serving time in the senior management at PetroChina also remains a conduit for political power. Ma Fucai was recently appointed as an alternate member of the Central Committee of the Communist Party.<sup>45</sup> And the former head of PetroChina parent CNPC was recently named head of the Ministry of Public Security, which controls China’s police forces. This Ministry has been responsible for the

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41. *Id.* As will be discussed below, the PetroChina IPO is the lead project in a planned stream of public offerings by Chinese SOEs.

42. *Id.*

43. Jon Ogden, *Shareholders Remain Pawns in Party Line*, S. CHINA MORNING POST, May 8, 2002, at 12 (“[P]icture the amazement if a table of Exxon Mobil executives featured United States Energy Secretary Spencer Abraham telling the press Exxon would not be buying ChevronTexaco because he deemed the price too high.”).

44. *Id.*

45. *List of Alternate Members of the 16th CPC Central Committee*, XINHUA ECONOMIC NEWS SERVICE, Nov. 15, 2002.

crushing of the Falun Gong religious movement in China.<sup>46</sup>

## B. The Chinese Context

### 1. Economic Reform

The PetroChina IPO must be viewed in the context of the dramatic economic changes that have been taking place in China for several years. As far back as the early 1980s, the Chinese Communist Party began to search for alternative economic forms that would allow it to maintain its political control, while at the same time improving economic growth and worker productivity. Reaction to the excesses of the Maoist era led to the emergence of a concept called “market socialism,” where the regime would establish a variety of new structures that made room for a private sector and foreign investment. Initially, these were limited to the freeing up of prices for the agricultural sector, the encouragement of a small-scale private sector in consumer and light industrial goods, and the establishment of Special Economic Zones, particularly in coastal regions. The latter were able to take advantage of their proximity to the regional economic powerhouses like Japan and the so-called “tigers” of East Asia, including South Korea, Hong Kong, Malaysia, and Singapore.<sup>47</sup>

Slowly the reform process expanded to the point where the core assets of the state-owned economy were to be restructured and privatized. In theory, the regime’s goal is to privatize the great majority of SOEs.<sup>48</sup> Many of these have already carried out a form of homegrown privatization built around “debt for equity” swaps, where a company’s workforce is forced to buy shares in their own debt-laden and unproductive firms or else face dismissal. Alternatively, worker pension funds are expropriated by current management and invested as operating capital in the money-losing ventures “so workers become ‘shareholders’ by default without any say in the management of the enterprise and, in addition, risk losing their share when the company is sold.”<sup>49</sup> Often, despite their reorganization as joint-stock companies, management remains the same and local government officials continue to control the entities.<sup>50</sup>

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46. Michael Forsythe, *China Names Former PetroChina Head Top Cop, People’s Daily Says*, BLOOMBERG NEWS, Dec. 9, 2002.

47. For an overview of the reform process, see Diamond, *supra* note 10.

48. There are roughly 380,000 SOEs in China. The largest of these are controlled by the central government as in the case of CNPC. Smaller and medium size SOEs are controlled by local and provincial governments. It is estimated that this sector employs directly more than 100 million people, and supports the livelihood of an additional 200 million people. Xinqiang Sun, *Reform of China’s State-owned Enterprises: A Legal Perspective*, 31 ST. MARY’S L.J. 19 (1999); see also JOE STUDWELL, *THE CHINA DREAM: THE QUEST FOR THE LAST GREAT UNTAPPED MARKET ON EARTH* 260-61 (2002) (arguing that “government’s response to looming fiscal crisis . . . is to claim that the state owns all kinds of valuable assets that it can sell to cover its expenditures”); Diamond, *supra* note 10.

49. International Union of Foodworkers, Hong Kong: IUF Mission Report, Dec. 1977, at 3 [hereinafter IUF Mission Report].

50. Sun, *supra* note 48, at 32. Also, “the SOE’s are linked closely with . . . government agencies . . . . The managers of these SOE’s are state cadres . . . assigned to an SOE to work not as an enterpriser [*sic*] but as a bureaucrat.” *Id.* at 46. This introduces a further complexity: as cadre, managers are not subject to unemployment risk if the SOE fails—only the rank and file workers are, as the Chinese saying goes, “pushed into the sea” of unemployment.

This process is linked intimately to efforts to cut costs and slash work forces. The economically-active population of China consists of about 890 million people, with some 600 million in rural areas and 280 million in urban areas. The state sector employs approximately 100 million people, and it is thought that as many as one-third of these are slated for dismissal. In addition, 100 million rural workers are said to be surplus labor and are now being encouraged to move to urban areas, despite the dim prospects that await them there. Some 82,000 rural migrants to Beijing, for example, earn their living as scavengers of the city's trash dumps, sharing their workspace with rats and flies.<sup>51</sup>

The risk that the regime faces in this restructuring effort is the possibility that it may spark social turmoil that it cannot control. Thus, "modernization" of some sort becomes crucial, both to provide new jobs and to earn income to provide some minimal social safety net. The unanswered question for Chinese society is the final outcome of this important transition. The IPO of PetroChina was viewed by the regime as "a propeller for the mainland's painful state-sector restructuring," which Premier Zhu hoped would win the "heart and soul" of international investors back to China after the East Asian financial crisis of 1997-1998.<sup>52</sup> In 1999, an attempted IPO by CNOOC, the offshore oil company, failed to attract serious investor interest and was shelved.<sup>53</sup> Capital markets also reacted weakly to an offering of stock in the Beijing Capital International Airport entity.<sup>54</sup> These events highlight the risks that a privatization and capital market strategy entails for the state. In one view, the attempt to tap foreign capital markets is a way to provide a bridge to a new era of renewed growth and economic development. However, this strategy can also be viewed as an attempt by a dying bureaucratic regime, one that has outlived its social and economic relevance, to preserve its privileges.

Prior to his recent retirement, Premier Zhu was the leader of a faction within the Chinese Communist Party that is known as the "Shanghai mafia" or the "Shanghai gang." He is a former mayor of Shanghai as was his predecessor, Jiang Zemin. The last Shanghai mayor was said by U.S. businessmen to spend more time in Beijing than in Shanghai and was once thought of as a potential successor to Zhu. Many appointees to the top leadership positions in China are considered members of this faction.<sup>55</sup> Because of its long history as a port and industrial city, Shanghai has been the center of efforts to develop alternative economic forms in China. The Shanghai-headquartered Baoshan Steel Group was slated to become the next IPO for the regime once the PetroChina IPO was

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51. Erik Eckholm, *Amid Garbage and Disdain, China Migrants Find a Living*, N.Y. TIMES, Feb. 11, 2000, at A1.

52. Wang Xiangwei, *PetroChina Sets Out Stall of Sweeteners for Investors*, S. CHINA MORNING POST, Jan. 24, 2000, at 1.

53. *CNOOC Says Listing Withdrawal Due to Change in U.S. Policy/Weak Confidence*, AFX-ASIA, Nov. 11, 1999. Christine Chan, *China Plays Suffer as Move Seen Putting Damper on Beijing's Plans to Fund State Reform, CNOOC Postpones Dual Listing*, S. CHINA MORNING POST, Oct. 16, 1999, at 1.

54. Ho Swee Lin, *Shortfall in Beijing Airport Equity Offering*, FIN. TIMES, Jan. 28, 2002, at 33.

55. See James Kynge & Richard McGregor, *Chinese Old Guard Gives Way to New in Orderly Handover*, FIN. TIMES, Nov. 15, 2002, at 11; Richard McGregor, *Rising Star Named New Shanghai Mayor*, FIN. TIMES, Feb. 21, 2003, at 9; see also Richard McGregor, *"Shanghai Gang" Faces Life Without Benefactor Jiang: China's Leader Surrounded Himself with Acolytes from Shanghai. Will They Survive Without Him?*, FIN. TIMES, Nov. 8, 2002, at 9 ("Known collectively as the 'Shanghai Gang,' these comrades act as a tight network at the commanding heights of the central government."); *Five Clear Jiang Allies in New China Leadership*, AFX EUROPEAN FOCUS, Nov. 15, 2002.

completed.<sup>56</sup> (Though, as we will see below, those plans had to be altered once the PetroChina IPO ran into serious trouble.).

Although the Shanghai gang's "market socialist" ideology now predominates in the Communist Party, Maoist views favoring a strong state still receive a hearing. Events like the bombing of the Chinese embassy in Serbia, or the entry of China into the World Trade Organization, are used by the anti-reform elements to assert their views.<sup>57</sup> Thus, the leadership must navigate between the so-called "left," on the one hand, and, on the other, elements within the reform groups that want to push reform faster, or that have personal stakes in the success of their particular industry or party faction. The decision, for example, to make PetroChina the first IPO in the planned pipeline was apparently made only after an intense internal battle in the regime. The other domestic oil entity, Sinopec, hoped to go first, but top executives in PetroChina parent CNPC threatened a kind of "shock therapy" to win the day.<sup>58</sup> They asserted that they were so in need of foreign investment, without it they would be forced to lay off up to one million workers overnight, thus threatening the regime with widespread social unrest. It is no surprise, therefore, to find that there was speculation that Premier Zhu played a personal role in the offering process.<sup>59</sup>

Behind the PetroChina IPO is the fear of the Chinese state bureaucracy that as China opens up to the outside world, it risks a collapse of key industries that can no longer compete on a global basis. The choice for the regime can be viewed as a fork in the road, with one road leading to Singapore and the other to Moscow. If the regime gets to Singapore, it will have established a modern industrial country without major social unrest and yet have maintained its authoritarian power over Chinese society. The road to Moscow demonstrates the alternative: the regime could try the imposition of "shock therapy" in an effort to "catch up" with the West overnight, but it may face the unintended collapse of the older SOE's which cannot match the superior competitive power of foreign capital.

Clearly, the regime wants to get to Singapore but fears it may wake up and find itself in Moscow. Thus, the modernization of its "crown jewels" in the energy sector serves a dual purpose: provide the increased resources necessary for continued economic expansion, and defend the ability of its oil industry to compete, or at least hold its own, with foreign capital. PetroChina is optimistic about its ability to lead this effort. In the view of company spokesman Zhang Xin: "We believe PetroChina has the strength, given the wide range of CNPC reforms in recent months to become one of the world's top

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56. Ho Swee Lin, *Baoshan Iron and Steel Group Sets \$1bn Target for Share Issue*, FIN. TIMES, Feb. 9, 2000, at 33.

57. See Willy Wo-Lap Lam, *Leftists Make Late Bid to Slow Reforms*, S. CHINA MORNING POST, Feb. 10, 2000, at 9 (noting that "heavyweight leftists, or quasi-Maoists" oppose privatization as "succumb[ing] to the temptation of 'bourgeois liberalisation'").

58. Gabriel Lafitte, *Tibet's Natural Resource Heritage on Sale to Wall Street Bidders: A Report from Milarepa Fund* (Draft), Jan. 2000, at 2, 23-24 (arguing that "Chinese state policies in recent years have deliberately shut down CNPC's competitors" noting that "all three oil SOE's are jostling to recapitalize by floating their shares" and noting "the lengths CNPC managers have gone to in order to win official permission to list their enterprises' shares"). Interview with Ho Swee Lin, Author, FIN. TIMES, Hong Kong/Beijing Bureaus (Mar. 10, 2000).

59. *Id.*

hydrocarbons majors.”<sup>60</sup> Industry experts, however, think this goal is more than a decade away.<sup>61</sup> Premier Zhu’s goal was to find a way to build a competitive oil sector without using state assets. He is viewed as the “architect” of the policy of tapping international equity markets to find the needed cash.<sup>62</sup>

## 2. A Changing Oil Industry

With economic growth comes an increase in energy use.<sup>63</sup> China is no exception. China experienced double-digit growth in the early 1990s and the economy was still growing at a pace of 8 to 9% at the end of the decade. Total primary energy use, a Rice University study indicates, rose from 665 million tons of “oil equivalent” (mtoe) in 1990 to 935 mtoe in 1996. This figure could double by 2010. The relative decline in the importance of oil to the advanced economies is a process that China is not yet able to benefit from. In fact, the rate of oil use could accelerate as the economy develops—transportation needs alone could drive this process.

Inevitably, China has in recent years become an oil importer after decades of being able to rely solely on its own land-based and offshore reserves. Domestically, China can rely on proven reserves of some nineteen billion barrels—less than half that of Russia and far below the reserves of the leading OPEC members.<sup>64</sup> China must now import between 500,000 and 700,000 barrels of oil a day (b/d) but this is expected to climb to as much as 3.5 million b/d by 2010. Imports in 1999 alone jumped 43%.<sup>65</sup>

China has attempted to secure additional reserves internationally. To date, its efforts consist largely of various joint venture projects such as those by CNPC in Kazakhstan, Peru, Venezuela, and Sudan.<sup>66</sup> China also had plans to invest in Iraq once the U.N. sanctions were lifted. Industry experts believe, however, that these efforts have a natural limit—unless China can modernize its refinery assets, it cannot process large amounts of the type of oil available from many of these sources. Its efforts to secure offshore sources of oil in the South China Sea—through CNOOC—have borne fruit but are now reaching a limit. Crude oil production from offshore sources dropped in 1999 after a five-year

60. Lawrence Basapa, *China Launches “World Class” Petro Giant*, CHEMICAL NEWS & INTELLIGENCE, Nov. 10, 1999.

61. *Id.*

62. Malcolm Nixon, ed., *PetroChina’s IPO – More to it Than Meets the Eye?*, HART’S ASIAN PETROLEUM NEWS, Jan. 31, 2000.

63. The figures presented here are drawn from CHINA AND LONG-RANGE ASIA ENERGY SECURITY: AN ANALYSIS OF THE POLITICAL, ECONOMIC AND TECHNOLOGICAL FACTORS SHAPING ASIAN ENERGY MARKETS (Baker Institute Study No. 11, Center for International Political Economy and James A. Baker III Institute for Public Policy, Rice University, Apr. 1999) [hereinafter Baker Institute Study], available at <http://www.bakerinstitute.org/Pubs/workingpapers/claes/index.html> (last visited Nov. 15, 2003).

64. *Id.*; see also BP Statistical Review of World Energy, June 2003, at 4.

65. Baker Institute Study, *supra* note 63; see also *China Accelerates Shift in Energy Policy, Restructuring of State Petroleum Firms*, OIL & GAS J., Jan. 10, 2000.

66. It is the latter project that is the source of domestic U.S. opposition to the PetroChina IPO raised by a number of religious and other groups. See David B. Ottoway, *Chinese Fought on NYSE Listing; Groups Cite Oil Firm’s Role in Sudan*, WASH. POST, Jan. 27, 2000, at E01 (noting that “conservative religious and human rights groups have launched a campaign to block” PetroChina offering); Mark Landler, *China’s No. 2 Oil Company Prepares to Go Public*, N.Y. TIMES, Oct. 12, 2000, at W1 (noting that investment by PetroChina parent in Sudan “led human rights and labor groups to organize a bitter campaign against PetroChina’s offering”).



plateau in growth rates. New fields are to be brought on line in joint ventures with foreign companies. But until recently, China's offshore production was largely earmarked for export (mainly to Australia) to earn much-needed foreign exchange. This has changed. In 2000, for example, exports were down two-thirds from the previous year. The oil is now needed domestically to compensate for reduced output driven by cost cutting coupled with growing domestic demand. Thus foreign investors see three major opportunities: reliance on high sulfur Middle East oil requires expensive upgrades to China's refineries; the breakup of the domestic oil industry gives foreign capital new opportunities to compete; and the pace of economic growth has led to a permanent shift in the source of China's oil supply.

The planned IPOs then, led by PetroChina, represent a last ditch attempt to protect key state assets from the inevitable onslaught of the global market. It is thought that one of the arguments used by the domestic oil industry managers in discussions with the top Beijing leadership rested on what was being called "the last free lunch"—an argument which said, in effect, the state owes us this one last favor (support for access to capital markets) before the state carries out its intention to join the World Trade Organization (WTO). Once in the WTO, China will face increasing pressure to open up key sectors of the economy to direct competition and greater foreign ownership, and this could well spell the end of the days of privileged SOE's.<sup>67</sup> "The Chinese oil companies have to act now, before it is too late, to improve their efficiencies," in the words of one oil industry source.<sup>68</sup>

A variation on this theme suggests that it is the Government itself, not the oil potentates of CNPC, that want to retain control of the oil industry. Proponents of this view point to the desire of the PRC to appear to be competing while retaining actual control of the publicly traded firms. "PetroChina management will not be able to prevent the looting of its resources on the instructions of its parent or even the government, which many fear may happen if crisis situations, especially of a financial nature, develop making dipping into PetroChina's pockets irresistible," a leading oil industry source argued.<sup>69</sup> The parent company, CNPC, retains majority ownership and is a privileged recipient of earnings distributions.<sup>70</sup> In turn, the Chinese government retains control of CNPC.

Thus, it is plausible to suggest that the division of assets between Sinopec and CNPC is intended to create a permanent duopoly rather than spark domestic competition. As one leading oil industry source put it, "[t]he purpose of the CNPC-Sinopec monopolies was to strengthen resistance to foreign petroleum company penetration of the business, which would take place at some non-negotiable defined stage, after China was

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67. On the impact of joining the WTO, see GORDON C. CHANG, *THE COMING COLLAPSE OF CHINA* (2001).

68. *Restructuring of China's Oil Industry Continues as Doubts About its Success Loom*, OIL & GAS J., Jan. 3, 2000, at 19.

69. Nixon, *supra* note 62.

70. PetroChina Prospectus, *supra* note 21, at I-31 (stating that "CNPC, as the majority shareholder of the Company, may seek to influence the determination of the amount of dividends paid by the Company with a view to satisfying its cash flow requirements including those relating to its obligations to provide supplementary social services to its employees and a limited number of third parties").

admitted to the WTO.”<sup>71</sup> This suggests that the restructuring strategy devised by the CNPC, the Chinese government, and the Goldman Sachs-led team of advisers, in fact, relies on the lack of domestic competition. Together with an extended phase-in period of the WTO-forced opening of the energy sector, this would give the Chinese oil giants “several years to strengthen their fortresses, making it very difficult and certainly costly for any foreign firms to take them on in their own respective backyards.”<sup>72</sup> As one thorough study of the restructuring put it:

CNPC [PetroChina’s parent entity] has been groomed to be at the forefront of China’s strategy to enter the global top 500 transnational corporate league. The Chinese party-state has, over many years, selectively favored its petroleum monopoly corporation, with many policy decisions designed to make it bigger, stronger, more profitable, and better able to compete, both within China and around the world, with the major oil corporations which are household names to anyone in the western world who owns a car.<sup>73</sup>

The key move was to find a way to offer up the best of the assets available without the “dead weight” of the aging state monopoly. This need was reinforced by the failure of the CNOOC offering in 1999 and led to the so-called “Plan B”: PetroChina was set up with only the best operational assets of CNPC, very few of the debts, and none of the overhead associated with retaining a million redundant workers and their families.<sup>74</sup> According to *Hart’s Asian Petroleum News*:

[T]he fundamental policy being put in place confirms that CNPC and Sinopec will put into practice their domestic market muscles aimed at keeping foreign intruders at arms length. The use of foreign money, through minority stock sales will continue to be pursued, on the theme that ‘their money’ will be sought and used, but control will always be in the PRC hands.<sup>75</sup>

### C. Human Rights

Just as the PetroChina IPO was ready to launch, reports were reaching the West that the Chinese regime had undertaken yet another crackdown on alleged affiliates of the spiritual movement, the Falun Gong.<sup>76</sup> A Hong Kong-based human rights group reported that Chinese security forces detained approximately 2,000 members of the movement during February of 2000. The group estimated that 5,000 members had been sent to prison labor camps for “re-education” and another 300 sent to jail since the crackdown started last year.<sup>77</sup> This crackdown began to reach even those Chinese who might have been thought, in the Chinese context at any rate, to be above the law: a Chinese civil court judge was detained for three months and “given daily injections of a drug that made

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71. Nixon, *supra* note 62.

72. *Id.*

73. Lafitte, *supra* note 58, at 2.

74. *Id.*

75. *Id.*

76. 2,000 Falun Gong Members Arrested During Spring Festival, JAPAN ECON. NEWSWIRE, Feb. 10, 2000.

77. *Id.*

him sleepy and muddled . . . .”<sup>78</sup>

Membership in Falun Gong is illegal in China, though the threat to public safety that might justify such a law is unknown to outsiders. The regime believes that any form of independent organization is a threat to its legitimacy and power. This untimely crackdown was apparently sparked by a demonstration by Falun Gong members on Chinese New Year’s Eve, the fourth of February. Demonstrators assembled in Tiananmen Square in Beijing and attempted to unfurl banners. One hundred people were arrested, and the arrests then spread to more than forty cities throughout China.

This fear of independent activity by the population serves well as a general theme for assessing the approach of the PRC to human rights in general and labor rights in particular. Thus, in a statement to senior party figures in early 2000,<sup>79</sup> PRC President Jiang Zemin “warned that the Falun Gong sect poses as much of a threat to the Communist Party as the Solidarity movement did to the communists in Poland in the 1980s.”<sup>80</sup> Of course, to deal with Polish Solidarity, the Polish government imposed martial law for a decade, arresting thousands, and setting back the democratic reform process in Eastern Europe for years. Jiang suggested that the sect members, together with “unemployed farmers and workers and splittists among ethnic minorities [are] the most destabilizing factors in society.”<sup>81</sup> Jiang “expressed concern that the jobless in rural and urban areas might ‘join hands’ to pose a challenge to the leadership.”<sup>82</sup> As the International Union of Foodworkers put it in a 1997 report following a research mission to Hong Kong: “There is no dispute about the nature of the regime in China: it is a one-party state where the CPC bureaucracy constitutes a ruling class exercising a monopoly of power enforced by extensive police control and by the repression of dissident opinion and activity.”<sup>83</sup>

The Falun Gong crackdown is only the latest example of the approach that the Chinese Communist regime has long taken to basic civil liberties and human rights. Amnesty International summarized the human rights picture in China at the end of 1999 on the eve of the PetroChina IPO:

Hundreds, possibly thousands, of activists and suspected opponents of the government were detained during the year. Thousands of political prisoners jailed in previous years remained imprisoned, many of them prisoners of conscience. Some had been sentenced after unfair trials, others were still held without charge or trial. Political trials continued to fall short of international fair trial standards. Torture and ill-treatment remained endemic, in some cases resulting in death. The death penalty continued to be used extensively.<sup>84</sup>

Despite suggestions by some that limited reform is leading China to the “rule of law,” it is very clear that the country remains under the arbitrary “rule of men.” China

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78. Cindy Sui, *China Using Asylums to Suppress; Banned Movement’s Followers Reportedly Institutionalized*, WASH. POST, Feb. 12, 2000, at A17.

79. Willy Wo-Lap Lam, *Jiang Compares Sect’s Threat to Solidarity*, S. CHINA MORNING POST, Feb. 12, 2000.

80. *Id.*

81. *Id.*

82. *Id.*

83. IUF Mission Report, *supra* note 49, at 17.

84. AI REPORT 1999: CHINA, AMNESTY INTERNATIONAL, 1999 [hereinafter AI REPORT 1999].

signed the International Covenant on Civil and Political Rights in October of 1999 and allowed the UN High Commissioner for Human Rights, Mary Robinson, to visit the country, but, according to Amnesty International, “repression of dissent continued, culminat[ed] in December in the trial of high profile dissidents” and the introduction of new regulations controlling “social groups” and publishing.<sup>85</sup> Amnesty concluded that these were signs of “increasing restrictions on freedom of expression and association.”<sup>86</sup>

Those minimal legal protections that do exist are often abused. “Political trials continued to fall far short of international fair trial standards,” Amnesty concluded, “with verdicts and sentences usually decided by the authorities before trial, and appeal hearings usually a formality.”<sup>87</sup> Amnesty reports that a series of trials of pro-democracy activists took place in several provinces where defendants were not provided adequate time or resources to mount effective defenses. One veteran pro-democracy activist and bookseller from Qingdao in the Shenzung province, Chen Zengxiang, was “reportedly tried in secret [in October 1999] and sentenced to seven years’ imprisonment for ‘seeking to subvert the State power.’”<sup>88</sup> He had been held in jail without access to a lawyer since May of 1999.<sup>89</sup>

One legal scholar who attempted to put an optimistic face on recent legal reforms in China nonetheless admitted, “[r]e-education through labor continues to be imposed on dissidents . . . .”<sup>90</sup> He noted that this penalty could be used to incarcerate individuals without a charge or trial. He describes several instances of torture of those held in the re-education camps.<sup>91</sup> The PRC Ministry of Justice itself admits that 200,000 people are living in prison labor camps.<sup>92</sup> The Laogai system forces prisoners “to plant, harvest, engineer, manufacture and process all types of products for sale in the domestic and international markets.”<sup>93</sup> Ironically, perhaps tragically, Dun & Bradstreet actually publishes statistics that assess the output of these prisons. In a 1998 report, they indicated that ninety-nine of these camps produced more than \$800 million in revenue for the state.<sup>94</sup> The camp list included the Nanbao Salt Works, where famed Chinese dissidents Wei Jingsheng and Wang Dan were once held.<sup>95</sup> Here is how Wei described Nanbao:

At Nanbao, political criminals and other criminals labor as slaves—with no income, no job safety—and make this enterprise one of the largest salt chemical factories in Asia. Every year, millions of yuan in profit from this industry contribute to the Chinese government’s efforts to oppress its own

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85. *Id.*

86. *Id.*

87. *Id.*

88. *Id.*

89. AI REPORT 1999, *supra* note 84.

90. Daniel C. Turack, *The New Chinese Criminal Justice System*, 7 CARDOZO J. INT’L. & COMP. L. 49, 58 (1999).

91. *Id.* at 59.

92. *Id.* at 58.

93. THE LAOGAI RESEARCH FOUNDATION, A RARE INSIGHT INTO CHINA’S LAOGAI ECONOMY: DUN & BRADSTREET DIRECTORY LISTS FORCED LABOR CAMPS, at 13 (June 30, 1999), *available at* <http://www.laogai.org/economy> (last visited Nov. 16, 2003) [hereinafter LAOGAI RESEARCH FOUNDATION].

94. *Id.* at 9.

95. Wei Jingsheng’s activities on behalf of democratic rights extend back to the “Democracy Wall” movement of 1970s. Wang Dan was a leader of the student movement that took over Tiananmen Square in 1989, sparking widespread support among Chinese workers.

people.<sup>96</sup>

The Dun & Bradstreet report includes a wide range of industrial companies encompassing cement, rubber, machine tools, motorcycle engines, aluminum products, diesel engines, a paper mill, a fertilizer factory, and a silk plant.

Given China's continued abuse of the civil liberties and human rights of its general population, it should come as no surprise that it brutally suppresses any effort to establish a free trade union movement and the labor rights that are generally associated with such a movement. Independent trade unions are outlawed in China. The right to strike is forbidden. An effort to establish an Autonomous Workers Federation as part of the wider Democracy Movement of 1989 was met with particularly harsh repression. Many affiliates of that Federation are still in prison or labor camps. Amnesty details numerous ongoing abuses of workers for their organizing and other activity.<sup>97</sup> Arrests and arbitrary detentions were made throughout 1999, as labor unrest increased due to the worsening economic situation. Here are some of the examples they report:

Li Qingxi, a laid-off worker from the Datong coal mine in Shanxi province, was arrested in January when he posted publicly a statement calling for independent trade unions. He was sentenced in March without charge or trial to one year of "re-education through labour," reportedly to be served "at home." Zhang Shanuang, a labour rights activist from Hunan province, was detained in July after trying to set up a group to help laid-off workers. He was sentenced in December to 10 years' imprisonment, accused of having "illegally provided information to overseas hostile organizations and individuals," reportedly for speaking about farmers' protests in his province in a *Radio Free Asia* interview.<sup>98</sup>

The widely respected China Labour Bulletin, based in Hong Kong, confirms that the process of "[e]conomic restructuring has led to huge pressures on the Chinese labour market . . . many workers laid off from SOEs have expressed . . . dissatisfaction with the long working hours, short-term contracts and miserly benefits that more than not await them in the private sector."<sup>99</sup> Linked to this dissatisfaction is a rise in labor disputes, despite the frightening risk that such voicing of grievances to official bodies entails. According to Tim Pringle, a longtime and very close follower of Chinese labor conditions based in Hong Kong,

[T]he [Chinese Government's] Ministry of Labour and Social Security [reports that] there were increases in labour disputes in all types of enterprises in 2000. Of the 327,152 that officially occurred, 24.2 percent [were] in SOEs, 20 percent in so-called collectively-owned enterprises, 15.5 percent in foreign-

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96. PR Newswire, *The Laogai Research Foundation: Dun & Bradstreet Provides Rare Insight Into Financial Scope of Chinese Forced Labor Camps* (June 30, 1999), available at [http://www.findarticles.com/cf\\_0/m4PRN/1999\\_June\\_30/55035248/p1/article.jhtml](http://www.findarticles.com/cf_0/m4PRN/1999_June_30/55035248/p1/article.jhtml) (last visited Jan. 14, 2004).

97. AI REPORT 1999, *supra* note 84. AMNESTY INTERNATIONAL, PEOPLE'S REPUBLIC OF CHINA: LABOUR UNREST AND THE SUPPRESSION OF THE RIGHTS TO FREEDOM OF ASSOCIATION AND EXPRESSION (WORKERS WANT TO EAT—WORKERS WANT JOBS), Mar. 4, 2002.

98. AI REPORT 1999, *supra* note 84.

99. *Unemployment in China*, CHINA LABOUR BULLETIN No. 50 (Sept.-Oct. 1999), available at [http://www.china-labour.org.hk/iso/article.adp?article\\_id=1652](http://www.china-labour.org.hk/iso/article.adp?article_id=1652) (last visited Nov. 4, 2003).

invested enterprises and 14 percent in private Chinese-owned companies. These statistics represent the continuation of a spectacular increase in disputes that began in the early 1990s.<sup>100</sup>

Of course, the vast majority of such disputes are reported only as “solved” with few details available on the facts. There are serious procedural obstacles to bringing these conflicts before the dispute resolution bodies, so it is unknown how many on the job grievances go unreported.<sup>101</sup> In fact, the worst fears of critics of the PetroChina IPO and restructuring process came true in the spring of 2002, when massive demonstrations by laid off workers took place in the Daqing oilfields owned by CNPC and PetroChina.<sup>102</sup> These were soon followed by large protests by unemployed workers in several parts of China, including an unusual demonstration by workers in Beijing itself. Arrests of protest leaders, two of whom were charged with “sedition” and were initially charged with the death penalty in a secret trial, were paired with modest economic concessions by the regime, thus ending this particular wave of unrest.<sup>103</sup> However, one sociologist calls these demonstrations evidence of a “veritable labor insurgency” underway in China.<sup>104</sup>

All of China’s industrial workers are members of the only “trade union” body allowed to exist—the All-China Federation of Trade Unions (ACFTU). The ACFTU is a constituent body of the Chinese State and thus is controlled by Communist Party cadre. As in the former Soviet Union and its Eastern European satellites, this is a “trade union” in name only. It is, in fact, in the Chinese regime’s own words, “a mass organization of the working class” and it serves as a transmission belt for the party and state leadership. The Communist Party appoints all of its officials. As the ACFTU itself stated in 1990:

[T]he administration of union cadres by the Party is an unchangeable principle. The ACFTU should work together with the Organisation Department of the Central Committee of the [Chinese Communist Party] in laying down regulations concerning cadre management and in monitoring the nomination, investigation, election, approval and allocation of union leaders.<sup>105</sup>

The same document goes on to state that:

[T]rade unions must resolutely oppose any organisation or individual expressing political views countering those of the Party. . . . On discovering the formation of workers’ organizations which oppose the Four Cardinal Principles<sup>106</sup> and endanger the national regime, the trade union must

100. Tim Pringle, *Industrial Unrest in China—A Labour Movement in the Making?*, CHINA LABOUR BULL. (Jan. 30, 2002), available at [http://www.china-labour.org.hk/iso/article.adp?article\\_id=1956](http://www.china-labour.org.hk/iso/article.adp?article_id=1956) (last visited Nov. 16, 2003).

101. *Id.* (noting that “although the figures [for labour disputes] reflect widespread dissatisfaction and an increase in rights awareness among workers, they do not tell the whole story”).

102. *Daqing Oilfield Workers’ Struggle* (Chinese Labour Bulletin radio broadcast, Mar. 5, 2002).

103. The death penalty was later withdrawn, but the two union activists are now serving four-year prison terms. Press Release, “Subversion” Charges Must Not Be Used to Imprison Rights Activists, Amnesty International, Jan. 14, 2003. See Stephen F. Diamond, *The “Race to the Bottom” Returns: China’s Challenge to the International Labor Movement*, 10 U.C. DAVIS J. INT’L L. & POL’Y (forthcoming 2003).

104. Lee, *supra* note 22.

105. IUF Mission Report, *supra* note 49, at 17-18.

106. The four cardinal principles include: 1) To keep to the socialist road; 2) To uphold the people’s democratic dictatorship; 3) To uphold the leadership by the Communist Party; and 4) To uphold Marxism-

immediately report to same-level party committees and senior-level unions, and must resolutely expose and dissolve them. When necessary, the union should demand the dissolution of such organisations by the government in accordance with the law. Concerning organisations initiated by workers out of their specific economic interests, the union should advise them to dissolve and terminate their activities through persuasion and counseling.<sup>107</sup>

Thus, the ACFTU serves as the “eyes and ears” of the state inside every workplace. Far from supporting democratic and free trade unionism, the ACFTU’s central purpose is to carry out State and Party directives and to do everything it can to insure that all workers fall into line as well. It is no surprise to find out, therefore, that the ACFTU is viewed by the State as a vehicle for encouraging worker support *for* the very economic reform process that is devastating the social conditions of tens of millions of workers. Those who do not conform to the new economic order are subject to ACFTU “mobilizations.” The Chinese political police (Public Security Bureau or “PSB”) have issued “guidelines” that state that:

[T]he union[s] must . . . co-ordinate with the PSB, organise “public order and prevention teams” to protect the internal security and order of the enterprises, as well as social order. Staff and workers should be mobilized to struggle against all forms of criminal and illegal behaviour. The union must also assist the relevant authorities to deal adequately with the education and employment of dismissed employees, workers who have committed errors and those have completed sentences and been released.<sup>108</sup>

This kind of directive can only be characterized as chilling.

In addition to the dramatic human rights picture and the suppression of basic trade union freedoms, the general situation of workers present particular problems. Unemployment and forced migration have already been mentioned. Further problems include the widespread use of under-employment, short-term work and contract labor, the continued control of labor mobility by the State, and massive violations of basic health and safety precautions. Official statistics report nearly 7 million unemployed urban workers, but the China Labour Bulletin estimates that the total is closer to 21 million.<sup>109</sup> And even official statistics admit to 30 million “more [workers] than needed” in the urban areas. These are now supplemented by some 80 to 100 million “floating people” who have left their villages looking for work in other areas of the country.<sup>110</sup>

Despite the need for a massive shift in employment to new entities, the State fears that uncontrolled mobility could open the door to organized opposition to the regime. Thus, it has largely kept in place a decades-old system of labor registration—the *hukou*

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Leninism and Mao Zedong Thought. See CONST. OF THE COMMUNIST PARTY OF CHINA (CPC) (amended and adopted at the 16th CPC National Congress on Nov. 14, 2002) (on file with author).

107. IUF Mission Report, *supra* note 49, at 18.

108. *Id.*

109. The official figures can be found in Fei-Ling Wang, *Labor Issues and Foreign Direct Investment in the PRC 112*, in 6 ADVANCES IN CHINESE INDUSTRIAL STUDIES—THE MANAGERIAL PROCESS AND IMPACT OF FOREIGN INVESTMENT IN GREATER CHINA 177 (C. Jayachandran et al. eds., 1999). The China Labour Bulletin estimates are described in their study feature: *Unemployment*, *supra* note 99.

110. See Wang, *supra* note 109.

system.<sup>111</sup> Under *hukou* every Chinese citizen is required to “have a registration with the *hukou* authority or *hukou* police at birth.”<sup>112</sup> In theory, no Chinese may work or live outside of the area where they were registered at birth. To accommodate some economic pressures, the regime has instituted a system for providing workers with temporary residence permits. Punishment of both employers and employees is meted out if workers are hired without a permit.

The PetroChina IPO emerged within this matrix of workforce issues. It was seen by the regime as part of a long-range plan of the State to dismiss the one million or so workers of CNPC. The precise plans were, and remain, unclear. The sketchy offering documents provided to investors indicated that the new entity would send a portion of the proceeds from the IPO up to the parent CNPC to make severance payments to the laid off workers.<sup>113</sup> Severance varies from region to region in China, but was expected to be one year’s average salary, or \$1200 per worker. PetroChina and CNPC tried to reassure investors that these obligations would not absorb the lion’s share of the new entity’s profits, but doubts persisted.<sup>114</sup> Further, any such reassurances meant appearing to leave the problem of severance unsolved. In fact, the Daqing protests in 2002 were in reaction to an attempt to cut back on the severance package awarded to dismissed CNPC and PetroChina workers.<sup>115</sup> Since collective bargaining does not exist in China, the CNPC workforce has no voice in any of the discussions about these issues now underway among CNPC executives, State and Communist Party representatives, and the legions of foreign investment bankers, lawyers, accountants, and consultants periodically employed to advise the company and regime. Thus, foreign investors—many of them institutions like pension funds, university endowments, and mutual funds that now are at the core of global capital markets—were being asked to participate in a large socio-economic experiment masked as just another IPO. It was this unusual situation that would help give rise to the unprecedented PetroChina Campaign.

#### D. Corporate Governance

As is widely understood among the fund managers responsible for the assets of large institutional investors, the concept of “fiduciary duty” must guide all investment decisions. This is a judicially-created doctrine that obligates the fiduciary “to act for someone else’s benefit, while subordinating one’s personal interests to that of the other person.”<sup>116</sup> It is considered the “highest standard of duty implied by law.”<sup>117</sup> In the memorable words of Justice Cardozo:

Many forms of conduct permissible in a workaday world for those acting at

111. *Id.* at 178.

112. *Id.*

113. PetroChina Prospectus, *supra* note 21, at I-31.

114. James Kynge, *China Seeks to Ease Fears on CNPC Float, Oil Minister Says IPO Funds Will Not Go on Redundancies*, FIN. TIMES, Jan. 26, 2000, at 34; Nixon, *supra* note 62 (“[A] very large part of the monies raised will not go into new technologies and equipment, but rather into paying off debts and compensating a massively overstocked workforce, for it is a cardinal policy of the government that social stability must be maintained.”).

115. Chinese Labour Bulletin, *supra* note 102.

116. BLACK’S LAW DICTIONARY 625 (6th ed. 1990).

117. *Id.*



arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions . . . . Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court.<sup>118</sup>

In a financial context, such a duty requires the fiduciary to manage the assets under his or her control as a prudent person would manage his or her own property. In the context of a decision to purchase equity in an unprecedented structure and in a foreign country that has little or no experience with private enterprise and capital markets, it can only be considered prudent for an investment manager or trustee to consider a wide range of issues that in an American or European context can be taken for granted. Whereas in the United States, for example, it is at least plausible to rely on the price and volatility of the stock markets to provide investors with sufficient information to make investment decisions. This was simply impossible in the case of the PetroChina offering.<sup>119</sup>

The PetroChina IPO raised a wide range of additional concerns. These included the risks associated with the outmoded physical assets of the Chinese oil industry, the potential for continuing state interference in the new entity's management, the influence of the regime's broader policy concerns on the future direction of the entity, and the human and labor rights concerns that massive layoffs raise. However, an additional set of issues that are traditional areas of interest for investment managers were of particular concern in the offering. These formed the backdrop for the eventual success of the campaign against the IPO. In turn, these issues, together with the labor and human rights concerns, have become a significant part of the content of changes to the capital markets that are being raised in a variety of settings in the wake of the campaign, including the issuance of the Unger Letter.<sup>120</sup> These fiduciary-related questions, all of which are the subject of disclosure requirements under U.S. securities laws, included concerns about

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118. *Meinhard v. Salmon*, 249 N.Y. 458, 464 (N.Y. 1928).

119. For a discussion of the ability of investors in U.S. capital markets to be able to rely on "the integrity of the market price," see *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988). A significant intellectual challenge to the efficient markets hypothesis that underlies the Court's opinion has been mounted in the last decade by the emergence of increasing evidence that even in developed economies the stock market is not an efficient allocator of capital but, instead, responds to irrational human behavior. See Robert J. Shiller, *From Efficient Markets Theory to Behavioral Finance*, 17 J. ECON. PERSP. 83, 102 (2003) ("[T]he recent worldwide stock market boom, and then crash after 2000, had its origins in human foibles and arbitrary feedback relations and must have generated a real and substantial misallocation of resources. The challenge for economists is to make this reality a better part of their models."); ROBERT J. SHILLER, *IRRATIONAL EXUBERANCE* (2000) (analyzing the recent stock market boom); ANDREI SHLEIFER, *INEFFICIENT MARKETS: AN INTRODUCTION TO BEHAVIORAL FINANCE* (2000) (using behavioral finance as a basis for critique of the efficient market hypothesis); and HERSH SHEFRIN, *BEYOND GREED AND FEAR: UNDERSTANDING BEHAVIORAL FINANCE AND THE PSYCHOLOGY OF INVESTING* 4 (2002) (arguing that "psychological phenomena pervade the entire landscape of finance").

120. Elizabeth Wine, *Calpers Sticks to Ethical Stance*, FIN. TIMES, Feb. 20, 2003, at 17 (explaining that the "largest and most powerful public pension fund in the US . . . signals . . . staunch support for its socially responsible investing (SRI) policy").

the size and price of the offering, the use of proceeds from the offering, the potential difficulties for the new entity in an intensely competitive global market, the lack of modern forms of corporate governance in China, the absence of a market for corporate control to enforce discipline on management, and several other risk factors.

### 1. The Size and Price of the Deal

Throughout the offering process, the deal team appeared to be uncertain about its direction. Early reports indicated that PetroChina would sell as much as \$10 billion worth of common stock.<sup>121</sup> That was then scaled back to as little as \$5 billion in some reports, though the consensus figure was thought to be about \$7 billion. This was then publicly scaled back by the deal team to \$5 billion—with a suggestion that that had been their goal all along. However, when the \$10 billion amount surfaced in the business press, the team made no apparent effort to dissuade investors that that was their goal. As indicated, the final amount was scaled back again to the end result of \$2.9 billion. Only a last-minute injection of cash from BP<sup>122</sup> and several Beijing friendly Hong Kong financiers saved the offering.<sup>123</sup>

Deal size often fluctuates prior to the pricing of a deal, but rarely in such large volumes. In addition, the fluctuations appeared to reflect great uncertainty about the potential success of the offering, in light of the failure of the October 1999 effort by CNOOC and the weakness of the Beijing Airport offering. This offering was part of a larger plan to bring through several additional deals in the oil sector and other major industrial sectors. All told, China probably hoped to raise almost US \$20 billion in the year following this IPO. Even at US \$7 billion there was some doubt that the capital markets would be willing to absorb the issue. “Oil and gas is not exactly a hot spot for IPOs right now,” one portfolio manager said.<sup>124</sup> “Technology has been and continues to be the place to be.” While a leading oil industry source noted that “[i]t was clear that demand was weak for the IPO when lead underwriter Goldman Sachs slashed the size of the offering in mid-March.”<sup>125</sup> In addition to cutting back on the deal size, the underwriters aimed for a conservative price of 5.5 times 1999 EBITDA,<sup>126</sup> below the 7.5x multiple that contributed to the CNOOC disaster. But this priced PetroChina well below the 8-10x generally found in the oil industry. Thus, the *Wall Street Journal* concluded, “[i]nvestors are likely to get their low price because reformers believe that the listing must succeed. But as an executive close to the company says: ‘It’s a story that

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121. Yasuhiro Goto, *China Oil Firms Prepare for the Big Time, Massive Streamlining Underway to Help Them Take on Foreign Giants*, THE NIKKEI WKLY., May 29, 2000, at 24 (stating that the PetroChina “issue has . . . continued to flounder in both [Hong Kong and New York] markets, keeping . . . funds actually raised below one-third the original target of 10 billion”); Karol Nielsen, *PetroChina Begins Trading; Sinopec Postpones, Reduces IPO*, CHEM. WK., Apr. 19, 2000, at 25 (describing how PetroChina’s weak reception by investors caused PRC to delay entry of other planned IPOs).

122. BP is the new corporate name for British Petroleum.

123. Jim Lobe, *Activists Win on Petrochina, Target BP-Amoco*, INTER PRESS SERV., Apr. 5, 2000 (“[T]he only major buyers [of PetroChina stock] to date, in addition to BP Amoco, are four Hong Kong-based companies” considered “under Beijing’s influence.”).

124. Paul Merolli, *PetroChina IPO Garners Tepid Response*, OIL DAILY, Apr. 3, 2000.

125. *Id.*

126. “EBITDA” is a widely used financial metric that gives a measure of the cash flow earned by a corporation. It stands for “earnings before interest, taxes, depreciation and amortization.”

takes some explanation.”<sup>127</sup> Once again, the larger political context of the offering is crucial to understanding its dynamic.

## 2. The Use of Proceeds from the Offering

There was serious dispute about the proposed use of proceeds. The public controversy centered on the investment by CNPC in an oil exploration venture in the Sudan. Feeling the political heat, PetroChina and its underwriter Goldman Sachs altered the text of its first draft of the preliminary prospectus and alleged in an amendment that the Sudan project would stay at the parent level and not be managed by PetroChina.<sup>128</sup> Potential investors also expressed concern about suggestions that PetroChina had agreed to dividend earnings up to CNPC for the retirement of corporate debt and to make severance payments to laid-off workers. Such payments would consume half the proceeds of the offering, leaving investors wondering what they were really buying: social protection for the threatened management of an obsolete company or the shining “crown jewels” of a new global player in the energy business? The remaining proceeds were not felt to be

[E]nough to invest in exploration or infrastructure projects, let alone expanding its petrochemical and retail network of petrol stations . . . . What CNPC is saying is: “We are big and we are lousy but we will get better with your money,” said one banker. That is not the way to enter the international markets. Investors are not a bunch of simpletons.<sup>129</sup>

## 3. Competitiveness of the New Entity

It is unclear whether or not PetroChina would be a profitable firm if it were truly to stand on its own and compete with foreign oil companies. CNPC remained the beneficiary of substantial government protection. Much of the Chinese oil sector receives price protection on the domestic market and benefits from restrictions on imported product. The *Financial Times* reported that CNPC “must persuade investors it can compete in the absence of government protection. Its profits . . . have been virtually guaranteed by the state.”<sup>130</sup> When this concern was placed next to the issue of repaying CNPC’s remaining indebtedness, approximately US \$14 billion at the time the offering was announced,<sup>131</sup> investors clearly had reason to worry about where their money would be going. PetroChina would take over the key productive assets of CNPC and the parent was to be left with one million redundant workers. How would those debts be repaid and the pension obligations for the redundant workers be met? The need to fend off social unrest with a severance package is apparently the motivation behind a requirement that half of PetroChina’s earnings be earmarked as dividends for CNPC. Yet this has clearly

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127. Peter Wonacott & Ian Johnson, *PetroChina Prepares to Go Public: Changes Fail to Break its State Ties*, WALL ST. J. INTERACTIVE EDITION, Jan. 14, 2000, at A13.

128. “Use of Proceeds Verification,” PetroChina Prospectus, *supra* note 21, at 119-20.

129. Ho Swee Lin, *Investors to Tread Warily in China Oilfields*, FIN. TIMES, Dec. 23, 1999, at 8.

130. *Id.*

131. *Id.* (“To top it all, CNPC has a lot of debts to repay: more than Rmb 115.3bn at the end of’ 1998).

not worked.<sup>132</sup> Since CNPC remains in control of eighty-five percent of the company's stock, enforcing that requirement will not be a problem—but any expectation that outside shareholders will share equally in the rewards is called into question.

#### 4. Parent and Party Control

CNPC, of course, controls both the board of directors and shareholders' meetings. Some smaller CNPC subsidiaries had shares listed in Hong Kong in the past and in no instance have outside shareholders been given any management or board-level role in the company. This past history led one oil industry analysis to suggest that "[b]y offering corporate shares without allowing any participation in the corporate management, the Chinese state oil companies will have to prove to the potential foreign investors that their business operations are competitive, transparent and well-managed."<sup>133</sup> Of course, it should also be asked precisely how an investor is to exercise "shareholder democracy"—which lies at the heart of capitalism's investment philosophy—in a country where the most basic democratic rights are violated on a daily basis. Will shareholders be free to speak at shareholder meetings? Will they be granted the right of assembly, free speech, and the ability to present grievances to management that are denied PetroChina's own workers? For that matter, can the new management team at PetroChina—to be compensated via an unprecedented incentive scheme tied to company performance<sup>134</sup>—be counted on to speak freely about the company's problems?

Chinese law makes it illegal for the shares held directly by the state or state-owned enterprises in an SOE to be traded on a secondary market.<sup>135</sup> Thus, mergers and acquisitions are practically impossible. PetroChina management will be free of one of the basic sources of competitive pressure on the modern corporation: the fear that poor performance will result in the sale of the company and the dismissal of current management. In the words of one observer,

even after converting a state enterprise into a joint stock company under the Company Law and publicly offering its stocks for trading under the securities laws, the pressure on the state enterprise's manager to perform well remains minimal. The state still maintains effective public ownership, and private investors have very limited influence on management.<sup>136</sup>

As noted above, all top Company officers are cadre of the Chinese Communist Party and thus never face the prospect of real unemployment.

While share offerings by Chinese companies are the exception, some prior experience is available. A review of the risks that these companies face, taken from their

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132. Lee, *supra* note 22.

133. *Restructuring of China's Oil Industry Continues as Doubts Regarding its Success Loom*, OIL & GAS J., Jan. 3, 2000, at 19.

134. Ho Swee Lin, *Western Wiles to Woo the Market*, FIN. TIMES, Mar. 14, 2000, at 18.

135. K. Matthew Wong, *Securities Regulations in China and Their Corporate Finance Implications on State Enterprise Reform*, 65 FORDHAM L. REV. 1221, 1242 (1996); William H. Simon, *The Legal Structure of the Chinese "Socialist Market" Enterprise*, 21 J. CORP. L. 267 (1996); see also Celia Lam & Wei Jie, *China's State-Owned Share Dilemma*, available at <http://www.financeasia.com/articles/9A05131D-D655-11D6-81E60090277E174B.cfm> (last visited Sept. 17, 2003).

136. Wong, *supra* note 135, at 1242.

filings with the SEC, indicate the following common concerns: the value of China's currency, the renminbi, is subject to change based on government policy and should be considered potentially volatile; the Chinese government controls the convertibility of the renminbi into foreign exchange and this could be used to hinder payouts to shareholders; companies may not be able to secure sufficient foreign exchange to carry out restructuring; China's legal system is not complete and, therefore, enforcement of existing laws or contracts based on existing law may be uncertain and sporadic, and it may be difficult to obtain timely and equitable enforcement of those contracts and laws.<sup>137</sup> All of these issues have a common root: the continued role of an undemocratic regime in its nation's core economic entities. These would all fuel the concerns that led to the PetroChina Campaign.

### III. THE PETROCHINA CAMPAIGN

As word of the proposed initial public offering of PetroChina began to spread in late 1999, a loosely formed coalition of groups emerged to oppose it. This was an exceptional event in the capital markets. Boycotts of economic activity have been used by political groups for many years, most notably the divestment campaign aimed at breaking the apartheid regime of South Africa.<sup>138</sup> Opposition to a particular offering by a specific company, however, was then and remains exceptional.<sup>139</sup> In the end, though, it was the structure and then the success of this coalition that was the true exception. It was this exceptional quality, I will argue below, that signaled the larger political, social, and legal significance of the Campaign.

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137. See, e.g., PetroChina Prospectus, *supra* note 21, at 30-47.

138. A recent example included efforts to delay bond offerings by Russian and Chinese corporations in the U.S. in 1997. See Bruce Clark, *Move to Curb Chinese Access to US Capital*, FIN. TIMES, Nov. 6, 1997, at 4; Betsy McKay, *Russian Bond Offerings Delayed Due to Turmoil*, WALL ST. J., Nov. 7, 1997, at A16. These moves were linked to elements within the conservative wing of the Republican Party, and appeared to have been motivated by national security concerns, and included proposals by Republican congressmen to establish an Office of National Security within the Securities and Exchange Commission to review planned offerings for national security implications. See WILLIAM J. CASEY INSTITUTE, *Russian Bonds Rocked by Second Hearing in a Week Focusing on Undesirable Foreign Penetration of U.S. Markets*, PERSPECTIVE, No. 97-C 169 (Nov. 10, 1997), available at [http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=97-C\\_169](http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=97-C_169) (last visited Sept. 18, 2003). Such a national security-related effort may have more traction in a post-September 11th world.

139. Claims that corporations violate an array of human rights appear to be on the rise. Notable examples include the ongoing litigation against the Unocal Corporation for its role in Burma and the recently settled claims of WWII Holocaust victims against Swiss banks. See *Doe v. Unocal*, 248 F.3d 915 (9th Cir. 2001). See generally Terry Collingsworth, *ILRF Cases to Enforce Labor, Human Rights Under Alien Tort Claims Act*, WORKER RIGHTS NEWS, Vol. 5 No. 1, Spring 2002, at 3, available at <http://www.laborrights.org> (last visited Sept. 18, 2003); Beth Stephens, *The Amoralty of Profit: Transnational Corporations and Human Rights*, 20 BERKELEY J. INT'L. L. 45, 46 (2002) (stating that "[m]orally defensible or not, business as usual or not, if corporations are complicit in human rights violations, the victims of the abuses have a legal right to compensation from those corporations"); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1201 (1999) (evaluating "whether the Securities and Exchange Commission (SEC) has the power to require social as well as financial disclosure by public reporting companies to promote social transparency"); Note, *Should the SEC Expand Nonfinancial Disclosure Requirements?*, 115 HARV. L. REV. 1433, 1435 (2002) [hereinafter *Should the SEC Expand*] (arguing "for a mandate bounded by considerations of investor welfare and underpinned by the same economic logic that supports mandatory financial disclosure").

Opposition emerged, initially, from anti-slavery, religious, and conservative national security groups who focused on the operations of PetroChina parent CNPC in the oil-rich African nation of Sudan. The Sudanese-based Greater Nile Oil Project, a joint venture in which CNPC held a minority position, was accused of human rights violations including the use of forced labor.<sup>140</sup> In fact, the Chinese originally intended to bring CNPC itself public directly but backed off when it realized that the parent company's role in the Sudan would trigger political opposition. The decision was then made to set up PetroChina as a subsidiary of CNPC, leaving the Sudanese operations at the parent level. In its prospectus prepared for investors with the assistance of Goldman Sachs, PetroChina explained that it received "most of the assets, liabilities and interests of CNPC relating to CNPC's *domestic* exploration and production, refining and marketing, chemicals and natural gas businesses," while "CNPC retained . . . assets and liabilities relating to *international* crude oil and natural gas exploration and production and refining and pipeline operations."<sup>141</sup> In addition, CNPC and PetroChina pledged to "establish separate accounts into which their respective proceeds" from the IPO would be deposited. CNPC asserted that it would use its income from the sale of its shares in the IPO only to repay debt and fund employee retraining and severance, and not for its Sudanese joint venture.<sup>142</sup>

This structural arrangement, known in financial circles, perhaps regrettably, as a "Chinese Wall," was insufficient to quell these early critics. A largely, though not exclusively, conservative group of some 200 people led by former Republican Secretary of the Treasury William E. Simon and former Nicaraguan contra backer and Assistant Secretary of State Elliott Abrams signed an open letter to President Clinton on December 9, 1999, soon after the first draft of the PetroChina registration statement had been filed with the SEC. They argued that:

CNPC and its investment banker, Goldman Sachs, will shortly seek to avoid the Executive Order<sup>143</sup> [blocking U.S. funds from the Sudan] and public censure by a "restructuring" scheme purporting to withhold IPO funds from CNPC's commitments in Sudan, Iraq and other terrorist states. The fungibility of money and the scale of CNPC's activities in Sudan thoroughly undermine the credibility of the contrivance. No such arrangement would have been

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140. CNPC's partners included Talisman Energy, Inc., a Canadian concern that faced similar political pressure. In late 2002, in another sign of the significance of the new movement sparked by the PetroChina Campaign, Talisman announced the planned sale of its stake in the Sudan. Talisman CEO Jim Bucklee expressly acknowledged the impact of the protests over the human rights abuses when he announced his company's exit from the region: "Talisman shares have continued to be discounted based on perceived political risk in-country and in North America to a degree that was unacceptable for 12% of our production. Shareholders have told me they were tired of continually having to monitor and analyze events relating to Sudan." Press Release, Talisman Energy, Inc., Talisman to Sell Sudan Assets for C\$1.2 Billion (Oct. 30, 2002), available at <http://www2.ccnmatthews.com/scripts/ccn-release.pl?2002/10/30/1030131n.html?cp=tlm> (last visited Sept. 18, 2003). The sale was finally completed only in March of 2003 when Talisman announced at the signing ceremony of the sale to a state-owned Indian company that it was done "under US pressures." *Talisman Transfers Sudan Stake to Indian Company "Under US Pressure,"* AGENCE FRANCE PRESSE, Mar. 9, 2003.

141. PetroChina Prospectus, *supra* note 21, at 4 (emphasis added).

142. *Id.* at 119-20.

143. In late 1997, President Clinton invoked his emergency economic powers to impose sanctions on the Government of Sudan. Exec. Order No. 13,067, 62 Fed. Reg. 59,989 (Nov. 3, 1997).

permitted to evade America's successful assault on South African apartheid, and it must not be permitted to do so in the service of Sudanese genocide.<sup>144</sup>

These objections began to register politically. President Clinton's Treasury Department expanded the list of prohibited companies in the Sudan to include the Greater Nile Petroleum Operating Co., Ltd.<sup>145</sup> A group of largely conservative religious leaders sent a similar letter to large institutional investors, including major pension funds.<sup>146</sup>

Nonetheless, PetroChina and Goldman Sachs continued to plunge ahead with their preparations for the offering. An upbeat account of the proposed new offering appeared in *Business Week* in late January 2000, with only scant reference to the Sudanese connection.<sup>147</sup> Even this was swatted away with nary a second thought by Goldman's leading international spokesman, Robert Hormats: Sudan is "not an issue because of the extraordinary steps the company is taking to ensure IPO proceeds are only used domestically," he argued.<sup>148</sup> At this point it was not clear that the emerging PetroChina coalition would have the weight to stop the offering. The largest and most politically-sensitive pension funds, the giant college teacher based TIAA-Cref and the California Public Employees Retirement System (CalPERS), together managing more than \$400 billion in assets, refused to commit one way or the other.<sup>149</sup>

At this point, the new coalition received an exceptional boost. The AFL-CIO publicly announced its opposition to the IPO with the publication of a detailed report echoing the concerns of the religious, human rights, and anti-slavery groups but also discussing the kinds of corporate governance, legal, and labor concerns described in Part I of this Article.<sup>150</sup> Pointedly, the AFL-CIO report ignored the national security concerns raised by the conservative elements in the informal coalition. The labor federation held a conference call with Wall Street investment managers to announce the release of the report and it was widely reported in the financial press.<sup>151</sup> The federation's new Office of Investment, headed by experienced shareholder and labor activist William Patterson, began a systematic effort to discuss the problems with the offering with fund managers

144. An Open Letter to President William Jefferson Clinton (Dec. 9, 1999), available at [http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=99-R\\_143](http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=99-R_143)at (last visited Sept. 22, 2003).

145. Press Release, Office of Public Affairs, Treasury Department, Treasury Applies Sudan Sanctions to Joint Oil Venture No. LS-393 (Feb. 16, 2000), available at <http://www.ustreas.gov/press/releases/l3393.htm> (last visited Sept. 21, 2003).

146. Letter to James Burton, CEO of CalPERS (Jan. 24, 2000), available at [http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=00-C\\_09](http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=00-C_09)at (last visited Sept. 22, 2003).

147. *Can This Giant Fly*, *supra* note 28, at 94B (the PetroChina offering "will provide an important blueprint for overhauling state enterprises . . . [that] could mark the emergence of China's new corporate giants on the world scene").

148. *Id.*

149. David Ottaway, *Chinese Fought on NYSE Listing; Groups Cite Oil Firm's Role in Sudan*, WASH. POST, Jan. 27, 2000, at E01.

150. The author prepared the initial draft of the AFL-CIO report.

151. Stephen Fidler & John Labate, *Left and Right Unite in Protest over PetroChina Offering: Concern Over Chinese Group has Brought Seattle-Style Activism to Financial Markets*, FIN. TIMES, Mar. 21, 2000, at 6 (stating "an extraordinary ad hoc coalition . . . has united left-leaning protest groups, trade unions and conservative national security types against the offering"); James Cox, *AFL-CIO Flexes Muscle Against China IPO*, USA TODAY, Mar. 10-12, 2000, at B3.

and pension fund trustees.

The AFL-CIO was able to bring considerable weight to the discussions. The labor federation has thirteen million members in the United States. Labor union trustees sit on the boards of union-sponsored pension funds that manage approximately \$400 billion in financial assets. They also sit on the boards of major public pension funds that manage an additional \$1 trillion in assets. These funds, in turn, hire fund managers that were part of the same investment banks conducting the PetroChina IPO and planning several other Chinese IPO's. With tens of millions of dollars of fees at stake, there was little doubt that Wall Street would be forced to listen to this new voice in the capital markets. Within a few days of the AFL-CIO intervention, both TIAA-Cref and CalPERS announced their intention not to purchase shares in the IPO.<sup>152</sup> Over the next several weeks the Campaign snowballed as more funds agreed not to purchase shares in the offering.

Some on Wall Street seemed to get the message. Mark Melcher, a leading analyst at Prudential Securities, and his colleague Stephen Soukup, issued a report assessing the impact of the Campaign. Responding to some who called the IPO's opponents "economic Luddites" who would have a "temporary" impact, they said that such a view was:

[D]ead wrong . . . this is, as the song goes, the start of something big . . . .  
[W]hen the dust settles on this dispute, the gurus of international investment banking will find that their jobs have been made permanently more difficult by the appearance of a new social investment category that has been declared taboo by some of their largest customers, and by the addition of a new and highly complicated variable to their already crowded due-diligence agendas.<sup>153</sup>

The high point of this Campaign, or perhaps the low point from the perspective of PetroChina and Goldman Sachs, was a near physical confrontation between the bankers and their oil company clients, on the one hand, and, on the other, the protestors at the St. Regis Hotel in New York City in late March 2000. As part of its "road show," a standard means of bringing company executives together with potential investors in advance of a securities offering, Goldman had scheduled a luncheon at the hotel for potential investors in the IPO. The AFL-CIO scheduled what it called a "counter road show" in the same hotel. Richard Trumka, as its Secretary-Treasurer the number two leader of the labor federation, and a former head of the militant United Mine Workers Union, led the union delegation. The trade unionists brought with them a Tibetan monk to talk about the oil company's impact in Tibet and Harry Wu, the well-known survivor of the Laogai, China's prison labor camps. The morning of the road show Goldman Sachs decided to avoid the confrontation and cancelled their luncheon at the St. Regis, setting up shop instead a few blocks away at the Four Seasons.<sup>154</sup> The labor-led force, meanwhile, held their very visible press conference at the St. Regis.

152. Telephone interview with William Patterson, Director, Office of Investment, AFL-CIO (Feb. 28, 2003); see also John Labate & Ho Swee Lin, *China Oil IPO Fires Up Union Campaign*, FIN. TIMES, Mar. 10, 2000, at 6.

153. MARK L. MELCHER & STEPHEN R. SOUKUP, PETROCHINA DUSTUP: THE START OF SOMETHING BIG, POTOMAC GLOBAL EQUITY RESEARCH PERSPECTIVE, PRUDENTIAL SECURITIES (Mar. 22, 2000), available at [http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=00-C\\_30at](http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=00-C_30at) (last visited Sept. 17, 2003).

154. Adam Shell, *Goldman Moves Pitch for IPO to Avoid Clash, AFL-CIO Urges Investors to Avoid PetroChina Stock*, USA TODAY, Mar. 23, 2000, at 2B; Michael M. Phillips, *PetroChina's IPO Roadshow Opens, While Opposition Forces Rally Nearby*, WALL ST. J., Mar. 23, 2000, at A14.



A week after the near confrontation in New York, a Congressional group including Republican Spencer Bachus, Democrat Dennis Kucinich, and Socialist Bernard Sanders, addressed a letter to President Clinton echoing the Campaign's concern that the company would use proceeds from the IPO to support environmentally-damaging projects in Tibet and the joint venture in Sudan.<sup>155</sup> These events took their toll. The company and its bankers were forced to rethink the deal. The launch date was pushed back and, as reports of investor disinterest or opposition came in, they scaled back the size of the offering, from an initial goal of raising \$10 billion to the final figure of \$2.9 billion.<sup>156</sup>

#### IV. THE UNGER LETTER

The impact of the Campaign, however, did not stop with the actual IPO. PetroChina's stock price sank below the stated offering price upon its debut and took months to recover.<sup>157</sup> A headline in *The New York Times* said it all: "China's No. 1 Oil Company Goes Public With Whimper."<sup>158</sup> The Chinese government absorbed their experience with this flagship offering and announced it would be delaying or shelving altogether the planned offering of several other industrial companies.<sup>159</sup> Meanwhile the emboldened participants in the PetroChina Campaign turned their attention to potential regulatory and institutional reform.

Responding to complaints from fund managers at major investment banks, the AFL-CIO began an effort to establish investment screens at the pension funds on whose boards they sat.<sup>160</sup> The fund managers claimed they had been "blindsided" by the Campaign and, fearing the loss of management fees, said they would be happy to implement the approach of the Campaign if given clear guidance by pension fund trustees. The most significant and successful effort came at CalPERS, the giant public employee retirement fund for California state employees. After months of research and lobbying, the labor trustees on the CalPERS board led by Sean Harrigan, a vice president of the United Food and Commercial Workers union and now president of CalPERS, and joined by sympathetic public officials such as Phil Angelides, California's state treasurer, and Willie Brown, San Francisco mayor and a gubernatorial appointee to the board, proposed and won the adoption of a new policy governing the fund's equity investments in the so-called "emerging market" countries, including China.

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155. Letter to President Clinton (Mar. 31, 2000), available at [http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=00-C\\_33at](http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=00-C_33at) (last visited Sept. 17, 2003).

156. See *supra* text accompanying notes 121-123.

157. Ho Swee Lin, *PetroChina Shares Plunge After Float*, FIN. TIMES, Apr. 8, 2000, at 8.

158. Mark Landler, *China's No. 1 Oil Company Goes Public With Whimper*, N.Y. TIMES, Apr. 8, 2000, at C2.

159. Ho Swee Lin, *Poor Investor Response Forces China to Delay Two Listings*, FIN. TIMES, Apr. 1, 2000, at 17. In late 2000, an offering of stock by a second Chinese oil company, Sinopec, was made and ran into similar political opposition. Its shares trade down significantly from their offering price. Roger W. Robinson, International Security Dimension of Portfolio Management, Remarks at the Investor Responsibility Research Center, Inc. Conference (Oct. 26, 2001). One report suggested that China had planned an additional 120 stock offerings on the international capital markets. Those ambitious plans, if genuinely intended, were quietly withdrawn. Mark Landler, *Stakes in China Suddenly Seem Less Appealing*, N.Y. TIMES, Mar. 31, 2000, at C1.

160. The discussion that follows is based on contemporary interviews with William Patterson, Director of the Office of Investment at the AFL-CIO, a leading participant in the PetroChina Campaign.

The new CalPERS policy required the \$147 billion fund's staff to begin active management of its "emerging market" equity investments and to hire new fund managers with an active, as opposed to passive or indexed, investment approach. The trustees also approved a list of "investibility screens" aimed at shaping the Fund's investments in emerging markets. According to CalPERS,

the screens outline financial and economic factors, and three additional factors that include transparency, political stability and prohibitions on abusive labor practices. Managers will [now] be selected based on their ability to invest in emerging markets and adherence to the Global Sullivan Principles and the International Labor Organization's Declaration on Fundamental Principles and Rights at Work.<sup>161</sup>

The substance of the new CalPERS policy reflected the same issues raised by the PetroChina Campaign and, in fact, many of the individuals involved in the Campaign took part in the effort to shape and implement the new CalPERS policy.

The impact of the new policy was soon felt when CalPERS announced that it would suspend future equity investments in several countries, including Indonesia, Thailand, Malaysia, and the Philippines. At the same time the fund announced it would open the door to new investment in Poland and Hungary due to improvements in those countries.<sup>162</sup> The announcement sent share prices in several Asian markets tumbling and set off an intense round of negotiations as those countries attempted to make changes in domestic policy in order to win back CalPERS investments.<sup>163</sup> Months of lobbying by the Philippine government convinced CalPERS to reverse its position against equity investments there. The fund agreed to back a new investment fund in Thailand sponsored by a private investment group and the International Finance Corporation (IFC), an arm of the World Bank, but, so far, none of the committed capital has been invested. The fund will "only make investments in companies that agree to comply with Government of Thailand and IFC environmental and social policies, including high standards of corporate governance and transparency."<sup>164</sup> A dialogue between CalPERS and senior Thai government officials is underway, and the implementation of domestic reforms there may open the door to future investment.<sup>165</sup> A similar policy is being considered by the New York City retirement system and the State of Connecticut public employees fund.<sup>166</sup>

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161. Press Release, CalPERS, CalPERS Board Takes Action on Investment and Other Measures (Nov. 15, 2000), available at <http://www.calpers.org/whatsnew/press/2000/1115a.htm> (last visited Sept. 17, 2003).

162. Press Release, CalPERS, CalPERS Adopts New Model for Investing in Emerging Markets (Feb. 20, 2002), available at <http://www.calpers.org/whatsnew/press/2002/0220a.htm> (last visited Sept. 17, 2003).

163. Bruce Einhorn, *Will CalPERS Kill Asia's Rally*, BUS. WK., Feb. 25, 2002 ("Thailand's market dropped 6.7%... after the CalPERS news hit. The Philippines and Malaysia fell 3.9% and 1.7%, respectively..."); Carolina Braunschweig, *LPs Carry Their Weight Beyond Venture Capital*, BUYOUTS, Sept. 9, 2002 (Philippines and Thailand "sent high-level delegations to Sacramento to ask CalPERS to reconsider its decision.").

164. Press Release, CalPERS, CalPERS Invests \$75 million in Thailand Equity Fund (Oct. 29, 2001), available at <http://www.calpers.org/whatsnew/press/2001/1029a.htm> (last visited Sept. 17, 2003).

165. William Barnes, *Can Thailand Win Back Calpers?*, FIN. TIMES, June 11, 2002, at 46.

166. Robert Collier, *State Employees' Pension Fund Flexes Its Muscle Around the World*, SAN FRANCISCO CHRON., July 21, 2002, at A12. CalPERS recently reaffirmed their approach to the EMC screens. Telephone Interview with William Patterson, Director of Office of Investment, AFL-CIO (Feb. 28, 2003) (on file with author).

A broader political campaign was underway as well. The AFL-CIO and others in the loosely organized "PetroChina Coalition" argued that disclosure documents filed by PetroChina and Goldman Sachs with the SEC all but ignored the risks highlighted by the Campaign. Responding to these concerns, a Congressionally-created United States Commission on International Religious Freedom issued a report in May of 2000 that called for greater disclosure by PetroChina, especially with respect to the use of proceeds from the IPO to pay off parent company CNPC debt. "[M]illions of those dollars from CNPC's sale of PetroChina shares may well end up benefiting" the joint venture in Sudan.<sup>167</sup> The Commission called on the SEC to "be especially careful to investigate the adequacy and reliability of representations made in any filings related to the recent sale by CNPC and PetroChina of PetroChina shares."<sup>168</sup>

This discussion led, in turn, to pressure for legislative or other regulatory reform with respect to disclosure by foreign corporations that attempt to issue securities in the U.S. capital markets. In March of 2001, Republican Congressman Frank Wolf, of Virginia, addressed a letter to Laura Unger, who was then serving as Acting Chairman of the Securities and Exchange Commission following the departure of longtime SEC Chairman Arthur Levitt.<sup>169</sup> Congressman Wolf noted the role that PetroChina's parent company CNPC played "in providing the Government of Sudan with unprecedented resources to carry out its war and atrocities against Southern Sudan" and contended "more people are suffering and have died because of the PetroChina listing."<sup>170</sup> He argued that the purchase of shares in the offering might have violated a 1997 Executive Order that imposed "comprehensive economic sanctions on Sudan."<sup>171</sup> He urged Chairman Unger "to vigorously investigate this matter and take appropriate action" and argued that the apparent violation of the Executive Order "offers grounds for de-listing PetroChina from the NYSE [the New York Stock Exchange]."<sup>172</sup> He sent nearly identical letters to Secretary of the Treasury Paul O'Neil and Chairman of the New York Stock Exchange Richard Grasso. He followed up the letter with a direct meeting with Unger and a second letter on April 2, 2001.

Chairman Unger replied to the Wolf letters and meeting on May 8, 2001 with a detailed five-page letter and the submission of a memorandum by David B.H. Martin, then Director of the Division of Corporate Finance of the SEC.<sup>173</sup> The Division has major responsibility for reviewing and assessing the disclosure provided by issuers of securities on a U.S. securities exchange, including the New York Stock Exchange where PetroChina had listed its securities.<sup>174</sup> The Unger Letter detailed the actions that the SEC

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167. *Report of the United States Comm. on International Religious Freedom*, May 1, 2000, at 3.

168. *Id.* at 5.

169. Letter to Ms. Laura Unger, Acting Chairman of Securities and Exchange Commission, from Frank Wolf, Member of Congress (Mar. 8, 2001), available at [http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=01-F\\_20](http://www.centerforsecuritypolicy.org/index.jsp?section=papers&code=01-F_20) (last visited Sept. 17, 2003).

170. *Id.*

171. *Id.*

172. *Id.*

173. See *id.*; Memorandum from David B.H. Martin to Acting Chairman Laura Unger (May 8, 2001) [hereinafter Martin Memorandum].

174. American investors in PetroChina would purchase "American depositary shares," or ADS's, "[s]ecurities representing an ownership interest in a foreign company's common stock." MODERN DICTIONARY

had taken in response to the Wolf inquiries and outlined several initiatives it planned to undertake in the near future. The Chairman and staff of the SEC met or spoke with representatives of several of the organizations included in the PetroChina Campaign or knowledgeable about the offering, including the Center for Security Policy, the U.S. Commission on International Religious Freedom, the U.S. State Department, and the Treasury Department's Office of Foreign Assets Control (OFAC).<sup>175</sup> In the discussions with other federal agencies, the SEC "raised the possibility of interagency cooperation on Sudan."<sup>176</sup>

The Chairman met with Directors of each of the SEC's major divisions and she stated that "[t]hey are sensitized to this issue and will be looking for *creative ways to enhance investors' access to material information* about foreign investment in Sudan and its impact on the human rights situation there."<sup>177</sup> As suggested in the next section, this commitment is the crucial step taken by the Unger Letter, reinforced by the several initiatives promised by the Chairman. These include: a proposed rulemaking to require electronic filing by foreign companies who register their securities with the SEC; a new requirement that the SEC will end selective review of filings by certain foreign issuers and instead "review all registration statements filed by foreign companies which reflect material business dealings with governments or countries subject to U.S. economic sanctions"; a requirement of "enhanced disclosure" in securities filings by foreign issuers doing business in sanctioned countries; a commitment to bring to the attention of OFAC any disclosure in registration statements filed by foreign companies which "reflect material dealings" with countries subject to sanctions; and support for the "formation of an interagency working group on Sudan."<sup>178</sup>

## V. SOME INITIAL ARGUMENTS

Whether or not the Unger Letter was a "bombshell," as the *Financial Times* suggested, its release nonetheless certainly hit a nerve. It seemed to confirm the worst fears of leading financial figures like Federal Reserve Chairman Alan Greenspan, who quickly denounced efforts to attach political criteria to disclosure when given a chance in testimony to the Senate Banking Committee a few weeks after the release of the Letter.<sup>179</sup> His opportunity to begin a counter-attack on the PetroChina Campaign came when asked a very friendly question by then Chairman of the Committee, Senator Phil Gramm, Republican of Texas, in reference to proposed legislation that would limit China's ability to raise capital in the U.S. capital markets. Gramm noted:

Mr. Chairman [referring to Greenspan], as you're aware, we have spent years battling the effort by [the] American government to use trade as a tool of foreign policy . . . . And except for those pariah states, where we have virtually

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FOR THE LEGAL PROFESSION (3d ed. 2001), available at <http://www.lexis.com> (last modified Nov. 2, 2003). In the case of the PetroChina IPO, the Bank of New York would act as the depository for the ADS's, each of which would represent 100 underlying shares in PetroChina. PetroChina Prospectus, *supra* note 21, at 5, 19.

175. OFAC is responsible for administering the sanctions on Sudan. See *supra* note 123.

176. Unger Letter, *supra* note 2, at 1-2.

177. *Id.* at 2 (emphasis added).

178. *Id.* at 2-4.

179. Greenspan, *supra* note 3.

a state of war . . . we have gotten away from using economic trade as a tool of foreign policy. We now have a new proposal . . . that seeks for the first time to use access to our banking system as an instrument of American foreign policy . . . . [These] tools that are being used represent, in my opinion, a very real threat to our prosperity . . . .<sup>180</sup>

The Chairman of the Federal Reserve embraced the concerns of Senator Gramm wholeheartedly:

Mr. Chairman, I certainly agree with the comments you have made, and I clearly understand the motives underlying Senator [Fred] Thompson's bringing this amendment forward . . . . [I]t's the openness and the lack of political pressures within the [American financial] system which has made it such an effective component of our economy and, indeed, has drawn foreigners generally to the American markets for financing as being the most efficient place where they can in many cases raise funds . . . . [T]o the extent that we block foreigners from investing, from raising funds in the United States, we probably undercut the viability of our own system . . . . I am not even sure how such a law would be effectively implemented . . . . [I]f we were to block China or anybody else for that matter from borrowing in the United States, they could very readily borrow in London and be financed [there] by American investors . . . . And therefore I must say, Mr. Chairman, I join in your concerns about that amendment and I trust it would not move forward . . . .<sup>181</sup>

Chairman Greenspan's comments pose a serious challenge for proponents of human rights and other related "social" or "political" disclosure through the capital markets. Is there really a debilitating paradox at work here, as Greenspan suggests? Do efforts to advance the international human rights agenda through the capital markets have the effect of destroying the very functioning of those capital markets? Traditional approaches to securities regulation provide a useful but, in the end, only partial response to this question. A closer look at recent changes in the *structure* of the global capital markets, and in the *political responses* to the globalization process that underlies those structural changes, provides a useful supplement to our understanding. This Part reviews each of these three in turn and suggests both their value and their limitations.

### *A. The Traditional Securities Law Approach*

The core principle behind capital market regulation in the United States, and many other leading economies, particularly the United Kingdom, is quite straightforward.<sup>182</sup> No security can be offered or sold in the United States, unless the transaction is registered with the Securities and Exchange Commission or an exemption to that registration

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180. The Federal Reserve's Second Monetary Policy Report for 2000: Hearing Before the Senate Comm. on Banking, Housing and Urban Affairs, 106TH CONG. 12 (2000) (statement of Sen. Phil Gramm, Chairman (R-TX)).

181. Greenspan, *supra* note 3. Senator Gramm was so pleased with the response of Chairman Greenspan that he released a press release the same day headed "Gramm, Greenspan Share Concerns About Limits on China's Access to U.S. Capital." Press Release, Senate Banking Committee, Jul. 20, 2000.

182. See Securities Act of 1933 (codified as amended at 15 U.S.C.S. § 77a (2003)); and Securities Exchange Act of 1934 (codified as amended at 15 U.S.C.S. § 78a (2003)).

requirement is available. If a transaction is to be registered, then the seller of the security must provide adequate disclosure of all material information about the issuer and the security to potential purchasers. Even in transactions where the seller has an available exemption, disclosure that is almost the equivalent of that provided in registered offerings will occur because of demand from potential buyers. It is thought disclosure, like sunshine, is “the best of disinfectants.”<sup>183</sup> The basic disclosure obligations were put in place in the 1930s in response to a major capital shock that brought the U.S. economy to a standstill. Rampant conflicts of interest and obscure and overly complex financial schemes were found to pervade the securities industry.<sup>184</sup> While the New Deal Era architects of the new regime had much more ambitious plans for restructuring of the U.S. financial and corporate system, the disclosure requirements were their longest lasting and perhaps most significant reform.<sup>185</sup>

A key word in this basic disclosure framework is the concept of *materiality*, which has been the subject of agency interpretation and judicial pronouncement ever since the passage of the original securities acts. And at one level the entire debate about whether or not human rights concerns belong inside the capital markets can be explored within the framework of the concept of materiality. Understandably, given the mandate of the SEC, that is the way in which the Unger Letter frames the question. Unger notes that as a result of the campaign against the PetroChina IPO, the SEC had become “sensitized” to issues involving human rights and the capital markets. She stated that the Commission and its staff would be “looking for creative ways to enhance investors’ access to material information” about issuers who access the U.S. capital markets and have investments in countries like the Sudan—where PetroChina’s parent company had significant operations—and the impact of such investments on human rights.<sup>186</sup>

A focus on materiality originally arose in the securities law regime because of important structural changes that were taking place in the forms of corporate organization and in the financial markets.<sup>187</sup> As economic activity became more complex and grew in

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183. LOUIS D. BRANDEIS, *OTHER PEOPLE’S MONEY AND HOW BANKERS USE IT* 62 (1933). Although this requirement is simple enough, the content of that disclosure is outlined in a complex set of rules and regulations issued by the Securities and Exchange Commission.

184. See JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET* 29 (1982) (citing 1933 inaugural address of President Franklin Delano Roosevelt that Senate investigation of Wall Street led to the conclusion that the “[p]ractices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men”).

185. *Id.* Under the leadership of SEC Chairman William O. Douglas, significant changes in bankruptcy law (the Chapman Act of 1938) and the structure of the utility industry (the Public Utility Holding Company Act of 1940) were made. Douglas and other members of Roosevelt’s “Brain Trust,” actually hoped to make more far-reaching changes that ran into resistance from Wall Street and the more limited vision of FDR himself. *Id.* at 40–41. At one point, for example, Justice Douglas had been in favor of “public” directors serving on the boards of major corporations, a move he believed the SEC had the power to impose. See Roberta S. Karmel, *The Future of Corporate Governance Listing Requirements*, 54 SMU L. REV. 325 (2001). However, as Karmel concludes, “[t]he views of Justice Douglas remain controversial. The more common view is that the Securities Act is a full disclosure, rather than a merit, statute and the SEC does not have the power to regulate corporate governance.” *Id.* at 337. In the wake of the Sarbanes-Oxley reforms put in place in the post-Enron era, that widely accepted conclusion is undergoing some, though not major, erosion.

186. See *supra* text and accompanying notes 157–178.

187. There exists important literature on industrial organization that receives too little attention in legal scholarship on corporations. See SCOTT R. BOWMAN, *THE MODERN CORPORATION AND AMERICAN POLITICAL*

scale and scope in the early part of the twentieth century, entrepreneurs were increasingly forced to widen their search for capital beyond family structures. The corporate form of economic organization became dominant along with its central structural characteristic—the separation of ownership and control—which was described so vividly in the landmark study by Berle and Means, written in the wake of the 1929 Crash.<sup>188</sup> Berle and Means were in a sense frightened by the emergence of a separation between ownership and control of the modern corporation, between a dispersed shareholder base and a centralized managerial group, because of the implications that a concentration of economic power in small groups of insiders had for a democracy. This structure was both a solution to an emerging problem—the increasing complexity of modern industry—and a cause of a new set of problems, namely problems of governance within the new framework and between this new corporate world and the surrounding polity.<sup>189</sup>

Modern securities regulation helped to solve the new problems by providing shareholders a consistent and reliable information package in the form of regular disclosure by publicly traded corporations and disclosure about securities offerings made by corporations. The concept of *materiality*—understood to mean all the information that a reasonable investor requires to make an informed investment decision<sup>190</sup>—lies at the heart of this disclosure regime. It is widely believed that the requirement that companies provide material information on a regular basis to shareholders and potential investors helps to close the gap between owners and managers, or, in the language of “law and economics,” helps lower the costs associated with the principal-agent problem created by the separation of ownership and control.<sup>191</sup>

It should not seem like too big a step for the SEC to take when it acknowledges that disclosure about potential human rights violations by a corporation, or associated with a

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THOUGHT: LAW, POWER, AND IDEOLOGY (1996); WILLIAM G. ROY, *SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA* (1997); MARTIN J. SKLAR, *THE CORPORATE RECONSTRUCTION OF AMERICAN CAPITALISM, 1890-1916: THE MARKET, THE LAW AND POLITICS* (1988); and MAURICE ZEITLIN, *THE LARGE CORPORATION AND CONTEMPORARY CLASSES* (1989). An important exception to my contention that this literature remains largely outside of legal scholarship is OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* (1985), who relied heavily in his transaction cost theory of the corporation and its governance on the work of ALFRED CHANDLER, *THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS* (1977).

188. ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932) [hereinafter BERLE & MEANS].

189. The Berle-Means thesis has been viewed as a foundation for both what might be called the “social protection” framework (probably most important to Berle and Means themselves) that animated securities law analysis in the New Deal, and much of the Keynesian era, but also for the “agency cost” perspectives of law and economics thinking that has dominated the securities law field for the past two decades. Whereas Berle and Means saw the problem as one of using law to shape the behavior of managers now in “control” of the new powerful monopolistic, post-private property industrial groups to enhance the larger “community” interest, the “law and economics” school attempted to use the concept of “agency” costs to mount a market driven counter-revolution against what they see as the potential for opportunistic managerial behavior in firms that are still living in a world of private property. See BERLE & MEANS, *supra* note 188, at 351, 356; Adolf A. Berle, *High Finance: Master or Servant*, 23 YALE L.J. 43 (1933), cited in SELIGMAN, *supra* note 184; Michael C. Jensen & William H. Meckling, *The Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1986). A recent appraisal of both approaches is considered in William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737 (2001).

190. *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); see *infra* text accompanying note 198.

191. Jensen & Meckling, *supra* note 189.

corporation's operations, could be considered material to a potential investor. The SEC already requires companies to disclose details about their environmental liabilities, potential problems related to intellectual property, and relationships with employees. The SEC long ago agreed to increase disclosure of so-called "soft" information, such as projections about the future course of a company's business model, even making available a safe harbor for forward-looking statements.<sup>192</sup> In fact, the triumph of the "efficient market hypothesis"<sup>193</sup> would appear to reinforce the requirement that progressive effort be made to expand the reach of disclosure requirements. Because the hypothesis mandates that past, or hard, information is of little use to the evaluation of a company's future prospects, the door was opened to the requirement that soft information about the impact of future events be disclosed to the markets.<sup>194</sup> More recently, the SEC signaled its interest in increasing the level of disclosure by companies of what are called "intangibles," such as human capital and intellectual property.<sup>195</sup> The mandate of the Unger Letter is entirely consistent with this approach.

Nonetheless, in addition to the competitive and other concerns raised by Alan Greenspan, some commentators worry that Chairman Unger opened up a kind of Pandora's box. A recent Note in the *Harvard Law Review* commented:

One observer has suggested that the Unger Letter will 'lead to lobbying for further measures by the SEC to demand additional disclosure on environmental or broader human rights grounds.' *Indeed. Not to mention equal employment opportunity, workplace and consumer safety, and any other political or social concern implicated by corporate behavior.* If the SEC has concluded that information unrelated to a firm's financial performance may nonetheless be material, then it has *opened a door to all types of mandated disclosure.*<sup>196</sup>

This comment reflects a disconcerting misreading of current securities law requirements which, as noted above, mandate a wealth of complex disclosure requirements that already can or do include much of what the Note's author worries about.<sup>197</sup> In addition, the comment seems to have been made in ignorance of the origins

192. Safe Harbor Rule for Projections, Securities Act Release No. 6084, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) P82,117 (July 2, 1979) (adopting Exchange Act Rule 3b-6, 17 C.F.R. § 240.3b-6 (1986), and Securities Act Rule 175, 17 C.F.R. § 230.175 (1986)).

193. See discussion *supra* note 121.

194. See William J. Carney, *Defining a Security: The Addition of a Market-Oriented Contextual Approach to Investment Contract Analysis*, 33 EMORY L.J. 311, 340 (1984) ("[I]nvestors are only concerned with expected future earnings, inspection of information about future prospects might loom large as a major feature of investor protection. It is in the nature of such statements that they are not fully verifiable.").

195. SEC Chairman Harvey L. Pitt, Remarks Before the AICPA Governing Council (Oct. 22, 2001). Such an effort has a good deal of support among business managers. See *Three Fourths of Portfolio Managers Surveyed Find Pro Forma Reporting Useful*, PR NEWswire, Nov. 7, 2001 ("Sixty percent of managers want more information about intangible assets, and six out of 10 want more detailed disclosures about internally generated intangibles, such as the value of brand names, customer lists, among other items.").

196. *Should the SEC Expand*, *supra* note 139, at 1434-35 (emphasis added).

197. Imagine Johns Manville not disclosing the risks associated with asbestos litigation, or the Denny's restaurant chain not disclosing to investors the progress of litigation related to charges of racial discrimination in its restaurants. More recently, American multinational corporations have been found to be potentially liable in American courts for human rights violations committed in association with their operations in foreign countries, thus highlighting the need recognized by the Unger Letter to enhance corporate disclosure related to



of the Unger Letter in the PetroChina Campaign where, as this Article demonstrates, it was not *whether* to disclose certain non-traditional risk factors (since PetroChina made extensive disclosures of non-traditional information) but *how* to disclose them in a manner that investors found meaningful. As the Martin Memorandum transmitted to Congressman Wolf by Chairman Unger notes, “the Supreme Court has held that information is material if ‘there is substantial likelihood that a reasonable shareholder would consider it important in making an investment decision.’ TSC Indus. Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).”<sup>198</sup> That disclosure about human rights violations or violations of U.S. economic sanctions are unusual or non-traditional is not to be doubted. There is little basis, however, to suggest that that alone renders such disclosure *non-material*, even if one takes the traditional approach to materiality adopted by the SEC which “generally focuses on matters that have affected, or will affect, a company’s profitability and financial outlook.”<sup>199</sup> Indeed, that is the grounding provided by the SEC in the Martin Memorandum. Equally important in securities law, however, is the *meaningful* nature of disclosure, something that is just as much, if not more, at issue in securities law since the PetroChina Campaign. One court stated, “[t]he registration process established under the [Securities] Act [of 1933] is designed to require disclosure to investors in a *meaningful manner* of the material facts concerning securities which are offered to members of the public.”<sup>200</sup>

The fact that the *Harvard Law Review* Note is grounded in a “law and economics” analysis may explain its limitations.<sup>201</sup> The standard set of law and economics objections to the established securities law regime include concern about federal as opposed to state regulation of the financial markets, and stronger objections to the once widely accepted norm that the market itself is not likely to mandate such disclosure if left to its own devices. These *federalist* and *private ordering* objections to the securities law regime do raise important concerns and often highlight flaws in regulatory practice.<sup>202</sup> Nonetheless,

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such developments to investors. See discussion *supra* note 139.

198. Martin Memorandum, *supra* note 173, at 2.

199. Williams, *supra* note 139, at 1251 n.280, stating:

[R]ecognizing that investors invest primarily to obtain an economic return is not fundamentally inconsistent with requiring expanded environmental disclosure, civil rights disclosure, and other sorts of social disclosure. Expanded social disclosure is extremely useful for the investor qua economic investor, because the information disclosed may portend future economic conditions, even if it is not ‘economically material’ at the time of disclosure.

SEC rules provide a catch-all that provides the Commission a great deal of flexibility in setting disclosure requirements. See Rule 408, Securities Act, 17 C.F.R. § 230.408 (1988) (“In addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.”).

200. Sec. and Exch. Comm’n v. Great Western Land & Dev., Inc., et al., 1965 U.S. Dist. LEXIS 9834 (D. Ct. Ariz.) (emphasis added). For a persuasive argument that expanded social disclosure can be mandated by the SEC under proxy rules of the Securities Exchange Act of 1934 (the “1934 Act”), the companion statute to the Securities Act of 1933, see Williams, *supra* note 139, at 1207 (“[T]he SEC has the authority to require expanded social disclosure under section 14(a)” of the 1934 Act.).

201. On law and economics generally, see RICHARD A. POSNER, *ECONOMIC ANALYSIS OF THE LAW* (1998); in the context of corporate finance, see FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

202. On federalism, see EASTERBROOK & FISCHEL, *supra* note 201; on private ordering, see DAVID D.

these issues are not triggered in particular by the efforts to add human rights disclosure to the regime. The decision about whether or not human rights disclosure is a good thing or not seems *a priori* to the discussion of what institutional means should be adopted to make sure the goals agreed upon are reached. Furthermore, the emergence of the PetroChina Syndrome reflects a change in the nature of the global economy. The institutions that have traditionally regulated economic activity must adapt to reflect those changes. Traditional law and economics analysis provides only a partial explanation for the PetroChina Syndrome, and thus will be inadequate to the task of mapping an institutional future for the global economy.

There is a further potential objection from law and economics, however, that might be more appropriately raised by the evolution in the disclosure regime indicated by the Unger Letter. Opponents of this kind of disclosure could conceivably argue that the requirements of the Letter amount to a *regulatory taking*<sup>203</sup> if it were found that the new disclosure regime was strict enough that it might either prevent companies from raising capital in the U.S. securities markets—as suggested is indeed possible by the Lukoil example<sup>204</sup>—or because it might force companies to restructure their operations in significant ways in order to provide the markets with positive sounding disclosure. The latter possibility assumes, of course, that companies will be reluctant to affirm that they do indeed violate international human rights or progressive corporate governance standards. For example, one of the arguments raised by the oil industry is that it is forced to operate in parts of the world where there are all sorts of bad actors. They have to go where the oil is and deal with whomever controls it, thus some level of association with human rights violations seems almost inevitable. There are problems with this view of international business activity and with the way that oil companies use this argument. There is, for example, an extensive and rapidly growing literature on socially responsible business activity that undermines the cogency of this position from within the business community itself.<sup>205</sup> Nonetheless, one could imagine the development of a counter-attack to the Unger Letter logic from business along these lines.<sup>206</sup>

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FRIEDMAN, LAW'S ORDER: WHAT ECONOMICS HAS TO DO WITH LAW AND WHY IT MATTERS (2001).

203. The core support for a doctrine that a regulation can be a "taking" is found in the U.S. Constitution: "Nor shall private property be taken for public use, without just compensation." U.S. CONST. amend. V. The Rosetta stone for strong versions of the principle of a *regulatory taking* is found in Justice Holmes' opinion for the Court in *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1927) ("The general rule at least is, that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking."); *Keystone Bituminous Coal Ass'n. v. DeBenedictis*, 480 U.S. 470, 502-03 (1987) (Rehnquist, C.J., dissenting) (stating "the holding in *Pennsylvania Coal* . . . has for 65 years been the foundation of our 'regulatory takings' jurisprudence").

204. See *supra* text accompanying notes 3-9.

205. See Press Release, United Nations Global Compact, Global Compact and World Bank Institute Cooperate on CSR Program (Mar. 6, 2003), available at <http://www.unglobalcompact.org/portal/Default.asp> (last visited Nov. 10, 2003) (describing corporate social responsibility program).

206. Business groups have made some headway in extending the "regulatory takings" concept to the international economic arena under the protections offered by the North American Free Trade Agreement (NAFTA). Article 1110, Chapter 11, of NAFTA states that:

No party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure *tantamount to nationalization or expropriation of such an investment* ("expropriation"), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of

There is a natural response to the potential takings complaint based in the analysis suggested above regarding the expansion of the disclosure regime mandated by the Unger Letter.<sup>207</sup> I argued there that the commitment by Chairman Unger to look for “creative ways to enhance investors’ access to material information” about human rights violations was consistent with the general principles articulated for many years by the SEC with respect to disclosure.<sup>208</sup> There is, therefore, in the SEC’s approach to disclosure, the kind of “structural habit” that Holmes suggested placed a limit on the application of the takings argument.<sup>209</sup> As Robert Brauneis has written:

Holmes thought that the positive law of a jurisdiction could be described, not just as an accidental aggregation of specific, unrelated rules, but as a body of

compensation in accordance with paragraphs 2 through 6.

Canada-Mexico-United States: North American Free Trade Agreement, 32 I.L.M. 289 (1993); 32 I.L.M. 605, 641 (1993) (emphasis added). Several companies have argued that environmental and other regulations amount to “expropriation” and on two occasions have been able to win either money damages through the dispute resolution process established in NAFTA or force a favorable settlement on a member state. See Chart of Chapter 11 Cases, Global Trade Watch, Public Citizen, *available at* <http://www.citizen.org> (last visited Nov. 2, 2003) (U.S. chemical company wins \$13 million in dispute over Canadian regulation on gasoline additive; U.S. firm wins \$15.6 million in dispute over construction permit for toxic waste dump in Mexico). See also William Greider, *The Right and US Trade Law: Invalidating the 20<sup>th</sup> Century*, THE NATION, Oct. 15, 2001, *available at* <http://www.thenation.com> (last visited Nov. 2, 2003) (“Under Chapter 11, foreign investors from Canada, Mexico, and the United States can sue a national government if their company’s property assets, including the intangible property of expected profits, are damaged by laws or regulations of virtually any kind.”) In a situation similar to the discussion about disclosure here, in 1994 the cigarette manufacturer Philip Morris was able to beat back efforts by the Canadian government to impose a “plain packaging” requirement for cigarettes which would have removed terms like “light,” “low tar” and “mild” from packaging. The company claimed the measure would have been tantamount to an expropriation of its trademarks in violation of Art. 1110. The Canadian government recently renewed its effort to impose “plain packaging” requirements and, once again, Philip Morris is opposing them and threatening action under NAFTA. Ronald J.T. Corbett, Comment: *Protecting and Enforcing Intellectual Property Rights in Developing Countries*, 35 INT’L. LAW. 1083 (2001); Public Citizen, Philip Morris Warns Canadian Public Health Proposal Violates NAFTA, 2 Harmonization Alert 1 (Mar.-Apr. 2002).

207. See *supra* text accompanying note 1.

208. Unger Letter, *supra* note 2, at 2.

209. In a late 19th century takings case, Holmes defended half price fares on a privately run streetcar system for children traveling to school against a charge of a “taking” by the streetcar company on the grounds that to do otherwise would be to violate the deep “structural habit” represented by public support for education. Holmes wrote:

[C]onstitutional rights like other [sic], are matters of degree and . . . the great constitutional provisions for the protection of property are not to be pushed to a logical extreme, but must be taken to permit the infliction of some fractional and relatively small losses without compensation, for some at least of the purposes of wholesome legislation . . . . Education is one of the purposes for which what is called the police power may be exercised . . . . *Structural habits count for as much as logic in drawing the line.* And, to return to the taking of property, the aspect in which I am considering the case, general taxation to maintain public schools is an appropriation of property to a use in which the taxpayer may have no private interest, and, it may be, against his will. It has been condemned by some theorists on that ground. Yet no one denies its constitutionality. People are accustomed to it and accept it without doubt. The present requirement is not different in fundamental principle, although the tax is paid in kind and falls only on the class capable of paying that kind of tax—a class of quasi public corporations specially subject to legislative control.

*Interstate Consol. St. Ry. Co. v. Commonwealth of Massachusetts*, 207 U.S. 79, 86-87 (1907) (emphasis added; citations omitted).

law that exhibited an internal structure, organized around a variety of principles or paradigm cases. Those “structural habits” provided a basis for assessing how much change in positive law a particular piece of legislation caused . . . . The “property” protected by the Constitution is not a theorist’s ideal, but the actual, established practice of a particular legal tradition . . . . [The regulation in question] must be evaluated in terms of how different it is from established practice . . . . [Where] it “is not different in fundamental principle”—it does not amount to so drastic a change as to require compensation.<sup>210</sup>

Brauneis argues that Holmes’ view was that only “radical, discontinuous alterations” in one’s property rights where “change was measured as deviation from fundamental principles, or structural habits, embedded in the organized body of standing positive law” were deserving of constitutional protection.<sup>211</sup>

There is another deeper dimension to this argument that must be considered. The flip side of a regulatory taking, particularly in a world of global capital flows, is “regulatory arbitrage.”<sup>212</sup> This occurs where corporations take advantage of the flexibility and liquidity of global capital markets to run around efforts by states to regulate corporate activity in the public interest.<sup>213</sup> When this occurs it can be assumed to offend a particularly deep “structural habit.” Normally this is thought of as a “race to the bottom” as opposed to a “race to the top.”<sup>214</sup> Typically, those who normatively favor government regulation argue that issuers will try to lower their costs by issuing securities, or chartering their corporation, in a jurisdiction with the least onerous, and perhaps least socially protective, regulatory schema. Thus an overarching regulatory framework is

210. Brauneis, *supra* note 18, at 642-43 (citing *Interstate Consol.*, 207 U.S. at 79).

211. *Id.* at 701.

212. John C. Coffee, Jr., *The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications*, 93 NW. U. L. REV. 641, 697 (1999) (arguing that “accepting any significant disparity in disclosure standards for one market creates an unstable environment in which political pressures are likely to produce regulatory arbitrage—and the proverbial ‘race to the bottom’”).

213. See Kellye Y. Testy, *Comity and Cooperation: Securities Regulation in a Global Marketplace*, 45 ALA. L. REV. 927, 929 (1994) (“[C]onflicts among national regulatory regimes may encourage regulatory arbitrage as well as ill will among and between nations.”); see also Amir N. Licht, *Regulatory Arbitrage for Real: International Securities Regulation in a World of Interacting Securities Markets*, 38 VA. J. INT’L L. 563, 633 (1998) (“[F]oreign listing becomes a medium through which undesired effects can be exported from one country to another.”); Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation*, 107 YALE L.J. 2359 (1998) (advocating regulatory competition). Licht argues that *financial* arbitrage can ameliorate the impact of *regulatory* arbitrage, because in an efficient market the price of the company’s stock will reflect the value that investors place on the company’s choice or, in the case of a dual listing, its mix, of regulatory regimes. In some sense, that is precisely what happened when PetroChina attempted its IPO. The PetroChina Campaign was part of the process by which information about the company was integrated into the market price—a price, as indicated, that the underwriters adjusted downward as poor investor reaction during the road show accumulated.

214. See Licht, *supra* note 213, at 635.

Virtually all the existing literature on international securities regulation is preoccupied with two basic issues: the question of regulatory competition among national regulatory regimes, and the related problem of extraterritorial application of such regimes (extraterritorial jurisdiction). At the heart of the debate stands the likelihood of detrimental regulatory arbitrage—the so called ‘race to the bottom’—if issuers migrated to markets with lower-quality regulation. The alternatives to this scenario are a beneficial ‘race to the top’ or to some middle-range ‘optimum’. From these scenarios different conclusions may be drawn about the need for regulatory intervention.

necessary to prevent issuer arbitrage that slowly but surely eats away at socially desirable standards. Meanwhile, those who are more skeptical about the efficacy of government intervention argue that, in a competitive market, prices will accurately reflect investors' preferences for a particular regulatory regime, and thus an efficient market for the securities of a company can help police the regime choice. Thus, Amir Licht argues that *financial* arbitrage can ameliorate the impact of *regulatory* arbitrage because in an efficient market the price of the company's stock will reflect the value that investors place on the company's choice or, in the case of a dual listing, its mix, of regulatory regimes.<sup>215</sup> In some sense that is precisely what happened when PetroChina attempted its IPO. The PetroChina Campaign was part of the process by which information about the company was integrated into the market price—a price, as indicated, that the underwriters adjusted downward as poor investor reaction during the road show accumulated. Far from undermining the argument here about an expansion of the concept of materiality, this reinforces it. Thus, the market has signaled the importance of the issues raised in the PetroChina IPO and the Unger Letter reflects that signal.

But I am suggesting a different kind of problem. Issuers who wish to raise capital may not be able to assure investors of a high enough return on their investment to overcome the concerns raised in their home market, where the normal protections available to investors do not exist. In such a case, the issuer may attempt to partially “expropriate” the reputation value possessed by a highly regulated and efficient market, such as that of the United States, in order to raise capital at a lower price than would otherwise be possible. Another way of stating the problem is to suggest that insiders may be able to obscure informational asymmetries that give them an advantage over outside potential purchasers of the company's securities by hiding behind the positive veil that listing in a well-established and highly-regulated market may offer. Some scholars appear to address this problem by identifying a subset of issues associated with the general set of issues called “international regulatory competition.”<sup>216</sup> The subset looks at the possibility of “piggybacking” where issuers, as Licht points out, “may want to list their stocks on foreign markets with a view to improve their corporate governance, thereby creating shareholder value.”<sup>217</sup> Licht argues that while most commentators conclude that this is evidence of a “race to the top” with the consequence of increases in shareholder value, his own research on Israeli companies that list extraterritorially in the United States provides evidence of a “race to the bottom,” as managers take advantage of a weaker corporate governance regime in the United States.<sup>218</sup>

An issuer of securities in a wholly state-owned enterprise, however, could engage in an exceptional form of “managerial opportunism” in order to appropriate the value

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215. *Id.* at 633.

216. *Id.*

217. Amir N. Licht, *Managerial Opportunism and Foreign Listing: Some Direct Evidence*, 22 U. PA. J. INT'L ECON. L. 325, 326 (2001).

218. *Id.* at 326 (stating that “piggybacking may also have a dark side in the sense that foreign listing transactions could be guided, inter alia, by managerial opportunism”); *but see* Roberta Romano, *The Need for Competition in International Securities Regulation*, 2 THEORETICAL INQ. L., Article 1, at para. 2 (2001), available at <http://www.bepress.com> (last visited Nov. 20, 2003) (“[T]here is no evidence supporting the claim that competition would result in a race to the bottom, with issuers choosing the lowest level of disclosure possible.”).

associated with the extraterritorial listing. This risk of opportunism seems likely to increase when one considers an SOE in an undemocratic society. The clash of competing interests of the multiple constituencies found in the SOE's of post World War II social democratic Europe, for example, would help mitigate the risk of managerial opportunism by greatly increasing the transparency and accountability of the offering process. But that is precisely what is absent in countries like China where the regime has delayed democratization while attempting to undertake market reforms. The legitimating impact of interest group pluralism, central to the structure of the post World War II democratic states, is entirely absent in the Stalinist form of state ownership.<sup>219</sup> Thus, what seems like a "regulatory taking"—the imposition of a particular disclosure regime regarding human rights—may be more properly understood as the only available corrective for this new form of regulatory arbitrage and, therefore, consistent with our established Holmesian "structural habits."

PetroChina knew that it had no chance to raise billions of dollars on its *domestic* Shanghai stock exchange. The Chinese government places far greater limits on capital liquidity than the United States or Europe, and institutional investors consider the level of corruption there to be intolerably high.<sup>220</sup> Thus, not surprisingly, the quality of the corporations that offer their shares only domestically in China is considered far worse than those that are able to make international offerings. Hence, Chinese issuers suffer a reputation effect or, rather, they add, perhaps inappropriately, to the value of their reputations if they can figure out a way to list successfully overseas, ideally in New York or London but at least in Hong Kong. For years, Chinese mainland companies have understood this problem and when seeking to raise their profile, and to raise significant amounts of new capital, have listed shares on the Honk Kong exchange.

PetroChina was not only formed to step around its parent company's operations in Sudan, but to attempt to sidestep the very serious issues that undermine the ability of China's own domestic stock exchanges to attract significant capital investment. China's new form of regulatory arbitrage was the equivalent of a kind of "social dumping"<sup>221</sup> when it attempted to foist the securities of its reorganized SOEs on unwitting foreign investors, who would otherwise never invest directly through a domestic Chinese exchange in the same company. As discussed above, little reassurance was offered to U.S. investors that somehow the listing requirements of the New York Stock Exchange or the rules and regulations that govern corporate behavior generally in the United States

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219. A substitute form of legitimization does take place in such regimes, as suggested at the outset of this Article, but it is largely driven by ideology and the arbitrary use of power rather than the checks and balances of an accountable institutional structure.

220. Rahul Jacob, *Graft in Asia on Rise, Says Business*, FIN. TIMES, Mar. 13, 2003, at 9 (stating that "Graft is endemic in China: according to the most conservative estimates, the magnitude of corruption ranges from 3 to 5 percent of GDP").

221. See generally Catherine Barnard, *Social Dumping and the Race to the Bottom: Some Lessons for the European Union from Delaware?*, 25 EUR. L. REV. 57 (2000) (demonstrating how competition between jurisdictions in a deregulated internal market lowers standards, inducing market participants to flock to the state with the lowest social standards, thus leading to a race to the bottom); Mark Barenberg, *Law and Labor in the New Global Economy: Through the Lens of United States Federalism*, 33 COLUM. J. TRANSNAT'L L. 445 (1995) ("The substantive legal standards implemented by federal authorities may permit social dumping in the form of movements of capital either across the borders of geographic, public institutions . . . or across the boundaries of functional, private institutions . . .").

could actually be enforced against a company whose management would remain firmly in the hands of the Chinese Communist Party.<sup>222</sup>

### B. A Structural Approach

At the core of the transition to a world of global capital markets is a shift away from commercial banks as the most important financial intermediaries to a range of new financial institutions, including pension funds, mutual funds, university endowments, and a new world of wealthy and sophisticated individual investors who provide funding for the private equity world of hedge funds, buyout groups, and venture capital. A 1996 study published by the American Enterprise Institute documented this significant development.<sup>223</sup> As the study noted:

For more than two centuries banks in the United States were the main repository of households savings and the primary source of credit for businesses. They occupied the central role in the intermediation of credit. In the 1980s and 1990s all that . . . changed. Innovations in financial markets . . . allowed many borrowers to bypass banks entirely, and newly developed nonbank financial intermediaries . . . invaded the traditional turf of banks by taking their customers and undercutting their profitability. During those two decades banks [saw] their share of traditional financial intermediation steadily eroded as non-bank financial intermediaries . . . provided better substitutes for traditional banking services and as innovations in the financial markets . . . enabled business borrowers to directly access credit markets for their funds.<sup>224</sup>

This is further evidenced by changes in the macro-economy. As a percentage of personal disposable income, U.S. savings have dropped steadily over the last twenty years, from a post World War II high of 10.9% in 1982 to a post-WW II low of 2.3% in 2001.<sup>225</sup> Meanwhile during the same time period there has been an explosion of borrowing through the capital markets. Credit market borrowing by the domestic non-financial sector of the economy grew explosively in the last twenty-five years from \$194 billion per year in 1975 to \$2 trillion in 2001.<sup>226</sup> Growth of total credit market debt outstanding for the domestic non-financial sector mirrored this expansion, rising from approximately \$2.3 billion in 1975 to nearly \$20 trillion in 2001.<sup>227</sup> This borrowing, of course, points to the new intermediaries, the financial players who are engaged in purchasing these debt instruments on behalf of the new creditors, namely pension funds and investment companies. As Edwards notes, “[t]heir share of intermediary assets grew from 20 percent in 1980 to almost 40 percent in 1994, and that growth shows no sign of

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222. See *supra* text accompanying notes 133-137.

223. FRANKLIN R. EDWARDS, *THE NEW FINANCE: REGULATION & FINANCIAL STABILITY* (1996).

224. *Id.* at 10.

225. National Accounts Data, Bureau of Economic Analysis, U.S. Department of Commerce, available at <http://www.bea.gov/bea/dn1.htm> (last visited Sept. 17, 2003).

226. Flow of Funds Accounts of the United States, The Federal Reserve Board, available at <http://www.federalreserve.gov/releases/Z1/Current/annuals/a1975-1984.pdf>, Release date: Sept. 9, 2003 [hereinafter Flow of Funds 09/09/03], and at <http://www.federalreserve.gov/releases/Z1/Current/annuals/a1995-2001.pdf>, Release date: Dec. 5, 2002 [hereinafter Flow of Funds 12/05/02] (last visited Nov. 10, 2003).

227. Flow of Funds 09/09/03, *supra* note 226, at 51; Flow of Funds 12/05/02, *supra* note 226, at 51.

abating.”<sup>228</sup> Pension funds alone owned more than 32% of the outstanding value of U.S. equities held by households in 2000.<sup>229</sup>

If pension funds and mutual funds, among others, are the key new financial players, this fact has not been lost upon those who manage such funds nor those who are the beneficiaries of such funds. Most importantly, one of the central institutions of what could be called the older, and perhaps now exhausted, “Industrial Relations” era, the trade union movement, also plays a key role in this new “Capital Markets” era.<sup>230</sup> Thus, as noted above, the AFL-CIO’s affiliates directly control pension funds with financial assets currently valued at some \$400 billion. Indirectly, as trustees of plans jointly sponsored with employers or the public sector, the labor movement oversees funds with assets valued at approximately \$5 trillion. Under the new leadership of the AFL-CIO, which took office in 1995, the labor movement has established, in its Washington, D.C. headquarters, a Department of Corporate Affairs and an Office of Investment, and has sponsored the establishment of a non-profit entity called the Center for Working Capital. These new organizations attempt to mobilize the financial resources found in the pension fund assets of union workforces in support of the labor movement’s broad goals, including international labor standards and human rights, progressive forms of corporate governance and democratic political change in emerging markets, and other forms of socially responsible investment, while maintaining the long term returns to the funds. In addition the AFL-CIO is working on an international effort to promote a similar approach by labor movements in other countries. The major international labor umbrella group, the International Confederation of Free Trade Unions based in Brussels, is the sponsor of a Global Task Force that coordinates cross-border campaigns in the capital markets.

While the PetroChina Campaign became the signature event of this new movement, it is not the only example. Just prior to its intervention in that effort—in late 1999 and early 2000—the AFL-CIO responded to a call for assistance by the German trade union movement in the battle which erupted after a hostile takeover bid was announced by Vodafone, the upstart British mobile phone company, for Mannesmann, the giant century-old German industrial concern. In this Campaign, a further dimension of the labor movement’s leverage in the financial markets became clear. While union pension funds owned only a small percentage of the shares of Mannesmann and, thus, could not likely have a significant effect on the outcome of the tender offer, the fund managers hired by pension funds to manage their investments controlled on behalf of their various clients some thirteen percent of the shares of Mannesmann.

In what has become the standard approach of the AFL-CIO in such campaigns, they issued a report to managers of pension funds that argued against the takeover bid, linking traditional union concerns with the fiduciary duty of fund managers and trustees to protect the asset value of their beneficiaries.<sup>231</sup> The report was released publicly and

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228. EDWARDS, *supra* note 223, at 16.

229. Flow of Funds Accounts of the United States, The Federal Reserve Board, available at <http://www.federalreserve.gov/Pubs/Bulletin/2001/0701lead.pdf> (last visited Sept. 17, 2003).

230. On this division of history between an Industrial Relations era and a Capital Markets era, see *infra* text accompanying notes 267-275.

231. OFFICE OF INVESTMENT, AFL-CIO, THE VODAFONE HOSTILE BID FOR MANNESMANN: THE WRONG TRANSACTION FOR LONG-TERM INVESTORS, Nov. 22, 1999. The author drafted the initial version of this report. See also Press Release, AFL-CIO, Statement by AFL-CIO President John Sweeney on Mannesmann Takeover



brought to the attention of Wall Street analysts, many of whom, of course, work for the same financial institutions as the fund managers of the major pension funds. The threat of opposition to the bid was taken seriously enough by the Vodafone team that Vodafone CEO Chris Gent made a strenuous effort to engage AFL-CIO President John Sweeney in discussions about the bid. When Sweeney refused to engage in such discussions without the participation of German union leaders, Gent made several written public statements reassuring the German work force that the takeover bid would not disturb existing labor-management relations. In the final days of the acquisition, Gent finally entered into face-to-face negotiations with the German union leadership—something he had thought he could avoid and that is indeed relatively rare in the mergers and acquisitions environment.

A more recent and ongoing example is the international campaign by the labor movement to support efforts to restore democracy in Burma, which has been ruled by a brutal military dictatorship for several decades. Labor has joined with a wide range of non-governmental organizations to oppose companies that continue to invest in Burma. Initially these efforts focused on Unocal, the California-based oil company, which built a natural gas pipeline across Burma in a joint venture with the military. Widespread human rights abuses are known to have accompanied this project, including forced labor to build the project, forced relocations of villagers; and killings, beatings, and rapes of villagers who resisted the project. The AFL-CIO introduced a shareholder resolution calling on Unocal to respond to these charges and to set aside a portion of its profits from the pipeline in a trust fund for the future economic development of a democratic Burma.<sup>232</sup> More recently, as noted above, the AFL-CIO joined with British unions to pressure Premier Oil, a British company, which continues to operate in Burma. In particular, the AFL-CIO asked the American oil company, Amerada Hess, to either use its twenty-five percent stake in Premier to pressure Premier to withdraw or else to sell all of its stake in the company.<sup>233</sup>

While many of these capital market campaigns focus on intervening in the capital markets to stop a transaction when organized labor believes its core principles are implicated, the trade union movement is also developing a framework for changing the way that Wall Street and corporations think about investment decisions. It wants to broaden the core concepts that motivate basic investment decisions—in a sense, to endogenize human rights, democratic politics, and progressive corporate governance into the concept of materiality, on the investor side, and into the concept of valuation on the company side. An important example of this approach was the decision by CalPERS to put in place an “investment screen” to control the way its fund managers invest its members’ assets in the equity markets of the so-called “emerging market countries.” Now those investment decisions must include weighting for the core labor standards established by the International Labor Organization, which include the right to freedom of association, the right to engage in collective bargaining, prohibitions against the use of forced labor and abusive child labor, and against discrimination in employment. Thus, the

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(Nov. 22, 1999). The following discussion is based on personal observations of the author.

232. Press Release, AFL-CIO, Worker Shareholders Challenge Unocal’s Plans For New Investment in Burma and Ask For Commitment to Global Labor Standards (May 20, 2002) (on file with author).

233. Press Release, AFL-CIO Calls for Shareholder Vote on Amerada Hess’ Acquisition of Triton (Aug. 2, 2001).

PetroChina Campaign reflects in part a structural shift to a new environment where capital markets have important social and political effects. But that has not meant that the older institutional players, such as organized labor, have been left behind.

### C. A Political Approach

Because organized labor has lost the most as a result of the end of the Industrial Relations era, it is particularly motivated to develop its role as an institutional investor in the new Capital Markets era. But it is not just the labor movement that has begun to notice the potential for advancing a political agenda through the capital markets. In that earlier era, collective bargaining and union activity was understood to be a complement to traditional parallel political institutions. "Industrial democracy" on the shop floor stimulated workers' interest in and understanding of broader democratic processes.<sup>234</sup> In addition, the exercise of freedom of speech and association in the workplace, once fought for and won, was not likely to be given up lightly in society at large.<sup>235</sup> Thus, labor unions have been seen as a key force in civil society that serve as a counterweight to the concentration of power in financial, corporate, or government bodies. Some used this perspective to argue that unions are a natural component of U.S. politics and the American model of industrial capitalism. It was this kind of approach to labor-management relations that made industrial relations ideology a central part of U.S. foreign policy in the Cold War. There is more than coincidence in the fact that "Wild Bill" Donovan, the founder of the Office of Strategic Services (OSS), the forerunner of the Central Intelligence Agency (CIA), practiced labor law and that William Colby, head of the Phoenix counterinsurgency program in Vietnam and later a Director of the CIA, began his career after wartime service with the OSS as a labor lawyer first for Donovan's own Wall Street law firm and then for the National Labor Relations Board in Washington, D.C.<sup>236</sup> The OSS itself had a very active labor branch during World War II, "created to work with Socialist trade union groups in the European underground."<sup>237</sup> The CIA played a central role in attempting to use the American Industrial Relations system and ideology as part of a wider effort to combat the success of Stalinism during the Cold War. Colby, for example, was directly involved in such efforts in post-World War II Italy.<sup>238</sup> Other leading figures of the post-war era who came out of the Industrial Relations era included: Clark Kerr, President of the University of California during its Free Speech Movement; economists John Dunlop and John Kenneth Galbraith at Harvard; and George Schultz, first at the University of Chicago, and then Stanford, and later the holder of four Cabinet level positions, including Secretary of Labor, State, and Treasury. These are only intriguing bits of anecdotal evidence, of course, but there is little doubt that for most of the Cold War, the United States professed to support

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234. See *infra* text accompanying notes 276-286.

235. This can be thought of as analogous to the influence of World War II on the post war civil rights movement. Having fought, yet again, on behalf of the United States in the war, black Americans came home to the world of Jim Crow. This time, however, they joined with many in the labor movement that had been established in the 1930s to break this country's system of *de jure* racism.

236. WILLIAM COLBY & PETER FORBATH, *HONORABLE MEN: MY LIFE IN THE CIA* 62, 74-75 (1978).

237. R. HARRIS SMITH, *OSS: THE SECRET HISTORY OF AMERICA'S FIRST CENTRAL INTELLIGENCE AGENCY* 12 (1972).

238. COLBY & FORBATH, *HONORABLE MEN*, *supra* note 236, at 108-40.

collective bargaining and unionization as a vital bulwark against "totalitarianism."<sup>239</sup>

In the post-Cold War era of globalized capital markets, this particular dimension of U.S. foreign policy and domestic legitimation has been undermined. Certainly this is one of the factors that motivate labor's interest in advancing a capital markets strategy. The Cold War era foreign policy establishment, however, has not simply disappeared into investment banks, business schools, or early retirement. While adherents of a neo-liberal free trade ideology have been the dominant force in American foreign policy over the last two decades or so, a group of "neo-conservatives" emerged from a pro-labor wing of the Cold War to fight what was often, until September 11, a rear guard battle to promote a foreign policy that it viewed as vital to the narrower *national interests* of the United States.<sup>240</sup> The idea of joining multilateral missions to stop "ethnic cleansing" in obscure European countries, like the newly recognized states of the former Yugoslavia, or genocide in Rwanda was not high on their list of priorities. In the first few months of the Bush Administration it looked as if this perspective on foreign policy was, in fact, gaining the upper hand. The appointment of a foreign policy team linked to the Ford Administration and the Cold War era (not to the era of globalization), the withdrawal of the United States from the Kyoto environmental treaty, and the confrontation with China over a downed spy plane, all hinted at the return of unilateralism defined by a vaguely defined "national interest" in contradistinction to the pure globalization, market *ueber alles* view of many in the Clinton era.

Some in this national interest layer in American politics saw the PetroChina Campaign as a way to put itself back on the political map at a turning point in American politics. Though of secondary importance relative to the weight on the AFL-CIO and large institutional investors, an important force in the campaign against the IPO was led by the Center for Security Policy, a Washington think tank with links to the neo-conservative William Casey Institute, headed by former investment banker Roger Robinson. This Center forms the core of a somewhat broader political group that has supported some of the Congressional activism that led to the issuance of the Unger Letter, including ties to Congressman Wolf and Senator Brownback, Republican of Kansas, and then Senator Fred Thompson, Republican of Tennessee, who have all been active on religious freedom, China, and human rights issues.

Of course, the literature issued by this wing of the PetroChina Campaign rarely mentioned the layoffs of nearly a million workers that would follow a successful restructuring of PetroChina, nor the absence in China of free and independent trade unions to provide workers a voice in the shock therapy now being implemented by that regime to its domestic economy. Instead their concern—one that was indeed shared by the labor movement—focused on the denial of religious freedom and the use of forced labor by the Chinese oil industry in Sudan.

Ironically, while the national interest perspective appears to have made some headway in the Bush Administration, that national interest is, of course, in the process of being radically redefined. And, ironically, one of the first beneficiaries of the new post-

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239. Today a dim echo of this approach lives on in the activities of the Congressionally-funded National Endowment for Democracy and the State Department's Advisory Committee on Labor Diplomacy.

240. Since 9/11, the ascendancy of the national interest/neo-conservative wing of the foreign policy establishment has been marked with the appointment of figures like Paul Wolfowitz, Elliott Abrams, Otto Reich, and John Poindexter to key administration positions.

9/11 war against terrorism was Sudan. One of the promises dangled in front of the Sudanese regime in return for some kind of support for the anti-terror effort was the possibility of lifting the sanctions in place against that regime for its human rights violations. Some in the neo-conservative national interest camp are calling foul. "The Bush administration risks appearing craven where they too pretend that Sudan warrants a clean bill of political health based on Khartoum's assistance to fight terrorism," according to the Casey Institute's Roger Robinson.<sup>241</sup>

There is, of course, *some* reflection of national interest politics in today's labor movement. Its heaviest concentration remains in parts of the international affairs wings of the AFL-CIO. But, in general, the Cold War anti-communist character of the labor movement has disappeared. The effort of the Sweeney administration to establish a "new internationalism" as the basis of an independent foreign policy for the global labor movement has been successful within much of labor. This is the approach that animates labor's campaigns on international trade and finance as seen in labor's presence at the Seattle WTO demonstrations in 1999, and at the annual meetings of the International Monetary Fund and the World Bank. While this movement waned somewhat in reaction to the terrorist attacks on September 11, it is likely to be a permanent feature of international politics. The recent massive demonstrations against the war with Iraq indicate the persistent significance of an emerging independent world public opinion.<sup>242</sup>

In addition to these *neo-liberal*, *national interest* and *new internationalist* perspectives, there is also a mirror image to the national interest approach found in developing, or so-called "emerging market" countries. While having obtained some additional leverage over the world system because of their newfound "comparative advantage" (i.e., their ability to offer global corporations cheap labor),<sup>243</sup> many of these countries still find themselves locked out of key markets in the advanced countries and far behind in key areas of economic growth, like high technology. In response, there has emerged in many of these countries what might be called a *neo-mercantilism* as they negotiate their way around the new institutions of the global economy.<sup>244</sup> Examples of this dynamic include the debates underway over the value of capital controls<sup>245</sup> or the right to produce cheaply drugs to fight AIDS in the developing world.<sup>246</sup> The politics of neo-mercantilism is likely to be a source of resistance to efforts like the PetroChina Campaign, though domestic labor movements in some of these countries have welcomed

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241. Manimoli Dinesh, *Sudan Sanctions Renewal Draws Focus to Cooperation in US's Terrorism War*, OIL DAILY, Nov. 6, 2001, at 8.

242. Patrick E. Tyler, *A New Power in the Streets*, N.Y. TIMES, Feb. 16, 2003, at A1.

243. Diamond, *Bridging the Divide*, *supra* note 10.

244. See Marshall Auerback, *Korea's Election Results: Another Decisive Turn Against Washington*, INT'L PERSP., available at <http://www.PrudentBear.com> (Dec. 24, 2002); Marshall Auerback, *Cognitive Dissonance and the Washington Consensus*, INT'L PERSP., available at <http://www.PrudentBear.com> (Jan. 8, 2002); Marshall Auerback, *Thailand's Election: More Signs Of Backlash Against The West*, INT'L PERSP., available at <http://www.PrudentBear.com> (Jan. 16, 2001).

245. See Marshall Auerback, *Capital Controls: The Counterattack Has Begun*, INT'L PERSP., available at <http://www.PrudentBear.com> (Jan. 21, 2003) [hereinafter Auerback, *Capital Controls*]; Marshall Auerback, *Capital Controls: Malaysia Ends A Successful Experiment With No Fanfare*, INT'L PERSP., available at <http://www.PrudentBear.com> (May 8, 2001).

246. Mukdawan Sakboon, *Aids Activists Step Up Drug-access Drive*, THE NATION (THAILAND), Mar. 7, 2003.

the new internationalist approach of the AFL-CIO, which represents a significant shift from the Cold War era links to official U.S. foreign policy.

One can delineate, therefore, four different political camps in the post-Cold War period: neo-liberalism, neo-mercantilism, the national interest grouping, and new internationalism. The *neo-liberal* model has animated the core of U.S. international economic policy in the Capital Markets era and is the source of the strongest opposition to the use of the capital markets as an arena to advance human rights.<sup>247</sup> The *neo-mercantilists* of the Third World are also likely to oppose such efforts though for their own narrower interests, particularly as a bargaining chip to use inside the new global institutions like the WTO. Many, though not all, in the *national interest* or neo-conservative camp inside the United States welcomes the capital markets initiatives, but have a more limited agenda defined by their real focus on advancing a particularly hawkish approach to U.S. foreign policy. Finally, there is what I believe is the central motivating force behind the anti-globalization movement and the kind of capital markets initiative evidenced in the PetroChina Campaign—the *new internationalism* actively promoted by the AFL-CIO and its sister organizations in the global labor movement, and among its friends in environmental and human rights organizations.

## VI. THE NEW ERA: FROM KEYNES TO FRIEDMAN

As I have suggested here, one could consider the recent turn in the SEC's behavior towards concern about human rights within the context of theoretical debates about materiality and the nature of our disclosure regime. Further, discussions of the new role of capital markets, institutional investors, and of the different political camps that have emerged in response to globalization add to our understanding of the PetroChina Syndrome. But there is another theoretical framework that is perhaps even more helpful in understanding its potential long-term significance. While the debate about corporate governance and the securities law regime is responsive to the issues raised by the separation of ownership and control, the same development in economic history—the rise of the large vertically-integrated multinational corporation—created another problem, one that is analyzed by Massimo De Angelis in his recently published book entitled *Keynesianism, Social Conflict and Political Economy*.<sup>248</sup>

De Angelis describes a problem with which both John Maynard Keynes and the Polish economist, Michał Kalecki, Keynes' contemporary, grappled. The emergence of the large industrial manufacturing concern required the creation of a large industrial working class, both to work in the new factories, such as Henry Ford's massive River Rouge complex which employed 120,000 workers in a single site, and to consume the products of this new industrial economy, such as the Model A cars that started rolling off the Rouge assembly line in the late 1920s. De Angelis suggests Keynes and Kalecki understood that with this massive concentrated employment of industrial workers came a new confidence among those workers that employers *needed* them. They could no longer be pushed so easily into unemployment to serve as a "reserve army of labor" which had undermined, for many decades, efforts to form stable and effective trade unions. This

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247. Alan Greenspan can be seen as a key representative of this perspective.

248. MASSIMO DE ANGELIS, *KEYNESIANISM, SOCIAL CONFLICT AND POLITICAL ECONOMY* (2000) [hereinafter DE ANGELIS].

new awareness emboldened workers to push for wage increases and improved working conditions, and was reflected in the strike waves that hit the American economy in the mid-1930s and throughout World War II, even in the face of difficult economic conditions. Thus, De Angelis notes “the organizational and confrontational maturity of what was, following the Soviet revolution, Fordism and the Great Depression, *a new kind of working class*.”<sup>249</sup>

Keynes and Kalecki, as economists, argued that this new era of social conflict gave rise to a phenomenon known as “wage stickiness” or “wage rigidity”: the prospect of unemployment, even in the depths of the Great Depression, no longer frightened employees *with jobs* into lowering wage demands, thus interfering with the alleged self-correcting role of markets. De Angelis stated that “[a]ccording to Keynes’ biographer Skidelsky . . . ‘the incomplete British recovery from the depression of 1920-1922 started Keynes on the road to the Keynesian Revolution.’ This incomplete recovery had revealed the persistence of unemployment and *at the same time* the rigidity of real wages.”<sup>250</sup> This forced economists to grapple with a new world. The heritage of “Say’s Law”—the world of the nineteenth century where “market forces” (i.e. the reserve army of labor) would drive down the price of labor until it was once again profitable for capitalists to re-hire unemployed workers and hence end the Depression—had apparently been surpassed.<sup>251</sup> As De Angelis argues, “the recognition of unemployment as a problem by economic theory (namely Keynesianism) originated out of the failure of downward movements of the business cycle to provide the traditional disciplinary device for both the employed and unemployed labor force.”<sup>252</sup> Unemployment ceased to play its counter-cyclical role in lowering wages to allow employers to once again begin expanding investment.

A new institutional structure had to be built to deal with this problem. Without new institutions, employers would lose control over the system of production and their motive for investing in new production.<sup>253</sup> This was not an idle threat. It had indeed happened in one extreme instance. In 1917, the working class of Russia overthrew a weak capitalist regime that only several months before had assumed power reluctantly after the ouster of the Russian monarchy by a broad revolutionary movement. While that workers’ regime was later itself crushed in a brutal civil war as a new bureaucratic authoritarian government rose to power under Stalin, the risk of conceding to workers’ power was clear to capitalist theoreticians like Keynes:

Keynes’ revolution in economics can be understood as a reaction to working-class struggles in Europe and general insurgency in other parts of the world. It is the product of the change in the balance of forces between classes during the struggles of the 1920s and 1930s and during the Second World War.<sup>254</sup>

Keynes, in fact, personally witnessed a dramatic version of these events when

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249. *Id.* at 6-7 (emphasis added).

250. *Id.* at 17 (emphasis in original).

251. *Id.* at 30.

252. *Id.* at 6.

253. Michał Kalecki, *Political Aspects of Full Employment*, in 1 COLLECTED WORKS OF MICHAŁ KALECKI—CAPITALISM: BUSINESS CYCLES AND FULL EMPLOYMENT 351 (Jerzy Osiatyński ed., 1990), cited in DE ANGELIS, *supra* note 248, at 4.

254. DE ANGELIS, *supra* note 248, at 13-14.

Britain's government was nearly toppled by the General Strike of 1926. On the eve of the Strike, Keynes admitted that "[t]he trade unions are strong enough to interfere with the free play of the forces of supply and demand, and public opinion . . . supports the trade unions in their main contention that coal-miners ought not to be the victims of cruel economic forces which *they* never put in motion."<sup>255</sup> The events of 1926 had a particularly deep impact on Keynes' re-thinking of the role of class power in economic theory:

Repressive policies had been called [for by some] on the basis of the fact that the strikers had broken the law. "To those who clamoured that the General Strike was illegal and stepped outside the limits of constitutional action, Keynes gave a short reply: 'That may be so, but so what?.'" The balance of forces has changed and [Keynes understood that] "legality must be adjusted to fit the new situation."<sup>256</sup>

Without a new institutional arrangement, the only alternative would be the kind of repression that was indeed taking place in the emerging Stalinist and fascist countries. As Keynes admitted, "[i]t is only in a highly authoritarian society, where sudden, substantial, all-round changes could be decreed that a flexible wage-policy could function with success. One can imagine it in operation in Italy, Germany or Russia, but not in France, the United States or Great Britain."<sup>257</sup>

Thus, a central institutional outcome of the "Keynesian Revolution" was the emergence of the *industrial relations* system that dominated economic life in the advanced economies of the post-war world well into the late 1970s.<sup>258</sup> At the heart of this new structure was what many stylized as a "social contract" between employers and workers under government supervision (or even at times control) where wage increases were granted over time in exchange for productivity increases. In some countries these deals were, and remain, explicit (as in European and Japanese corporatism) or exalted (as in the Stalinist regimes), while they remained only implicit in others (as in the collective bargaining systems in the United States and the United Kingdom). This industrial relations system promised a relatively equitable distribution of income, stability in economic growth, and only moderate divergence in growth patterns between countries. De Angelis terms this solution to the "wage rigidity" problem identified by Keynes and Kalecki as "the social microfoundations of Keynesianism."<sup>259</sup>

However, the system could not last forever. As early as the 1960s, it became clear that firms were living on borrowed time, as De Angelis describes:

From the mid-1960s many basic economic indicators showed a turning point. Investments that were flourishing in the 1950s and 1960s turned sour and

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255. JOHN MAYNARD KEYNES, *Am I a Liberal?*, in IX THE COLLECTED WORKS OF JOHN MAYNARD KEYNES, ESSAYS IN PERSUASION 305 (1972), cited in DE ANGELIS, *supra* note 248, at 20.

256. Antonio Negri, *Keynes and the Capitalist Theory of the State post-1929*, in REVOLUTION RETRIEVED: WRITINGS ON MARX, KEYNES, CAPITALIST CRISIS AND NEW SOCIAL SUBJECTS 1967-83 19-20 (1988), cited in DE ANGELIS, *supra* note 248, at 21.

257. JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT INTEREST AND MONEY 269 (1936), cited in DE ANGELIS, *supra* note 248, at 29.

258. DE ANGELIS, *supra* note 248, at 83.

259. *Id.* at 6.

worsened after the 1974 oil crisis. Business and manufacturing investment collapsed . . . . Industrial profit rates began their downturn in the mid-1960s . . . . Inflation began to approach double digits by the late 1960s. The welfare state appeared to crumble under weight of increasing deficits and exponential increase of the public debt. All these trends could be translated into DM [Deutschemarks], lire, or pounds because the turning point was more or less evident in all major capitalist countries . . . .<sup>260</sup>

At the center of this crisis were the institutions, such as collective bargaining, that regulated labor-management relations. What had once been a boon to capitalist success, the use of the industrial relations framework to regulate wages and productivity, became an albatross. The industrial relations system tended to lock in older technology due to management's attempts to constrain worker power on the shop floor or management reluctance to confront that power. This was linked to a second problem: the collective bargaining system was imposed from above to try and break the back of the idea that workers had independent power in a "full employment" economy.<sup>261</sup> Thus, the social microfoundations were political too, and the imposition of a political system, while offering some newly found stability or equity to workers, also chafed at the level of the rank and file worker. Productivity was thus under attack.

[I]f the "golden age" had seen an impressive increase in productivity growth, the subsequent period suffered what numerous observers have called the "productivity slowdown." What is more important, productivity in most OECD countries grew less than money wages, thus leading to inflationary pressures as business tried to restore profit margins.<sup>262</sup>

Senator Edward Kennedy, a leading pro-labor Democrat, noted at the time:

[T]he effect that worker discontent has on productivity. The National Commission on Productivity states that in at least one major industry, absenteeism increased by 50%, worker turnover by 70%, worker grievances by 38% . . . and disciplinary lay-offs by 44% in a period of 5 years. How much does that cost the economy in terms of low productivity?<sup>263</sup>

The answer appeared to be significant. One contemporaneous follower of the events noted:

Absenteeism has important effects on production . . . . The cost of all this to management is enormous. For example in 1971, in the Oldsmobile Division of GM alone, the cost of absenteeism (considering only fringe benefits) was about \$50 million. Turnover costs were another \$29 million . . . . GM's labour costs rose from 29.5% of sales in 1962 to 33% in 1972 . . . . The firm's investment

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260. *Id.* at 143.

261. *Id.* at 90 (noting that "the single most important achievement of the [collective bargaining] contract from business' perspective was the establishment of a mechanism that took the control of production away from workers").

262. *Id.* at 143.

263. Minutes of Senate Subcommittee on Employment, Manpower and Poverty (July 25, 1972), *cited in* KEN WELLER, *THE LORDSTOWN STRUGGLE AND THE REAL CRISIS IN PRODUCTION* 3-4 (1973) [hereinafter WELLER], available at <http://www.geocities.com/cordobakaf/weller.html> (last visited Sept. 17, 2003).



per worker rose from \$5,000 in 1950 to \$24,000 in 1969. James Roche, Chairman of GM, commenting on these figures, said: "tools and technology mean nothing if the worker is absent from his job" and went on to stress the domino effect of absenteeism on co-workers, on quality and efficiency, and on other GM plants with related production. "We must receive a fair day's work for which we pay a fair day's pay . . . ." <sup>264</sup>

As productivity and profitability slowed in the late 1960s, employers began to use the same institutional structure to ratchet up the pressure on workers. Bargaining became tougher and the resolution of grievances through negotiations and arbitration slower. Some employers began to break away from the institutional structure to engage in aggressive union busting or runaway shops. In the newly formed General Motors Assembly Division (GMAD), for example, management became particularly aggressive. United Auto Workers Union President Leonard Woodcock called it "the roughest and toughest in GM." <sup>265</sup> At the Lordstown, Ohio GMAD plant, there were 100 unresolved grievances when the Division took over. That soon skyrocketed to 1400. Workers began to react. Sabotage of cars became frequent, absenteeism exploded, and informally workers began to leave a certain percentage of cars unfinished as they sped along the assembly line. The workers' protests became so apparent that they even caught the eye of the national media when *Time Magazine* noted that at Lordstown, "autos regularly roll off the line with slit upholstery, scratched paint, dented bodies, bent gear-shift levers, cut ignition wires, and loose or missing bolts. In some cars the trunk key is broken off right in the lock, thereby jamming it." <sup>266</sup> The number of cars needing repairs before they left the plant ran so high the plant was often forced to close for lack of space. A mini strike wave occurred in the United States, including a strike at Lordstown <sup>267</sup> and numerous other auto plants and a wave of wildcat, or unofficial, strikes in several industries. An even more intense strike wave hit much of Western and Eastern Europe. France nearly descended into civil war in 1968, as factory occupations spread across the country. Meanwhile, to the south, Italy experienced its "Hot Autumn" led by rank and file workers in 1969. These battles were echoed in the Eastern Bloc where only Soviet tanks could suppress the Prague Spring of 1968, and in Poland where major strike waves took place in 1970 and 1976 in the run-up to the emergence of the Solidarity Movement in late 1980.

Partially in response to this unrest in the 1970s, De Angelis argues, the advanced economies shifted gears and gutted the decades old Industrial Relations system. For De Angelis, the archetypal figure of the twenty-five year period following World War II was Keynes, but for the new era, Milton Friedman emerged as the archetype. <sup>268</sup> Friedman promoted the idea of liberalized exchange rates and, of course, the expansion of free market institutions. These ideas began to take hold, first in the Nixon Administration and

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264. WELLER, *supra* note 263, at 3 (citations omitted).

265. *Id.* at 11.

266. *Id.* at 12.

267. See EMMA ROTHSCHILD, *PARADISE LOST: THE DECLINE OF THE AUTO-INDUSTRIAL AGE 17* (1973) (referring to the Lordstown strike as "the most famous contemporary example of worker alienation").

268. DE ANGELIS, *supra* note 248, at 144 ("Friedman's (1968) presidential address to the American Economic Association . . . represented the . . . undermining of theoretical support for demand management policies.").

later more aggressively under Presidents Carter and Reagan. The U.S. decision to suspend convertibility of the dollar into gold in 1971 signaled a break with the older institutional framework. Now, increasingly, employers could expand their operations internationally as market institutions were spread to more and more countries, and deregulation of currency trading increased their operational flexibility.<sup>269</sup> These steps were crucial building blocks of the phenomenon now called “globalization.” They heralded the arrival of a new disciplining force that could replace the Industrial Relations system, and perhaps solve the problem of declining productivity and profitability. No longer did employers have to engage in collective deals or social contracts with workers in order to trade wage gains for productivity increases, nor did they have to engage in pitched battles at the factory gates and on the shop floor to raise productivity. Now employers could rely on the entrance into the labor market, a new *global* labor market, of hundreds of millions of previously unavailable workers. After all, if Mexico instituted genuine contract and property rights and a liberalized exchange regime, and also offered cheap labor, it would become far more attractive to auto industry executives to break up their troublesome, aging, and expensive workforces in places like Flint, Michigan and move operations to the new non-union maquiladora zone in northern Mexico. This would replicate the runaway shop policy that the textile industry had put to such good use in moving to the southern United States to avoid Northern unions in the middle of the twentieth century.<sup>270</sup>

Note here the important role that the capital markets can play. Now that more than a trillion dollars are traded back and forth every day in the currency markets alone, those markets provide a kind of daily vote by key financial institutions on the attractiveness for investors of every country in the world. Social welfare spending, union influence over business decision making, and other dimensions of the Keynesian era are now seen by many participants in these markets as introducing inefficiency and rigidity into economic development. Sovereign debt instruments and domestic currencies are ripe for speculative attack as a form of political pressure. As De Angelis notes: “In a context of open capital markets, the simple announcement of a government’s Keynesian intentions may well be sufficient to bring the government to its knees via a massive capital outflow.”<sup>271</sup>

In the run-up to the Brazilian elections, for example, global speculators began a sell-off of Brazilian debt instruments and the Brazilian currency.<sup>272</sup> This forced the

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269. This explains in part the fierce opposition that emerges whenever economically-troubled developing countries attempt to implement protective measures like currency controls. See Auerback, *Capital Controls*, *supra* note 245 (noting “that US trade negotiators are working proactively to ensure that any incipient resort to [capital controls] is to be eliminated as . . . future trade deals are pursued”).

270. See generally HARLEY SHAIKEN, *MEXICO IN THE GLOBAL ECONOMY: HIGH TECHNOLOGY AND WORK ORGANIZATION IN EXPORT INDUSTRIES* (1990) (discussing advanced manufacturing systems in Mexico). Of course, those textile mills have now, for the most part, moved on to places like Mexico and China as well.

271. DE ANGELIS, *supra* note 248, at 157.

272. Ian Campbell, *Analysis: Brazil’s Hopeless Defense*, UPI, Oct. 17, 2002 (noting Brazilian “growth has . . . been modest because of the constant need to keep interest rates high in order to sell debt, attract foreign portfolio capital inflows and curb growth in imports and in the external deficit”); Simon Romero, *Brazil Raises a Key Rate By 3 Points*, N.Y. TIMES, Oct. 15, 2002, at C1 (describing “an unexpected move in the middle of the standoff between Brazil’s government and financial institutions speculating about the direction of the real [Brazilian currency]”); Jonathan Wheatley, *Brazil: Business Likes Lula – But Wall Street Doesn’t*, BUS. WK., Oct. 14, 2002, at 35; *Soros Slams Antsy Markets Facing Brazil’s Leftist Candidate*, AFX EUR. FOCUS, Oct. 8,

government to raise interest rates on financial assets denominated in the domestic currency to try and stop the sell-off.<sup>273</sup> That, in turn, only made the domestic economic situation worse as the cost of financing the government budget increased dramatically. The prospect of the election of leftist former labor leader, Luis Inacio da Silva, known popularly as “Lula,” “ha[d] Wall Street freaked. Ever since last spring, when the first polls showed Lula with the lead, credit agencies and New York investment banks . . . issued dire warnings and downgraded Brazil’s [credit] ratings, causing Brazil’s currency to plummet and helping to precipitate” an IMF bailout.<sup>274</sup> The government was forced to negotiate a stringent agreement with the International Monetary Fund that placed a severe restriction on government spending. In a highly unusual development, candidates in the ongoing presidential campaign were forced to sign on to a commitment to abide by the IMF restrictions if they were elected. In the new era, the post-Keynesian era, the global capital markets provide capitalism with the essential disciplinary device necessary to assure profitability.<sup>275</sup>

In this environment, industrial relations, collective bargaining, even unions themselves, are not just out-gunned, they at first glance appear to be truly irrelevant. As De Angelis noted, “[f]inancial integration and liberalization allows capital mobility to serve as a disciplinary device to limit the scope of any concessions by individual governments that could harm national competitiveness and to present ‘adjustment’ in terms of cuts in welfare spending and entitlements as a necessity posited from the outside.”<sup>276</sup>

## VII. CONFRONTING THE LEGITIMATION DEFICIT

As powerful as this argument is in explaining the new era, however, it leaves out a second concern triggered by globalization, a concern that is at the heart of our legal system, a concern about *legal process*, secured in part by the institutions of labor law. Only an understanding of this dimension of the Industrial Relations era allows us to see the potential for a progressive, labor-led response to the issues posed by the new Capital Markets era. While De Angelis emphasizes in his assessment of the Keynesian era the economic effects of a particular institutional arrangement, he fails to recognize an equally important aspect of the industrial relations system, namely, its ability to put in place a workplace rule of law that helped to *legitimate* the outcome of wage-productivity bargaining. What some have called “American approach to industrial relations”<sup>277</sup> was

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2002, at 35.

273. In late 2002, benchmark Brazilian interest rates stood at 25%. John Barham, *Heading Out of the Storm*, LATIN FIN., Feb. 2003, at 16; *Interest Rate is Increased After All; New Signal to the Markets Gets Poor Response*, LATIN AM. WKLY. REP., Jan. 28, 2003, at 41.

274. Franklin Foer, *Radical Solution*, NEW REPUBLIC, Sept. 23, 2002, at 15.

275. *Id.*

276. DE ANGELIS, *supra* note 248, at 151.

277. See Stephen F. Diamond, *Labor Rights in the Global Economy: A Case Study of the North American Free Trade Agreement*, in HUMAN RIGHTS, LABOR RIGHTS AND INTERNATIONAL TRADE 218 (Lance A. Compa & Stephen F. Diamond eds., 1996, 2003) [hereinafter Diamond, *Labor Rights*]; for a sophisticated critique, see Katherine Van Wezel Stone, *The Post-War Paradigm in American Labor Law*, 90 YALE L.J. 1509, 1566 (1981) [hereinafter Stone, *Post-War Paradigm*] (stating “the industrial pluralist metaphor of the plant as a mini-democracy . . . [is] mere illusion”). Note that my argument comes at this question from a slightly different angle

based on the promotion of a common law of the shop floor that developed out of organizing campaigns, grievance processing, and contract negotiations. This system was created by a series of statutes, beginning with the National Labor Relations Act of 1935 (often referred to as the “Wagner Act” after its chief legislative author, Senator Wagner),<sup>278</sup> and later institutionalized by several important Supreme Court decisions, notably the famous Steelworkers Trilogy cases of the early 1960s.<sup>279</sup> As Justice Douglas said in one of those crucial opinions:

The collective bargaining agreement states the rights and duties of the parties. It is more than a contract; it is a generalized code to govern a myriad of cases which the draftsmen cannot wholly anticipate . . . . The collective agreement covers the whole employment relationship . . . . It calls into being a *new common law*—the common law of a particular industry or of a particular plant . . . . A collective bargaining agreement is an effort to erect a *system of industrial self-government*.<sup>280</sup>

This new approach was as much a result of popular protest through widespread strikes in the 1930s, including three general strikes in San Francisco, Minneapolis, and Toledo, as it was a product of legislative and judicial effort. The centerpiece of the new industrial relations system was the National Labor Relations Board, established by the 1935 Act. Its role in monitoring and adjudicating labor-management conflict was an attempt to take the emerging class warfare then breaking out on the streets of major American cities back to the negotiating table, by setting up a process for union recognition while limiting the ability of workers to continue more radical efforts to control the production process. As a 1961 study cited by labor law scholar Katherine Van Wezel Stone concluded: “The gains from this system [of industrial relations] are especially noteworthy because of their effect on the recognition and dignity of the individual worker . . . . Wildcat strikes and other disorderly means of protest have been curtailed and an effective work discipline generally established.”<sup>281</sup> The Wagner Act, therefore, can be seen as a “double-edged sword”—a legal instrument that cut both ways, in favor initially, it seemed, of workers, but over time providing the framework for severely curtailing worker power. As labor law historian Karl Klare noted, “the liberal model of industrial democracy simultaneously *invites* and *limits* employee participation in workplace governance.”<sup>282</sup> The fact that it provided procedures such as mandatory

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than Professor Stone, suggesting that it is internal workplace conflict that pushes its way outward to a battle over broader democratic principles, while at the same time generating periodic compromises that are seen as legitimate stalemates or cease-fires between employer and employee. For further discussion of inward legitimization effects of the Wagner Act, see Katherine Stone, *The Structure of Post-War Labor Relations*, 11 N.Y.U. REV. L. & SOC. CHANGE 125 (1982-83) and Craig Becker, *Democracy in the Workplace: Union Representation Elections and Federal Labor Law*, 77 MINN. L. REV. 495 (1993).

278. 29 U.S.C. §§ 151-69 (1935).

279. *United Steelworkers v. Enter. Wheel & Car Corp.*, 363 U.S. 593 (1960); *United Steelworkers v. Warrior & Gulf Navigation Co.*, 363 U.S. 574 (1960); *United Steelworkers v. Am. Mfg. Co.*, 363 U.S. 564 (1960).

280. *Warrior*, 363 U.S. at 578-80 (emphasis added).

281. INDEPENDENT STUDY GROUP FOR THE COMMITTEE FOR ECONOMIC DEVELOPMENT, *THE PUBLIC INTEREST IN NATIONAL LABOR POLICY* 32 (1961), cited in ARCHIBALD COX ET AL., *LABOR LAW* 571 (8th ed. 1977), cited in Stone, *Post-War Paradigm*, *supra* note 277, at 1576.

282. Karl E. Klare, *Critical Theory and Labor Relations Law*, in *THE POLITICS OF LAW: A PROGRESSIVE*

bargaining and grievance procedures for workers to attempt to secure basic improvements in their lives helped cement acceptance of the compromise.<sup>283</sup>

A broader claim was also made for the industrial relations system. Figures like John Dunlop, George Schultz, and Clark Kerr argued more or less explicitly that it provided a base for the vision of liberal pluralism they felt was essential to govern industrial society. In the view of these "strong IR" figures, modern industrial capitalism was a world where competing centers of power—labor, government, and business—each had a legitimate role in broader political and social life. Thus, a more formalized tripartite relationship was the stabilizing core of a system that allowed the rapid change and development, inherent in capitalism's waves of "creative destruction," to take place without triggering radical or destructive reactions. Clark Kerr, for example, wrote of

the contribution of the unions to a sense of consensus in industrial society, to the sense that the rules and rewards are just and acceptable, and to how they thus lead to social tranquility . . . . [T]he overall impact of unionization has been to contribute to a sense of fair play, a sense of acceptance of the arrangements of industrial society.<sup>284</sup>

This is not just a matter of appearances. The basic building blocks of an active and democratic labor movement are the right to organize, the right to bargain collectively, and the right to strike. These rights run parallel to basic political rights found in general social life—the right to assembly, the right to freedom of speech, and the right to petition the government for the redress of grievances. Thus, the "common law of the shop floor" runs parallel to democratic governance in society at large.<sup>285</sup> Just as the common law that emerges inside the workplace guarantees that there is some check against arbitrary power in economic life, federal and constitutional structures provide a countervailing force against abuse of power in the polity as a whole, whether as checks on the assumption of power by a single individual or unrestricted abuse of majoritarianism. In fact, there is an essential link between these two parallel processes that explains the fact that with the exception of authoritarian or totalitarian societies, labor movements inevitably become involved in political activity. There is a reciprocal relationship between the expression of civil liberties inside a workplace and in society at large. A vibrant and effective trade union is impossible to sustain as an island of freedom in a sea of authoritarianism. The right to organize, for example, depends vitally on the freedom of speech. Thus, to preserve their successes at the workplace, labor unions must also continually defend civil liberties in the outside political realm. Conversely, those in society at large who value civil liberties recognize their importance inside the workplace as well. Thus, in recent years, human rights organizations like Amnesty International and Human Rights Watch have paid increasing attention to labor rights issues. The existence of a vibrant trade

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CRITIQUE 539, 561 (David Kairys ed., 1998); Karl E. Klare, *Judicial Deradicalization of the Wagner Act and the Origins of Modern Legal Consciousness, 1937-1941*, 62 MINN. L. REV. 265 (1978).

283. But see Stone, *Post-War Paradigm*, *supra* note 277, at 1577 (Industrial relations system suffers from an "antinomy" such that "the more successful the theory [of industrial pluralism] is as a tool of manipulation, the less tenable it is as a mode of legitimation.").

284. CLARK KERR, MARSHALL, MARX AND MODERN TIMES: THE MULTI-DIMENSIONAL SOCIETY 48 (1969).

285. Diamond, *Labor Rights*, *supra* note 277.

union movement, then, is often a litmus test for a country's progress towards democracy and freedom. This is the substance of the "pluralism" of the Industrial Relations era. The value we place on a *process* of "deliberative and pluralistic decision-making"<sup>286</sup> is central to the legitimization of the outcomes of that decision-making.

For De Angelis, this perspective on the role of trade unions is a difficult one to comprehend. He views the new trade union movement of the 1930s not as an adversarial effort to represent the interests of workers, but as bodies "institutionaliz[ed] by the state . . . to control the grass-roots . . ."<sup>287</sup> Of course, if this were an accurate description, it would not have been possible for the unions to play the role that Kerr describes. Only an organization that has some legitimacy with its own membership could have engaged in the compromises he describes and survive.<sup>288</sup> Nor would an institution whose only role was to impose outcomes negotiated in smoke filled back rooms on a compliant rank and file be able to animate the wider activity of that same rank and file in general political and social life, as the "strong IR" view suggests was the case. The labor movement must inevitably wrestle with its need to confront employers and, on occasion, the state, in order to win material improvements for its membership while simultaneously remaining concerned with survival in a persistently hostile environment. This is not a dynamic that De Angelis seems to understand. In one sense, Kerr and De Angelis are flip sides of the same coin, with Kerr hoping for the integration of the trade unions into a wider capitalist apparatus, and De Angelis thinking the deed has been done. De Angelis mistakes the more conservative pronouncements of some trade union officials for the actual labor movement itself.<sup>289</sup> Kerr, at least, would acknowledge the existence of an adversarial relationship, while De Angelis at the end of the day cannot see this as a realistic phenomenon. That is why he cannot see any role for the adversarial process in creating legitimacy in the Keynesian era.

If the transition from a collective bargaining dominated system to one where global capital markets play a central role preserves the disciplinary function still so crucial to modern capitalism, it has left behind the central legitimating impact of the sophisticated

286. Jonathan Turley, *Dualistic Values in the Age of International Legisprudence*, 44 HASTINGS L.J. 185, 186 (1993).

287. DE ANGELIS, *supra* note 248, at 49. De Angelis is not alone in this view of the emergence of the modern American labor movement in the 1930s. De Angelis' perspective is not simply that of an obscure Italian commentator, though it echoes the views of figures like Antonio Negri who helped found the "autonomist" tradition with which De Angelis is affiliated. An echo of this viewpoint is found in the United States in the work of Staughton Lynd and others. See "WE ARE ALL LEADERS"—THE ALTERNATIVE UNIONISM OF THE EARLY 1930s (Staughton Lynd ed., 1996).

288. It is true that Kerr's view is an exaggeration of trends. Kerr always fancied himself a far-sighted analyst of emerging tendencies in modern capitalism. The most insightful criticism of Clark Kerr can be found in HAL DRAPER, *THE MIND OF CLARK KERR* (1964). This short book grew out of a series of lectures by Hal Draper, delivered to students at Kerr's own University of California at Berkeley just prior to the breakout there of the Free Speech Movement that would end Kerr's career.

289. A classic example is De Angelis' misreading of the labor movement's no strike pledge in World War II. While made formally by labor officials, it was broken on a regular basis by many local unions in both the AFL and CIO, most notably by the coal miners, the machinists in defense plants, and some autoworkers locals. Despite the tension between these layers *within* the trade union movement itself, De Angelis sees the unions as a monolith "subordinating the interests of the rank and file to those of 'the country.'" DE ANGELIS, *supra* note 248, at 58. This view is echoed in the work of Lynd, *supra* note 287. *But see* NELSON LICHTENSTEIN, *LABOR'S WAR AT HOME: THE CIO IN WORLD WAR II* (1982) (discussing deep dissent in CIO over the pledge).

system of process generated by industrial relations. The missing element in today's environment is precisely what figures like Clark Kerr thought was so crucial about the earlier framework—the institutions that developed “a sense of consensus.” Kerr went even so far as to suggest that unions’ ability to help generate this consensus “may well be their one great justification. It is easier to get the appearance of economic justice than to be certain about its reality—and the unions give the appearance.”<sup>290</sup> While many may argue with Kerr’s suggestion about the actual impact of unionization, there can be little argument that this contribution to “consensus” is absent in the era of globalization. Unions still exist, of course, but they have suffered significant losses in the face of rapid technological change fed by the emergence of new global labor markets. No institutional framework remotely comparable to that of the Keynesian era exists to mediate class conflict over the process of economic development. Instead, unforgiving global capital markets force reluctant players into line, but with little or no opportunity for impacted social groups to debate or engage decision makers. Instead of constructive dialogue and conscious planning of economic activity that addresses the entire social cost of rapid economic change, those most intimately impacted by such change are often left with only violence or apathy as a way out. This takes a very mild form in the United States, for the time being,<sup>291</sup> but it is altogether different in many parts of the world.

Thus, there is no sense emerging that this is a system committed to what Kerr called a “sense of fair play.” Quite the opposite, in fact, as a broad sector of the population in both advanced and developing countries have begun to express their view that the new era is an intensely unfair one. This was manifested most openly at the demonstrations against the World Trade Organization in Seattle in 1999. The protests there ranged across the political and social spectrum, including both middle class environmentalists and working class trade unionists. Thus, this *legitimation deficit* suggests the emergence of a vacuum in social and political life. Whether it will be filled by regulation, or altered private behavior, or open social conflict, or perhaps all three is not yet clear. But the anti-globalization/pro-globalization divide is not simply about the division of spoils, not simply about the fights between winners and losers, it is also about power—power to influence, power to participate, power to debate. This concern with power is the emerging content of process in the anti-globalization era. The possibility that this content will be shaped by destructive conflict or even reactionary or fundamentalist movements is what leads me to suggest the possibility of an emerging PetroChina Syndrome, where social groups with significant concerns about the impact of the new era are locked out of decision-making processes and are forced to turn to more radical solutions. A legal order that promises to protect the general interest but fails to provide accessible, transparent, and accountable mechanisms to generate legitimate outcomes can only be said to be

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290. KERR, *supra* note 284, at 48.

291. While memories of the 1992 riots by African American and Latino residents of south central Los Angeles have begun to fade, the economic and social conditions that, in part, sparked this event have certainly not. See CALIFORNIA LEGISLATURE ASSEMBLY SPECIAL COMMITTEE ON THE LOS ANGELES CRISIS, TO REBUILD IS NOT ENOUGH: FINAL REPORT AND RECOMMENDATIONS OF THE ASSEMBLY SPECIAL COMMITTEE ON THE LOS ANGELES CRISIS (1992), available at <http://www-lib.usc.edu/~anthonya/la/reb/i.htm> (last visited Nov. 4, 2003) (arguing that “like other urban conflagrations—from Watts to Miami—the 1992 Los Angeles Crisis was sparked by a single incident, yet rooted in grievances and tensions which had accumulated for years” and that “economic troubles only exacerbated the tensions tearing at the heart of Los Angeles”).

suffering a legal pathology.

### VIII. CONCLUSION

The PetroChina Campaign represented an important and innovative first step in the constructive forging of a genuinely legitimate new world order, and thus is evidence of that pathology but also points to its resolution. By its tactics, agenda, and choice of methods, it sent a strong signal about the inadequacies of the current neo-liberal regime. It represented the emerging outline of a new model of global economic development. On a tactical level, it chose to bring politics into the capital markets where they are manifestly unwelcome. Thus, it forced the recognition of the political impact and relevance of those markets. The capital markets can no longer be seen, as Alan Greenspan would prefer, as simply passive intermediaries between savers and investors. They are inherently political because they impact social outcomes. But they violate the fundamental precepts of a legitimate political order. They provide no institutional mechanism to hold them accountable for their impact. What the PetroChina Campaign illustrated was that the normal mechanisms that are supposed to guarantee the so-called “integrity” of the markets broke down when they attempted to digest the mix of an authoritarian economy with a democratic one. The PetroChina IPO represented an attempt to impose a particular social and economic order that corresponds to the needs of those few with the resources and ability to take advantage of those markets. The fact that the Chinese regime was forced to bring an abrupt halt to its global capital markets strategy indicates the effectiveness of the tactical choice to intervene in those markets made by the Campaign.

The agenda of the Campaign grew largely out of the range of issues raised by the “new internationalism” fostered by the Sweeney Administration at the AFL-CIO, but it was also reflective of the efforts of many NGO’s in the human rights and environmental activist communities. In what are likely to be only fortuitous circumstances linked to China’s particular political history, the agenda was fortified by the presence of conservative religious groups concerned about religious freedom. But even among conservatives there is a growing concern about the impact that neo-liberal globalization is having on traditional ways of life.<sup>292</sup> The agenda expanded into arguments about the appropriate forms of corporate governance in the new era. In the post-Enron environment, such a concern looks remarkably prescient. Thus, it can be fairly said that in a single effort, the Campaign raised awareness of some of the most significant dimensions of the globalization process. In many ways, the Campaign is an echo of the efforts by organizers like Walter Reuther and A.J. Muste in the early 1930s to call attention to the social costs of the new-market driven industrial order. A similar effort was made by figures like the future Justice Brandeis and labor activists Florence Kelley and Rose Schneiderman in the Progressive movement of the early twentieth century to battle sweatshops and harsh conditions in the workplace.

Finally, in its choice of methods—addressing its concerns first to the stewards of the retirement assets managed by large institutional investors, and then to regulators—the

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292. The most articulate and palatable of such perspectives is JOHN GRAY, *FALSE DAWN: THE DELUSIONS OF GLOBAL CAPITALISM* (1998).



Campaign found a new way to press for progressive reform. Institutional investors are significant new players in the global economy. They are becoming aware of the weight of that responsibility, and cannot afford to hide behind narrow definitions of “fiduciary duty” while their assets are manipulated by Wall Street fund managers and investment banks at significant cost to the values and goals of the fund beneficiaries, American workers. Using the power and influence of these institutions to force the Securities and Exchange Commission to acknowledge the importance of the Campaign’s agenda to investors, as the Commission did with the issuance of the Unger Letter, represents a small but notable step in response to the legitimation deficit created by the globalization process.

The outcome of this process cannot be predicted. What can be recognized and accepted, however, is that we are confronting an entirely new set of problems. In the past, for example in the era of Holmes or Douglas, constructive and progressive responses to such problems have emerged by first recognizing that a problem exists, and, second, by asking, through research and argument, what the real dimensions of that problem are. Only then can we move to constructive institution building that helps resolve the problems. The emergence of the PetroChina Syndrome can be seen as a social variant of the miner’s canary—warning us that there is, indeed, the possibility of an explosion.

#### IX. POSTSCRIPT

Late in the night on December 23, 2003, a natural gas well owned by PetroChina and operated by CNPC burst, and sent a cloud of toxic gas over the countryside in Chongqing in southwestern China.<sup>293</sup> In what Chinese media called a “zone of death,” at least 243 people died while hundreds more suffered skin burns and poisoning.<sup>294</sup> Within a few days, the New York Times reported that the Chinese government admitted that CNPC “cut corners” including not having the right safety equipment on site, improperly dismantling equipment needed to prevent such a blowout and waiting hours to ignite the gas in order to prevent its deadly spread to the surrounding area.<sup>295</sup> The Times noted that “China also forbids workers to organize independent unions that might make safety a higher priority.”<sup>296</sup>

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293. *China Gas Blast Death Toll Rises* (BBC News television broadcast, Jan 5, 2004).

294. *Id.*

295. Joseph Kahn, *China Blames State-Owned Company in Gas Blast*, N.Y. TIMES, Jan. 4, 2004, at 3.

296. *Id.*