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Private securities litigation in China: Passive people's courts and weak investor protection

Abstract

This article addresses remedies for defrauded public investors in the Chinese legal system and the passive attitude of China's courts to private securities litigation. Despite the existing laws in China prohibiting securities fraud, the absence of an efficient enforcement regime leaves shareholders vulnerable to a wide range of abuses. Weak legal remedies for victims of securities fraud, especially poor law enforcement and judicial governance, have led to a waste of judicial resources. In particular, China's courts have adopted a passive attitude to securities disputes (typically prior to 2003, when the courts were absent in dealing with private securities actions), although this situation is changing gradually. This article analyses procedural reforms such as shareholders' derivative actions, class actions and shifting evidential proof for defendants. Judicial practices in securities fraud, including false statements, market manipulation and insider trading, are also addressed. This article then highlights the importance of establishing an active and independent system of legal enforcement for the protection of investors. In conclusion, it suggests introducing class actions, the inversion of the burden of proof and facilitating private remedies for individual shareholders by enhancing judicial review, judicial independence and judicial governance.

Keywords

private securities litigation, investor protection, judicial governance

PRIVATE SECURITIES LITIGATION IN CHINA: PASSIVE PEOPLE'S COURTS AND WEAK INVESTOR PROTECTION

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ABSTRACT

This article addresses remedies for defrauded public investors in the Chinese legal system and the passive attitude of China's courts to private securities litigation. Despite the existing laws in China prohibiting securities fraud, the absence of an efficient enforcement regime leaves shareholders vulnerable to a wide range of abuses. Weak legal remedies for victims of securities fraud, especially poor law enforcement and judicial governance, have led to a waste of judicial resources. In particular, China's courts have adopted a passive attitude to securities disputes (typically prior to 2003, when the courts were absent in dealing with private securities actions), although this situation is changing gradually. This article analyses procedural reforms such as shareholders' derivative actions, class actions and shifting evidential proof for defendants. Judicial practices in securities fraud, including false statements, market manipulation and insider trading, are also addressed. This article then highlights the importance of establishing an active and independent system of legal enforcement for the protection of investors. In conclusion, it suggests introducing class actions, the inversion of the burden of proof and facilitating private remedies for individual shareholders by enhancing judicial review, judicial independence and judicial governance.

I INVESTOR PROTECTION IN CHINA: 'A RIGHT WITHOUT ADEQUATE REMEDY'?

China's People's Courts play a weak role in protecting securities investors. Prior to 2002, there was almost no private securities litigation in China.¹ The Judicial Interpretations on false statements,² enacted by the Supreme People's Court in 2002³

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¹ Before 2002, China's courts usually did not accept any civil actions concerning securities disputes brought by individual shareholders, even if there were a few suits from the 1990s to early 2000s.

² Judicial interpretation refers to a formal interpretation made by the Supreme People's Court. According to Article 33 of 《中华人民共和国人民法院组织法》 [*Organic Law of the*

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and 2003,⁴ made civil compensation available for securities fraud. Nevertheless, public investors were not allowed to litigate two other kinds of securities fraud — market-price manipulation and self-dealing — until the end of 2007. The first civil action concerning market manipulation was concluded in May 2012.⁵ The first private litigation concerning insider trading was filed in 2008 but only a few such cases were tried by 2013.⁶

This article addresses the passive attitude of China's courts to securities litigation. Part I reviews the *status quo* of weak law enforcement regarding private securities litigation in China. Part II analyses the wide use of settlement in securities disputes

People's Courts of the People's Republic of China] (People's Republic of China) National People's Congress, 9 February 1983; the 'Supreme People's Court gives interpretation on questions concerning specific application of laws and decrees in judicial proceeding'. The Supreme People's Court exercises supervision over the application of the judicial interpretation of the local People's Courts at various levels and its judicial interpretations are binding on the trial work of all local People's Courts. In practice, judicial interpretation is important to the trials of local courts, which may not accept certain category of cases if the Supreme People's Court has not issued corresponding judicial interpretation.

³ 最高人民法院于受理证券市场因虚假陈述引发的民事侵权纠纷案件有关问题的通知》 [The Notice of the Supreme People's Court on the Relevant Issues concerning the Acceptance of Cases of Disputes over Civil Tort Arising from False Statement in the Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002.

⁴ 最高人民法院于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market] Supreme People's Court, 9 January 2003.

⁵ 余以墨[Yimo Yu], 《操纵市场民事赔偿盼望司法解释》 [Judicial Interpretation Is Expected for Civil Compensation Concerning Market Manipulation] (30 May 2012) 投资快报 [Investment Express] <<http://stock.jrj.com.cn/2012/05/30000013304709.shtml>>.

⁶ 申屠青南[Qingnan Shentu], 《首例内幕交易民事赔偿案戏剧收场》 [First Civil Compensation Case of Insider Trading Ended Dramatically] , (8 October 2008) 中国证券报 [China Securities Daily] <http://www.cs.com.cn/xwzx/03/200810/t20081008_1614540.htm> (accessed Nov 9, 2014).

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and institutional barriers to shareholder derivative actions, class actions and the burden of proof. Under the *Securities Law of the People's Republic of China*, (the 'PRC Securities Law') there are three main kinds of securities fraud: false statements; market manipulation; and insider trading.⁷ The law governing these offences, and its application in recent cases, is discussed in Part III. Part IV highlights three factors affecting the judicial governance of private securities litigations in China: the deference of the courts to the defendant administrative party when exercising judicial review in administrative actions; the functions of judicial interpretations in securities disputes; and the lack of judicial independence. In order to enhance judicial governance of securities litigation in China, Part V suggests the introduction of class litigation and the facilitation of private remedies for individual shareholders.

A *The Courts' Weak Role*

In China, the courts generally adopt a passive attitude to private securities litigation. During the first decade of China's stock market,⁸ China's courts took an extremely conservative attitude to securities litigation. In September 2001, the Supreme Court even issued a notice (the '2001 Notice') to all courts refusing securities actions.⁹ From 1991 to 2001, individual investors who suffered as a result of false statements and market manipulation could rarely seek a legal remedy through judicial enforcement.

⁷ Art 69-72, 《中华人民共和国证券法》 [*Securities Law of the People's Republic of China*] (Republic of China) National People's Congress, 29 December 1998, amended in 2004, 2005, 2013 and 2014.

⁸ The two stock exchanges in China, the Shanghai Stock Exchange and Shenzhen Stock Exchange, were established in 1991.

⁹ On September 21, 2001, the Supreme People's Court issued 'Notice of the Supreme People's Court on Refusing to Accept Civil Compensation Cases Involving Securities For the Time Being (No. 406 [2001])' (《最高人民法院关于涉证券民事赔偿案件暂不予受理的通知》[2001]第406号). This notice states: 'The capital market of our country has been in the phase of normalization and development and many problems have emerged, such as insider trading, frauds, rigging the market and other acts. These acts have damaged the fairness of the securities exchanges, infringed upon the legal rights and interests of the investors, affected the safe and healthy development of the capital market, and shall be normalized step by step. At present, these new situations and new problems that deserve attention and study have emerged in the courtroom, but due to the limitation of the legislative and judicial conditions of the present time, it is not time to accept and try this kind of case. So it is decided after deliberation that the civil compensation cases caused by the acts mentioned above shall be denied temporarily.' This Notice was repealed by the Supreme People's Court on April 8, 2013.

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In the few cases filed in the first trial courts in China, no investor won a case. For example, in the first trial of *Zhongmin Liu v Tianjin Bohai Chemical Industry Group*,¹⁰ the Shandong Province Jinan Municipal Lixia District People's Court overruled the claim of the plaintiff on the grounds of 'inadequate evidence'.¹¹ In 1998, the Shandong Province Jinan Intermediate Court affirmed the first trial.¹² This case might have been the first securities civil action officially filed with the court after China launched its securities market in 1990. In *Shunzhen Jiang v Chengdu Hong Guang Industry Co, Ltd*,¹³ the investor plaintiffs lost again.¹⁴ From 1990 to 2001, thousands of victims were refused civil compensation by the judicial system.

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- ¹⁰ 刘中民诉渤海集团股份有限公司虚假陈述股票交易损失赔偿纠纷案》[*Zhongmin Liu v Tianjin Bohai Chemical Industry Group – False Statement Compensation Dispute Case*], 山东省济南市历下区人民法院 [Shandong Province Jinan Municipal Lixia District People's Court, People's Republic of China], 历经初字第 722 号[Economic Case No 722], 1996.
- ¹¹ 张海波[Haibo Zhang], 《谁是向上市公司索赔第一人 赔偿历程可前移》[*Who is the First Plaintiff to Sue Listed Companies; The History of Securities Civil Compensation Should Date Back*] (19 December 2002) 新浪财经[Sina Finance] <<http://finance.sina.com.cn/t/20021219/1301292060.shtml>>.
- ¹² 刘中民诉渤海集团股份有限公司上诉案》[*Zhongmin Liu v Tianjin Bohai Chemical Industry Group – False Statement Dispute Appeal Case*], 山东省济南市中级人民法院[Shandong Province Jinan Intermediate People's Court], 济中经终字第 41 号[Economic Appeal No 41], 1998. See 邹光祥 [Guangxiang Zou], 资本危与机之二：证券民事赔偿忽然提速》[*The Capital Crisis II: Securities Civil Compensation Suddenly Speeds Up*] (29 December 2002) 21 世纪经济报道 [21 Century Economic Report] <<http://finance.sina.com.cn/roll/20021229/2209296070.shtml>>.
- ¹³ 姜顺珍诉 PT 成都红光实业股份有限公司》[*Shunzhen Jiang v Chengdu Hong Guang Industry Co, Ltd – False Statement Dispute Case*], 上海市浦东新区人民法院 [Shanghai Municipal Pudong New Area People's Court], 浦经初字第 3964 号[Economic Case No 3964], 1998.
- ¹⁴ In the case of *Shunzhen Jiang v Chengdu Hong Guang Industry Co Ltd*, the plaintiff Ms. Jiang brought a lawsuit of false statement against the Chengdu Hong Guang Industry Co Ltd on December 4, 1998. The Shanghai Municipal Pudong New Area People's Court made a verdict to dismiss this lawsuit in April 1999. See 张海波[Haibo Zhang], 《第一章：法院大门迟迟不开 股民索赔一波三折》[*Chapter One: The Court's Gates Are Closed; It's Difficult for Securities Investors to Claim for Compensation*] (12 November 2012) 搜狐财经 [business.sohu.com] <<http://business.sohu.com/66/06/article204280666.shtml>> (accessed Nov 8, 2014).

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In this respect, the *Notice of the Supreme People's Court on Issues Concerning the Acceptance of Civil Compensation Cases Arising from False Statements in the Securities Market* (2002) (the '2002 Notice') is a landmark development.¹⁵ The 2002 Notice opened the door to civil compensation for the victims of securities frauds in China. The 2002 Notice made civil actions concerning false statements admissible with pre-action administrative penalties enforceable by the China Securities Regulatory Commission ('CSRC').¹⁶ On 9 January 2003, the Supreme Court issued the *Notice of Certain Issues on the Admission of Civil Tort Dispute Cases Concerning False Statements in the Securities Market* (2003) (the '2003 Judicial Interpretation'). The 2003 *Judicial Interpretation* came into effect on 1 February 2003 and further developed a trial basis for Chinese courts dealing with civil litigation concerning false statements related to securities.

The lack of provisions creating legal liabilities for securities torts in both the *PRC Company Law* and the *PRC Securities Law* has clearly increased difficulties in the trial of private securities litigation, and these difficulties have been exacerbated by procedural issues associated with the burden of proof and the acceptance of cases.¹⁷ The consequences of violating the *PRC Securities Law*, which are set out in 36 articles in the 2004 Amendment¹⁸ and 48 articles in 2005 and 2014 Amendments,¹⁹ include criminal liabilities, administrative sanctions, administration fines and civil liability. As a matter of fact, only one article concerns civil compensation. It states: 'Where anyone violates the present Law and shall be subject to civil liabilities of compensation and payment of fines and penalties, and if his properties are not sufficient to cover all the payment at the same time, he shall bear civil liabilities.'²⁰ In

¹⁵ See 《最高人民法院关于受理证券市场因虚假陈述引发的民事侵权纠纷案件有关问题的通知》 [Notice of the Supreme People's Court on Issues Concerning the Acceptance of Civil Compensation Cases Arising from False Statements in the Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002.

¹⁶ China Securities Regulatory Commission (CSRC) is the regulator of China's securities and futures markets. The commission is authorised by the State Council to regulate China's securities and futures market.

¹⁷ 李国光[Guoguang Li], 《在上海投资者保护国际研讨会上的讲话》 [Speech on Practices, Problems and Prospect of China's Securities Litigation at the International Seminar of Investor Protection in Shanghai] (20 June 2002), in 李国光, 贾伟 [Guoguang Li and Wei Jia] ed., 《证券市场虚假陈述民事赔偿制度》 [Civil Compensation System Concerning False Statements on the Securities market] (法律出版社[Law Press], 2002), 264–9.

¹⁸ See art 175–210, the *PRC Securities Law* (1999 and 2004 amendment).

¹⁹ See art 188–235, the *PRC Securities Law* (2005 and 2014 amendments).

²⁰ See art 209, the *PRC Securities Law* (1998, 2004 amendment), and art 232, the *PRC Securities*

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reality, victims of securities fraud were not permitted to file civil cases prior to 2002; even if courts opened the door to civil compensation concerning false statements, the Supreme People's Court set a criminal judgment or an administrative decision as a procedural prerequisite. That is, civil compensation was possibly placed after criminal fines or administrative fines in practice. The 2003 *Judicial Interpretation* made it possible for investors to seek legal remedies for false statements. Later, civil actions concerning insider trading became available for individual victims, although difficulties associated with filing a case and collecting evidence, and the time-consuming nature of successful litigation, have not fundamentally changed due to substantive and procedural flaws in the current system, the often inadequate professional quality of judges and local government interference.²¹ The Supreme People's Court is still drafting judicial interpretations for market manipulation. The CSRC has made administrative decisions concerning cases such as *Yan Jun Chen et al v Zhejiang Hang Xiao Steel Structure Co Ltd*,²² but thousands of victims of affiliated transactions and market manipulation have to wait to begin compensatory lawsuits. Additionally, the Supreme People's Court initiated research on judicial interpretations of the *PRC Securities Law* in 2006.²³

In addition, law enforcement related to securities disputes is still an area of uncertainty in China. According to Pistor and Xu, the more incomplete the law, the more residual legislative rights are allocated between 'lawmaking and law enforcement powers (LMLEP)'.²⁴ When the government has an overwhelmingly strong influence in legislation and law enforcement, the courts have a very limited

Law (2005, 2014 amendment).

- ²¹ 沈丽[Li Shen], 《证券民事赔偿诉讼难的现状及对策》 [*Present Situation and Solutions on Difficulties of Securities Civil Compensation*] (2010) 《南方金融》 [South China Finance] Vol. 5, 66–8 <http://guangzhou.pbc.gov.cn/publish/guangzhou/1355733486627/_fileupload/BAABAA19.pdf>.
- ²² 陈艳军等诉浙江杭萧钢构股份有限公司虚假陈述赔偿纠纷案》 [*Yan Jun Chen et al v Zhejiang Hang Xiao Steel Structure Co, Ltd – False Statement Compensation Dispute Case*], 浙江省杭州市中级人民法院 [Zhejiang Province Hangzhou Municipal Intermediate People's Court], 杭民二初字第 133 号 [Civil Case No 133], 2007.
- ²³ 郭锋[Feng Guo], 《证券欺诈行为民事责任调研报告》 [*The Investigation and Research Report on Civil Liabilities of Securities Fraud*] (27 March 2010) 中国金融服务法治网 [www.financialservicelaw.com.cn] <<http://www.financialservicelaw.com.cn/article/default.asp?id=103>>.
- ²⁴ Katharina Pistor & Chenggang Xu, *Beyond Law Enforcement: Governing Financial Markets in China and Russia* (2004) The University of Hong Kong School of Economics and Finance <http://www.sef.hku.hk/~cgxu/publication/PX_H&T_Chapter%209.pdf>.

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residual enforcement role and cannot operate truly independently if neither the Court nor the judge has independent status. Moreover, interest-driven local governments often influence law enforcement. Local protectionism increases the uncertainty surrounding law enforcement and selective enforcement. Apart from the failure of deterrence,²⁵ important issues related to judicial enforcement in China are selective and inadequate enforcement, and issues related to inefficient and ineffective enforcement in securities civil litigation.

B *Inadequate Enforcement*

Substantial procedural loopholes have impeded minority shareholder remedies. As discussed above, prior to 2002 Chinese courts held a negative attitude towards any kind of civil action concerning securities disputes brought by individual shareholders, even if there were a few lawsuits from the 1990s to early 2000s. On 21 September 2001, the Supreme People's Court issued a *Notice on Temporarily Suspending Acceptance Cases Concerning Securities Civil Compensation*. The 2001 Notice required that securities actions relating to civil compensation not be filed in any Chinese court. The Supreme People's Court issued the *Notice of Certain Issues on Civil Tort Disputes Arising from False Statement in Stock Market* on 15 January 2002, but this notice only required the acceptance of certain cases. On 9 January 2003, the Supreme People's Court issued another *Notice of Certain Issues on the Admission of Civil Tort Dispute Cases Concerning False Statements in the Securities Market* and started to accept private securities disputes concerning false statements of listed companies in 2003. In theory, since the end of 2007, the People's Courts have started to accept all three kinds of securities fraud in China: false statements, market-price manipulation and self-dealing. However, in practice, procedural obstacles make it difficult for individual plaintiffs to file stockholder suits in the courts. First, there are prerequisites for filing stockholders suits. Either the court's criminal judgment or the CSRC's administrative decision serves as the prerequisite for bringing civil litigation

²⁵ Pistor and Xu, above n 25, have developed a model to show the deterrence failure under the 'incomplete law'. They also set forth tradeoffs concerning allocation residual lawmaking and law enforcement powers among legislatures, courts and regulators. See Katharina Pistor & Chenggang Xu, 'Governing Emerging Stock Markets: Legal vs. Administrative Governance' (2005) 13(1) *Corporate Governance: an International Review* 5, 8. See also Katharina Pistor and Chenggang Xu, 'Incomplete Law - A Conceptual and Analytical Framework and its Application to the Evolution of Financial Market Regulation' (2003) 35 *Journal of International Law and Politics* 931, available at SSRN <<http://ssrn.com/abstract=310588>> or <<http://dx.doi.org/10.2139/ssrn.310588>>.

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concerning securities fraud. In the Supreme People's Court's draft revision of the *PRC Securities Law* in December 2008, it was suggested that these prerequisites be removed.²⁶ Second, class actions are not currently available in securities disputes; hence, the same suit may be dealt with by courts in different jurisdictions. Group actions are available. However, China's group action is different from its class action as the judgment applies only to registered litigants. The third obstacle is the applicable burden of proof. In contrast with the position in the United States, China's courts have not reversed the onus of proof in securities disputes, and it is usually difficult for individual shareholders to find enough evidence to support their claims. Fourth, shareholder derivative actions have been accepted by the courts, but not widely used. Fifth, securities arbitrations are restricted to disputes between members of securities exchanges, or between the securities exchange and its members, but not to individual securities disputes.

On the other hand, 'tunneling' was pervasive in China's listed companies,²⁷ especially controlling shareholders tunneling and misappropriating assets and resources out of companies.²⁸ However, victims of securities fraud have only received limited compensation in the past civil actions. In 2002, the CSRC investigated all companies listed on the Shanghai Stock Exchange and Shenzhen Stock Exchange. The results demonstrate that the total amount of misappropriated capital by controlling shareholders was ¥96.7 billion,²⁹ which was almost equal to the sum of refinancing

²⁶ 王光平[Guangping Wang], 《证券法司法解释建议取消证券民事诉讼前置程序》[*The Judicial Interpretation on Securities Law Suggests to Remove Procedural Prerequisites of Private Securities Action*] (9 December 2008) 中国证券报 [*China Securities Daily*] <<http://finance.sina.com.cn/stock/y/20081209/03515608178.shtml>> (accessed Nov 7, 2014).

²⁷ 'Tunneling', also referred to as 'self-dealing' or 'investor expropriation' is defined by Johnson *et al* (2000) as 'the transfer of resources out of a company to its controlling shareholder'. See Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 'Tunneling' (2000) 90(2) *The American Economic Review* 22, 22-3. Aside from the 'tunneling of assets and profits', tunneling may also be realised through the 'taking of corporate opportunities'; 'executive perquisites to excessive compensation'; 'over-investment in pursuit of growth'; 'private benefits of control'; 'transfer pricing' and 'expropriating minority shareholders through financial transactions'. See also Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, 'The Law and Economics of Self-Dealing' (2008) 88(3) *Journal of Financial Economics* 430, 430.

²⁸ 午言 [Yan Wu] 《人民日报：股民事事赔偿何时不再难》[*People's Daily: When Will Securities Civil Compensation Be No Longer Difficult*] (1 August 2011) 人民日报 [*People's Daily*] <http://news.xinhuanet.com/finance/2011-08/01/c_121752732.htm> (accessed Nov 5, 2014).

²⁹ The CSRC made a survey of 1,175 listed companies at the end of 2002 and found that

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capital raised from both A-share and B-share markets in that year.³⁰ Although the CSRC enhanced monitoring measures to prohibit controlling shareholders from illegally misappropriating the capital of listed companies, the numbers were still ¥57.7 billion in 2003, ¥50 billion in 2004, and ¥48 billion by June 2005.³¹ In the first six months of 2006, the amount of capital misappropriated by controlling shareholders was ¥31.57 billion in 147 listed companies (including 88 state owned and 59 privately operated listed companies).³² Such misappropriation has seriously affected the business operation of involved listed companies and violated the interests of minority shareholders. However, it would appear that China's public investors suffered losses over and above those identified by the CSRC. It is estimated that less than 10% victims of false statements brought lawsuits and their subject matter amounts accounted for no more than 5% of the total loss.³³

Compared with administrative penalties for securities frauds, civil compensation for individual investors is quite low. It has been reported that, as of 2006, twenty listed companies violated securities laws and paid only ¥5,000,000 to nearly 300 investors in civil compensatory actions in China.³⁴ In other words, the average cost for securities frauds in terms of civil compensation was only ¥250,000 for each violation. However, from 1999 to 2002 the CSRC conducted 192 cases and extended

large shareholders misappropriated ¥96.7 billion in 676 listed companies. See 谢卫军 [Weijun Xie], 《从治理结构缺陷透析上市公司道德风险》 [*Analysis on Moral Risk in Listed Companies by Flaws of Corporate Governance*] (19 January 2007) 《商务周刊》 [Business Weekly] <<http://finance.sina.com.cn/stock/t/20070119/13173263795.shtml>>.

³⁰ Refer to statistic data of CSRC, <<http://www.csrc.govcn>>. The total amount of traded market value was about ¥1.25 trillion in 2002; the sum of raised capital was ¥96.138 billion.

³¹ 余珂 [Ke Yu], 《证监会副主席重申年内解决上市公司资金占用问题》 [Vice President of CSRC Readdresses to Solve the Capital Misappropriation of Listed Companies in the Year of 2006] (28 February 2006) 《经济日报》 [Economic Daily] <http://www.govcn/jrzg/2006-02/28/content_213113.htm> (accessed Nov 12, 2014).

³² 严整 [Zheng Yan], 《上市公司利益冲突研究》 [*Study on the Conflict of Interest in Listed Companies*] (PhD Thesis, Southwest University of Finance & Economics, 2007) 91.

³³ 刘俊海, 宋一欣 [Junhai Liu and Yixin Song] ed, 《中国证券民事赔偿案件司法裁判文书汇编》 [*The Court's Judgments Collection of Civil Compensation Cases in Securities in China*] (北京大学出版社 [Peking University Press], 2013), 20.

³⁴ 王璐 [Lu Wang], 《[最新统计显示造假上市公司违规成本仅 25 万元]》 [*The Latest Statistics show that the Fraud Violation Costs of a Listed Company is only ¥250,000 on average*] (30 April 2006) 《上海证券报》 [Shanghai Securities News] <<http://finance.people.com.cn/BIG5/1039/60370/60417/60429/4343815.html>>

administrative penalties to 92 cases, in which penalties totaled ¥1,490,000,000.³⁵ It is clear that actual civil compensatory penalties related to securities were lower than compensation in judgments and far lower than administrative penalties. Considering the inadequacy of judicial enforcement, it is easy to understand the existence of pervasive securities fraud in China's stock markets in the 1990s and early 2000s.

C Selective Enforcement

Selective enforcement means that executors of the law exercise discretion as to which laws to enforce, the extent of enforcement, and whether to enforce the ruling after trial. From 1991 to 2007, the People's Courts were selective in filing a case concerning securities torts. After 2002, the courts shifted from refusing false statement torts to conditionally accepting such cases. One notable aspect of selective enforcement is to set up a procedural prerequisite that prevents investors from bringing civil actions until the CSRC has made a decision concerning suspected securities fraud. This administrative decision forms both a compulsory precondition to the filing of a securities action and the factual basis for the relevant lawsuit.³⁶ The 2005 amended *PRC Securities Law* added that undertaking insider trading or market manipulation and causing losses to investors shall be grounds for liability to pay compensation.³⁷ For this reason, the courts started to conditionally accept such cases after 2007. That is, the procedural prerequisite still applied to civil compensation of insider trading and market manipulation.

It is not difficult to find further instances of selective enforcement in various areas of securities disputes, ranging from filing securities litigations, to applying laws and regulations, to undertaking investigations by the court, to executing post-action judgments. Huang examined Chinese courts' selective system of financial disputes and found that Chinese courts had screened cases through formal legal rules and informal rules on account of 'incomplete law', the incapacity of courts to react to changing financial markets and the political consideration of maintaining social

³⁵ 邹光祥[Guangxiang Zou], 《资本危与机之二：证券民事赔偿忽然提速》[*The Capital Crisis II: Civil Compensation of Securities Litigation Suddenly Speeds up*] (29 December 2002) 21st Century Economic Report <<http://finance.sina.com.cn/roll/20021229/2209296070.shtml>>.

³⁶ 关于受理证券市场虚假陈述案件的通知》[Notice of the Supreme People's Court on Issues Concerning Acceptance of Civil Compensation Cases Arising from False Statement in Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002, art 2.

³⁷ Art 76 and 77, the *PRC Securities Law* (2005 Amendment).

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stability.³⁸ The formal screening rules include setting up litigation limits, such as restraints of acceptance courts, procedural prerequisites and the exclusion of class actions; informal screening rules include various 'local policies' indicating cases not to accept, cases to suspend and cases in which to freeze enforcement.³⁹ Aside from limits on securities torts, disputes of warrants, initial offerings and many shareholder derivative actions were subject to screening.⁴⁰

From the perspective of costs and benefits, when the costs of direct enforcement are extremely high, the enforcer tends to avoid executing the law to the extent possible. According to the Vice-president of the Supreme People's Court, the various shortcomings in securities law, the often-low quality of professional judges, and the potential explosion of securities actions, have encouraged the Supreme People's Court to adopt a very conservative attitude to securities actions, such as setting up a strict procedural prerequisite of securities action.⁴¹ The enforcers were inclined towards selective enforcement to avoid the huge costs of full enforcement. Selective enforcement may 'decrease' the costs of violating securities laws; however, the costs investors incur for legal remedies are extremely high.

D Ineffective Enforcement

China's Supreme People's Court was understandably concerned about the explosion and abuse of 'securities actions'. From 2002 to the beginning of 2004, minority shareholders brought approximately 1000 securities actions.⁴² Even after the

³⁸ 黄韬[Tao Huang], 《中国法院受理金融争议案件的筛选机制评析》[*The Screening Mechanism of Financial Legal Disputes in Chinese Courts*] (2011) 《法学家》[*The Jurist*]

³⁹ Ibid.

⁴⁰ 天津证监局[CSRC Tianjin Branch], 《十年维权路漫漫: 投资者权益保护稳步前行》[*The Long Way in the Last Decade for Civil Compensation Defenders: Investor Protection Is Steadily Approaching*] (10 October 2012) 中国证券监督管理委员会 [China Securities Regulatory Commission] <http://www.csrc.gov.cn/pub/tianjin/xxfw/tjfxjy/tjtzzyqbh/201210/t20121010_215613.htm>.

⁴¹ 李国光[Guoguang Li], 《在人民法院受理证券市场有关民事侵权纠纷案件新闻发布会上的讲话》[Speech at the Press Conference on the People's Courts' Acceptance of Disputes over Civil Torts on the Securities Market] (20 June 2002), in 李国光, 贾纬[Guoguang Li and Wei Jia] ed., 《证券市场虚假陈述民事赔偿制度》[*Civil Compensation System Concerning False Statements on the Securities market*] (法律出版社[Law Press], (2002)) 259-63.

⁴² See 王芳[Fang Wang], 《全国证券索赔案件近千起: 股民如何索赔造假公司》[*There Are Over 1,000 Litigation Concerning Securities Compensation Around the Country: How Can*

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enactment of the 2002 *Notice*, some courts still took a passive attitude to the filing of securities lawsuits. An example is the case of *Zaoding Yan et al v Guang Xia (Yinchuan) Industry Co Ltd*⁴³ After the CSRC levied an administrative penalty for false statements issued by the defendant, only four plaintiffs successfully brought a civil action in the Yinchuan Intermediate Court in July 2002. The court then refused to file more cases on the grounds that these civil actions had to wait for the final decision of the corresponding criminal trial. The other plaintiffs could not file their suits until April 2004. However, in order to avoid or reduce paying civil compensation, large shareholders transferred assets and funds out of the defendant Company from April 2002 to 2004.⁴⁴ In another false statement case, *Xiaomei Cao v Dongfang Electronics Co Ltd*,⁴⁵ the Qingdao Intermediate People's Court filed 2716 cases for 6989 investors in joint and individual actions because class litigation was not allowed.⁴⁶ Since the statute of limitation was only two years, additional plaintiffs only had approximately three months in which to file their cases in court. Many victims lost their opportunity to bring a lawsuit. It ultimately took eight years for plaintiffs to receive compensation though a settlement with defendants.⁴⁷

Unfortunately, in several securities actions, the courts were not inclined to make decisions in favor of the investors. In the case of *Zhongmin Liu v Tianjin Bohai Chemical Industry (Group) Co Ltd*,⁴⁸ the Jinan Intermediate People's Court in Shandong

Shareholders Lodge a Claim Against Companies Making False Statements] (3 May 2004) 北京青年报[Beijing Youth Newspaper] <<http://finance.sina.com.cn/t/20040503/0356748990.shtml>>.

⁴³ 阎皂定等诉广夏(银川)实业股份有限公司》[*Zaoding Yan et al v Guang Xia (Yinchuan) Industry Co, Ltd – False Statement Dispute Case*], 宁夏银川中级人民法院 [Yinchuan Intermediate People's Court, People's Republic of China], 2006.

⁴⁴ Baidu pedia, 《银广夏事件》[*The Event of Yin Guang Xia*] <<http://baike.baidu.com/view/1320425.htm>>.

⁴⁵ 曹小妹等诉烟台东方电子信息产业股份有限公司》[*Xiaomei Cao et al v Dongfang Electronics CoCo, Ltd*], 山东省青岛市中级人民法院[Shandong Province Qingdao Municipal Intermediate People's Court, People's Republic of China], 2007.

⁴⁶ 缪因知[Yinzhi Miao], 《证券诉讼在中国: 适用前景与改进方略》[*Securities Litigation in China: Applying Prospect and Improvement Strategies*] (2012) 《北方法学》[Northern Legal Science] Vol.1

<<http://www.chinalawinfo.com/LawOnline/ArticleFullText.aspx?ArticleId=81922>>.

⁴⁷ 谢嘉晟[Jiasheng Xie], 《我国虚假陈述索赔第一案东方电子案历时 8 年结案》[*The Case of Dongfang Electronics Co Ltd, China's First Claim for False Statement, Took Eight Years to Conclude*] (4 March 2011) 《东南网》[Southeast Net] <http://news.xinhuanet.com/legal/2011-03/04/c_121148252.htm>.

⁴⁸ 刘中民诉渤海集团股份有限公司虚假陈述股票交易损失赔偿纠纷案》[*Zhongmin Liu v Tianjin Bohai Chemical Industry Group – False Statement Compensation Dispute Case*], 山

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Province alleged that there was no causal relationship between the damage to the plaintiff's investment and Bo Hai Group's false statement.⁴⁹ The final judgment of this case⁵⁰ supported the first trial.⁵¹ In this case, both the first trial court and the second trial court made judgments favouring the wrongdoers. The courts did not effectively protect the interests of investors.

Even if some plaintiffs win civil compensatory lawsuits, they are not guaranteed compensation since the decision may not be executed. Difficulty in enforcement and local protectionism are detrimental to efficient post-action implementation. The CSRC did not have the power to take measures on the bank accounts of suspected companies until 2007.⁵² The wrongdoers often make use of the CSRC's investigation period to transfer their assets and illegal earnings out of listed companies. Moreover, the pre-action administrative investigation and payment of administrative penalties usually weaken the payment capability of the defendant listed companies. After paying the administrative penalty, many listed companies either suffer from a sharp fall in stock price or a shortage of funds on account of large shareholders' tunnelling and embezzlement, thus the defendant companies may not have enough money to pay the compensation to individual investor plaintiffs. In the case of *Lihua Chen et al v Daqing Lianyi Petrochemical Co Ltd*,⁵³ it took five years from filing the suit to execution.

东省济南市历下区人民法院 [Shangdong Province Jinan Municipal Lixia District People's Court, People's Republic of China], 历经初字第 722 号[Economic Case No 722], 1996.

⁴⁹ 任自力[Zili Ren], 《中国证券市场违规要案点评》 [Comments on Important Non-compliance Cases over Securities Business in China] (法律出版社 [Law Press], 2002) at 55–60.

⁵⁰ 刘中民诉渤海集团股份有限公司上诉案》 [Zhongmin Liu v Tianjin Bohai Chemical Industry Group – False Statement Dispute Appeal Case], 山东省济南市中级人民法院[Shangdong Province Jinan Intermediate People's Court], 济中经终字第 41 号 [Economic Appeal No 41], 1998.

⁵¹ 刘俊海, 宋一欣[Junhai Liu and Yixin Song] ed., 《中国证券民事赔偿案件司法裁判文书汇编》 *The Court's Judgments Collection of Civil Compensation Cases in Securities in China*, (北京大学出版社 [Peking University Press], 2013), 99–101.

⁵² The CSRC may adopt measures to restrict capital and securities accounts of the suspected parties and other related accounts controlled by the suspected parties to purchase and sell securities when the CSRC investigated the cases concerning insider trading and market manipulation since May 2007. See 中国证券监督管理委员会限制证券买卖实施办法》 [Measures of China Securities Regulatory Commission for Restricting the Purchase and Sale of Securities] (People's Republic of China) China Securities Regulatory Commission, Order No 45, 18 May 2007, arts 2–3.

⁵³ 陈丽华等诉大庆联谊石化股份有限公司》 [Lihua Chen et al v Daqing Lianyi Petrochemical Co Ltd], 黑龙江省高级人民法院 [Heilongjiang Province High People's Court, People's Republic of China], 中华人民共和国最高人民法院公报[Zhong Hua Ren Min Gong He

Even so, plaintiffs may run into difficulty in executing the judgment of civil cases after the trial.⁵⁴ Some plaintiffs who won the case of *Fan Li v Sunfield Science & Technology* did not get full compensation in accordance with the judgments or conciliation documents.⁵⁵ Another reason for ineffective post-action implementation is that China lacks the corresponding mechanisms to guarantee that violators pay civil compensation.

E Inefficient Enforcement

It is obvious that judicial resources have not been fully used in civil compensation. Resources, such as litigation, arbitration, mediation and reconciliation, have not been effectively deployed. In particular, Chinese courts did not accept civil actions concerning false statements until 2002, and Chinese courts did not accept civil actions concerning insider trading and market-price manipulation until 2007. Prior to 2001, only a few cases concerning civil compensation for securities disputes were accepted by courts. Under the *PRC General Principles of the Civil Law*, the statute of limitation of action for private securities litigation is only two years.⁵⁶ Nevertheless, the 2003 *Judicial Interpretation* had no retrospective effect. For example, in *Zaoding Yan et al v Guang Xia (Yinchuan) Industry Co Ltd*,⁵⁷ by the time the 2003 *Judicial Interpretation* was issued victims had less than three months left to file their cases in court. As a result, many victims lost their opportunity to bring a lawsuit.⁵⁸ Arbitration could not be

Guo Zui Gao Ren Min Fa Yuan Gong Bao - Gazette of the Supreme People's Court of the People's Republic of China] 11, 21 December 2004.

⁵⁴ 宣伟华[Weihua Xuan], 《大庆联谊虚假陈述案维权诉讼艰苦 判决后不执行》[*After the Hard Trial of False Statement Compensation in Daqing Lianyi Case, Judgments May Not Be Executed*] (12 October 2006) 中国证券报 [China Securities Daily] <<http://www.grandall.com.cn/newsroom/media-coverage/440.htm>>.

⁵⁵ 李凡诉黑龙江圣方科技股份有限公司诉讼案》[*Fan Li v Sunfield Science & Technology*], 哈尔滨市中级人民法院 [Heilongjiang Province Ha'erbin Municipal Intermediate People's Court, People's Republic of China], 2004. The civil compensation case against *Shengfang Sci & Tech* took 12 years. 刘雯亮[Wenliang Liu], 《民事赔偿 12 年漫漫征途 证券维权团队负重前行》[*A Civil Compensation May Take 12 Years; Securities Rights Team Matched with Heavy Loads*] (11 May 2013) 证券时报网 [Securities Times], <http://epaper.stcn.com/paper/zqsb/html/2013-05/11/content_469550.htm>.

⁵⁶ See art 135, 《民法通则》[the *PRC General Principles of the Civil Law*] National People's Congress, 12 April 1986, amended in 2009 and 2014.

⁵⁷ 阎皂定等诉广厦（银川）实业股份有限公司》[*Zaoding Yan et al v Guang Xia (Yinchuan) Industry CoCo, Ltd – False Statement Dispute Case*], 宁夏银川中级人民法院 [Yinchuan Intermediate People's Court, People's Republic of China], 2006.

⁵⁸ 李鸿友[Hongyou Li], 《ST 银广厦：首批股民向银广厦索赔 500 万》[*ST Yin Guang Xia:*

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adopted as an alternative means of dispute resolution in these cases, as the contracts signed by public shareholder victims did not contain arbitration clauses.

Additionally, securities actions are often time-consuming. For example, it took about five years for the court to deal with the case of *Xiaomei Cao v Dongfang Electronics Co Ltd*,⁵⁹ and it took four years for the courts to deal with the case of *Yang Liu et al v 999 Medical & Pharmaceutical Co Ltd*.⁶⁰ The pre-action procedure for administrative penalties sets another high threshold for bringing a civil securities action. It takes some time for the CSRC to investigate the suspected violators and make its decision, which postpones filing time. The violators may take advantage of this time delay to transfer assets and tunnel listed companies.

As China has not introduced class actions, numerous plaintiffs often file in respect of the same matter. In the case of *Xiaomei Cao v Dongfang Electronics Co Ltd*,⁶¹ the Qingdao Intermediate Court put 2,716 cases on file respectively for 6,989 plaintiffs by January 2005.⁶² All the cases concerned the same false statement of Dongfang Electronics Co Ltd. Considerable time and human resource was wasted on repetitive filings.

First Group of Shareholders Claim for ¥5,000,000] (22 April 2004) 华西都市报 [West China Metropolis Daily] <<http://news1.jrj.com.cn/news/2004-04-22/000000797977.html>> (accessed 16 November 2014).

⁵⁹ 曹小妹等诉烟台东方电子信息产业股份有限公司》[*Xiaomei Cao et al v Dongfang Electronics CoCo, Ltd*], 山东省青岛市中级人民法院 [Shandong Qingdao Municipal Intermediate People's Court, People's Republic of China], 2007. This case lasted from February 8, 2003 to August 25, 2007. 中国证券投资者保护网[SIPF], 《东方电子虚假陈述赔偿案》[*The Civil Compensation Case of Dongfang Electronics Co Ltd regarding False Statement*] (24 October 2009) 中国证券投资者保护网 [WWW.SIPF.COM.CN] <<http://www.sipf.com.cn/NewCH/qybh/10/47748.shtml>>.

⁶⁰ 刘洋等诉三九医药股份有限公司虚假陈述民事赔偿案》[*Yang Liu, et al v 999 Medical & Pharmaceutical CoCo, Ltd*], 广东省深圳市中级人民法院 [Guangdong Province Shenzhen Municipal Intermediate People's Court, People's Republic of China], 深中法民二初字第151号 [Civil Case No 151], 15 November 2004.

⁶¹ 曹小妹等诉烟台东方电子信息产业股份有限公司》[*Xiaomei Cao et al v Dongfang Electronics CoCo, Ltd*], 山东省青岛市中级人民法院 [Shandong Qingdao Municipal Intermediate People's Court, People's Republic of China], 2007.

⁶² 岳敬飞[Jingfei Yue], 《东方电子换帅 律师抛'橄榄枝'》[*The Dongfang Electronics Company Changes Its Management and Attorneys Put out the Olive Branch*] (24 November 2006) 中国证券网 [China Stock Net] <http://big5.xinhuanet.com/gate/big5/www.cnstock.com/stock315/2006-11/24/content_1665024.htm>.

Another relevant aspect is the professional skill and experience of Chinese judges. These judges often lack the expertise necessary to deal with securities cases.⁶³ So far there have been few precedents for use in Chinese legal practice. There have been numerous cases in common law systems to refer to, but judges are usually not familiar with those precedents. It may take considerable time for judges to resolve basic legal techniques. Judges need to gain experience to handle various complicated issues such as the confirmation of causal relationships, the calculation of damages, and joint litigation.

Moreover, many judgments are not efficiently implemented.⁶⁴ Conflicts between administrative remedies and civil compensation often result in inefficient enforcement. In circumstances where the defendant listed company does not have the assets to pay criminal fines, administrative penalties and civil compensation to plaintiffs, the defendant shall bear civil liability and pay civil compensation first under the *PRC Securities Law*.⁶⁵ However, in reality, violators may not be able to pay both civil compensation and administrative penalties at the same time. In such cases, since an administrative decision is prerequisite to a corresponding civil action, administrative penalties have procedural priority over the civil compensation.⁶⁶ To rectify the situation, it would be necessary to establish a corresponding payment mechanism or specific funds for post-action enforcement that would ensure payment to defrauded investors.

II SELECTED REMEDIES FOR MINORITY SHAREHOLDERS

From the perspective of procedural law, minority shareholders should obtain necessary remedies through judicial enforcement. This part of the article discusses remedies available to shareholders with a focus on the institutional problems involved in civil proceedings.

⁶³ 李国光，贾纬〔Guoguang Li and Wei Jia〕ed.《证券市场虚假陈述民事赔偿制度》[Civil Compensation System Concerning False Statements on the Securities market] (法律出版社[Law Press], 2002).

⁶⁴ 宣伟华[Weihua Xuan],《大庆联谊虚假陈述案维权诉讼艰苦 判决后不执行-记大庆联谊虚假陈述民事索赔共同诉讼案》[After the Hard Trial of False Statement Compensation in Daqing Lianyi Case, Judgments May Not Be Executed — Record of Co-litigation of False Statement Compensation in Daqing Lianyi Case] (12 October 2006) 中国证券报 [China Securities Daily] <<http://www.grandall.com.cn/newsroom/media-coverage/440.htm>>.

⁶⁵ 《中华人民共和国证券法》[*Securities Law of the People's Republic of China*] (People's Republic of China) National People's Congress, 29 December 1998, art 207.

⁶⁶ Ibid.

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A Procedural Remedy: Shareholder Derivative Actions

Chinese law provides shareholders with derivative actions as a legal remedy to prevent controlling shareholders from harming the interests of minority shareholders and listed companies.⁶⁷ The direct action traditionally available to shareholders was insufficient to effectively prevent controlling shareholders from tunnelling assets or profits out of listed companies, a practice which has remained pervasive for the last two decades. For example, the CSRC found that major shareholders in 676 out of 1,175 listed companies held up to ¥96.7 billion by the end of 2002. In 2003, up to ¥57.7 billion in 623 listed companies was held by their major shareholders. In early 2005, major shareholders and their affiliated parties collectively held funds of ¥50.9 billion.⁶⁸ Although large shareholders in 320 listed companies returned misappropriated funds by the end of 2005, according to the Xinhua Agency, approximately ¥22,570,000,000 of assets in 95 listed companies were still illegally transferred or occupied by controlling shareholders by 10 November 2006.⁶⁹ Surprisingly, only a small number of derivative suits were brought by minority shareholders in China subsequent to the enactment of the revised provisions of the *Company Law of the People's Republic of China* (1993) in 2005.⁷⁰ It is important to further develop the shareholders' derivative action remedy, so as to balance conflicts of interest between minority shareholders and majority shareholders in listed companies.

In a derivative suit, the company, which is bound by the result of the derivative action, is the plaintiff; the shareholders who bring the derivative action cannot rely directly on the previous decision. The listed company is the beneficiary. The shareholder derivative action was not introduced in China until the *Company Law* was amended in 2005. The first shareholder derivative case in Mainland China involved 78 minority shareholders who sued Sanlian Group, the previous controlling

⁶⁷ See 《中华人民共和国公司法》 [Company Law of the People's Republic of China] National People's Congress, 29 December 1993, art 111.

⁶⁸ 王璐 [Lu Wang], 《大股东'掏'声依旧 509 亿元占款无猛药难清》 [Large Shareholders Are Still Tunneling; Hard to Clear 50.9 Billion Misappropriated Funds without Drastic Measures] (5 April 2005) 上海证券报 [Shanghai Securities News] <http://news.xinhuanet.com/fortune/2005-04/05/content_2786775.htm>.

⁶⁹ See 江国成 [Guocheng Jiang] 《八部门要求加紧解决大股东占用上市公司资金问题》 [Eight Departments Require to Solve the Problem of Large Shareholders' Misappropriation of Listed Companies' Funds] (10 November 2006) 新华社 [Xinhua News Agency] <http://www.govcn/jrzg/2006-11/10/content_438252.htm>.

⁷⁰ Art 152, the *PRC Company Law* (2005 Amendment).

shareholder of the ST Sanlian Commerce Co Ltd for infringement of the 'Sanlian' trademark on 11 December 2009.⁷¹ Under the *PRC Company Law*, where directors or the management illegally impair the interests of the company and cause any loss, shareholders holding 1% or more of the listed company may require the supervisory board to claim for compensation on behalf of the company. If the supervisory board refuses or fails to file a lawsuit within 30 days, or in certain emergency circumstances, the above-mentioned shareholders may lodge a lawsuit directly in the court.⁷² Since Chinese company law does not stipulate that the plaintiff (the company) pays litigation expenses, shareholders are generally reluctant to initiate a derivative suit. Perhaps for this reason, derivative suits have not been effective in protecting the interests of minority shareholders.

B Procedural Remedy: Class Action v Group Litigation

Many common law countries, including the United States,⁷³ the United Kingdom,⁷⁴ Canada,⁷⁵ Australia,⁷⁶ and New Zealand,⁷⁷ permit class actions in securities litigation. The introduction of class actions was a significant step in the protection of minority shareholders. However, in accordance with the *2002 Notice*, the court shall accept a tort compensation concerning false statement in the form of a single or joint lawsuit, but class action is not allowed.⁷⁸ Chinese researchers have explored the suitability of partly introducing American approaches. For example, Zhong et al discuss the possibility of introducing American-style class actions in securities litigations, which are not available under current judicial rules in China,⁷⁹ and Du contends that

⁷¹ 中国证监会福建监管局[The CSRC Fujian Branch], 《股东代表诉讼制度—达摩克利斯之剑》 [Shareholder Derivative Action—The Sword of Damocles] (1 September 2011) <<http://www.sunnada.com/?p=479>>.

⁷² 中华人民共和国公司法》 [Company Law of People's Republic of China] National People's Congress 29 December 1993, amended in 1999, 2004, 2005 and 2013.

⁷³ *Federal Rules of Civil Procedure* USCA. § 1332(d) (2014), rr 23, 28.

⁷⁴ *Civil Procedure Rules 1998* (UK), r 19.6.

⁷⁵ *Federal Courts Rules* SOR/98-106, rr 334.1–334.4.

⁷⁶ *Federal Court of Australia Act 1976*, pt IVA.

⁷⁷ *High Court Rules 2008* (NZ) SR 2008/80, r 4.24.

⁷⁸ 最高人民法院关于受理证券市场因虚假陈述引发的民事侵权纠纷案件有关问题的通知》 [The Notice of the Supreme People's Court on the Relevant Issues concerning the Acceptance of Cases of Disputes over Civil Tort Arising from False Statement in the Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002, art 4.

⁷⁹ 中南大学法学院课题组[Research Group of Central South University Law School], 《美国证券集团诉讼法研究》 [A Study on the Securities Class Litigations in the United States]

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China's judicial system faces many insurmountable obstacles due to the absence of class actions, which are seriously detrimental to securities legislation.⁸⁰ From 1990 to May 2013, about 15,000 investor plaintiffs in false statement cases claimed approximately ¥1.5 billion. However, most of these cases were tried in the form of individual litigation; the others were tried in the form of joint litigation.⁸¹ In practice, the repetitive filing of similar cases is a waste of time and money for plaintiffs and defendants. For example, in the civil compensation against Guang Xia (Yinchuan) Industry Co Ltd, more than 100 lawsuits were filed at the Yinchuan Intermediate court by August 2004.⁸² Moreover, small awards of compensation and inefficient enforcement disadvantage individual investors in China.

Private securities litigation may take the form of group litigation. According to China's Supreme People's Court, 'group litigation' refers to situations where either side involves more than ten people. Also, the plaintiff of securities litigation can select either individual action or joint action.⁸³ Courts may combine two or more cases, which have the same facts and defendant(s), into joint litigation. Joint litigation can be conducted through representative action. The acts of such representatives in the litigation shall be valid for the party they represent, although modification or waiver of claims or admission of the claims of the other party or pursuing a compromise with the other party shall be

(16July 2004) 上海证券交易所 [Shanghai Stock Exchange] <<http://biz.sse.com.cn/cs/zhs/xxfw/jysjs/sseResearch/2005-3/20053e.pdf>>.

⁸⁰ 杜要忠[Yaozhong Du], 《美国集团诉讼基础程序规则研究》 [*The Study on Basic Procedural Rules of Class Litigations in the U.S.*] (深圳证券交易所综合研究所字第 0061 号 [Shenzhen Securities Exchange Research Institution Report No 0061], 14 August 2002), <<http://www.szse.cn/UpFiles/Attach/1088/2003/11/05/report0064.pdf>>.

⁸¹ 刘俊海, 宋一欣[Junhai Liu and Yixin Song] ed., 《中国证券民事赔偿案件司法裁判文书汇编》 [*The Court's Judgments Collection of Civil Compensation Cases in Securities in China*] (北京大学出版社 [Peking University Press], 2013), 19.

⁸² 刘呈军[Chengjun Liu], 《银广夏涉案标的激增 立案标的达 1.8 万亿元》 [*The Object of Litigation in the Case of Yin Guang Xia Increases up to ¥1.8 Trillion*] (18 August 2004) 中华工商时报 [China Business Times] <<http://finance.sina.com.cn/t/20040818/0158955827.shtml>>.

⁸³ Individual action is the counterpart of joint action. The latter concerns the same subject matter of the action or under the same category when both parties consist of an individual party. 'Joint litigation' refers to litigation whereby 'one party or both parties consist of two or more persons and the subject matter of the action is the same or under the same category, the People's Court may adjudicate them together upon the consent of all the parties.' See 《中华人民共和国民事诉讼法》 [*Civil Procedure Law of the People's Republic of China*] (People's Republic of China) National People's Congress, 9 April 1991, art 53.

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subject to the consent of the party they represent.⁸⁴ However, the Chinese representative action, in the context of securities in China, is quite different from a class action, and has several disadvantages.

First, unlike in a class action, the decision of private securities litigation does not apply to those who do not join the joint action. According to the *PRC Civil Procedural Law*, representative litigation can be divided into representative lawsuits with exact numbers of litigants and representative lawsuits without exact numbers of litigants.⁸⁵ However, under China's joint litigation or representative litigation, the exact number of litigants in a joint litigation must be determined prior to the trial.⁸⁶ If the number of litigants is not certain when the lawsuit is filed, the People's Court may issue a public notice informing interested persons (who are entitled to a claim) to register with the court within a fixed period.⁸⁷ The settlement only applies to registered litigants and those who have instituted legal proceedings during the time of the said notification period.⁸⁸ Once a trial commences, the exact number of plaintiffs and defendants is fixed and the any settlement only applies to registered and eligible litigants. This means that the settlement cannot be expanded to apply to investors who have not registered with representative litigation.⁸⁹

Secondly, the *2003 Judicial Interpretation* allows a party with a large number of litigants to authorize 2 to 5 representatives to deal with joint litigation.⁹⁰ However, plaintiffs may not be able to reach an agreement in selecting or electing representatives. In the case of *Xiaomei Cao*

⁸⁴ See 《中华人民共和国民事诉讼法》 [Civil Procedure Law of the People's Republic of China] (People's Republic of China) National People's Congress, 9 April 1991, art 54.

⁸⁵ Article 54 of the *PRC Civil Procedural Law* (1991) stipulates representative litigation with exact numbers of litigants. Article 55 of the *PRC Civil Procedural Law* (1991) stipulates representative litigation without exact numbers of litigants. See also 《最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见》 [Opinions of the Supreme People's Court on Several Issues Concerning the Application of the Civil Procedure Law of the People's Republic of China] (People's Republic of China) Supreme People's Court, Fa [1992] No. 22, 14 July 1992, art 60 and 61.

⁸⁶ See 《关于受理证券市场虚假陈述案件的通知》 [Notice of the Supreme People's Court on Issues Concerning Acceptance of Civil Compensation Cases Arising from False Statement in Securities Market] (People's Republic of China) Supreme People's Court, 15 January 2002, art 14.

⁸⁷ 《中华人民共和国民事诉讼法》 [Civil Procedure Law of the People's Republic of China] (People's Republic of China) National People's Congress, 9 April 1991, art 54.

⁸⁸ Ibid art 55.

⁸⁹ Ibid art 54.

⁹⁰ 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market] Supreme People's Court, 9 January 2003, art 14.

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v Dongfang Electronics Co Ltd,⁹¹ there are more than 6,800 plaintiffs. Even if plaintiffs elect representatives, it is possible that representatives will be involved in conflicts with plaintiffs during the action. The substitution of representatives, and the acceptance, change and relinquishing of claims of the opposing party should be approved by the plaintiffs to the action.⁹² Quite often, a large number of individual plaintiffs cannot reach an agreement on certain substantial or procedural issues.⁹³ Assuming some plaintiffs will disagree with decisions made by representatives, how can these opposing plaintiffs change their representatives? The current civil procedural law or judicial interpretation does not provide any instructions. The plaintiffs may take considerable time seeking compromise.

Thirdly, filing the same case in different courts may lead to different results, casting doubt upon the consistency of law enforcement and resulting in a waste of judicial resources. In the two years after the Supreme People's Court issued the 2002 Notice on the admission of securities litigations, Chinese courts accepted approximately 1,700 securities lawsuits.⁹⁴ For this reason, among others, many legal scholars, such as Hu,⁹⁵ Yang,⁹⁶ and Ren,⁹⁷ have strongly argued for the introduction of class actions in China's civil procedural system. In the future, the courts should introduce class actions for securities lawsuits in order to reform the current Chinese civil procedural system.

⁹¹ 曹小妹等诉烟台东方电子信息产业股份有限公司》[*Xiaomei Cao et al v Dongfang Electronics Co, Ltd*], 山东省青岛市中级人民法院 [Shandong Qingdao Municipal Intermediate People's Court, People's Republic of China], 2006.

⁹² 中华人民共和国民事诉讼法》[*Civil Procedure Law of the People's Republic of China*] (People's Republic of China) National People's Congress, 9 April 1991, art 54.

⁹³ 吴英姿[Yingzi Wu], 《代表人诉讼制度设计缺陷》[*The Design Flaws of the Representative Litigation*] (2009) 《法学家》[*The Jurist*] Vol.5, 66–78.

⁹⁴ 张能[Neng Zhang]《团体诉讼+维权组织 两手抓投资者维权》[*Joint Action + Right Protection Organization: Two Alternatives for Protecting the Rights of Investors*] (26 October 2004) 上海证券报 [Shanghai Securities News] <<http://finance.sina.com.cn/roll/20041026/123036439t.shtml>> (accessed 14 November 2014).

⁹⁵ 胡永庆[Yongqing Hu], 《证券欺诈民事赔偿案件中集团诉讼模式之构建》[*The Formation of Croup Action For the Securities Fraud Litigation*] (2004) 74(4) 《比较法研究》[*Journal of Comparative Law*] 105, 105–20.

⁹⁶ 杨峰 [Feng Yang], 《证券欺诈群体诉讼制度研究》[*Study on Institutes of Group Litigation Concerning Securities Fraud*] (中国社会科学出版社 [China Social Science Publishing House], 2007).

⁹⁷ 任自力[Zili Ren], 《证券集团诉讼：国际经验&中国道路》[*Securities Class Action: International Experience and China's Way*] (法律出版社 [Law Press], 2008).

C *Inversion of the Burden of Proof*

A plaintiffs' inability to prove causation in securities fraud can result in the failure of the civil action. In some countries, such as the SEC Rule 10b-5, shifting the burden of proof to the defendant in torts of insider trading protects investors. However, in China, individual victims often cannot supply adequate evidence of manipulation, the wrongdoing of manipulators, and causation of loss. Chinese investors also bear the burden of proof in securities torts. For example, in the case of *Zhongmin Liu v Tianjin Bohai Chemical Industry (Group) Co Ltd*,⁹⁸ the plaintiffs lost the case because the court deemed that the plaintiffs had failed to prove the relevant causal relationships. Many experts, such as Professor Larry Lang,⁹⁹ have argued that the burden of proof should be reversed in securities-related actions.

Under Chinese law, the burden of proof is only reversed in specific tort actions concerning highly dangerous operations, environmental pollution, damages caused by a raised or managed animals, defective products, common danger, damages caused by medical acts, damages caused by falling items or special patent infringement.¹⁰⁰ Although in 2011 the Supreme People's Court issued a judicial interpretation, which shifted part of the burden of proof in respect of specific evidence from the administration supervisory authority to the insider trader or a third party in insider-trading administrative penalty proceedings¹⁰¹, shifting the

⁹⁸ 刘中民诉渤海集团股份有限公司上诉案》[*Zhongmin Liu v Tianjin Bohai Chemical Industry Group – False Statement Dispute Appeal Case*], 山东省济南市中级人民法院 [Shandong Province Jinan Intermediate People's Court], 济中经终字第 41 号[Economic Appeal No 41], 1998.

⁹⁹ 郎咸平 [Larry H.P. Lang], 《郎咸平上海财经大学演讲文字实录》 ['Speech of Professor Larry H.P. Lang at Shanghai Finance & Economics University'] (13 May 2005) 郎咸平中文网 [www.langxianping.cn] <http://www.langxianping.cn/langxianping/langxianping_caijingdaxue_TXT.html> (accessed Nov 12, 2014).

¹⁰⁰ See 《最高人民法院关于适用《中华人民共和国民事诉讼法》若干问题的意见》 [*Opinions of the Supreme People's Court on Certain Issues Concerning the Application of the Civil Procedure Law of the People's Republic of China*] (People's Republic of China) Supreme People's Court, 14 July 1992, art 74; see also 《最高人民法院关于民事诉讼证据的若干规定》 [*Provisions of the Supreme People's Court on Evidence in Civil Proceedings*] (People's Republic of China) Supreme People's Court, 21 December 2001, art 4.

¹⁰¹ See 《最高人民法院印发'关于审理证券行政处罚案件证据若干问题的座谈会纪要'的通知》 [*Notice of the Supreme People's Court on Printing and Distributing the 'Minutes of the Symposium on Certain Issues Concerning the Evidence for Hearing of Securities-related Administrative Punishment Cases*] (People's Republic of China) Supreme People's Court, 13 July 2011, art 1.

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burden of proof to the *inside trader* has not been introduced in securities civil proceedings.

D Settlement as a Dispute Resolution

Conciliation or mediation proceedings are widely adopted in Chinese courts. Under the Chinese law, the court may distinguish between right and wrong and mediate disputes on the condition that parties do so voluntarily and that the facts are clear in civil suits.¹⁰² A judge or a panel (the collegial bench) may preside over the proceeding and the agreement reached by the parties is binding.¹⁰³ As in other disputes, less than half of securities cases are resolved through judgments or arbitration. Many disputes are resolved through settlement or conciliation. In the case of *Zhenyang Wu, Rongxian Yao et al v ST Chengdu Hong Guang Industries Co Ltd*,¹⁰⁴ eleven shareholders brought a lawsuit in the Chengdu Intermediate People's Court and claimed for tort damage of ¥248,995. The court held a settlement hearing. After negotiation, both parties agreed that the defendants should pay 90% of the claimed damage.¹⁰⁵

Examples of cases in which conciliation proceedings were successful include a number of influential cases:

- (i) In the first securities civil case in September 2002, *Miaoqiu Peng v Shanghai Jiabao Industry & Commerce Co Ltd*,¹⁰⁶ the defendant paid ¥800 to the plaintiff. Ms. Peng became the first investor to receive compensation resulting from such action in China. Later 16 plaintiffs reached conciliation with 15 defendants in January 2003.¹⁰⁷

¹⁰² Art. 85, the PRC Civil Procedure Law (2007 Amendment).

¹⁰³ Ibid art 86 and 90.

¹⁰⁴ 吴振扬、姚荣仙等诉红光实业虚假陈述案》 [*Zhenyang Wu, Rongxian Yao et al v Chengdu Hong Guang Industry CoCo, Ltd*], 成都市中级人民法院 [Sichuan Province Chengdu Municipal Intermediate People's Court, People's Republic of China], 2002.

¹⁰⁵ 王璐 [Lu Wang], 《'红光案'四年两地诉讼路 为求权益无遗憾》 [*The Hongguang Case Took Four Years in Two Cities; Plaintiffs Feel No Regret for Their Rights*] (27 November 2002) 《上海证券报》 [Shanghai Securities News] <<http://www.people.com.cn/GB/jinji/20021127/875535.html>> (accessed 14 November 2014).

¹⁰⁶ 彭淼秋诉上海嘉宝实业(集团)股份有限公司案》 [*Miaoqiu Peng v Shanghai Jiabao Industry & Commerce CoCo, Ltd*], 上海市第二中级人民法院 [The 2nd Intermediate People's Court of Shanghai Municipality, People's Republic of China], 沪二中民三(商)初字第53号 [Civil Case No 53], 5 November 2002.

¹⁰⁷ 杨金志、郝文艳[Jinzh Yang & Wenyan Yu], 《ST嘉宝虚假陈述案结案 大部分原告获得赔偿》 [*The False Statement Case of ST Jiabao has been Fully Adjudicated; Most Plaintiffs Got*]

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- (ii) In *Lingpei Zhang v Chengdu Hong Guang Industry Co Ltd*,¹⁰⁸ the plaintiffs reached a settlement with the listed company and the underwriter.¹⁰⁹
- (iii) In *Fan Li v Sunfield Science & Technology*,¹¹⁰ the case ended with conciliation. The defendant agreed to pay the plaintiff's claims for the loss of investment balance, stamp duty and commission.¹¹¹
- (iv) The case of *Guoming Dong et al v Jinzhou Port Co Ltd*¹¹² also ended with conciliation in on 12 April 2005.¹¹³
- (v) In the lawsuit against *Jinan Qingqi Motorcycles Co Ltd*,¹¹⁴ filed in September 2003 and resolved at the beginning of 2006, the plaintiffs got 80% of what they claimed. The compensation payment was relatively high compared to other securities actions.¹¹⁵

Compensations] (27 January 2003) 新华网 [Xinhua Net] <<http://finance.sina.com.cn/roll/20030128/0833307127.shtml>>.

¹⁰⁸ 张玲培诉红光实业等虚假陈述民事侵权赔偿纠纷案虚假陈述民事赔偿案》 [*Lingpei Zhang v Chengdu Hong Guang Industry Co Ltd et al – False Statement Compensation Dispute*], 四川省成都市中级人民法院 [Sichuan Province Chengdu Municipal Intermediate People's Court, People's Republic of China], 成民初字第 862 号[Civil Case No 863], 25 November 2002.

¹⁰⁹ 刘俊海, 宋一欣[Junhai Liu and Yixin Song] ed., 《中国证券民事赔偿案件司法裁判文书汇编》 [*The Court's Judgments Collection of Civil Compensation Cases in Securities in China*], (北京大学出版社 [Peking University Press], 2013), 385–6.

¹¹⁰ 李凡诉黑龙江圣方科技股份有限公司诉讼案》 [*Fan Li v Sunfield Science & Technology*], 黑龙江哈尔滨市中级人民法院 [Heilongjiang Province Ha'erbin Municipal Intermediate People's Court, People's Republic of China], 2004.

¹¹¹ 刘俊海, 宋一欣[Junhai Liu and Yixin Song] ed., 《中国证券民事赔偿案件司法裁判文书汇编》 [*The Court's Judgments Collection of Civil Compensation Cases in Securities in China*], (北京大学出版社 [Peking University Press], 2013), 37–8.

¹¹² 董国明等诉锦州港股份有限公司诉讼案》 [*Guoming Dong et al, v Jinzhou Port CoCo, Ltd*], 辽宁省沈阳市中级人民法院 [Liaoning Province Shenyang Municipal Intermediate People's Court, People's Republic of China], 沈中民(3)权初字第 20 号 [Civil Case No 20], 2003.

¹¹³ *Ibid* 42–5.

¹¹⁴ 陈华妹等诉济南轻骑虚假陈述民事赔偿案》 [*Huamei Chen et al v Jinan Qingqi Motorcycles Co Ltd*], 山东省济南市中级人民法院[Shandong Province Jinan Municipal Intermediate People's Court, People's Republic of China], 2006.

¹¹⁵ 宋一欣 [Yixin Song], 《我所知道的济南轻骑民事赔偿案》 [*What I Have Known about the Civil Compensation Case of Jinan Qingqi*] (26 October 2006) 中国证券网 [China Securities Net] <http://www.cs.com.cn/rx/03/200610/t20061026_1009676.htm> (accessed 14 November 2014).

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- (vi) In *Yanjun Chen et al v Zhejiang Hang Xiao Steel Structure Co Ltd*,¹¹⁶ the CSRC made an administrative decision on the violation of disclosure rules and misleading statements made by the Zhejiang Hang Xiao Steel Structure Co Ltd. 127 investors brought civil actions to claim damages. In May 2009, 118 investors were compensated for 82% of their losses after negotiations with the defendants. Since the limitation of action expired on May 14 2009, those who did not file a lawsuit by then lost their rights of action.¹¹⁷
- (vii) In *Xiaqin Wang et al v Topsun Science and Technology Co Ltd*,¹¹⁸ 148 plaintiffs sued the defendant for false statement at the Shanxi Province Xi'an Intermediate People's Court. In December 2012, all suits ended with conciliation and 148 investors got compensation of more than ¥12.95 million.¹¹⁹ In July 2013, Topsun Science and Technology Co Ltd changed its name to 'GuangYuYuan Chinese Herbal Medicine Co Ltd'¹²⁰

As of the end of 2008, about 80% of securities civil actions were concluded by conciliation, which concerned nearly 10,000 plaintiffs of false statement compensation and the subject matter amount of more than RMB 800 million.¹²¹ As a flexible way to resolve a

¹¹⁶ 陈艳军等诉浙江杭萧钢构股份有限公司虚假陈述赔偿纠纷案》[*Yanjun Chen et al v Zhejiang Hang Xiao Steel Structure CoCo, Ltd – False Statement Compensation Dispute Case*], 浙江省杭州市中级人民法院 [Zhejiang Province Hangzhou Municipal Intermediate People's Court], 杭民二初字第 133 号 [Civil Case No 133], 2007.

¹¹⁷ 陆媛[Yuan Lu], 《杭萧钢构 118 名投资者历时两年索赔成功》[*It Takes Two Years for 118 Investors in the Case of Hang Xiao Gang Gou to Get Compensation Successfully*] (21 May 2009) 第一财经日报 [China Business News] <<http://finance.ifeng.com/stock/zqyw/20090521/687707.shtml>> (accessed 15 November 2014).

¹¹⁸ 王霞琴诉东盛科技股份有限公司》[*Xiaqin Wang et al v Topsun Science and Technology Co, LtdLtd*], 陕西省西安市中级人民法院 [Shanxi Province Xi'an Municipal Intermediate People's Court, People's Republic of China], 2012.

¹¹⁹ 杨一苗[YimiaoYang], 《ST 东盛虚假陈述遭股民索赔调解结案 赔千余万》[*The False Statement Case against the ST Topsun Science and Technology Co LtdLtd Ended with Conciliation; The Defendant Paid More Than Ten Million Yuan*] (13 December 2012) 新华网 [Xinhua Net] <<http://finance.sina.com.cn/360desktop/stock/s/20121213/105013992161.shtml>> (accessed 16 November 2014).

¹²⁰ Sina Finance, 《广誉远中药股份有限公司 (600771)》[*GuangYuYuan Chinese Herbal Medicine Co Ltd*] <http://money.finance.sina.com.cn/corp/go.php/vCI_CorpInfo/stockid/600771.phtml> (accessed 16 November 2014).

¹²¹ 张安基[Anji Zhang] 《42 家上市公司因虚假陈述或成被告》[*42 Listed Companies May*

case, conciliation clearly has the advantage of saving time and costs for both parties rather than going through a second-instance hearing. Therefore, judges often encourage conciliation so as to reduce the costs of litigation both for benefit of the parties and of society.

III PRIVATE LITIGATION OF SECURITIES DISPUTES

This section examines the litigation mechanism of three categories of securities fraud: false statement, insider trading and market manipulation. The Supreme People's Court has still to enact a unified judicial interpretation to cover jurisdiction, forms, parties, burden of proof, causation and calculation of loss of private securities litigation. So far, only the 2003 *Judicial Interpretation* on false statement has been implemented.

A Private Litigation of False Statements

False statements concern the disclosure of information in contravention of securities laws and regulations through the creation of false records, misleading statements related to major events, improper disclosure, or omission of relevant statements, during the process of issuance and transaction of securities. China's information disclosure system includes three levels: Stipulations of the Securities Law, CSRC's administrative regulations and stock exchange's rules. False statements are regulated by ch 3 s III of the *PRC Securities Law*, titled 'On-going Disclosure of Information', and the relevant judicial interpretations of the Supreme People's Court.¹²²

In China, media exposure of many cases of misrepresentation and false financial statements in 2000 prompted the CSRC to strengthen legal regulation to enhance disclosure of information in the securities market. In particular, the *Measures for the Administration of Disclosure of Shareholders Equity Changes of Listed Companies* ('Measures') came into force on 1 December 2002.¹²³ The *Measures* referred to situations in which:

Become Defendants Due to False Statement] (1 April 2009) 每日经济新闻 [Daily Economic News] <<http://money.163.com/09/0401/04/55PMS2PL00251RJ2.html>>.

¹²² 中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress, 29 December 1998, art 63–72.

¹²³ 上市公司股东持股变动信息披露管理办法》 [*Measures for the Administration of Disclosure of Shareholder Equity Changes of Listed Companies*] (People's Republic of China) CSRC, 28 September 2002.

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- (i) shareholders' equity has changed or may have been changed through dealings in the securities market;
- (ii) the number of shares controlled by a certain investor has changed; or
- (iii) the structure has been changed through legal means other than dealings in the securities market.

Moreover, to standardize disclosure of information in relation to listed companies, the CSRC promulgated a series of legal document formats,¹²⁴ which provided elaborate instructions for public announcements and disclosure reports. Together with the *Interim Provisions on the Management of the Issuing and Trading of Stocks*,¹²⁵ these formats (or rules) developed a legal framework for the disclosure of information related to takeover bids. This development represented considerable progress over existing legislation. Moreover, special disclosure liabilities were required by the CSRC's series *Preparation Rules for Information Disclosure by Companies Offering Securities to the Public* (No. 1-26). To enhance its regulation on information disclosure, the CSRC issued *Administrative Measures for the Disclosure of Information of Listed Companies* in 2007.¹²⁶

Aside from issues of forms of litigation, burden of proof and settlement as discussed above, the 2003 *Judicial Interpretation* highlights the following aspects:

1 *Procedural Prerequisite and Jurisdiction*

Investors must bring a private securities lawsuit on the ground of either a relevant administrative penalty decision by the CSRC, Ministry of Finance or other administrative authorities, or an effective criminal judgment made by the People's Court.¹²⁷ This stipulation is called as 'procedural prerequisite of securities civil

¹²⁴ These formats are stipulated in Rules 15–19 of the *Circular of the China Securities Regulatory Commission on the Content and Format of Information Disclosure of Public Listed Companies* (2002).

¹²⁵ 股票发行与交易管理暂行条例》〔*Interim Provisions on the Management of the Issuing and Trading of Stocks*〕 (People's Republic of China) the State Council, 22 April 1993.

¹²⁶ 上市公司信息披露管理办法》〔*Administrative Measures for the Disclosure of Information of Listed Companies*〕 (People's Republic of China) China Securities Regulatory Commission, 30 January 2007.

¹²⁷ 最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》〔*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*〕 (People's Republic of China) Supreme People's Court, 9 January 2003, art 6.

litigation'. The jurisdiction of such cases is 'the intermediate people's court of the city where the people's government of the province, municipality directly under the Central Government, autonomous region is located, of the city directly under state planning or of the special economic zone'.¹²⁸

2 The Defendants

A relatively large range of defendants are defined under Chinese law. Violators (relating to false statements) include:

- (i) sponsors, controlling shareholders and other actual controllers;
- (ii) issuers or listed companies;
- (iii) underwriters;
- (iv) recommenders;
- (v) accounting firms, law firms, asset evaluation agencies and other intermediary agencies;
- (vi) senior management such as directors, supervisors and managers of the aforesaid items (ii), (iii) and (iv), and the person taking direct responsibility of the aforesaid item (v); and
- (vii) other agencies or individuals who make false statements.¹²⁹

3 Principles of Liability

Violators may bear joint liability due to certain circumstances.¹³⁰ Liability for false statements for wrongdoers may arise in a number of ways:

- (i) the sponsor, issuers or listed company shall bear the liability for civil compensation for the losses caused by their false statement to the investors;¹³¹

¹²⁸ Ibid art 8.

¹²⁹ Ibid art 7.

¹³⁰ Ibid, refer to art 26–28.

¹³¹ See 《中华人民共和国证券法》 [Securities Law of the People's Republic of China] (People's Republic of China) National People's Congress, 29 December 1998, art 63, 69; see also 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market] (People's Republic of China) Supreme People's

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- (ii) the responsible director, supervisor, senior manager or any other person of the issuer or the listed company shall bear the joint liability for compensating the losses, unless there is evidence to prove that they have no fault;¹³²
- (iii) the actual controller shall bear the liability for compensation. The issuer and listed company shall be jointly and severally liable with the actual controller;¹³³
- (iv) the securities underwriter or the person recommending the listing of securities shall bear the liability for compensating the losses caused by his false statement to the investors, unless there is evidence to prove that he has no fault;¹³⁴
- (v) senior managing members such as the liable board directors, supervisors and managers, etc. shall bear the joint liability for compensation with the securities underwriter or the person recommending the listing of securities;¹³⁵
- (vi) the professional intermediary agencies and their direct responsible persons shall assume the liabilities for compensation for the part, of the losses, caused due to their liabilities, unless there are evidences proving the innocence of the aforesaid personnel;¹³⁶ and

Court, 9 January 2003, art 21.

¹³² See 《中华人民共和国证券法》 [*Securities Law of the People's Republic of China*] (People's Republic of China) National People's Congress, 29 December 1998, art 69; see also 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 21.

¹³³ See 《中华人民共和国证券法》 [*Securities Law of the People's Republic of China*] (People's Republic of China) National People's Congress, 29 December 1998, art 69; 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 22.

¹³⁴ 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 23.

¹³⁵ *Ibid.*

¹³⁶ The civil liabilities of accounting firms, law firms, asset evaluation agencies and other

- (vii) Where other institutions or natural persons making the false statement as mentioned in Item 7 of Article 7 of these Provisions, in violation of Article 5, 72, 188 and 189 of the Securities Law, cause losses to the investors, they shall assume the liabilities for compensating such losses.¹³⁷

4 Causation Between False Statement and Loss

Article 18 of the 2003 *Judicial Interpretation* lists certain situations in which the court can identify the causation relationship between false statements and damage:¹³⁸

- (1) The investment of the investor refers to securities directly related to false statements;
- (2) (2) the investor purchases the securities on the implementation date of false statements or thereafter, and before the exposure or correction date or theretofore; or
- (3) (3) the investor suffers damage due to selling or continually holding the concerned securities on the exposure or correction date of the false statement or thereafter.

In addition, Article 19 of the 2003 *Judicial Interpretation* lists certain exceptional situations under which the court cannot identify the causal relationship between false statement and damage.¹³⁹

- (1) If the relevant securities have been sold by the plaintiff prior to the exposure or correction date of the false statement;

intermediary agencies are also called expert's liability for the false statement. See 《中华人民共和国证券法》 [*Securities Law of the People's Republic of China*] (People's Republic of China) National People's Congress, 29 December 1998, arts 173; 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 27.

¹³⁷ 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 25.

¹³⁸ Ibid art 18.

¹³⁹ Ibid art 19.

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- (2) if the investment is made by the plaintiff on or after the disclosure or correction date of the false statement;
- (3) If the investment is made by the plaintiff when he knows that the statement is false;
- (4) If the loss or part of it is caused due to other factors, such as the risk of the securities market system; or
- (5) If the plaintiff maliciously makes the investment and manipulates the price of securities.

It is worth noting that the 2003 *Judicial Interpretation* does not provide a definition of 'system risks of the securities market' of art 19(4). In practice, the courts utilise different criteria to deal with the loss arising from system risks of the securities market. Take the example of *He Zhang v Tianjin Bohai Chemical Industry Group*;¹⁴⁰ the court dismissed this case on the ground that Bohai's stock price change was the result of external system risk of the stock market and there was no causation between the plaintiff's loss and the defendant's false statement. This judgment is controversial.¹⁴¹ Cai examined civil cases of false statements, and found that judges deducted the loss cause by market risks in five cases, but did not deduct market risks in three other cases.¹⁴²

Articles 18 and 19 of the 2003 *Judicial Interpretation* only deal with liabilities for 'induced rising' caused by false statements because there was no short selling mechanism when it was enacted in 2003.¹⁴³ Articles 18(2) and 19(1) deal with

¹⁴⁰ 张鹤与银座渤海集团股份有限公司虚假陈述证券民事赔偿纠纷案》[*He Zhang v Tianjin Bohai Chemical Industry Group – False Statement Compensation Dispute Case*], 山东省济南市中级人民法院 [Shandong Province Jinan Municipal Intermediate People's Court, People's Republic of China], 济民二初字第12号 [Civil Case No 12], 7 July 2004.

¹⁴¹ 郑重[Zhong Zheng], 《ST渤海小股东一审败诉:是非曲直仍是谜》[*Minority Shareholders of ST Bohai lost the First Trial: The Reason Is a Riddle*] (11 November 2004) 《财经时报》[*Financial & Economics Times*] <<http://media.163.com/04/1111/15/14TS0THE0014186P.html>>.

¹⁴² 蔡伟真[Weizhen Cai], 《论系统风险对证券市场虚假陈述损害赔偿额确定的影响》[*Study of System Risk's Effects on Ascertaining the False Statement Compensation of Securities Market*] (2014) 《中国证券》[*China Securities*], Vol. 5, pp. 39–48. <http://www.sac.net.cn/yjcbw/zgqzz/2014/2014_05/201407/P020140709542270577652.pdf>.

¹⁴³ China's stock market operated as a one-way market, before the share price index futures (SPIF) and margin trading business were introduced in 2010 and margin trading was introduced in 2012. The 2003 *Judicial Interpretation* should be updated due to the

'transaction causation' and 'loss causation' respectively.¹⁴⁴ Trading causation and loss causation are based on the theory of 'fraud-on-the-market'.¹⁴⁵ In fraud-on-the-market cases, plaintiffs must show that, but for the defendant's misrepresentation, the plaintiff would not have suffered loss.¹⁴⁶ The 2003 *Judicial Interpretation* does not completely identify all situations in which false statements may cause loss. It ignores some situations. For example, a violator may provide false information on short-sales prior to a fall in the stock price, causing an investor loss. In this scenario, violators are not deemed to have caused the investor's loss. Moreover, if the violator conceals material information, which does not benefit the listed company, so that investors are misled into believing that stock prices will increase and do not sell stocks, causation is not established in accordance with the 2003 *Judicial Interpretation*.

5 Calculation of Investor Damages related to False Statements

After a court has made a decision on the benchmark date of a false statement, the plaintiffs must calculate their investment loss in accordance with the 2003 *Judicial Interpretation*.¹⁴⁷ Under Chinese law, the current approach is to calculate the actual loss suffered by investors. The actual loss includes:

introduction of three short selling mechanisms.

¹⁴⁴ Chinese judges referred to U.S. practices when drafting the 2003 *Judicial Interpretation*. See 李国光·贾纬[Guoguang Li and Wei Jia] ed., 《证券市场 虚假陈述民事赔偿制度》 [Civil Compensation System Concerning False Statements on the Securities market] (法律出版社[Law Press], (2002)). In *Basic Inc. v Levinson*, 485 U.S. 224, 248-49 (1988), the plaintiff should show 'transaction causation', that is, the plaintiff's reliance on the false statement in the trading. In *Huddleston v Herman & Maclean*, 640 F.2d 534, 549 (5th Cir. 1981), the plaintiff should show 'loss causation', that is, nexus between the loss and the defendant's misconduct.

¹⁴⁵ The fraud on the market theory has been applied in such cases as *Blackie v Barrach* 524 F 2d 891, 909-10 (9th Cir, 1975) and *Basic, Inc. v Levinson* 485 US 224 (1988). The fraud on the market theory is based on the efficient market hypothesis. It assumes that in an efficient stock market, market information is that embodied in stock prices. Investors invest in stocks according to 'justifiable reliance': that is, the stock price reflects all disclosed information according to law on an information-efficiency securities market. Therefore, if anyone discloses a false statement, this is regarded as a fraud on all investors and the whole stock market.

¹⁴⁶ For example, in *Basic Inc. v Levinson*, 485 U.S. 224, 248-49 (1988), the plaintiff Max Levinson must show he and other shareholders' reliance on the defendant's released 'merger discussions' when selling the defendant's shares.

¹⁴⁷ 最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from

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- (1) The losses related to investment variance;
- (2) the commission and stamp duty relating to the losses of investment variance; and
- (3) the interest of the investment from the purchase date until the selling date or benchmark date, calculated in terms of the demand deposit rates of the bank during the same period.¹⁴⁸

The 'Actual Loss' suffered by investors can be calculated in two circumstances:¹⁴⁹

- (1) The calculation of Actual Loss suffered by those who sell their stocks on the benchmark date and prior to the benchmark date.

In this circumstance 'Actual Loss' = the Losses of Investment Variance (a) + the Commission and Stamp Duty Relating to the Losses of Investment Variance (b) + the Interest of Investment from the Purchase Date until the Selling Date or the Benchmark Date (c), when:

- (a) The Losses of Investment Variance = (Weighted Average Price of Purchasing - Actual Weighted Average Price of Selling) × Number of Selling Shares on or Prior to the Benchmark Date;
- (b) The Commission and Stamp Duty Relating to the Losses of Investment Variance = (a) × (The Commission Rate + The Rate of Stamp Duty);
- (c) The Interest of Investment from the Purchase Date until the Selling Date or the Benchmark Date = ((a) + (b)) × the Weighted Average Days of Holding Shares Prior to the Benchmark Date (d) ÷ 360 × The Interest Rate; and
- (d) The Weighted Average Days of Holding Shares Prior to the Benchmark Date = $\sum(\text{Days of Holding Shares} \times \text{Number of Holding Shares}) \div \text{Sum of Holding Shares}$.

False Statement in Securities Market] (People's Republic of China) Supreme People's Court, 9 January 2003, Chapter VII (art 29 - art 35), 'ascertainment of losses'.

¹⁴⁸ Ibid art 30.

¹⁴⁹ Ibid art 4.

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- (2) The calculation of investment loss suffered by those who sell stocks after the benchmark date or still hold stocks after the benchmark date.

In this circumstance 'Actual Loss' = the Losses of Investment Variance (a') + the Commission and Stamp Duty Relating to the Losses of Investment Variance (b') + the Interest of Investment from the Purchase Date until the Selling Date or the Benchmark Date (c'), when:

- (a) (a') The Losses of Investment Variance = (Weighted Average Price of Purchasing - Actual Weighted Average Price of Selling) × Number of Selling Shares after the Benchmark Date or Number of Holding Shares after the Benchmark Date;
- (b) (b') The Commission and Stamp Duty Relating the Losses of Investment Variance = (a') × (The Commission Rate + The Rate of Stamp Duty);
- (c) (c') The Interest of Investment from the Purchase Date until the Selling Date or the Benchmark Date = ((a') + (b')) × the Weighted Average Days of Holding Shares after the Benchmark Date (d') ÷ 360 × The Interest Rate; and
- (d) (d') The Weighted Average Days of Holding Shares after the Benchmark Date = (Days of Holding Shares × Number of Holding Shares) ÷ Sum of Holding Shares.

The enactment of the 2003 *Judicial Interpretation* provided guidance for the trial of civil compensation of false statements; however, individual victims may not be fully compensated in subsequent civil action, as the listed company that is notionally liable pays the administrative penalty and also suffers losses from falling stock prices before the civil lawsuit. Therefore, it is important to establish a mechanism to guarantee the payment of post-action compensation through an Investor Protection Fund.¹⁵⁰ Moreover, other important issues, such as the due diligence of the plaintiff,

¹⁵⁰ The China Securities Investor Protection Fund Co Ltd was established on September 29, 2005. The duties of the China Securities Investor Protection Fund Corporation include: (i) managing the investor protection fund; (ii) dealing with the risks and bankruptcy of securities companies, (iii) managing compensated assets and compensating the creditors under the circumstance of closure, liquidation or bankruptcy of securities companies. See 《证券投资者保护基金管理办法》 [*Measures for the Administration of the Securities Investor Protection Funds*] (People's Republic of China) China Securities Regulatory Commission,

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the judgment of 'materiality' in false statements, and the 'inversion of *the burden of proof*', are not addressed in the current legal framework.

Another issue is the 'benchmark date'.¹⁵¹ The 2003 *Judicial Interpretation* stipulates the benchmark date as the disclosure or correction date of the false statement.¹⁵² However, identifying this date can be controversial in practice. For example, in the case of *Wei Chen et al v Hisense Kelon Electrical Holdings Co Ltd*,¹⁵³ three dates could have been chosen:

- (a) on 4 April 2003, when the Kelon Company publically disclosed its 2002 Annual Report. The CSRC later determined that the 2002 Annual Report included inflated income of ¥403.3 million and inflated profits of ¥119.96 million;
- (b) on 10 August 2004, when Professor Larry Lang disclosed that the Kelon Company was suspected of making false annual reports of its profitable performance;¹⁵⁴
- (c) on 10 May 2005, when the Kelon Company announced that it had been investigated by the CSRC. From 10 May to 14 July 2005, the accumulated volume of Kelon stocks reached 100% of its tradable shares in Shenzhen Stock Exchange;¹⁵⁵

30 June 2005, art 7.

¹⁵¹ See 郭峰, 程啸 [Feng Guo & Xiao Cheng] ed., 《虚假陈述证券欺诈侵权赔偿》 [*Discourse upon the Tort Damages for Misrepresentation in the Securities Market*] (法律出版社 [Law Press], 2003), 366.

¹⁵² See 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 33.

¹⁵³ 陈卫等诉海信科龙电器股份有限公司诉讼案》 [*Wei Chen et al v Hisense Kelon Electrical Holdings Co, Ltd*], 广东省广州市中级人民法院 [Guangdong Province Guangzhou Municipal Intermediate People's Court, People's Republic of China], 2009.

¹⁵⁴ 郎咸平 [Larry H. P. Lang], 《郎咸平: 在'国退民进'盛宴中狂欢的格林柯尔》 [*Green Cool: Carnival on the Feast of 'State-owned Economy Retreats, Non-State-owned Economy Approaches'*] (16 August 2004) 新浪财经 [Sina Finance] <http://finance.sina.com.cn/t/20040816/1202951523.shtml>

This public lecture was widely reported in China, which triggered an overwhelming and nationwide debate on *Kelon's* true performance.

¹⁵⁵ 张艳, 敖晓波 [Yan Zhang and Xiaobo Ao], 《科龙涉嫌违规收购三家公司股份遭证监会立案调查》 [*The Kelon Company Is Suspected to Violate Securities Regulations and Is Investigated by the CSRC*] (10 May 2005) 上海证券报 [Shanghai Securities News]

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- (d) on 2 August 2005, when the CSRC announced, through the Xinhua News Agency, that the CEO and some senior managers of the Kelon Company had violated securities law and were being detained by the Police Bureau;¹⁵⁶ and
- (e) on 5 July 2006, when the Kelon Company disclosed that the CSRC had levied an administrative penalty for its false statement.¹⁵⁷

According to art 20 of the 2003 *Judicial Interpretation*, the disclosure date should be 'the date on which false representation was initially disclosed in the newspapers, magazines, broadcasting stations, and television stations that issue or broadcast nationwide'.¹⁵⁸ However, no clear criteria exist by which to judge when a 'nationwide distribution or broadcast' occurs, and the identification of the exposure date is therefore debatable and, often, determined as a matter of judicial discretion. For example, in another case involving a false statement, *Xiaomei Cao v Yantai Dongfang*

<http://news.xinhuanet.com/stock/2005-05/10/content_2938339.htm>.

¹⁵⁶ 张旭东 [Xudong Zhang], 《顾雏军等涉嫌多项证券违法违规 已移送公安部门》 [*Gu Chujun etc. Are Suspected to Violate the Law and Detained by the Public Security Bureau*] (2 August 2005) 新华网 [Xinhua Net] <http://news.xinhuanet.com/stock/2005-08/02/content_3301931.htm>.

¹⁵⁷ 郭颀 [Jin Guo], 《证监会对*ST科龙违法事实开出 60 万元罚单》 [*The CSRC Imposes a Fine of ¥600,000 on the Kelon Company*] (5 July 2006) 人民网 [People's Net] <<http://finance.people.com.cn/GB/1041/4559695.html>>.

¹⁵⁸ 最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [*Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market*] (People's Republic of China) Supreme People's Court, 9 January 2003, art 33. Article 33 lists four methods for determining the 'benchmark date':

- (1) from the date of disclosure or alteration to the date on which the accumulative turnover of securities affected by such false representation is up to 100% of negotiable parts of such securities. The turnover of securities that are transferred under large transaction agreement shall not be calculated.
- (2) as the 30th day after the date of disclosure or alteration in the case that the benchmark date cannot be determined according to the provisions set forth in the preceding item prior to sessions.
- (3) as the trading day directly before delisting day in the case that such securities exited from securities transaction market.
- (4) as the trading day directly before the suspension day in the case that such securities suspend securities transactions, or in accordance with the provisions set forth in Item (1) of this Article in the case that the transactions are resumed.

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Electronics Co Ltd,¹⁵⁹ the Qingdao Intermediate Court decided that the exposure date was December 18, 2001, when the trading turnover was 100% of the transferable stocks.¹⁶⁰ In *Wei Chen et al v Hisense Kelon Electrical Holdings Co Ltd*,¹⁶¹ the Guangzhou Municipal Intermediated Court decided that 4 April 2003 was the implementation date of the defendant's false statement and 14 July 2005 was the benchmark date to calculate the loss of investment balance. The court determined that the plaintiff Chen's actual loss was ¥15,026.23, including his loss of investment difference, stamp duty, commission and interest. After deducting the loss of ¥4,391.11 arising from system risk (referring to the ShenZhen Stock Exchange Component Index), the compensation amount obtained by the plaintiff was ¥10,635.¹⁶²

B Private Litigation of Insider Trading

Inside information has two basic meanings. First, inside information may be 'price sensitive information'.¹⁶³ In *SEC v Texas Gulf Sulphur Co*,¹⁶⁴ a jury verified the price sensitive information. Second, inside information may be 'material' non-public

¹⁵⁹ 曹小妹等诉烟台东方电子信息产业股份有限公司》[*Xiaomei Cao et al v Yantai Dongfang Electronics Co, Ltd*], 山东省青岛市中级人民法院 [Shandong Qingdao Municipal Intermediate People's Court], 2007.

¹⁶⁰ In the case of *Dongfang Electronics Co Ltd*, there are a few exposure dates. One is September 14, 2001, when the Securities Daily issued the report of *Dongfang Electronics Co Ltd: Are Its Financial Data True?* Another date is October 12, 2001, when China Central TV broadcast about it. See 岳敬飞[Jingfei Yue], 《东方电子百起诉讼下月青岛集中庭审》[*A Hundred Securities Litigation against Dongfang Electronics Co Ltd Will Open the Court Session Next Month in Qingdao*] (18 August 2006) 中国证券网 [China Securities Net] <<http://www.cctv.com/financial/20060818/100963.shtml>>.

¹⁶¹ 陈卫等诉海信科龙电器股份有限公司诉讼案》[*Wei Chen et al v Hisense Kelon Electrical Holdings Co, Ltd*], 广东省广州市中级人民法院 [Guangdong Province Guangzhou Municipal Intermediate People's Court, People's Republic of China], 2009.

¹⁶² 刘俊海,宋一欣[Junhai Liu and Yixin Song] ed., 《中国证券民事赔偿案件司法裁判文书汇编》*The Court's Judgments Collection of Civil Compensation Cases in Securities in China* (北京大学出版社 [Peking University Press], 2013), 260–62.

¹⁶³ 'Price sensitive information' means information significantly affecting the price of a company's securities. For example, the Securities and Future Commission (SFC) uses 'insider information' to refer to 'price sensitive information'. See 'Background to the Guidelines' of the *Consultation Paper on the Draft Guidelines on Disclosure of Insider Information* issued by SFC in March 2010, available at: <<http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/openFile?refNo=10CP2>>.

¹⁶⁴ 401 F 2d 833 849 (2d Cir, 1968) (en banc), cert. denied, 394 US 976 (1969).

information.¹⁶⁵ The *PRC Securities Law (1998)* defines ‘inside information’ as ‘information that concerns the business or finance of a company or may have a major effect on the market price of the securities thereof and that hasn’t been publicised in securities trading’.¹⁶⁶ In accordance with China’s securities law, some ‘major events’ concerning investment, assets, liabilities, rights, interests or business achievements of the company, important personnel changes and litigations shall be regarded as ‘inside information’.¹⁶⁷

The *PRC Securities Law (1998)* defines ‘insider’ as a person ‘who has access to any insider information of securities trading or who has unlawfully obtained any insider information ...’ Such a person ‘is prohibited from taking advantage of the insider information he holds to engage in any securities trading’.¹⁶⁸ In addition, in September 2007, the CSRC announced and enacted the *Guidance on Determination of Insider Trading Activities in Securities Market (Trial Implementation)*,¹⁶⁹ now in force for some time. These methods define the scope of insiders and inside information in the Chinese context. It also stipulates the means by which the value of illegal proceeds is calculated.¹⁷⁰ The benchmark price of said securities shall be the market value at a certain trading date or the average price of a certain period after the inside information is released. The Supreme People’s Court may refer to the CSRC’s criteria when enacting its judicial interpretation on relevant civil compensation.

The first civil case in China concerning insider trading, *Ningfeng Chen v Jianliang Chen*,¹⁷¹ was accepted by the Nanjing Intermediate People’s Court in July 2008. Only four private securities cases concerning insider trading or the divulging of inside information were concluded in China by the beginning of 2013. Of the four cases, the plaintiff Ningfeng Chen withdrew suit, whereas other cases, *Zuling Chen v Haishen*

¹⁶⁵ See generally *TSC Industries, Inc. v Northway, Inc.* 426 US 438 (1976).

¹⁶⁶ 《中华人民共和国证券法》 [*Securities Law of the People’s Republic of China*] (People’s Republic of China) National People’s Congress, 29 December 1998, art 75.

¹⁶⁷ *Ibid* art 67.

¹⁶⁸ *Ibid* art 7.

¹⁶⁹ 《证券市场内幕交易行为认定指引(试行)》 [*Guidance on Determination of Insider Trading Activities in Securities Market (Trial Implementation)*] (People’s Republic of China) China Securities Regulatory Commission, 27 March 2007.

¹⁷⁰ Insider’s proceeds = (Income from sold securities + Value of holding securities) - Costs of buying securities.

¹⁷¹ 《陈宁丰诉陈建良诉讼案》 [*Ningfeng Chen v Jianliang Chen*],北京市第一中级人民法院[The First Intermediate People’s Court of Beijing Municipality, People’s Republic of China], 一中民初字第 8217 号[Civil Case No 8217], 22 October 2009.

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Pan,¹⁷² *Yan Li v Guangyu Huang*¹⁷³ and *Yi Wu v Guangyu Huang*,¹⁷⁴ were dismissed by the courts on the ground of lacking sufficient factual and legal basis. Liu compared criminal, administrative and civil securities cases concerning insider trading from 2007 to the beginning of 2013 and found that:

- (i) From 11 criminal cases, judicial authorities confiscated illegal income of ¥255.64 million and imposed fines or penalties of ¥71.302 million;
- (ii) from 35 administrative cases, the CSRC confiscated illegal income of ¥4.214 million and imposed fines or penalties of ¥9.998 million; but that
- (iii) no individual investor has yet received compensation in a civil insider trading case.¹⁷⁵

Liu's findings indicate that, compare with an insider's criminal liability and administrative liability, the enforcement of civil compensation was weak. However, in December 2013, the Shanghai Second Intermediate People's Court accepted the case of *Jufen Bao v Everbright Securities Co Ltd*¹⁷⁶ This may become the first case in

¹⁷² 陈祖灵诉潘海深诉讼案》[*Zuling Chen v Haishen Pan*],江苏省南京市中级人民法院[Jiangsu Province Nanjing Municipal Intermediate People's Court, People's Republic of China],宁民二初字第136号[Civil Case No 136], 2008.

¹⁷³ 李岩诉黄光裕内幕交易案》[*Yan Li v Guangyu Huang*],北京市第二中级人民法院[The Second Intermediate People's Court of Beijing Municipality, People's Republic of China], 2012.

¹⁷⁴ 吴屹峰诉黄光裕内幕交易案》[*Yifeng Wu v Guangyu Huang*],北京市第二中级人民法院[The Second Intermediate People's Court of Beijing Municipality, People's Republic of China], 2012.

¹⁷⁵ The four cases are *Ningfeng Chen v Jianliang Chen*, *Zuling Chen v Haishen Pan*, *Yan Li v Guangyu Huang*, and *Yifeng Wu v Guangyu Huang*. See 刘康喜[Kangxi Liu], 《证券内幕交易民事赔偿制度浅析——以行政责任、刑事责任与民事责任比较分析为视角》[*A Brief Analysis on Civil Compensation System of Securities Insider Trading: from the Perspective of Comparing Administrative, Criminal and Civil Liability*] (2013) 中国证券[China Securities] Vol. 4, 40-3 <http://www.sac.net.cn/yjcbw/zgzqzz/2013/2013_03/201304/P020130418400191857328.pdf>. The 22 private litigations concerning insider trading include: one civil action in 2007, one civil action in 2008; four private litigations in 2009; five private litigations in 2010; and eleven private litigations in 2011. See 张陵洋[Lingyang Zhang], 《最高法发布内幕交易司法解释》[*The Supreme People's Court Issues Judicial Interpretation on Insider Trading*] (23 May 2012) 北京商报 [Beijing Commercial Newspaper] <<http://finance.sina.com.cn/stock/y/20120523/082712125754.shtml>>.

¹⁷⁶ 包巨芬诉光大证券股份有限公司内幕交易案》[*Jufen Bao v Everbright Securities Co, Ltd*], 上

which investors receive civil compensation through judgment or settlement.¹⁷⁷

C Private Litigation of Market Manipulation

Many self-dealing cases in China also involve market manipulation. According to art 184 of the *PRC Securities Law (1998)*, market price manipulation is to ‘manipulate securities transaction prices, or fabricate false securities transaction prices or volumes, in an attempt to gain illegitimate interests or shift risks to other people’. In accordance with the *Criminal Law of the People’s Republic of China (1997)*, market manipulators shall be sentenced to no more than five years in prison or criminal detention, and be fined one-to-five times their illegal proceeds.¹⁷⁸ The *Supplementary Stipulations on Criteria for Prosecuting Economic Crimes (‘Supplementary Stipulations’)* specify criteria for market manipulation.¹⁷⁹ These criteria include:

- (i) holding or actually controlling circulating shares over 30% of the actual amount of circulating shares of a certain stock, and collusively buying or selling or continuously buying/selling shares, which add up to over 30% of the said stock, in twenty trading days, either on one’s own or by conspiring with other people;
- (ii) conducting securities transactions with each other that add up to over 20% of the amount of said securities in twenty trading days at a predetermined time, price and a predetermined method in collaboration with other people;
- (iii) taking oneself as the only party to a transaction and buying or selling to oneself without transferring the right to own the securities, the

海市第二中级人民法院 [The 2nd Intermediate People’s Court of Shanghai Municipality, People’s Republic of China], pending.

¹⁷⁷ 吴黎华[Lihua Wu], 《A股‘3·15’瞄准上市公司》 [A-share Victims Aimed at Listed Companies on March 15] (14 March 2014) 经济参考报 [Economic Information Daily] <<http://finance.people.com.cn/stock/n/2014/0314/c67815-24631028.html>>.

¹⁷⁸ 《中华人民共和国刑法》 [Criminal Law of the People’s Republic of China] (People’s Republic of China) National People’s Congress, 1 January 1980, amended in 1997, 2000, 2001, 2002, 2004, 2005, 2006, 2009, 2011 and 2014, art 182.

¹⁷⁹ 《关于经济犯罪案件追诉标准的补充规定》 [Supplementary Stipulations on Criteria for Prosecuting Economic Crimes] (People’s Republic of China) Supreme People’s Procuratorate and Ministry of Public Security, 5 March 2008, art 4.

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accumulative volume of which exceeds 20% of the trading sum of the said stock in twenty trading days;

- (iv) continuously reporting buying or selling a certain security and cancelling said reporting on the same trading date before the accumulative volume of transactions reach over 50% of the reported trading volume, either on one's own or by conspiring with other people;
- (v) listed companies and their directors, supervisors, senior managers, actual controllers, controlling shareholders or other affiliated parties making use of information for their advantage to manipulate securities trading prices or trading volume of said companies; and
- (vi) other serious means by which securities trading prices are rigged.

Additionally, in September 2007, the CSRC enacted its criteria in identifying price and market manipulation.¹⁸⁰

As to civil actions, the Supreme People's Court will provide judicial interpretations of the *PRC Securities Law*, which concerns proceedings related to market-price manipulation, in the near future. By convention, the judicial interpretation on civil compensation concerning market manipulation will be provided with the *Supplementary Stipulations*, outline above.

In July 2009, Yongqiang Wang sued Jianzhong Wang and Beijing Premiere Investment Consultants Ltd for compensation at the Beijing Second Intermediate People's Court. This is the first civil action concerning market manipulation that was accepted by a Chinese court. The defendant, Jianzhong Wang, who was the legal representative of Beijing Premiere Investment Consultants Ltd, was prosecuted for the crime of market manipulation in August 2012. The plaintiff claimed that he lost more than ¥101,000 from January 2007 to May 2008, when he followed the defendants' investment advisory report to the public and purchased three stocks. In May 2012, this case was concluded; both the Beijing Second Intermediate People's Court (the first instance court) and the Beijing High Court (the second instance court) dismissed the plaintiff's claims on the ground that the plaintiff did not have any evidence indicating the direct relevance between his loss and the defendants' market

¹⁸⁰ 市场操纵认定办法(试行)》[*Guidance on Determination of Manipulating Activities in Securities Market (Trial Implementation)*] (People's Republic of China) China Securities Regulatory Commission, 27 March 2007.

manipulation.¹⁸¹ Another case, *Wenshui Cheng and Yanze Liu v CNNC Hua Yuan Titanium Dioxide*, was also dismissed by the Beijing Second Intermediate People's Court in December 2011.¹⁸² Since the Supreme People's Court has not issued its judicial interpretation on civil compensation concerning market manipulation, local courts lack the legal basis and skills with which to conduct a trial of this kind.

To date, few victims have received compensation in respect of false statements, and no investors have succeeded in any civil action concerning insider trading or market manipulation. The question is: why was the interest of public investors not adequately protected in the current civil proceedings?

IV ENHANCING JUDICIAL GOVERNANCE OF PRIVATE SECURITIES LITIGATION

It took eleven years (from 1991 to 2002) for the courts to change their attitude to civil compensation of securities fraud — from refusing to accept, to conditionally accepting, false statement civil cases — and it took a few more years for courts to accept civil actions of insider trading and market manipulation. Judicial enforcement has been weak in this area.

A *Judicial Enforcement v Administrative Enforcement*

Chen describes three regulatory patterns of securities markets:

- (i) the administrative-oriented model adopted in China;
- (ii) the court-oriented model adopted in the United States and the United Kingdom prior to the mid-twentieth century; and

¹⁸¹ 王玉光[Yuguang Wang], 《股民诉‘股市黑嘴’民事赔偿案被驳回无证据认定股民损失与被告操纵行为有直接关联》 [*The Civil Compensation Case of Investor vs. ‘Stock Market Black Mouth’ Was Dismissed; No Evidence Shows That the Plaintiff’s loss is directly related to the Defendants’ Market Manipulation*] (20 December 2011) <<http://www.110.com/ziliao/article-264313.html>>.

¹⁸² 天津证监局[CSRC Tianjin Branch], 《十年维权路漫漫: 投资者权益保护稳步前行》 [*The Long Way in the Last Decade for Civil Compensation Defenders: Investor Protection Is Steadily Approaching*] (10 October 2012) 中国证券监督管理委员会 [China Securities Regulatory Commission] <http://www.csrc.gov.cn/pub/tianjin/xxfw/tjfxjy/tjtzzyqbh/201210/t20121010_215613.htm>.

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- (iii) the current 'administration + court' model currently adopted in the United States and the United Kingdom.

The third pattern is a trend in many countries.¹⁸³ China's current securities regulatory bodies include the CSRC and attached agencies, the self-regulatory organisations (the stock exchanges and the Securities Association of China) and the People's Courts. According to Gang Xiao, Chairman of the CSRC, of the 122 administrative cases concerning false statements handled by the CSRC from 2006 to 2012, only some investors claimed for compensation of ¥384 million against 46 listed companies, though many others missed opportunities for compensation. Those who sued the 46 listed company defendants only received compensation of approximately ¥67 million.¹⁸⁴ Conflicts arise in the allocation of residual enforcement rights between the administrative enforcer and the judicial enforcer within the current legal framework. Considering the overly expanded administrative powers in China, judicial enforcement should be greatly enhanced in order to effectively improve the legal protection of public investors. To this end, China should transition from an administrative-oriented model to the 'administrative + court' model.

The International Organization of Securities Commissions (IOSCO) sets the objectives of securities regulation as: protecting investors; ensuring transparency, fairness and efficiency of securities markets; and reducing systematic risks.¹⁸⁵ In the 31st annual meeting of IOSCO (Hong Kong) of June 2006, the chairman of the CSRC announced that China would be adopting the *Objectives and Principles of Securities Regulation* to improve regulation of securities. China's current judicial review system provides basic institutional arrangement for setting boundaries between court enforcement and executive enforcement. Nevertheless, there are still many specific problems in the practice of law enforcement.

An important area is the relationship between administrative enforcement and judicial enforcement to manage the criteria for the judicial review. Chinese courts

¹⁸³ 陈志武[Zhiwu Chen], 《证监会、法院与人大：如何分管证券市场？》 [*How do the CSRC, the Courts and the National People's Congress Supervise the Securities Markets Separately?*] (12 December 2002) <<http://www.china-review.com/sao.asp?id=1385>>.

¹⁸⁴ 李光磊[Guanglei Li], 《资本市场行政和解或让民事赔偿不再'路漫漫'》 [*Administrative Settlement of Capital Markets Makes Civil Compensation No Longer a Long Way*] (21 February 2014) 金融时报 [*Financial Times*] <<http://finance.sina.com.cn/stock/stocktalk/20140221/062418286654.shtml>>.

¹⁸⁵ International Organization of Securities Commissions (IOSCO), *Objectives and Principles of Securities Regulation* (May 2003), <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>>.

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have played a relatively passive role in the past two decades, and the judiciary seems to insist on judicial restraint in securities regulation.¹⁸⁶ In deference to the administrative section, the Supreme People's Court sets the precondition of administrative sanction as the prerequisite of securities-related civil compensation.¹⁸⁷ That is, relevant civil action cannot start until the CSRC makes an administrative sanction. The CSRC is under pressure both from disciplined parties and investors. Some violators use judicial review to bring lawsuits against the CSRC to remedy administrative punishment. Wrongdoers may even use administrative action as a strategy to put off forthcoming civil action. From the perspective of investors, they expect that the CSRC will sanction wrongdoers in the stock market so that they can seek civil remedy. Expectations of investors and the risk of litigation from violators enlarge the workload of the CSRC. However, considering the negative effects on civil compensation, this prerequisite stipulation seriously weakens the efficiency of remedies for investors. Although civil remedies should take precedence over administrative penalties, violators pay administrative fines first because civil actions have to wait for the result of administrative decisions. Some violators thus avoid bearing civil liabilities from their wrongdoings when they are not able to afford both. Thus, the administrative sanction of certain securities cases should not be regarded as the prerequisite for filing a civil action related to securities fraud.

In the recent reform of the CSRC, a system of reconciliation has been introduced in administrative regulation. This mechanism leaves room for the regulator and wrongdoers to reach a compromise instead of the general application of administrative punishment or sanction. In terms of a cost-benefit analysis, this system is suitable to resolve slight violations and reduces the CSRC's exposure to administrative lawsuits. It is also a way to avoid administrative sanction. This legal reform is an attempt to improve interaction and increase the flexibility of current executive sanctions. The CSRC has gained greater powers of law enforcement. The CSRC can freeze suspected bank accounts and may also take measures to restrict the purchase and sale of securities.¹⁸⁸ These restrictions can last no longer than 15 trading

¹⁸⁶ Judicial restraint refers to judges limiting the exercise of their own power. That is, judges should only interpret and declare law rather than making law.

¹⁸⁷ See 《最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定》 [Certain Provisions of the Supreme People's Court on Trial of Civil Compensation Cases Arising from False Statement in Securities Market] (People's Republic of China) Supreme People's Court, 9 January 2003, art 5.

¹⁸⁸ 中国证券监督管理委员会限制证券买卖实施办法》 [Measures of China Securities Regulatory Commission for Restricting the Purchase and Sale of Securities] (People's Republic of China)

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days but can be extended up to another 15 trading days upon approval.¹⁸⁹ These new measures aim to improve the efficiency of enforcement.

B Judicial Review: A Means to Restrict Administrative Power

The preceding section demonstrates that courts are participants in administrative actions, albeit relatively passive participants. While there must be some compromise and interaction between the judiciary and the executive, on the ground that the judiciary should show the necessary respect to the executive, the judiciary should not kowtow to overly-expanded executive power, or retreat from the rule-of-law. On the basis of the judicial reviews of *Hainan Kaili Central Development and Construction Co, Ltd v China Securities Regulatory Commission (CSRC)*,¹⁹⁰ Chinese courts appear to show considerable deference to the defendant government regulator in securities-related administrative lawsuits, rather than restricting procedural or substantial violations, *ultra vires* or abuse of administrative power.¹⁹¹

This proposition is supported by the *Provisions of the Supreme People's Court on Issues Concerning the Withdrawal of Charges in Administrative Proceedings* enacted by the Supreme People's Court in January 2008, which allow the accused executive organization to change their administrative act prior to the end of the administrative lawsuit.¹⁹² In addition, these provisions allow the plaintiff to withdraw the lawsuit if the defendant changes certain administrative acts under the following circumstances:

China Securities Regulatory Commission, Order No 45, 18 May 2007, art 4.

¹⁸⁹ Ibid art 5.

¹⁹⁰ 海南凯立公司诉中国证监会案》[*Hainan Kaili Central Development & Construction Co, Ltd (Kaili) v CSRC*], 北京市第一中级人民法院 [First Intermediate People's Court of Beijing Municipality, People's Republic of China], 一中行初字第 118 号 [Administrative Case No 118], 8 December 2000.

¹⁹¹ From 1990 to August 2003, the 1st Beijing Intermediate People's Court dealt with nine administrative cases concerning securities supervision. *Hainan Kaili Central Development & Construction Co Ltd (Kaili) v CSRC* was one of the few cases of a 'civilian beating the government'. See 林民华, 胡华峰, 崔文俊 [Minhua Lin, Huafeng Hu and Wenjun Cui], 《GATS 与证券行政案件几个问题的探讨》 ['Discussion on GATS and a Few Issues of Securities-Related Administrative Cases'] (2003) 21(6) 《政法论坛-中国政法大学学报》 [Tribune of Political Science and Law: Journal of China University of Political Science and Law] 139, 139-49.

¹⁹² 最高人民法院关于行政诉讼撤诉若干问题的规定》[*Provisions of the Supreme People's Court on Issues Concerning the Withdrawal of Charges in Administrative Proceedings*] (People's Republic of China) Supreme People's Court, 14 January 2008, art 1.

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- (i) The application for withdrawal of the suit represents the true intention of the plaintiff;
- (ii) the changes made by the defendant to the alleged specific administrative action do not violate the prohibitive provisions of the laws and administrative regulations, do not exceed or waive its functions, and do not damage the public interests and legal rights and interests of others;
- (iii) the defendant has changed or decided to change the alleged specific administrative action, notified in writing to the People's Court; or
- (iv) no objection has been raised by any third party.¹⁹³

This judicial interpretation is intended to establish more effective relationships with checks and balances between the trial court, the administrative subject and the subject of the administrative act.

Judicial review should help to boost legal transparency and enforcement concerning securities litigation in China. As an effective supervisory mechanism to restrict over-expanded administrative power, judicial review could facilitate the 'impartiality and transparency' of law enforcement. As an attempt to delineate the boundary of judicial regulation and administrative regulation, *Hainan Kaili Central Development and Construction Co Ltd v CSRC* is of great significance,¹⁹⁴ not only because it represents the first time that the CSRC failed in its defense, but also because the trial court reviewed the CSRC's stock issuance system. Thus, this case sets a good example for the transition from an administrative-oriented to an 'administration + court' regulatory system.

¹⁹³ Ibid art 2.

¹⁹⁴ 海南凯立公司诉中国证监会案》[*Hainan Kaili Central Development & Construction Co, Ltd (Kaili) v CSRC*], 北京市第一中级人民法院 [First Intermediate People's Court of Beijing Municipality, People's Republic of China], 一中行初字第 118 号 [Administrative Case No 118], 8 December 2000. See also 林民华, 胡华峰, 崔文俊 [Minhua Lin, Huafeng Hu and Wenjun Cui], 《GATS 与证券行政案件几个问题的探讨》 ['Discussion on GATS and Several Issues in Administrative Cases of Securities'] (2003) 21(6) 《政法论坛-中国政法大学学报》 [*Tribune of Political Science and Law: Journal of China University of Political Science and Law*] 139, 139-49.

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C Judicial Interpretation

As a traditional civil law country, judicial interpretation was not initially an official legal resource in China. However, as a result of the development of legal practices over the past two decades, judicial interpretation now plays an increasingly important role in applying or even making law. The *Resolution of the Standing Committee of the National People's Congress Providing an Improved Interpretation of the Law* described the division¹⁹⁵ between the legislature and judiciary.¹⁹⁶ The Standing Committee of the National People's Congress has the right to enact stipulations by means of decrees. It also takes responsibility for providing interpretations if the laws and decrees themselves need to be further defined or additional stipulations need to be made. At the same time, the Supreme Court is responsible for making interpretations related to the specific application of laws and decrees in court trials.¹⁹⁷ The *Provisions of the Supreme People's Court on the Work Concerning Judicial Interpretation* (2007) clarifies the nature, effect, classification, and procedure of judicial interpretation.¹⁹⁸ It stipulates that judicial interpretation made and enacted by the Supreme People's Court shall have legal effect.¹⁹⁹

Additionally, the *Provisions on Banning the Entry into the Securities Market* (2008) prescribes that the power to make judicial interpretations on specific issues concerning the application of law in trial work of the People's Courts shall remain with the Supreme People's Court.²⁰⁰ Judicial interpretation by the Supreme Court shall include the stages of project initiation, drafting and filing, discussion, promulgation, implementation and reporting for the record.²⁰¹ The research office of the Supreme Court is responsible for project initiation, examination, approval, and also the coordination of judicial interpretations. The Supreme Court supervises the application of its interpretations in the trials in all local People's Courts and specific courts; the upper level People's Courts supervise the application of judicial

¹⁹⁵ See 《全国人民代表大会常务委员会关于加强法律解释工作的决议》 [*Resolution of the Standing Committee of the National People's Congress on Reinforcing the Legal Interpretation*] Standing Committee of the National People's Congress, 10 June 1981.

¹⁹⁶ *Ibid.*

¹⁹⁷ *Ibid* art 1–2.

¹⁹⁸ See 《最高人民法院关于司法解释工作的规定》 [*Provisions of the Supreme People's Court on the Work Concerning Judicial Interpretation*] (People's Republic of China) Supreme People's Court, 9 March 2007.

¹⁹⁹ *Ibid* art 4.

²⁰⁰ *Ibid* art 2.

²⁰¹ *Ibid* art 9–26.

interpretations in lower level People's Courts.²⁰² Since case decisions do not have an official legal status in China, judicial interpretations are playing an increasingly important role in trials. Since there were no judicial interpretations relating to insider trading and market-price manipulation, these kinds of civil claims could not be filed in courts until 2007.

To some extent, the judicial interpretations of the Supreme People's Court serve as a bridge between statutes and precedents, and partially fulfil the function of case law. However, judicial interpretation cannot completely replace case law. Although the 2003 *Judicial Interpretation* resolved the difficulty investors had in filing civil actions, it cannot deal with all the specific circumstances of individual cases.

On occasion, the Supreme People's Court goes a little far in using the power of interpretation. The CSRC submitted the *Guidance on Determination of Insider Trading Activities in Securities Market (Trial Implementation)*²⁰³ and the *Guidance on Determination of Manipulating Activities in Securities Market (for Trial Implementation)*²⁰⁴ to the Supreme People's Court in 2007. The Supreme People's Court will enact its relevant judicial interpretations related to insider trading and market manipulation. Those involved in these violations may be banned from the stock market.²⁰⁵ In that circumstance, this judicial interpretation actually serves as quasi-legislation.

D Judicial Independence

Many Chinese scholars believe that the lack of judicial independence, government intervention, and the influence of interest groups all result in poor investor protection in China.²⁰⁶ Additionally, there is a shortage of professional judges and poor judicial

²⁰² Ibid art 28.

²⁰³ 证券市场内幕交易行为认定指引(试行)》〔*Guidance on Determination of Insider Trading Activities in Securities Market (Trial Implementation)*〕 (People's Republic of China) China Securities Regulatory Commission, 27 March 2007.

²⁰⁴ 市场操纵认定办法(试行)》〔*Guidance on Determination of Manipulating Activities in Securities Market (Trial Implementation)*〕 (People's Republic of China) China Securities Regulatory Commission, 27 March 2007.

²⁰⁵ See 《证券市场禁入规定》〔*Provisions on Banning the Entry into the Securities Market*〕 (People's Republic of China) China Securities Regulatory Commission, 22 June 2008, art 3.

²⁰⁶ 栾天虹[Tianhong Luan], 《投资者法律保护的理论与实证研究》〔*Theoretical and Empirical Research on Investors' Legal Protection*〕 (浙江大学出版社 [Zhejiang University Press], 2005) 181-4.

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governance. These are significant barriers that Chinese courts must overcome if they are to provide effective investor protection.

Regarding the decision-making process in securities litigation, trial judges are not usually involved in judgments or verdicts. Apart from the judges of the collegial panel, other people or organizations may participate in and influence adjudication, including the director of the civil tribunal, the president or vice-president of the court, the corresponding higher level People's Court, the Political & Legal Committee and the local government.

A series of international documents, including the *Universal Declaration on the Independence of Justice* (Montreal 1983),²⁰⁷ the *Beijing Statement of Principles of the Independence of the Judiciary in the LAWASIA Region* (1997),²⁰⁸ the *Universal Charter of the Judge* (1999)²⁰⁹ and the *Mt, Scopus International Standards of Judicial Independence 2008*,²¹⁰ establish certain basic requirements for the independence of courts and judges. The *Montreal Declaration on the Independence of Justice* (1983) states that the independence of judges includes substantive independence, personal independence and internal independence. Substantive independence refers to conducting trials, making verdicts, conducting procedural petitions, examining evidentiary effect and the competency of evidence.²¹¹ Personal independence requires that promotion, salary, retirement, disciplinary and other matters concerning judges should not be under the control of

²⁰⁷ *The Universal Declaration on the Independence of Justice* ('the Montreal Declaration 1983'), adopted at the final plenary session of the first world conference on the independence of justice held in Montreal (Quebec, Canada) on June 10th, 1983.

²⁰⁸ *The Beijing Statement of Principles of the Independence of the Judiciary in the LAWASIA Region* (1997), first adopted at the 6th conference of Chief Justices held in Beijing in August 1997 and amended in Manila on August 28, 1997. 32 Chief Justices signed in Asian Pacific Region by now.

²⁰⁹ *The Universal Charter of the Judge* was adopted at the meeting of the Central Council of the International Association of Judges in Taipei, Taiwan on November 17, 1999.

²¹⁰ *The Mt Scopus International Standards of Judicial Independence* was approved by the International Association of Judicial Independence and World Peace in Jerusalem on March 19, 2008, as amended in 2011 and approved in 2012.

²¹¹ See International Association of Judges, *The Universal Charter of the Judge* <<http://www.iaj-uim.org/universal-charter-of-the-judges/>>. Article 1 of the Charter notes that 'Judges shall in all their work ensure the rights of everyone to a fair trial. They shall promote the right of individuals to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law, in the determination of their civil rights and obligations or of any criminal charge against them.'

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the administrative authority.²¹² Internal independence requires that judges remain independent from their superiors and also higher courts.²¹³ We can compare the independence of judges in China with the criteria laid out by the *Montreal Declaration on the Independence of Judges* (1983):

	Criteria Set by the <i>Montreal Declaration on the Independence of Judges</i> (1983)	The 'Independent' Status of Chinese Judges
The Substantial Independence	Judges should be independent in: <ol style="list-style-type: none"> i. conducting trials; ii. making judgments; iii. conducting procedural petitions; and iv. examining the evidentiary effect and competence of evidence. 	Judgments made by Chinese judges may be restricted by: <ol style="list-style-type: none"> i. the trial committee of the court; ii. meetings of the court tribunal; the approval system of the director of the tribunal and/or director of the court; iv. the higher court and the judges of the higher court; v. the influence on the judgment from the Politics and Law Committee; vi. the influence on the judgment from local government; or vii. Supervision from People's Congress.
Personal Independence	Judges should be independent from the administrative authority in such	The nomination and appointment, salary, promotion, security of tenure and judicial ethics of

²¹² See *U.N. Basic Principles on the Independence of the Judiciary*, (1985), art 11, Adopted by the Seventh United Nations Congress and endorsed by General Assembly resolutions 40/32 of 29 November 1985 and 40/146 of 13 December 1985 and endorsed by General Assembly resolutions 40/32 of 29 November 1985 and 40/146 of 13 December 1985, which notes that 'the term of office of judges, their independence, security, adequate remuneration, conditions of service, pensions and the age of retirement shall be adequately secured by law'.

²¹³ See International Association of Judges, *The Universal Charter of the Judge* <<http://www.iajuim.org/universal-charter-of-the-judges/>>. Here it was noted that 'the judge, as holder of judicial office, must be able to exercise judicial powers free from social, economic and political pressure, and independently from other judges and the administration of the judiciary'.

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	Criteria Set by the <i>Montreal Declaration on the Independence of Judges</i> (1983)	The 'Independent' Status of Chinese Judges
	aspects as: i. promotion; ii. salary; iii. retirement arrangements; iv disciplinary measures; v security of tenure; and other matters concerning the judges' terms of employment and personal arrangements	Chinese judges are stipulated by the Judges Law. All these matters concerning judges are operated by the Politics Department of the court in accordance with the management model of administrative staff in the administrative authority. Promotion of judges is based on both work performance and political criteria. The latter criteria depend on their loyalty to CCP.
Internal Independence	Judges should be independent from their superiors or the higher court in confirming the facts and applying the law.	Chinese judges may consult the higher court regarding major and difficult cases. Sometimes the higher court may actively communicate with judges on certain cases.

Figure 3: Independence of Judges: The Montreal Declaration and Judges in China

The independence of the judiciary includes the independence of courts and the independence of judges. The independence of individual judges means judges should impartially exercise their duties free from political interference or control of any political party. Judicial committees have weakened the independence of courts from administrative authority. Judicial committees are established at all levels of Chinese courts, based on the principles of 'democratic centralism'. Judicial committees discuss important and difficult issues related to trials.²¹⁴ Decisions of judicial committees are binding on collegial panels of judges. Therefore, securities lawsuits are generally controlled by three levels of judicial organisations: the collegial panel of judges, the heads of civil tribunals, and judicial committees. Indeed, major decisions relating to influential securities cases, such as litigation, are usually made by judicial committees instead of judges hearing cases. In many Chinese courts, judgments must be approved by judicial committees. The routine work of judicial committees is led by the secretariat of the Politics and Law Committee in

²¹⁴ 《中华人民共和国人民法院组织法》 [Organic Law of People's Court of the People's Republic of China] (People's Republic of China) National People's Congress, 31 October 2006, art 10.

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government. Examination of practice reveals that judicial committees lack transparency and that their work proceeds in a relatively arbitrary way. The establishment of judicial committees, as the actual organ for trials, establishes a hierarchical system of judgments or rulings in People's Courts, and clearly affects the independence of courts. This system of judicial administration and management violates the independence of the judiciary. Consequently, some reform of the system of judicial committees is essential.

In accordance with the *PRC Civil Procedure Law*, the judgments and rulings of the second instance shall be final.²¹⁵ Judgments and rulings of the first instance, if they cannot be appealed according to law, or have not been appealed within the prescribed time limit, can be final and effective.²¹⁶ At the same time, China's *Civil Procedure Law* prescribes supervision of effective judgments and rulings. A retrial can take place in the following circumstances:²¹⁷

- (i) the president of a People's Court may exercise his or her discretion to refer the case to the adjudication committee if they find definite errors in a legally effective judgment or ruling rendered by the court;
- (ii) the Supreme People's Court may order a retrial conducted in the Supreme People's Court if definite errors are found in a legally effective judgment or ruling rendered by a local court at any level, or it may direct the People's Court at lower levels to conduct a re-adjudication;
- (iii) a party who believes that a legally effective judgment or ruling contains errors may petition the People's Court at the next level for a retrial without suspending the judgment or ruling during the retrial period; or
- (iv) the people's congress at the corresponding level may conduct a retrial. Although retrials are uncommon, the existence of supervision may theoretically lead to an endless inquiry of effective adjudications. There should, therefore, be the times limits regarding the initiation of retrials.

²¹⁵ 中华人民共和国民事诉讼法》[*Civil Procedure Law of People's Republic of China*] (People's Republic of China) National People's Congress, 9 April 1991, amended in 2008 and 2013, art 158.

²¹⁶ *Ibid* art 141.

²¹⁷ *Ibid* art 177 and 179.

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Two main factors thwart judicial independence: first, the highly administrative management of People's Courts; and secondly, local protectionism, which leads to interference in the judiciary. Unlike many common law countries, the management of the People's Courts is very similar to China's administrative organisations. Localisation seriously affects the impartiality of the securities adjudications, too. Court jurisdictions follow China's administrative divisions. Local government at various levels of the administrative regions may exert considerable influence on courts in corresponding jurisdictions; this includes influencing decisions relating to the personnel of courts, budgeting, or to the management of specific trials. For example, the heads of politico-legal committees of local government can be involved directly or indirectly in decisions related to court personnel, and also provide instructions on individual cases. According to the stipulated jurisdiction in relation to securities disputes, many important securities disputes are handled by the People's Court at the abode of the defendant. Some defendants have made use of their 'geographic and networking advantages' to exert pressure on the trial court. In the case of *Zaoding Yan et al v Guang Xia (Yinchuan) Industry Co Ltd*,²¹⁸ the Yinchuan Intermediate Court made many decisions on filing, compensation, and enforcement in favor of the defendant. Another typical case involving local protection was the case of *Mr. Wang v Hubei Jianghu Ecology Co Ltd*, previously named as 'Hubei Lantian Company Limited').²¹⁹ Protected by local government, the accused was never listed as the defendant by the local court. In many cases, maladministration and local protectionism seriously impair the exclusive competence of People's Courts and undermine the independence of courts.

In summary, the courts should play a more active role in reforming the relevant legal infrastructure in a situation of legislative supremacy, over-expanded administrative power, and a relatively weak judiciary. This legal reform can further reshape current regulation to develop an investor protection centered legal framework.

²¹⁸ 阎皂定等诉广夏（银川）实业股份有限公司》 [*Zaoding Yan et al v Guang Xia (Yinchuan) Industry Co, Ltd - False Statement Dispute Case*], 宁夏银川中级人民法院 [Yinchuan Intermediate Court], 2006.

²¹⁹ 王某诉湖北江湖生态农业股份有限公司诉讼案》 [*Mr. Wang v Hubei Jianghu Ecology Co, Ltd*], 湖北省武汉市中级人民法院 [Hubei Province Wuhan Municipal Intermediate People's Court, People's Republic of China], 2007.

VII CONCLUSION

Misappropriation by controlling shareholders is a common problem of corporate governance all over the world, especially in legal systems that cannot provide adequate protection for public shareholders. Unfortunately, Chinese courts, as the last resort, have not been active in enhancing legal protection to public investors. China's legal infrastructure and enforcement are poor, allowing controlling shareholders to easily manipulate actual control rights of listed companies and to maximize their own benefits rather than those of investors. Statistics at the beginning of this article indicate that Chinese courts have played a weak role in supporting the victims of securities fraud. It is estimated that, so far, less than 10% of victims have succeeded in gaining civil compensation through securities action in China.²²⁰ Legal resources have not been put to good use to protect the interests of investors. Further, failings of the current enforcement framework, such as inadequate, selective, inefficient or ineffective enforcement make things even worse. '*A right without remedy is not right*'.²²¹

China's courts held a passive attitude towards securities litigation prior to 2002. That changed, however, in early 2003 with the emergence of the policy of 'civil compensation for false statements' subsequent to the Supreme People's Court issuance of the *Notice of Certain Issues on the Admission of Civil Tort Dispute Cases Concerning False Statements in the Securities Market*. In 2006, the Supreme People's Court further decided that civil compensation for securities frauds was a crucial research project. Chinese courts still need to accumulate experience in the calculation of loss, causation of loss and fraud, and litigation procedures for securities frauds. This article provides the following proposals in improving relevant judicial governance:

- (i) the removal of the outdated 'procedural prerequisite of securities civil litigation';
- (ii) the introduction of class action and a reverse in *the burden of proof* in private securities actions; and
- (iii) the enhancement judicial independence and judicial governance.

²²⁰ 宋一欣[Yixin Song], 《证券民事赔偿经历七年之痒》 [*Securities Civil Compensation Experienced Seven Year Itch*] (8 May 2006) 新浪财经 [Sina Finance]. <<http://finance.sina.com.cn/stock/stocktalk/20060508/18542550117.shtml>> (accessed 8 November 2014)>.

²²¹ *Ubi jus, ibi remedium*. This maxim was recorded by English laws around 13th century (King Edward I), meaning 'there is no right without a remedy'.