PRIVATE SECURITIES LITIGATION IN CHINA:
MATERIAL DISCLOSURE ABOUT CHINA'S LEGAL SYSTEM?

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1. INTRODUCTION

This article examines private securities litigation in the People's Republic of China ("PRC" or "China").1 The Supreme People's Court of the PRC has recently enacted rules that establish parameters for private securities litigation.2 This Article analyzes the new rules, their context, and their significance. The analysis reveals that several daunting obstacles confront plaintiffs who wish to bring private securities litigation in China. Based on these obstacles, it appears unlikely that this form of investor protection will flourish in the PRC. However, the complexity of China's political economy prompts qualification of that forward-looking statement. If this form of litigation does flourish in China, its

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1 Specifically, this Article discusses private securities litigation on the mainland of the People's Republic of China ("PRC" or "China"); Hong Kong's stock market is inside the PRC since the reversion of Hong Kong to mainland sovereignty on July 1, 1997, and the PRC considers Taiwan to be a province of the PRC. However, both Hong Kong and Taiwan regulate their stock markets independently. Nonetheless, regulators from Hong Kong have been important players in the formation of mainland stock exchange policy. Anthony Neoh (Liang Dingbang) and Laura Cha (Shi Meilun) are two former Hong Kong securities regulators who have worked for the mainland China Securities Regulatory Commission ("CSRC"). Regulatory models from Taiwan have also influenced PRC stock market policy, particularly with respect to the mainland's recently-enacted Qualified Foreign Institutional Investor ("QFII") system.

2 See Guanyu shenli zhengquan shichang yin xujia chenshu yinfade minshi peichang anjian de ruogan guiding [Several Regulations Concerning the Adjudication of Civil Compensation Securities Cases Based upon Misrepresentation], (Supreme People's Court, Jan. 9, 2003) [hereinafter PSL Rules] available at http://www.people.com.cn/GB/jinji/35/159/20030110/905268.html (last visited June 1, 2003); 17 CHINA L. & PRAC. 53, 53-62 (Mar. 2003). Translations from Chinese used herein are by the Author unless otherwise noted.
impact could be enormous. Millions of domestic securities market participants could be affected. Due to regulatory changes identified in this article, many foreign investors could also be affected. Additionally, analysis of China’s approach to private securities litigation provides material disclosure about the current status of China’s legal system. It offers a window into the emergence of the rule of law and civil society in China and illuminates core difficulties of PRC reform efforts.

More than nine hundred private securities suits are now pending in China. The international accounting firm KPMG has already been named as a defendant for its role in auditing a PRC listed company. Goldman Sachs, Morgan Stanley, and J.P. Morgan Chase & Company (“JP Morgan”) are among the many globally prominent firms pursuing opportunities created by recent reforms in China’s securities sector, and they too may become entangled in this form of litigation. In addition to its importance for domestic and foreign investors, the development of private securities litigation in China also offers rich material for comparative law scholars. The robust debate in law reviews over recent years concerning how securities markets evolve and how they can best be regulated has largely ignored the important case of China. By detailing the functional and structural context of PRC securities markets, this article can help scholars who are not China specialists consider the PRC in those debates.

Section 2 describes private securities litigation in general, recounts its development in China, and provides critical background on China’s securities markets by identifying some of their “special characteristics.” Section 2 also explains the utility of a U.S. perspective for evaluating PRC securities regulation while acknowledging the danger of applying an inappropriate model to China. Section 3 critiques the substance of the new Supreme

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3 See Li Guoguang Gaoji Touzizhe: Dui Susong Fengxian Yingyou Xinti Zhunbei [Li Guoguang Tells Investors: Prepare Psychologically for Litigation Risks], SHANGHAI ZHENGQUAN BAO WANGLUO BAN [SHANGHAI SECURITIES TIMES ONLINE EDITION], Jan. 10, 2003 (reporting comments of Vice President of Supreme People’s Court that nine hundred private securities suits are pending throughout China) (on file with author).

4 See KPMG Faces Suit from Minority Shareholders, CHINA MORNING POST, Feb. 12, 2003 (reporting private securities litigation in PRC against KPMG for its role as auditor for PRC-listed Jinzhou Port) (on file with author).

People's Court rules on private securities litigation, identifying several significant obstacles plaintiffs will face. Among these obstacles, plaintiffs cannot attack insider trading and market manipulation through private securities litigation in China, and even some victims of disclosure fraud are denied relief. Government action must precede all private suits, and U.S. style class actions are not permitted. Finally, the jurisdictional requirements favor defendants. Given these aspects of the new rules, Section 3 then considers the prospects for private securities litigation in China, finding some reasons to hope that private securities litigation can flourish despite the many obstacles. Section 4 expounds upon the potential significance of private securities litigation in China, underscoring its relevance for domestic securities market participants, foreign investors, and academics. Section 5 broadens the analysis, contemplating what China's approach to private securities litigation discloses about China's legal system. It finds that ignorance of alternative approaches is rarely a factor driving PRC legal development, at least at a national level. China's approach to private securities litigation also discloses that state control remains at the core of Chinese regulation, although an extensive body of law has been developed to shape, and sometimes, limit, the exercise of that control. It is also apparent that PRC courts remain weak and engage in procedurally dubious rulemaking. Entrepreneurial lawyers, however, are now significant actors with respect to some PRC legal developments. Additionally, public discourse, though still subject to authoritarian repression in many areas, can be surprisingly critical of the government with respect to certain matters. Finally, China's approach to private securities litigation is analogous to some of the complexity and uncertainty that characterize PRC reform efforts. China's reform ambitions—legal and otherwise—often collide with political intransigence and prudential concerns, giving reforms an ambiguous character. No one knows where these complex dynamics will lead. There can be no assured outcome with respect to private securities litigation, much less with respect to overall political evolution in China.

2. BACKGROUND

2.1. General Description of Private Securities Litigation

Private securities litigation is civil litigation concerning
It is different from administrative enforcement or criminal prosecution. Those forms of action may penalize a defendant's behavior without providing any compensation to harmed investors. Also, those forms of action generally require active intervention by a governmental party—an administrative agency or criminal prosecutor must challenge some behavior whereas in private securities litigation an aggrieved investor seeks relief directly. Defendants are typically firms that issue securities, parties that trade securities, and other market participants such as underwriters, accounting firms, law firms, and individuals who work in these organizations. The basis for relief is generally that some kind of fraud has occurred, typically false disclosure, insider trading, or market manipulation. Claims are not usually predicated on general tort or contract theories alone, but rather are based on statutory or regulatory causes of action specific to securities law.

In addition to providing defrauded investors with a means to

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6 There is no universal definition of "securities." The PRC Securities Law does not define "securities," though the scope of the law is defined as applying to the issuing and trading of stocks, bonds, or other "securities" approved by the State Council within the PRC. See Zhonghua Renmin Gongheguo Zhengquan Fa [hereinafter PRC Securities Law], art. 2. (1999), translated in 13 CHINA L. & PRAC. 25, 25-66 (1999) (National People's Congress, Dec. 29, 1999). The scope of U.S. securities laws is broader, extending to the amorphous realm of investment contracts. See, e.g., SEC. v. Howey Co., 328 U.S. 293, 301 (1946) (establishing a test for determining when an investment contract constitutes a security, and stating, "[t]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others.").

7 Of course, the government has a role in private securities litigation. The dispute resolution forum and the rights and obligations being disputed are created with government participation. See Donald C. Clarke, Regulation and its Discontents: Understanding Economic Law in China, 28 STAN. J. INT'L L. 283 (1992) (arguing that PRC market development requires not only the diminishment of state economic planning but also state activism to build legal infrastructure).

8 For a thorough discussion of securities regulation, see 1-11 LOUIS LOSS & JOEL SELIGMAN, SECURITIES REGULATION (3d ed. 1989-2002). See 3 LOSS & SELIGMAN, supra ch.3 (providing information on the coverage of the Securities Act of 1933); see also 6 LOSS & SELIGMAN, supra ch. 6 (outlining the registration and post-registration provisions of the 1934 Act); 7 LOSS & SELIGMAN, supra ch.7 (explaining the regulation of the securities markets); 8 LOSS & SELIGMAN, supra ch.8 (providing information on the regulation of the brokers, dealers, and investment advisers).

9 See 9 LOSS & SELIGMAN, supra note 8, ch. 9 (outlining the elements of fraud among issuers and insiders); see also 10 LOSS & SELIGMAN, supra note 8, ch. 10 (providing information on market manipulation).

10 See 1-3 LOSS & SELIGMAN, supra note 8, ch. 1-3 (documenting the basis for applying the statutory and regulatory causes of action in securities law).
recover damages, private securities litigation can also stimulate the development of securities markets by strengthening incentives for legal compliance. In a given case, the number of plaintiffs and amount in controversy can be enormous; everyone who owned or traded a particular security may seek to recover damages when its value declines. The threat of such massive liability can stimulate behavior to avoid it. For example, companies are more likely to comply with disclosure duties if not doing so subjects them to serious liability risks. Markets with less disclosure fraud are then able to attract more funds and investors. The availability of capital then attracts more firms willing to operate transparently in return for comparatively low-cost external financing. This virtuous cycle can stimulate the development of robust securities markets.

Private securities litigation is authorized by many jurisdictions with substantial securities markets, though the degree to which it flourishes in practice varies substantially. The availability of class actions and the incentives for plaintiffs’ lawyers, such as large contingency fees, influence the preponderance of private securities litigation in particular jurisdictions. The world’s preeminent securities markets are those located in the United States, where private securities litigation plays an important role. United States securities law has influenced the development of PRC securities law, and this article will generally apply a U.S. perspective to the development of private securities litigation in China.

2.2. The Development of Private Securities Litigation in China

Effective February 1, 2003, Chinese courts shall adjudicate private securities litigation on the basis of rules issued by the PRC Supreme People’s Court. These rules, titled Several Regulations

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14 For additional discussion of this approach, see discussion infra Section 2.4.
Concerning the Adjudication of Civil Compensation Securities Cases Based upon Misrepresentation ("PSL Rules"), provide detailed parameters for private securities litigation in China.\textsuperscript{15} Organized in thirty-seven articles, the PSL Rules address: who may sue whom for what; who is eligible as plaintiff and defendant; and what behavior is actionable. The PSL Rules also address: the statute of limitations applicable to private securities litigation; which PRC courts have jurisdiction; what evidence plaintiffs must produce, when courts are to find causality between asserted illegal conduct and investor losses; what procedural forms of litigation are possible, and how to calculate damages.\textsuperscript{16}

The development of China's approach to private securities litigation has not been straightforward. A number of cases were filed before promulgation of the PSL Rules.\textsuperscript{17} However, no PRC court granted relief to a plaintiff, despite the existence of various legal provisions upon which they might have relied. For example, the PRC's General Principles of Civil Law provide that tort victims

\textsuperscript{15} See PSL Rules, supra note 2.

\textsuperscript{16} See Gao Fa Chutai Guanyu Zhengquan Minshi Qinquan Shoubu Xitong Sifa Jieshi [Supreme People's Court Unveils the First Systematic Judicial Interpretation Concerning Securities Torts], XINHUA NETWORK, Jan. 9, 2003 (outlining general provisions of the PSL Rules).

\textsuperscript{17} In 1996, Liu Zhongmin sued Shandong Bohai Corporation for RMB 1,040 (USD 125) after shares he bought in the company lost value following assessment by the CSRC of a penalty against the company for false accounting disclosure. His complaint was rejected in the first instance, and the verdict was upheld on appeal. Liu Zhongming v. Bohai Group, Jizhongjinghizhongzi No. 41, (Jinan Intermediate People's Court, Aug. 12, 1998), available at http://business.sol.sohu.com/10/25/article204292510.shtml (last visited on June 1, 2003).

PRC and foreign sources often erroneously cite another noted case as the first attempt at private securities litigation in China. On December 4, 1998, Jiang Shunzhen, an aggrieved shareholder of Shanghai-listed Hongguang Industrial Company Limited sought to recover losses of RMB 3,136 (USD 378), by suing twenty-four parties, including the underwriter Guo Tai Securities Corporation, the accounting and appraisal firms involved in the initial public offering ("IPO") and various other individuals. The Pudong People's Court rejected the suit in April 1999, even though the CSRC previously determined that the company engaged in fraudulent behavior, including falsely inflating profits and hiding negative financial information. See Zhengjia +\textsuperscript{c}azi [1998] 75 hao [CSRC Administrative Investigation No. 75, 1998]; see also Wenhai Cai, Private Securities Litigation in China: Of Prominence and Problems, 13 COLUM. J. ASIAN L. 135, 146 (1999) (describing the rejection as a "landmark case"); Trish Saywell, Demanding Action, FAR EASTERN ECON. R., May 13, 1999, at 42-43 (discussing the case in the greater context of increased litigation in China).
are entitled to civil compensation. More specifically, the PRC Securities Law, effective since July 1, 1999, provides that issuers, underwriters and their responsible directors and other corporate officers can be liable for losses suffered by investors because of false or misleading statements or material omissions in disclosure documents. The 1993 Provisional Rules on Stock Issuance and Trading, which preceded adoption of the PRC Securities Law and continue to be in effect to the extent that the Securities Law did not supplant specific provisions, proscribe various miscreant practices and provide that violators are liable for civil compensation. More recently, the Governance Standards for Listed Companies, promulgated in January 2002 by the China Securities Regulatory Commission ("CSRC") and the State Economic and Trade

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18 See Fagui Huibian Minfa Tongze [General Principles of the Civil Law of the People's Republic of China] in 2 THE LAWS OF THE PEOPLE'S REPUBLIC OF CHINA, 225 art. 106 (Jan. 1, 1987), art. 213 (1983-1986) [hereinafter General Principles of the Civil Law]; see also Cai, supra note 17, at 146. The drafters of the PSL Rules note in a book on the PSL Rules that a key difference between civil liability and criminal or administrative liability is that civil liability, unlike criminal or administrative liability, does not require a specific legal provision. They proffer, for example, that tort liability can arise from meeting the general elements of a tort, which they identify as an act, causality, fault, and damages. See Li GUOGUANG & GU WEI, ZHENGQUAN SHICHANG XUJIA CHENSHU MINSHI PEICHANG ZHIDU [THE CIVIL LIABILITY SYSTEM FOR SECURITIES MARKET MISREPRESENTATIONS] 34 (Falu Chubanshe 2003) [hereinafter PSL DRAFTERS' COMMENTARY] (on file with author). Thus, the Supreme People's Court justices who drafted the PSL Rules acknowledged that a judge can find liability for disclosure fraud even without the explicit provisions of the PRC Securities Law.

19 Article 63 provides:

If the share prospectus, method of offer of corporate bonds, financial or accounting report, listing report document, annual report, interim report, or ad hoc report announced by an issuer or distributing securities company contains a falsehood, misleading statement or major omission and thereby causes investors to sustain losses in the course of securities trading, the issuer or distributing securities company shall be liable for damages and the responsible director(s), supervisor(s) and or manager of the issuer or distributing securities company shall be jointly and severally liable for such damages.

PRC Securities Law, supra note 6, art. 63.

20 See Gupiao Faxing yu Jiaoyi Guanli Zanxing Tiaoli [Administration of the Issuing and Trading of Shares Tentative Regulations], State Council, art. 77 (1993), (providing "Weifan ben tiaoli guidong, gei ta ren zaocheng sunshi de, yingdang yi fa chengdan minshi peichang zeren" ["Anyone whose violation of these Regulations causes loss to others shall bear civil liability for compensation according to law."]) translated in 6 CHINA L. & PRAC. 23, 42 (1993).

Commission, also provide that investors can seek compensation through civil litigation when their rights are harmed.22 Despite such clear language, PRC courts rejected the initial cases brought by aggrieved investors.23

As intrepid plaintiffs continued to file suits, the Supreme People's Court took significant steps with regard to private securities litigation: (1) on September 21, 2001, the Supreme People's Court issued a notice instructing lower courts to temporarily not accept private securities litigation cases,24 (2) on January 15, 2002, the Supreme People's Court issued a notice indicating courts may accept private securities litigation based on false disclosure,25 and (3) on December 26, 2002, the Supreme People's Court adopted the PSL Rules, publicly issued on January 9, 2003, and effective February 1, 2003, providing specific parameters for the handling of private securities litigation based on false disclosure.26

After a flurry of private lawsuit filings against Guangxia (Yinchuan) Industries Corporation, a PRC listed company that nearly suffered an Enron-like implosion following revelations of egregious disclosure fraud including the outright fabrication of USD 89.98 million in profits, the Supreme People's Court issued a notice temporarily barring all private securities litigation.27 Within

22 See Shangshi Gongsi Zhili Zhunze [Notice on Issuing the Guideline on the Management of Listed Companies], art. 4, China Securities Regulatory Commission and State Economic and Trade Commission (Jan. 7, 2002) (stating that shareholders can seek to protect their rights through civil litigation in accordance with laws and regulations).

23 See supra note 18 and accompanying text.

24 See Guanyu Sheji Zhengquan Anjian Zan Bu Yu Shouli de Tongzhi [Notice Concerning Temporarily Not Accepting Civil Compensation Cases Related to Securities], Supreme People's Court, Sept. 21, 2001 [hereinafter September 21, 2001 PSL Notice].


26 See PSL Rules, supra note 2.

27 See Securities Market Calls For Civil Compensation, PEOPLE'S DAILY ONLINE, Dec. 3, 2001 (noting that Guangxia's stock price rose 440 percent in two years, then collapsed after the firm was revealed to have wildly fabricated revenues and profits), available at http://english.peopledaily.com.cn/200112/03/eng20011203_85851.shtml (last visited June 1, 2003).
four months the Supreme People's Court lifted its "temporary ban," but it did so only with respect to private securities litigation based on disclosure fraud. The ban remains in place for private securities litigation predicated on other types of action such as insider trading or market manipulation. Even after Chinese courts were notified that they may accept private securities litigation based on bad disclosure, nearly a year passed before the PSL Rules provided lower courts with specific operational instructions for handling such claims.

According to court officials, more than nine hundred private securities litigation cases have already been filed in China. Most of these suits are against about a dozen companies, already found guilty of flagrant disclosure rule violations in administrative actions, which suffered dramatic declines in their share prices. As of this Article, no private securities lawsuit has been resolved by judicial decision in China, although the first settlements of private

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28 A helpful chart comparing the final private securities litigation with the January 15, 2002 PSL Notice that initially proclaimed courts could accept private securities litigation (reversing the September 21, 2001 PSL Notice that temporarily ordered courts not to accept such cases) is provided in CAIJING MAG., Jan. 20, 2003 at 84, available at http://www.caijing.com.cn/mag/preview.aspx?ArtID=3854 (subscription required) (online version does not include the chart found in the print edition).

29 See PSL Rules, supra note 2, pmbl. (addressing only claims for misrepresentation); see also Notice of the Supreme People's Court on the Relevant Issues Concerning the Acceptance of Civil Tort Dispute Cases Caused by False Statements in the Securities Markets (Jan. 15, 2002) (addressing only claims for misrepresentation), available at www.isinolaw.com/jsp/common/content (last visited Sept. 30, 2003); Notice of the Supreme People's Court on Not Accepting Civil Cases of Compensation Concerning Securities Temporarily (Sept. 21, 2001) (halting all civil litigation concerning securities), available at www.isinolaw.com/jsp/common/content (last visited Sept. 30, 2003).

30 See Li Guoguang Tells Investors, supra note 3 (announcing up to nine hundred suits).

31 Some listed companies involved as defendants in the first waves of private securities litigation in China include ST Shandong Bohai, ST Shanghai Tongda Innovation Investment, ST Yantai Dongfang Electronic Information, ST Shanghai Jiabao Shiye, ST Fujian Jiuzhou Group, Xian Shengfang Keji, ST Yi An Technology, Shenzhen Sanjiu Medical, ST Guangxia (Yinchuan) Industry, Hubei Tianyi Science and Technology, Daqing Lianyi, and ST Chengdu Boxun Shuma Technology. For a catalog of these suits in English, see Economist Intelligence Unit, Courting Disaster, Allowing Private Investors to Sue Listed Companies for Faking Numbers is a Good Idea. But Will it Happen?, 24 BUS. CHINA 1-2, n.8 (Apr. 2003) (providing a detailed chart of pending litigation, and citing the Royal Institute of International Affairs as the source).
securities litigation occurred in early 2003. According to court officials involved in drafting the PSL Rules, PRC courts will eventually accept private securities litigation based on acts other than inadequate disclosure "when market and legal conditions are ripe," but the time table for this is not clear.

The development of private securities litigation in China is of course, part of the general development of securities markets in China, and it is important to embed the discussion of the PSL Rules in that context, examining in particular the "special characteristics" of China's securities markets.

2.3. Special Characteristics of PRC Securities Markets

On the surface, China's capital markets appear much like those of other jurisdictions. The PRC Company Law permits the

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32 While no PRC court has yet rendered a judgment in a contested case, the Chinese press reported widely on one case which settled through court-assisted mediation one month before the PSL Rules were enacted. See Zhongguo Shoushi Zhengquan Minshi Peichang an Shenjie, 11 Gumin Huo Pei 22 Wan, [China's First Securities Civil Compensation Case Resolved, 11 Investors Obtain 220,000 in Compensation], GUOJI JINRONG BAO [INT'L FIN.], Nov. 26, 2002 (reporting that eleven plaintiffs settled claims through mediation against the former Chengdu Hongguang Industry Corporation after three years of litigation, jointly obtaining the equivalent of USD 25,000). The CSRC imposed an administrative penalty on the firm for claiming (before listing) profits of RMB 54 million (USD 6.5 million) in 1996 when in fact the firm had lost RMB 103 million (USD 12.5 million). The CSRC imposed a fine of RMB 1 million (USD 120,000) in 1998. See also Investors Win for All in Securities Market, CHINA DAILY, Nov. 29, 2002, available at http://www.chinadaily.com.cn/doc/2002 (last visited Sept. 30, 2003).

33 See PSL DRAFTERS' COMMENTARY, supra note 18, at 37.

34 William Alford has eloquently described how the familiarity of PRC legal vocabulary can obscure rather than reveal Chinese realities:

[B]ecause contemporary Chinese legal developments may seem less exotic and distant to us than ... imperial Chinese law ... by reason of the language within which the new developments are cast, the modern setting within which they occur, and our growing personal interaction with Chinese colleagues—we must be doubly vigilant in examining these developments. We must guard against the tendency, that even the most cautious among us may share, to see the Chinese as now finally realizing—or at least saying they realize—the need to organize their legal and economic life the way we believe that we have chosen to do, and so validating the grand theories and other constructs through which we in the West seek to order our existence. In our inquiries, we must pay more careful heed to the setting within which the familiar language and new developments are presented.

formation of limited liability corporations and the PRC Securities Law permits the issuance and trading of shares. China’s listed companies have shareholders and boards of directors. In addition to equity, Chinese companies can issue debt and even hybrid instruments such as convertible bonds. Investors may directly purchase securities or they may invest through funds.

35 Article 3 of the PRC Company Law authorizes the creation of both limited liability companies (youxian zeren gongsi) and joint stock companies (gufen youxian gongsi). Only joint stock companies are able to publicly issue shares and thus be exposed to litigation under the PSL Rules. See LAWS OF THE PEOPLE’S REPUBLIC OF CHINA 293, 294 (1999) [hereinafter PRC Company Law]; id. at 328, art. 151.

36 Id. arts. 102-11 (1999). PRC Securities Law, supra note 6, at 32-38 (discussing the issuance and trade of securities).


38 See Dan Slater, Chinese Convertible Bonds: Treat with Care, FinanceAsia.com, June 5, 2003 (reporting RMB 5.6 billion (USD 602 million) raised in the first quarter of 2003 from the sale of convertible bonds, exceeding the amount raised by sale of stocks for the same period), available at http://www.financeasia.com/Articles/667A3D6-642E-11D781FA0090277E174B.cfm (last visited Oct. 21, 2003). But see id. (quoting the CFO of China Unicom, complaining that “the domestic bond market is still quite undeveloped and issuance approval is slow and complicated”).


Chinese issuers are subject to extensive disclosure requirements when they initially offer securities to the public and on a periodic basis thereafter.\textsuperscript{40} Such disclosure includes audited financial statements.\textsuperscript{41} A Chinese prospectus must contain risk factors (\textit{fengxian yinsu}), and descriptions of the company’s capital structure including the identity of its major shareholders and the holdings of the company’s officers.\textsuperscript{42} The intended use of the funds raised in a public offering must be disclosed.\textsuperscript{43} Indeed, the legal standard for what must be disclosed in China—beyond that which is specifically detailed in laws and regulations—is that issuers must disclose all that is material to an investor making an investment decision.\textsuperscript{44} The PSL Rules adopt U.S. “fraud on the market” theory so that eligible plaintiffs need not show direct reliance on faulty disclosure.\textsuperscript{45} Some defendants can also escape liability under the PSL Rules if they demonstrate that an investor’s losses were caused by systemic market forces or other factors unrelated to the problematic disclosure.\textsuperscript{46} All this is strikingly
familiar to U.S. securities lawyers. Indeed, until the recent reassignment of Gao Xiqing, two of the CSRC's four vice-ministers held U.S. law degrees and had practiced at least briefly in the United States.\textsuperscript{47}

Despite the echoes of U.S. law, companies listed on China's securities exchanges in Shanghai and Shenzhen operate in a vastly different regulatory environment than companies listed on the New York Stock Exchange or Nasdaq National Market. A number of "special characteristics"\textsuperscript{48} profoundly affect how China's securities markets operate.\textsuperscript{49} Identification of some of these special characteristics will benefit an exegesis of the PSL Rules.\textsuperscript{50}

\textsuperscript{47} Domestic critics of the CSRC have labeled a contingent within the CSRC as "the sea turtle faction" (hai gui pai), a pun in Chinese on "the faction returned from overseas." See Former CSRC Vice-Chairman Lands Fund Job / As a Part-Time Appointee, Gao Xiqing is Open to Other Roles in the Government, S. CHINA MORNING POST, Feb. 26, 2003 (reporting that former CSRC Vice-Chairman Gao Xiqing was appointed deputy head of the National Council for Social Security Fund after leaving the CSRC and that he and Laura Cha (a.k.a. Shi Meilun), who continues as a CSRC Vice Minister, are part of the "returned students" faction and have been blamed for policies driving down the market). See also Potter, supra note 13, at 143 n.116 (noting that "Gao Peiji, former general counsel for the Shenzhen Securities Exchange, was trained at Berkeley").


\textsuperscript{49} An earlier version of this list appeared in an article on new rules permitting foreign investment in PRC investment banks and fund management companies. See Hutchens, supra note 5, at 37 (identifying a number of general characteristics of China's stock markets); see also Organization for Economic Cooperation and Development, Information Disclosure and Corporate Governance in China, available at http://www.oecd.org/pdf/M000015000/M00015757.pdf (noting equivalent "special characteristics").

\textsuperscript{50} CSRC Vice Minister Laura Cha noted that the appeals to "special characteristics" are often used "as an excuse" in which "all unexplainable problems" are wrapped. See Shi Meilun Tan Jianguan [Laura Cha Discusses
2.3.1. Most PRC Investors are Individuals, Not Institutions

Most investors in the PRC's securities markets—and thus most potential plaintiffs in private securities litigation in China—are dispersed individual investors, referred to as "scattered households" (san hu). Although a relatively high percentage of the U.S. population owns shares, in the U.S., this ownership is generally mediated through mutual funds. The funds industry is in its infancy in China. The vast majority of Chinese investors remain individual "retail" investors, not institutional investors.

2.3.2. Most Listed Companies are Reformed State-Owned Enterprises, Not Private Firms

Commonly, securities markets allow private entrepreneurs to access public equity and debt markets to raise capital. In China, however, listed companies are almost never private companies. Rather, they are state-owned enterprises ("SOEs") that have been transformed into joint stock companies (gufen youxian gongsi) under the PRC Company Law. China's securities markets have been consciously designed from the "top down" to support the reform

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51 See generally Josh Friedman, BofA Fires Two Officers over Illegal Fund Trades, L.A. TIMES, Sept. 12, 2003, at B1 (noting that the U.S. mutual fund industry "counts 95 million Americans as customers").

52 See Xiangcai Authorised to Launch Series Fund, S. CHINA MORNING POST, Feb. 19, 2003, available at http://biz.scmp.com/bizchina/ZZZOIRMA3CD.html (reporting that "China has an unsophisticated fund management sector, where 54 of 71 existing investment funds are closed-end, and products familiar to more mature markets such as guaranteed and bond funds remain novel ideas"); see generally Tao, supra note 39 (discussing the regulatory framework of securities and investment funds in China).

53 The drafters of the PSL Rules acknowledge this. See PSL DRAFTERS' COMMENTARY, supra note 18, at 38 (citing statistics that 99.47% of PRC brokerage accounts have been opened by individual investors).

54 Zhou Xiaochuan, the previous CSRC chairman, estimated that about two-hundred private enterprises (minying qiye) are listed in the PRC. See Li Zhangzhe, ZHONGGUO GUSHI FAZHAN BUOGAO 2002 [CHINA STOCK MARKETS DEVELOPMENT REPORT 2002] (2003) [hereinafter, CHINA STOCK MARKETS DEVELOPMENT REPORT: 2002] (reporting Chairman Zhou's comments) (on file with author).

55 See, e.g., PRC Company Law, supra note 35, chs. III, IV (discussing state-owned enterprises ("SOEs")).
of SOEs, not to allow private firms to raise capital.\textsuperscript{56}

\subsubsection{Most Shares of Listed Firms are Illiquid, Unlisted Shares}

Just as China's securities markets do not serve private issuers, they do not function as a means to privatize the SOEs that are listed. In the "corporatized" SOEs that dominate China's securities markets, only about one-third of the firm's shares are typically floated on the public markets.\textsuperscript{57} These liquid shares (\textit{liutong gu}) are the ones available on the mainland exchanges, generally as A-shares, though a small number of issuers have foreign-currency denominated B-shares. The rest of the issuer's shares generally remain in government hands, either directly as state-owned shares (\textit{guoyou gu}) or indirectly as legal-person shares (\textit{faren gu}).\textsuperscript{58} This limited floatation of shares means that listed PRC companies are "publicly owned," not through their listed, tradable shares but through their \textit{unlisted}, illiquid shares. Because listed companies remain state-owned through unlisted shares, an "overhang" of unlisted, illiquid shares (collectively, \textit{fei liutong gu}) haunts China's securities markets. Investors worry that a deluge of state-owned shares into the markets could diminish the value of currently-listed shares by altering the current balance of supply and demand.\textsuperscript{59}

\textsuperscript{56} See \textit{e.g.}, Liu Ban, \textit{Private Sector Catches Listing Fever}, \textit{China Daily}, Feb. 25, 2003 (Hong Kong ed.), \textit{available at} \url{http://www.chinadaily.com.cn/cn/dos/2003-02/25/context_155786.htm} (noting the historical paucity of private firm IPOs on PRC securities markets because "the domestic stock market was positioned to mainly serve the reform and listing of State firms") (on file with author).

\textsuperscript{57} See \textit{PSL Drafters' Commentary}, supra note 18, at 26 (noting that the PSL Rules were formulated on the basis of two-thirds of the shares in PRC stock markets being illiquid). \textit{See also} Panorama, Shichang Tongji [Market Statistics] (detailing statistics on PRC securities markets including the market capitalization of all outstanding liquid shares), \textit{available at} \url{http://www.p5w.net/p5w/home/data/gengra/index.html} (last visited Sept. 30, 2003).

\textsuperscript{58} Fang Jun, \textit{Guo You Gu Jianchi TouShi [Examination of State-Owned Share Reduction]} 16-17 (2002) (including table), (stating that most illiquid shares are state-owned shares and that these legal-person shares (\textit{faren gu}) dominate the capital structure of listed companies, exceeding illiquid shares two-fold).

\textsuperscript{59} Efforts over the last two years to sell some portion of state-owned shares in order to fund China's social security fund backfired. The CSRC enacted a policy in mid-2001 requiring that companies conducting an IPO or issuing additional shares to make ten percent of the offering consist of state-owned shares. \textit{See Interim Measures on Selling of State-Owned Shares for Raising Social-Security Funds, State Council, June 12, 2001} [hereinafter QFII Rules]. After this plan was announced, the markets fell dramatically. On June 24, 2002, the Shanghai and Shenzhen stock markets increased by the largest single-day percentage in their history following an announcement that the sell-off of state-owned shares would
The illiquid capital structure of most listed firms also means that China’s securities markets do not create markets for corporate control.60

2.3.4. Foreign Exchange Controls Impose a “Chinese Wall” Between PRC Capital Markets and Global Capital Flows

The currency of the PRC is not freely convertible. The State Administration of Foreign Exchange (“SAFE”) has extensive rules about how funds can enter and leave China.61 The “people’s money” or renminbi (“RMB”), denominated in units called yuan, cannot be sent abroad without SAFE approval, and foreign exchange or hard currency coming into China is subject to similar restrictions.62 If Warren Buffett went to the local branch of a

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60 Writing before the PRC Securities Law was adopted, two commentators noted that the predominance of illiquid shares and commitment to government control in China preclude a market-based on corporate control.

Certain transactions that are routine in Western economies and that contribute to the vigor and efficiency of the economy are all but impossible under Chinese conditions. Mergers, acquisitions, tender offers, and corporate takeovers all have potential for restructuring allocation of resources and improving management of enterprises. Those transactions are largely dependent, however, on alienability of ownership in enterprises. In China, state shares and legal person shares, which comprise the preponderance of all outstanding stock, are critical impediments to alienability. Though one enterprise might buy some of the outstanding stock of another on the securities markets, it cannot possibly buy enough to take control. (citations omitted).


62 Zhang Baoying, deputy head of finance for China Unicom, a firm listed in Hong Kong and New York with its operations in mainland China, noted in an interview that these currency controls can affect operations:

Chinese interest rates are not set by the market, but administratively. We pay around 5.5% for a one to three-year loan, but we could pay three percentage points less than that in Hong Kong. On the other hand, we would need government approval from the State Administration of Foreign Exchange (SAFE) for every transfer from Hong Kong banks to the mainland.

See Dan Slater, China Unicom, FINANCEASIA.COM, (May 9, 2003) (describing requirements that SAFE Approve transfers from Hong Kong banks to mainland
Chinese brokerage company to open an account to trade Chinese A-shares, his money would not be welcome. A PRC resident wishing to use his or her RMB savings to buy shares, even those of Chinese companies, listed in Hong Kong or New York, would not be able to do so either. Thus, China’s system of currency control has effectively cut China’s securities markets off from global capital flows. There have been incremental reforms to chip away at the “Chinese wall” separating China’s securities markets from the international financial system, but these reforms remain marginal, and the RMB is not expected to become fully convertible in the near to medium term.

2.3.5. Shares are Classified by Ownership and Trading Location, Not Rights Per Se

China has an alphabet soup of share types: A-shares, B-shares, H-shares, and N-shares. There are also legal-person shares and state-owned shares. These labels do not, however, refer to classes
of shares with different customized rights as might be created by a company issuing common and various classes of preferred stock. Rather, these labels indicate who may own the particular block of shares, where they are traded, and in what currency they are denominated.\textsuperscript{66} A-shares are the mainstay of China's securities markets; they are the RMB-denominated shares listed in Shanghai and Shenzhen. B-shares are also listed on the PRC exchanges but are denominated in foreign currencies (U.S. dollars in Shanghai and Hong Kong dollars in Shenzhen). N-shares and H-shares are shares of PRC-registered companies which have been listed on overseas stock exchanges in New York and Hong Kong, respectively. (The same pattern is sometimes used with reference to L-shares listed in London and S-shares listed in Singapore.)\textsuperscript{67} The PRC Company Law makes no provision for shares of unequal rights, and China does not generally permit preferred shares with special negotiated rights. While Chinese companies with shares listed on overseas exchanges are subject to the securities regulatory regimes of those jurisdictions,\textsuperscript{68} the PSL Rules apply only to shares listed on exchanges approved by the CSRC, i.e. A-shares and B-shares traded on the Chinese mainland in Shanghai and Shenzhen.\textsuperscript{69}

\textsuperscript{66} Another label, "red chips," indicates where a firm is incorporated. China Unicom is a red chip. Its business is based in mainland China, but the listing vehicle for China Unicom is a Hong Kong-registered company. Thus, H-shares are shares issued in Hong Kong by mainland-registered companies, while red chips are those companies that not only list shares overseas but also register (incorporate) their listing vehicle in a jurisdiction other than the PRC mainland (while having most of their assets and business operations on the mainland). Red chip Unicom is listed in both New York and Hong Kong. Red chips now constitute a significant percentage of the market capitalization of the Hong Kong Stock Exchange. \textit{See generally} Charles De Trenck et al.,\textit{ Red Chips and the Globalisation of China's Enterprises} (2d ed. 1998).

\textsuperscript{67} Of course, firms sometimes list in more than one overseas market. For example, both PetroChina and Sinopec have issued both H-shares and N-shares.

\textsuperscript{68} Nasdaq-listed Netease has been subjected to private securities litigation in the United States, for example. \textit{See Netease has quarterly net profit, company's results mark an important milestone for China internet sector, ASIAN WALL ST. J.,} Aug. 6, 2002, at A8 (noting four unsettled class action shareholder lawsuits against Netease after the firm admitted problems with the disclosure of its advertising revenues).

\textsuperscript{69} \textit{See} PSL Rules, \textit{supra} note 2, arts. 2, 3 (limiting jurisdiction to trading on PRC-approved securities exchanges, which would exclude United Nations sanctioned exchanges inside the PRC and foreign exchanges, which were of course not established with PRC approval).
2.3.6. Government Approval Requirements are Ubiquitous

Government approval requirements are ubiquitous in the laws and regulations governing PRC securities markets.\textsuperscript{70} Government approval is required for a company to conduct an initial public offering ("IPO") or secondary offering.\textsuperscript{71} Whether or not a firm may issue corporate bonds and the interest rates that may be paid on them is determined by the government, not market forces.\textsuperscript{72} Whether a PRC company may list overseas is subject to CSRC approval.\textsuperscript{73} Mergers of listed companies are also subject to approval.\textsuperscript{74} Recently, the CSRC has conducted two rounds of "deregulation" eliminating a number of specific approvals it had required.\textsuperscript{75} These changes, however, were relatively minor.\textsuperscript{76}

\textsuperscript{70} "While on its face the Company Law promises the creation and organization of a semi-independent group of economic actors, in fact it both expresses and enables continuing state control over the economic and industrial system in China." Howson, supra note 48 at 172; see also Robert C. Art & Minkang Gu, \textit{China Incorporated: The First Corporation Law of the People's Republic of China}, 20 YALE J. INT'L L. 273, 289 (1995) (noting that under the Chinese Company Law, a firm's "processes of incorporation, operation, and capitalization...are...plainly matters of governmental control and permission, not of right").

\textsuperscript{71} \textit{See} PRC Company Law, supra note 35, arts. 152(1), 153, 154 (1993) (amended 1999) (requiring approval for an IPO); \textit{id.} art. 139 (requiring approval for a secondary offering); PRC Securities Law, supra note 6, art. 10 (requiring CSRC approval to list); see also, Gu & Art, supra note 60, 138 ("A reform that would be considered radical in China, though not elsewhere, would be to permit market factors, rather than extensive government regulation, to determine which companies can issue shares."). In addition to the government approvals required, the PRC Company Law imposes various merit-based requirements that must be met for a company to publicly issue shares. These include a requirement for three years of continuous profitability. \textit{See} PRC Company Law, supra note 35, art. 152. However, companies meeting the objective criteria are only eligible to list; they are not entitled to list until government permission is obtained. \textit{See id.} art. 153.

\textsuperscript{72} \textit{See} Qiye Zhaiquan Guanli Tiaoli [Provisions on the Administration of Enterprise Bonds], art. 10, State Council, Aug. 2, 1993, (providing for annual national plans that control the amount of corporate bonds to be issued); \textit{id.} art. 18 (capping corporate bond interest at forty percent over government-set interest rates for individual bank deposits for the same period).

\textsuperscript{73} \textit{See} PRC Company Law, supra note 35, art. 155 (1993) (requiring CSRC approval to list overseas).

\textsuperscript{74} \textit{See id.} art. 183 (1993) (requiring approval to merge).

\textsuperscript{75} \textit{See} Guanyu Di Yi Pi Quxiao Xingzheng Shenpi Xiangmu (32 xiang) de Tongzhi, [Notice Concerning the First Batch of 32 Cancelled Administrative Examination and Approval Items], China Securities Regulatory Commission, Dec. 21, 2002 (canceling various approval requirements); Guanyu Quxiao Di Er Pi Xingzheng Shenpi Xiangmu Ji Gaibian Bufen Xingzheng Shenpi Xiangmu Guanli Fangshi de Tonggao [Notice Concerning Cancellation of a Second Batch of Administrative Examination and Approval Items and Modification of the
Requirements for government approval are still fundamental features of China’s securities markets. Indeed, under the PRC Securities Law, CSRC approval is required “for each brokerage firm branch office opening in China.”

2.3.7. Rapid Development Creates a Policy Cauldron

Chinese securities markets are young, and their development rapid. The two mainland securities exchanges in Shanghai and Shenzhen were established in 1990 and 1991, respectively. In 1991, only fourteen companies traded on China’s securities exchanges; today, there are more than 1,200. The PRC Securities Law came into effect in 1999 and the PRC Company Law was

Management Style for some Administrative Examination and Approval Items], China Securities Regulatory Commission, Apr. 1, 2003 (eliminating more approval requirements).

76 Many of the rescinded items are for preliminary approvals. Approval is still required; the CSRC simply gave up a requirement that initial permission be obtained even to proceed with an application. The main substantive items in the first batch related to law firms. The CSRC had required lawyers and law firms engaging in securities work to be licensed by the CSRC. It has cancelled those requirements, apparently willing to let the market (or at least the Ministry of Justice or some other department) determine competence in providing legal advice.

77 See PRC Securities Law, supra note 6, art. 123.

78 Stock markets existed in China before the founding of the People’s Republic. However, the revolution’s ideology was hostile to their continued existence and the pre-1949 markets were shut down. See generally W.A. THOMAS, WESTERN CAPITALISM IN CHINA: A HISTORY OF THE SHANGHAI STOCK EXCHANGE (2001) (providing an account of the genesis, development, and collapse of the Shanghai Stock Exchange prior to the Communist takeover of 1949). Although China’s current era of economic reforms began in the late 1970’s after the death of Mao Zedong, the two current stock exchanges were not founded until 1990. Two useful works on the initial development of China’s stock markets are CARL E. WALTER & FRASER J.T. HOWIE, ‘TO GET RICH IS GLORIOUS’: CHINA’S STOCK MARKETS IN THE ‘80S AND ‘90S (2001) and ELLEN HERTZ, THE TRADING CROWD: AN ETHNOGRAPHY OF THE SHANGHAI STOCK MARKET (1998). For more background information on Chinese corporate law, see I.A. TOKLEY & TINA RAVN, COMPANY AND SECURITIES LAW IN CHINA (1998).


enacted in 1994. Policy innovations and reforms continue to occur at a torrid pace. Two years ago, one could correctly say that (a) PRC courts do not permit investors to sue listed companies for false disclosure, (b) there is no general legal basis for foreign

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82 See Jean Davis, Zhu Sanzhu’s Securities Regulation in China, 30 INT’L J. LEGAL INFO. 534, 535 (2002) (book review) (noting that “[n]ew rules of the China Securities Regulatory Commission and new regulations of the PRC’s two mainland stock exchanges are appearing daily”). The bewildering pace of change affects not only securities regulation, but PRC law in general; see, e.g., Randall Peerenboom, The X-Files: Past and Present Portrayals of China’s Alien “Legal System,” 2 WASH. U. GLOBAL STUD. L. REV. 37, 38 (2003) (hereinafter The X-Files) (“The pace of reform makes it difficult even for those within China to keep abreast of the latest developments. New laws and regulations are being issued at breakneck speed, old laws and regulations are amended continually, and whole new regulatory regimes and institutions are being created.”).
investment in China’s investment banking sector, (c) PRC citizens may not buy B-shares and (d) no foreign capital is permitted to enter the A-share market. None of the above are true today. While certain fundamentals, remain largely undisturbed, particularly those identified here as having special characteristics, have been the pace of change makes the study of Chinese securities regulation, and consequently of private securities litigation in China, a moving target.83

2.3.8. Developing in a System with Weak Courts and Constrained Judges

The PRC is not a jurisdiction with broadly “empowered” courts and judges. Comparatively weak PRC courts and judges operate in an ostensibly civil law system that does not theoretically permit judge-made law.84 More importantly, PRC judges and courts lack independence and are subject to structural conflicts likely to affect their handling of securities law cases and private

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83 For readers of Chinese, a series of books by Li Zhangzhe is particularly helpful for following PRC securities market developments. See, e.g., CHINA STOCK MARKETS DEVELOPMENT REPORT: 2002, supra note 54. The magazine Caijing is also quite useful. See http://www.caijing.com.cn/mag/default.aspx (subscription required).

84 See generally Susan Finder, Court System, in DOING BUSINESS IN CHINA ch. 2.1 (Freshfields ed., 2001); BROWN, supra note 48 (analyzing Chinese judicial administration and process); Donald C. Clarke, Power and Politics in the Chinese Court System: The Enforcement of Civil Judgments, 10 COLUM. J. ASIAN L. 1 (1996) [hereinafter Power and Politics in the Chinese Court System] (discussing the various problems plaguing the enforcement of Chinese court decisions and their implications for economic reforms); Susan Finder, The Supreme People’s Court of the People’s Republic of China, 7 J. CHINESE L. 145, 216 (1993) [hereinafter Supreme People’s Court] (“The increasing distribution of cases by the Court and lower courts is evidence that the Chinese judicial system is in a transition period from complete reliance on statute law to a mixed system of statute and case law.”). But see Nanping Liu, “Legal Precedents With Chinese Characteristics”: Published Cases in the Gazette of the Supreme People’s Court, 5 J. CHINESE L. 107 (1991) (showing that certain reported decisions may carry force as precedents).

85 Securities markets exist under a variety of legal systems, and a taxonomy between common and civil law systems is inadequate to describe the variety of legal systems in the world. China has a mixed system, drawing on elements from a variety of sources. In general, China does not emphasize case law. This is relevant to the debate concerning whether common law jurisdictions are more hospitable to the development of securities markets than civil law jurisdictions. See generally supra note 84 (showing that the force of precedent in Chinese decisions is dependent upon comments made by the courts and sensitivity to the issues involved).
securities litigation. Specifically, governments at the same level control PRC courts at the same level through appointment and budgetary powers. For example, the Qingdao People's Congress controls the budget and personnel of the Qingdao People's Courts. Additionally, adjudicative committees oversee PRC courts. These committees, consisting of representatives from branches of government other than the court system, supervise the work of the courts. In sensitive cases, they may direct judges to act in particular ways. Institutionally, the weakness of courts is likely to influence the development of private securities litigation in China, particularly given the other "special characteristics" identified above. PRC courts adjudicating private securities litigation may frequently be controlled by the same level of government which constitutes the majority shareholder in the defendant corporation, creating the obvious danger of partiality.

2.3.9. Securities Markets are Part of a Cultural Revolution in China

Securities market developments are at the vanguard of China's ongoing cultural, political, and economic transformation. Commonly observed, China's traditional business culture is characterized by discretionary power, secrecy, a substantial government role in large scale production, and personal connections (guanxi). Conversely, it is commonly asserted that

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89 See, e.g., Randall Peerenboom, Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China, 19 BERKELEY J. INT'L L. 161, 195 (2001) ("On the other hand, because of the institutional arrangements whereby the local people's congresses appoint and remove judges and local governments fund the courts, government officials are able to pressure judges to find in favor of . . . local companies in commercial disputes.").

90 A single sentence to summarize millennia of Chinese business practices is
securities markets depend on the rule of law, transparency, and the interactions of private parties who are often strangers. The development of securities markets is, therefore, a fascinating point of friction in an ongoing cultural revolution that is even stimulating growth of professions and institutions previously unknown in the PRC such as specialized branches of the accounting and legal professions, investment banks, and of course a gross oversimplification, but the features identified, while contestable (as is the notion of "China" itself), are useful characterizations of the context in which PRC securities markets are developing. Concerning China's traditional business culture, see generally Hill Gates, China's Motor: A Thousand Years of Petty Capitalism (Cornell Univ. Press 1996) (finding two dominant modes of production in Chinese economic history: the petty capitalist and the state-tributary, while large-scale private sector actors are generally absent). Concerning how this traditional culture interacts with modern corporate and securities law, see J. Ray Bowen II, & David C. Rose, On the Absence of Privately Owned, Publicly Traded Corporations in China: The Kirby Puzzle, 57 J. ASIAN STUDIES 442 (1998) (arguing that the threat of government confiscation drives economic activity into government institutions and family firms in China). For an example of the kinds of problems Bowen's argument is predicated upon, see Beijing Youth Daily Online, Getting Along With the Government (describing repeated official harassment of Jiang Caiyi, proprietor of a small grocery store in Shenyang), available at http://www.bjyouth.com/article.jsp?oid=2076459 (last visited Jan. 10, 2003). But see Teemu Ruskola, Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective, 52 STAN. L. REV. 1599 (1999-2000) (arguing that traditional clan organizational forms are functionally akin to modern corporations).


92 The term "investment bank," translated literally as "touzi yinhang" and colloquially shortened to tou hang, is commonly used in financial circles in China. However, laws and regulations generally use the term "securities company" (zhengquan gongsi) to refer to firms that provide underwriting (chengxiao) and brokerage (jingji) services.

Under the PRC Securities Law, securities companies are classified as either comprehensive (zonghe lei) firms or brokerage (jingji lei) firms. PRC Securities Law, supra note 6, art. 119. Only comprehensive securities companies can engage in securities underwriting. Id. arts. 129(1), 129(2), 129(3), 130. Comprehensive firms may also provide brokerage services and trade for their own accounts. Id. arts. 129(1), 129(2). Brokerage securities companies may only provide brokerage services. Id. art. 130.

Firm commitment (bao xiao) and agency (dai xiao) underwritings are both permitted under the PRC Securities Law. Id. art. 21. Any public offering in excess
The development of securities markets in China also encourage the development of notions such as risk consciousness among investors and expectations of legal compliance and transparency for officials. To observe the development of securities markets in a regime whose founding principles called for the eradication of private property and which previously shut down stock exchanges in China is a striking policy reversal at the very least.

2.3.10. No History of Private Securities Litigation

Another special characteristic of PRC securities regulation, particularly in contrast to the current U.S. system, is that PRC listed companies have not, historically, faced a threat of private securities litigation. To enforce disclosure rules and other securities laws and regulations, China relied primarily on administrative and occasionally criminal sanctions; private enforcement has been comparatively unimportant. Perhaps

of RMB 50 million yuan (approximately USD 6 million) must be underwritten by an underwriting syndicate. Id. art. 25. See also http://www.xe.com/ucc (providing a currency converter) (last visited Nov. 1, 2003).

93 The CSRC is independent of the securities industry in the sense that it is not a creation of market participants such as investment banks. However, it is not independent of the Chinese Communist Party. See Sebastian Heilmann, The Chinese Stock Market: Pitfalls of a Policy-driven Market, (Sept. 2002) (discussing the Financial Work Committee of the Chinese Communist Party as a control mechanism for the CSRC and other regulatory bodies of the financial sector), available at http://www.chinapolitik.de/studien/china_analysis/no_15.pdf.

94 See Chen Jie, ZHENGQUAN QIZHA QINQUAN SUNHAI PEICHANG YANJIU [SECURITIES FRAUD TORT INJURIES: RESEARCH ON COMPENSATION] (discussing an increase in the willingness of PRC investors to seek legal remedies) (on file with author).


97 See PSL DRAFTERS' COMMENTARY, supra note 18, at 183 (noting that the PRC
private securities litigation will become a more significant aspect of PRC securities markets now that the Supreme People's Court promulgated the PSL Rules. The degree of change will, of course, depend in large measure on the specific provisions of the rules which this Article will analyze.

2.4. How to Approach Chinese Securities Regulation

The above background provides the reader with sufficient context to make the upcoming analysis of the PSL Rules coherent. It generally imparts an explanation of securities litigation, how it developed in China to date, and what special characteristics distinguish PRC securities markets from more familiar models. Before launching into analysis of the PSL Rules, it is useful to pause for a methodological sidebar. What are the appropriate assumptions for analyzing the PSL Rules? Against what model or standard should they be judged? Unless we know what they are "for", how can we know what is "right" or "wrong" with the PSL Rules?

Donald Clarke recently identified and characterized as inadequate, at least for some purposes, the Ideal Western Legal Order ("IWLO") approach to Chinese law.98 In this approach, an analyst uses notions of an IWLO to measure legal developments in China.99 Measured against the IWLO standard, the analyst almost always finds China's approach wanting.100 Professor Clarke

Securities Law and PRC Economic Law in general stress administrative and criminal liability while slighting civil liability (zhong xingzheng xingshi zeren er qing minshi zeren); Hongchuan Liu & Zili Ren, Halfway to Effective Shareholder Protection, 17 CHINA L. & PRAC. 29, 30 (2003) (noting that the PRC Securities Law "paid little attention to civil remedies available to defrauded investors" in contrast to administrative and criminal provisions); Potter, supra note 13, at 147 (noting that "[t]he reporting requirements and compliance rules of the bureaucratic supervisory system play a more central role than the prospects for private action through either judicial or administrative process. Indeed, recurring efforts to expand the capacity for private litigation on corporate and securities matters continue to face strong resistance").

99 Id. at 95-100.
100 Something like an Ideal Western Legal Order ("IWLO") approach has certainly been used with regard to PRC securities laws. See, e.g., William I. Friedman, One Country, Two Systems: The Inherent Conflict Between China's Communist Politics and Capitalist Securities Market, 27 BROOK. J. INT'L L. 477, 479-80
postulates that a different model for understanding Chinese law, such as one that understands "legal" developments in China as the fruit of a fundamentally different system of governance with different goals, might make PRC contract, administrative, and constitutional "law" seem less crude, and less riddled with "mistakes." For example, the characteristic vagueness of PRC law can be understood as a virtue, not a shortcoming, if the purpose of PRC law is reconceptualized. Rather than existing to provide clear notice to private parties of legal rights and duties, PRC legal enactments exist to facilitate management of a complex society by an administrative state. Authorities in such a regime seek to provide guidance to subordinate actors while preserving the discretion to respond to circumstances flexibly. Vagueness and other perceived deficiencies of PRC law may actually be strengths, given the goals and assumptions of PRC legal enactments.

This arresting insight has implications for the study of PRC securities regulation. If the PRC is attempting to build robust capital markets with dispersed ownership similar to the securities markets in the United States, identifying disparities between PRC and U.S. securities laws and evaluating whether such disparities aid or inhibit the PRC's developmental goals is likely to be a fruitful exercise. However, if the PRC is attempting to do


For an approach decidedly unlike the IWLO model, see generally Frances H. Foster, Towards a Behavior-Based Model of Inheritance? The Chinese Experiment, 32 U.C. DAVIS L. REV. 77 (1998) and Frances H. Foster, Linking Support and Inheritance: A New Model from China, 1999 Wis. L. REV. 1199.

101 See Puzzling Observations, supra note 98, at 95 (proposing a different approach to modeling the legal system).

something else, this approach is likely to be of only marginal utility and may contribute to misunderstanding PRC law. So, is there any value in assessing the PSL Rules from the perspective of U.S. norms concerning private securities litigation, or is this a dubious IWLO exercise?

Undeniably, PRC securities markets and their regulatory environment are radically different from U.S. securities markets and their regulatory environment. Pittman Potter has noted that PRC regulatory norms and Western regulatory norms offer distinctly "competing visions of regulatory culture" with Chinese norms of "patrimonial sovereignty" in opposition to Western conceptions of "responsible agency" as the appropriate role for government.\textsuperscript{103} Beyond these normative orientations, PRC securities markets have developed for more than a decade with the clear goal of assisting SOE reforms. Thus, PRC securities markets are largely a product of government engineering, not private ordering, and they are designed to bring private capital under government control, not to privatize government assets. This is all very unlike U.S. securities markets. Given the stark differences, should evaluation of PRC securities regulation, and the PSL Rules take place specifically with reference to Chinese goals, not U.S. models? Is evaluating PRC securities regulation from a U.S. perspective not too narrow, perhaps even an example of disgusting ethnocentric triumphalism?\textsuperscript{104}

Actually, analysis of the PSL Rules from a U.S. perspective is desirable for several reasons. The PSL Rules developed with reference to U.S. models, so evaluation of the PSL Rules from a U.S. perspective can help reveal the operation of what Professor Potter terms the "selective adaptation" of foreign legal norms in China.\textsuperscript{105} Moreover, not all analysis comparing China to the U.S. and finding China deficient is necessarily crude IWLO analysis. One can avoid idealizing the Western (or U.S.) legal order, and one can be sensitive to the different cultural and historical context of PRC

\textsuperscript{103} See Potter, supra note 13, at 125 (contrasting the Western and Chinese regulatory cultures in economic sectors).

\textsuperscript{104} See Puzzling Observations, supra note 98, at 114-16 (discussing and critical evaluating charges of ethnocentrism in comparative law).

\textsuperscript{105} See Potter, supra note 13, at 119-21 (defining and discussing "selective adaptation"); see also Pitman B. Potter, The Chinese Legal System: Globalization and Local Legal Culture (Routledge, 2001) (analyzing the ongoing evolution of the Chinese legal system by the process of selective adaptation).
Additionally, no matter what the "special characteristics" of Chinese securities markets are today, PRC officials do not indicate that they expect China's securities markets to facilitate SOE reform then whither away. Rather, many PRC officials hope that the scale and importance of China's securities markets will continue to grow. In discussing how to foster the growth of their securities markets, PRC commentators routinely consider U.S. models. Given that China is shopping the world for regulatory approaches, it is hardly unseemly to compare PRC approaches with U.S. practices. Also, while securities markets naturally reflect the context in which they exist, they also seem to pose certain fundamental problems that transcend local cultures. The problem of information asymmetry and resulting impulse for investor protection is common to securities markets in all jurisdictions. A comparative law fact-finding mission that investigates how various systems address particular issues may discover alternative approaches to common problems. Finally, PRC legal enactments concerning securities markets routinely claim that "investor protection" is a purpose of the enactment. It is hardly obnoxious to analyze with reference to other jurisdictions the likelihood that a system will accomplish its own asserted purposes.

To understand PRC securities markets, one must grasp that they serve a transitional economy and are dominated by government rather than private ordering. PRC securities regulation is consequently characterized by administrative paternalism that facilitates cautious, state-modulated transformation of the old economic order. But it is vapid comparative analysis to simply nod at Chinese differences and conclude, "that explains it; they have a different model." PRC
securities regulation is too complex and dynamic for that. The development of PRC securities regulation is also characterized by aspirations for a new economic order with different organizing principles. A U.S. perspective, appropriately contextualized, can help one understand precisely how historical legacies and reformist ambitions collide in China’s securities regulatory regime.

3. CRITIQUE OF CHINA’S RULES ON PRIVATE SECURITIES LITIGATION

Chinese newspapers have hailed the PSL Rules as a major advancement for securities law in China. Official sources have declared that the PSL Rules provide the first functional basis for private securities litigation in China. The preamble to the PSL Rules recites “the protection of the lawful rights and interests of investors” (bao hu tou ziren hefa quanyi) as a motivating purpose of the PSL Rules. However, the PSL Rules impose many practical obstacles to bringing such lawsuits, and it is unclear what their

\[\text{Note:} \text{ Professor Clarke’s discussion of the IWLO and other models for understanding PRC law is subtle and nuanced, taking into account the dynamic nature of PRC conditions. See Puzzling Observations, supra note 98, at 95-114 (exploring different models used to understand the Chinese legal system).}

\[\text{Note:} \text{See e.g., Zhongda Tupo Changqi Li Hao / Ge Jie Renshi Pingshuo Gao Fa Guiding, Zhengquan Shichang Bao [Important Breakthrough with Long-term Benefits, People from All Walks of Life Comment on the Supreme People’s Court’s Rules]. CHINA SEC. TIMES, Jan. 1, 2003 (“wulun shi guangda zhong xiao touzizhe, zhuanjia xuezhe, hai she quanshang, shangshi gongsi, jun biaoshi guiding de fabu shi wo guo zhengquan shichang fazhixua jincheng de zhongyang lichengbei” [The masses of medium and small investors, scholars, securities firms and listed companies indicate that the PSL Rules are a milestone in the process of developing the rule of law in China’s securities markets.]), available at http://www.people.com.cn/GB/jinji/35/159/20030110/905274.html (last visited June 1, 2003).}

\[\text{Note:} \text{See PSL DRAFTERS’ COMMENTARY, supra note 18 at 277 (printing the comments of the Vice President of the Supreme People’s Court from a press conference given to unveil the PSL Rules).}

\[\text{Note:} \text{PSL Rules, supra note 2, pmb.}

\[\text{Note:} \text{Some of these ideas were first developed in postings to China Law Net (“CLNET”) shortly after the PSL Rules became effective. See Walter Hutchens, “China Court Accepts First Class-Action Shareholder Suit,” a series of CLNET postings on Feb. 19-20, 2003, including exchanges with Matthew C.J. Rudolph and Knut Pissler (on file with the author). Concerning CLNET, see generally http://www.law.washington.edu/clnet/.

Some obstacles to bringing private securities litigation in China are also identified by the Economist Intelligence Unit. See, e.g., Economist Intelligence Unit, supra note 31 (noting that private securities litigation for disclosure fraud “is a good idea in theory, but putting it into practice will be extremely difficult because of the huge scale of wrong-doing in the past, the fact that the government is implicated and the fact that many shareholders gambled their money away and}
3.1. Narrow Scope Denies Recovery to Victims of Insider Trading and Market Manipulation

The PSL Rules do not authorize litigation for all forms of securities fraud. Rather, the PSL Rules allow Chinese courts to accept only private litigation based upon bad disclosure, referred to as misrepresentations (xujia chenshu). Misrepresentations are defined to include outright false statements, misleading statements, and material omissions. The PSL Rules provide no basis for private securities litigation based on insider trading (neimu jiaoyi) or market manipulation (caozong shichang). In fact, the “temporary” ban on accepting private securities litigation issued by the Supreme People’s Court in September 2001 remains in effect for all suits except for those based on bad disclosure. Indeed, the drafters of the PSL Rules have indicated that courts adjudicating private securities litigation based on bad disclosure must disentangle any damages a plaintiff suffered due to insider trading or market manipulation and deny recovery for that portion of a plaintiff’s damages.

have no right to compensation”). The perspective of this article is sympathetic to plaintiffs, but the Economist piece points out, quoting Professor Clarke, that many investors bought speculatively and did not take seriously the disclosure upon which suits can now be based. See also Liu & Ren, supra note 97, at 29-32.

The PSL Rules do not reach misrepresentation in private placements, only in IPOs or trading on the national exchanges. See PSL Rules, supra note 2, art. 2; see also Liu & Ren, supra note 97, at 31 (criticizing the narrow scope of the PSL Rules both in terms of the failure to cover private placements and the failure to cover forms of fraud other than misrepresentations).

The PSL Rules do not reach misrepresentation in private placements, only in IPOs or trading on the national exchanges. See PSL Rules, supra note 2, art. 2 (limiting the scope of the PSL Rules to cases arising from a misrepresentation in a “securities market”); see also Liu & Ren, supra note 97, at 31 (criticizing the narrow scope of the PSL Rules both in terms of their failure to cover private placements and forms of fraud other than misrepresentations).

PSL Rules, supra note 2, art. 17.

See id. pmbl. (addressing only civil damages claims for misrepresentation); January 15, 2002 PSL Notice, supra note 25 (addressing only claims for misrepresentation); September 21, 2001 PSL Notice, supra note 24 (halting all civil litigation concerning securities).

See January 15, 2002 PSL Notice, supra note 25 (authorizing only private securities litigation based on misrepresentations subsequent to the September 21, 2001 PSL Notice).

See PSL DRAFTERS’ COMMENTARY, supra note 18, at 140 (indicating that courts should deny recovery for the portion of a loss due to insider trading or
The failure of the Supreme People’s Court to provide private causes of action for insider trading and market manipulation is unfortunate. Market manipulation and insider trading are certainly present in China’s securities markets. In one celebrated case, the CSRC brought administrative action against four investment companies after they opened more than 600 securities trading accounts and then acquired much of the publicly traded stock of Yorkpoint Science & Technology Company through these accounts. By trading among themselves, the investment companies drove up the market price dramatically and then sold their stakes to unsuspecting investors. The CSRC imposed a RMB 449 million fine (USD 54.25 million), confiscated an equivalent amount of illegal income, and barred several individuals from participation in China’s securities markets. Under the PSL Rules no private securities litigation can be brought, even for such egregious market manipulation. The defrauded investors are without recourse against the perpetrators even though the CSRC determined culpability and imposed administrative penalties against them.

The drafters of the PSL Rules inconsistently point out that false disclosure can be an element of insider trading or market manipulation, so the private litigation authorized by the PSL Rules may help plaintiffs in some insider trading or market manipulation cases. See id. at 83 (claiming that the PSL Rules can reach cases of market manipulation and insider trading).

This raises the interesting question of how the PSL DRAFTERS’ COMMENTARY will be applied by PRC courts. It is technically only persuasive authority. It is not an enactment of the Supreme People’s Court. Rather, it is a lengthy gloss on the PSL Rules, which are themselves a judicial interpretation of the Supreme People’s Court (in other words, it is an interpretation of an interpretation). However, it was written by the Supreme People’s Court justices who were most responsible for the drafting of the PSL Rules. It would thus seem to carry significant weight.

See, e.g., Zaloom & Hongchuan, supra note 80, at 26, 30-31 (noting that “[c]hapter 11 of the [PRC] Securities Law contains 36 sections on the details of administrative punishment for violations of the Securities Law . . . . [s]eventeen of those sections impose criminal liability . . . [t]he intent of the legislators is clearly to curb widespread fraud, manipulation, and other wrongdoing in securities markets by imposing harsh penalties”).

See Zhengjianfazi [2001] 7 hao [Administrative Penalty Decision No. 7, 2001] China Securities Regulatory Commission, Apr. 23, 2001 (assessing penalties of income confiscation and fines against four companies that illegally traded in the shares of Yorkpoint); Securities Market Calls for Civil Compensation, supra note 27 (noting the Yorkpoint case and discussing the inability of defrauded investors to obtain civil compensation despite strong administrative penalties for illegal activities); see also Karby Leggett, Lawsuits Flood China’s Securities Industry—Shareholders Allege Rife Manipulation, WALL ST. J., May 30, 2001, at Cl (discussing how a “flood of litigation is engulfing China’s securities industry”).
The drafters of the PSL Rules and other commentators observe that while Article 63 of the PRC Securities Law provides a basis for civil liability for disclosure fraud, no parallel provisions explicitly authorize civil damages for insider trading or market manipulation. Only administrative and criminal sanctions are mentioned in the provisions of the PRC Securities Law. There are several problems with accepting this as an adequate reason for the narrow scope of the PSL Rules. First, the PRC Securities Law does not prohibit civil liability for insider trading or market manipulation; it simply fails to provide an explicit basis for it. The Supreme People's Court could have found an "implied private cause of action" in the PRC Securities Law. Alternatively, the Supreme People's Court could have allowed plaintiffs to sue for insider trading or market manipulation based on a tort theory under the PRC General Principles of Civil Law. In the PSL Rules, the Supreme People's Court did neither of these things. Sadly, the Supreme People's Court's refusal to read the PRC Securities Law liberally in favor of investors is matched by a willingness to disregard some of the law's explicit provisions. If Article 63 of the PRC Securities Law enables civil suits for

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123 PSL DRAFTERS' COMMENTARY, supra note 18, at 186 (noting no basis for civil liability for insider trading, but only criminal and administrative punishments, in PRC Securities Law); ZHONGGUO ZHENGQUAN SHICHANG WENTI BAOGAO [CHINA NEGOTIABLE MARKET ISSUE REPORT] 404-05 (Wan Guohua ed., 2003) (hereinafter CHINA NEGOTIABLE MARKET ISSUE REPORT) (discussing PRC Securities Law, art. 63 on disclosure fraud, art. 183 on insider trading, and art. 71 on market manipulation, and finding that only the first provides a basis for civil liability while the other two mention only criminal and administrative sanctions).

124 PRC Securities Law, supra note 6, arts. 183-84 (market manipulation); see also CHINA NEGOTIABLE MARKET ISSUE REPORT, supra note 123, at 404-05 (noting that the PRC Securities Law provides only criminal and administrative sanctions for market manipulation and securities fraud).


126 Some PRC commentators have suggested private securities litigation be allowed with respect to market manipulation on a tort theory. See CHINA NEGOTIABLE MARKET ISSUE REPORT, supra note 123, at 405 (noting that in the absence of civil damages, investors' losses are uncompensated even when administrative or criminal penalties are imposed). Indeed, it is unclear why the drafters of the PSL Rules did not embrace this notion, given their own description of tort liability. See PSL Rules, supra note 2, art. 1 (providing for tort liability when "a party with a disclosure obligation violated law provisions by making misrepresentations and thereby caused him to incur loss").
disclosure fraud, then the PRC Securities Law was violated by the Supreme People’s Court Notice of September 2001, which temporarily barred all private securities litigation.\textsuperscript{127} The PSL Rules also violate Article 63 by stripping some victims of disclosure fraud of their rights to sue.

Supreme People’s Court officials indicate rules expanding the scope of private securities litigation to include insider trading and market manipulation will be forthcoming “when market and legal conditions are ripe.”\textsuperscript{128} Early promulgation of such enabling rules is desirable. If the PRC Securities Law is not quickly amended to provide explicitly for civil liability and for insider trading and market manipulation, the Supreme People’s Court should issue such rules based upon a tort theory.

3.2. Even Some Victims of Disclosure Fraud are Denied Recovery

Under the PSL Rules, some investors harmed by clearly fraudulent disclosure will be denied recovery.\textsuperscript{129} The problem arises because the PSL Rules instruct courts not to find causality between false disclosure and an investor’s losses when an investor: 1) buys a security prior to the false disclosure being made about that security, or 2) sells a security before the relevant falsity of disclosure is publicly revealed.\textsuperscript{130} This means, for example, that if an issuer fails to disclose good news, creating the impression that it is in worse condition than it actually is, investors selling shares prior to the public revelation of the good news will be denied recovery.

The scenario is likely to arise when a number of investors sell their shares in a particular listed company thinking that the firm’s current performance indicates dim prospects, only to later discover that the issuer withheld material positive information. Actually, the company was not in dire straits. Instead, it has recently signed several major contracts for lucrative work and entered into a

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\textsuperscript{127} Compare September 21, 2001 PSL Notice, supra note 24 (declaring that civil compensation cases concerning securities will temporarily not be accepted) with PRC Securities Law, supra note 6, art. 63 (imposing liability on issuers for damages suffered as a result of their fraudulent disclosures).

\textsuperscript{128} PSL DRAFTERS’ COMMENTARY, supra note 18.

\textsuperscript{129} See XUAN WEIHUA, XUJIA CHENSHU MINSHI PEICHANG YU TOUZIZHE QUANYI BAOHU [CIVIL LIABILITY FOR MISREPRESENTATIONS AND THE PROTECTION OF INVESTOR INTERESTS] 19 (Falü Chubanshe 2003) (discussing three types of victims of fraudulent disclosure who cannot sue under the PSL Rules).

\textsuperscript{130} PSL Rules, supra note 2, art. 19.
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merger agreement with a multinational conglomerate willing to pay a large premium to acquire the company's shares. Once this information is revealed, the company's share price increases substantially. If this information had been disclosed in a timely fashion, the value of the company's shares would have increased sooner. Consequently, investors who sold their shares before the information was revealed suffered losses (by getting a lower price) due to their reliance on the issuer's materially inadequate disclosure. The PRC Securities Law would impose a duty of timely disclosure on the listed company in this hypothetical.\(^{131}\) Even when the issuer's breach of that duty causes investors to suffer damages, the PSL Rules deny recovery to such investors. Because of the time at which they sold their shares (before the falsity of the disclosure was publicly revealed), such investors are barred from establishing causality between their losses and the issuer's false disclosure.\(^{132}\) This inability to establish causality means they cannot recover under the PSL Rules.\(^{133}\)

Ironically, this means the presumption of causality afforded by the PSL Rules will not benefit victims of disclosure fraud who are situated as the plaintiffs were in Basic Inc. v. Levinson\(^{134}\) in which the U.S. Supreme Court adopted the very "fraud on the market" theory the drafters of the PSL Rules acknowledge was incorporated into the PSL Rules.\(^{135}\) The defendants in Basic, Inc. repeatedly denied that an issuer was in merger talks. In fact, such talks had been underway. Once the merger talks were disclosed, the stock price rose. Plaintiffs in Basic had sold their shares after the false denials of merger talks were made and before the truth was revealed. Consequently, they sold at a price lower than the price they could have obtained if the false disclosure had not been made or if they had waited to sell until the true information was revealed. The Basic plaintiffs were able to recover damages through private securities litigation in the United States based on

\(^{131}\) See PRC Securities Law, supra note 6, art. 63 (requiring immediate disclosure of major contracts and merger agreements by listed companies).

\(^{132}\) PSL DRAFTERS' COMMENTARY, supra note 18, at 108.

\(^{133}\) See XUAN, supra note 129, at 19 (stating that the significance of articles 18 and 19 of the PSL Rules is that investors who sell before a disclosure date cannot obtain compensation).


\(^{135}\) See PSL DRAFTERS' COMMENTARY, supra note 18, at 25, 27 (discussing fraud on the market theory (shichang qizha lilun) and the principle of inferred reliance, (xinlai tuiding yuanze)).
these facts. However, if the Basic plaintiffs had sued under the PSL Rules, they would not have been able to establish causality because of the time at which they sold their shares. Similarly, if the president of a PRC-listed company withholds material positive information in order to acquire shares at a depressed price for himself, the sellers will have no cause of action against that president under the PSL rules. This is the precise fact pattern that caused the U.S. Securities and Exchange Commission to adopt Rule 10b-5 in 1947.

The drafters of the PSL Rules indicate situations in which good news is withheld (youkong xu jia chenshu) are more complex and rare than instances in which a company inflates its share price by disclosing false information (youduo xu jia chenshu). They also indicate the CSRC rarely brings administrative sanctions in such situations, but that if it did, the defrauded investors could seek a case-specific approval to sue from the Supreme People's Court (ge an pifu). While all this may be true, the denial of relief to victims of disclosure fraud in these situations has no basis in the PRC Securities Law. Liability for fraudulent disclosure is imposed by Article 63 regardless of whether the fraud arises from the creation of false good news,\(^\text{136}\) the withholding of important bad news, or silence concerning material good news. Moreover, Article 62 requires that major contracts, mergers, and other potential sources of good news be disclosed on an ad hoc basis.\(^\text{137}\) Thus the PSL Rules should be revised so that they do not strip this category of investors of their rights to sue.

3.3. Requirement of Enabling Government Action

A devastating weakness of the PSL Rules is that they require specific government action as a prerequisite for any private securities litigation.\(^\text{138}\) Under Article 6 of the PSL Rules, no private

\(^{136}\) PRC Securities Law, supra note 6, art. 23.

\(^{137}\) See id. art. 62(3) (requiring immediate disclosure of major contracts); id. art. 62(9) (requiring immediate disclosure of merger decisions).

\(^{138}\) The PSL Rules evidently require enabling government action with regard only to the alleged instance of misrepresentation, not with regard to each specific defendant. This conclusion is implied by, but not overtly stated in, the PSL Rules. Article 5 provides that in calculating the starting date for the limitations period, the earliest administrative penalty's publication date is to be used if there are multiple administrative penalties or administrative penalties and criminal findings. Although multiple agencies could issue administrative penalties against a single party (or a single party could incur both administrative and criminal
securities litigation can be adjudicated by a Chinese court unless an administrative penalty (xingzheng chufa jueding) or a criminal penalty has already been imposed. Thus, even when claims are based on bad disclosure and thus are within the scope of the PSL Rules, investors may not seek relief without enabling government action. This requirement has no basis in the PRC Securities Law and it strips investors of the right to sue for disclosure fraud explicitly provided for in the Securities Law. The requirement effectively puts the threat of private securities litigation under government leash.139 It substantially removes the “private” aspect of private securities litigation; under the PSL Rules, the government must sanction all “private” litigation. This significantly dilutes the potential of private securities litigation to create incentives for compliance with China’s disclosure laws. No army of private attorneys general will be unleashed without specific government sanction in each instance.140 Just as stock sanctions), it seems more likely this provision addresses the issuance of administrative penalties by one or more agencies against multiple defendants involved in a single instance of misrepresentation. Article 6 requires a plaintiff to submit evidence of the administrative penalty or criminal judgment as the foundation (yiju) for an action, but does not clearly state such action must be against each specific defendant. Thus, it appears CSRC action against a listed company could be the basis of private suits against the listed company and those associated with it such as the company’s directors, supervisors, and executives and the securities, accounting, appraisal, and law firms that may have assisted the listed company. See PSL Rules, supra note 2, arts. 5-6 (discussing the statute of limitations for civil damages actions and the acceptance of cases). But see Liu & Ren, supra note 97, at 31 (“Before the court accepts and hears a misrepresentation case, the government authority in charge must have already imposed administrative or criminal punishments on the persons responsible for making the misrepresentation.”).

139 See Donald C. Clarke, China’s Legal System and the WTO: Prospects for Compliance, 2 Wash. U. Global Stud. L. Rev. 97, 110-11 (2003) [hereinafter China’s Legal System] (noting, with regard to the CSRC, the prior action requirement in the January 15, 2002 PSL Notice permitting courts to accept private securities litigation that “[t]he Court apparently agrees with the plaintiffs that they have a valid claim under the Securities Law, but has interposed, without any statutory foundation whatsoever, the CSRC as a gatekeeper in order to ensure that claims not approved by the government will not come before the courts”); Posting of Donald C. Clarke, “Re: ‘joint action’ shareholder suits,” to CLNET (Dec. 17, 2002) (on file with author) (noting with regard to the PSL Rules that a requirement of enabling government action “has no basis in the Securities Law and is transparently a device to maintain government control over this kind of litigation”).

140 The drafters of the PSL Rules are well aware that civil liability can stimulate compliance with law. See PSL Drafters’ Commentary, supra note 18, at 185 (noting potential of civil liability to suppress illegal activity).
markets exist in China without privatization of ownership, private securities litigation exists in China without fundamental privatization of the cause of action.

Although the requirement of enabling government action is disappointing, the PSL Rules do improve upon the initial Supreme People’s Court Notice of January 15, 2002 that required that the CSRC itself impose an administrative sanction on a listed company before private lawsuits could be brought.\textsuperscript{141} The PSL Rules still require government action before a private suit can be brought, but now such action does not have to be specifically from the CSRC. In the PSL Rules, the requirement for enabling government action can be met with criminal findings by a court or with an administrative penalty from some source other than the CSRC.\textsuperscript{142} The Ministry of Finance is in charge of accounting standards in China.\textsuperscript{143} Its determinations of violations of financial accounting disclosure rules are likely to be the grounds for many suits brought under the PSL Rules. Indeed, the first private securities litigation involving a foreign party was predicated on such non-CSRC action.\textsuperscript{144}

This broadening in the PSL Rules of the ways to meet the enabling government action requirement should be helpful to some plaintiffs, but obtaining the required government enabling action may remain difficult for many potential plaintiffs. The CSRC itself may now be in a slow-down phase in terms of its enforcement efforts. The CSRC has new leadership. Its former chairman Zhou Xiaochuan has become head of China’s central bank.\textsuperscript{145} Under Zhou, the CSRC in recent years increased its

\textsuperscript{141} See January 15, 2002 PSL Notice, supra note 25, art. 2 ("[a]ccording to the law, a People’s Court shall not accept a case unless the party concerned files a civil legal proceeding” based on an investigation by CSRC).

\textsuperscript{142} See PSL Rules, supra note 2, art. 6 (discussing the necessary evidence that needs to be submitted when an investor institutes securities misrepresentation civil damages proceedings). The nuances of this may be complex in practice. See infra note 15860 and accompanying text.

\textsuperscript{143} See Kuaiji Fa [PRC Accounting Law], ch. 1, art. 6 ("A state uniform accounting system shall be formulated by the Finance Department of finance. . .").

\textsuperscript{144} See Ema Ma, KPMG Sued by Chinese Investor, BEIJING YOUTH DAILY ONLINE, Feb. 23, 2003 (reporting that the triggering of the litigation involving KPMG was predicated upon an administrative penalty imposed by the Ministry of Finance), at http://www.bjyouth.com/article.jsp?oid=2150576 (last visited June 1, 2003).

enforcement efforts, proclaiming 2001 a "year of market supervision" and bringing a record number of administrative actions against listed companies.\textsuperscript{146} However, these enhanced enforcement efforts were perceived by many Chinese to be part of the cause of significant market declines.\textsuperscript{147} Under the new PRC and CSRC leadership,\textsuperscript{148} rhetoric has shifted away somewhat from aggressive enforcement of securities laws. Previously, CSRC Vice Minister Laura Cha (a.k.a. Shi Meilun, a former Hong Kong securities regulator with U.S. legal training) remarked that, "what regulators should do is regulate; that is their duty . . . [a]s far as declines in market indexes are concerned, investors should broaden their vision to find another explanation."\textsuperscript{149} More recently, Shang Fulin, the new CSRC chairman, has emphasized that reform must be kept at pace with market development and the markets’ capacity for accepting change.\textsuperscript{150} Thus, it seems there is now less political momentum in China for aggressive enforcement of disclosure rules by the CSRC. If the CSRC is less interested in

\textsuperscript{146} See "Year of Supervision" for China's Stock Market: Roundup, PEOPLE'S DAILY ONLINE, Dec. 30, 2001 (reporting CSRC followed through on promise to make 2001 a year of market supervision, bringing more than forty enforcement actions and adding staff to investigate listed companies), at http://english.peopledaily.com.cn /200112/30/eng20011230_87763.shtml (last visited June 1, 2003).

\textsuperscript{147} The markets have responded positively to the apparent slowdown in reforms and enforcement. See China's New Top Regulator May Rain on Market Rally, WALL ST. J. ONLINE, Feb. 19, 2003 (reporting on market rallies following replacement of CSRC head Zhou Xiaochuan with Shang Fulin, whom many investors hoped would be different than Zhou, who "often unsettled the markets with his campaigns to crack down on market manipulation and to improve corporate governance") (on file with author).

\textsuperscript{148} For a discussion on the PRC power transition, see generally CHINA'S LEADERSHIP IN THE TWENTY-FIRST CENTURY: THE RISE OF THE FOURTH GENERATION (David Michael Finkelstein & Maryanne Kivlehan eds., 2002).

\textsuperscript{149} See Laura Cha Discusses Regulatory Supervision, supra note 50 (discussing an interview with Laura Cha, in which she stated "jianguanzhe yao zuo de jianguan, zhe shi tamen de renwu.... women zuo women yinggai zuo de shiqing, jin women di zhize. Zhiyu zhishu xiaidie, touzizhe ying yi geng gangkuode shiye qu xunzhao yuanyin").

\textsuperscript{150} See Tuijin Shichang Gaige Kaifang he Wending Fazhan [Promoting Market Reform and Opening and Stable Development], ZHONGGUO ZHENGQUAN BAO [CHINA SEC. J.], Jan. 27, 2003, at 1 (summarizing remarks of Shang Fulin at the National Securities and Futures Workshop held Jan. 24-26, 2003). Reading the tea leaves of the official PRC press suggests enforcement will slow down in 2003 compared with the previous two years. Many articles in early 2003 about meetings of regulators indicate market normalization must be kept apace market development. This differs from previous leadership comments that investor protection does not mean assuring investors will earn money.
enforcing disclosure requirements, it is unlikely other agencies, whose charge is not market regulation, will do so, even if the PSL Rules contemplate that actions by these other administrative agencies can enable private securities litigation.

Even if the political will to enforce disclosure rules remains strong, the resources of the CSRC and other agencies are limited. The CSRC is likely to become a bottleneck because it cannot monitor, investigate, and prosecute all, and perhaps not even most, cases of bad disclosure. China now has more than 1,200 listed companies. The CSRC has a small staff. Its enforcement division has few professionals. Help is provided by investigators from public security, but even so the CSRC is stretched too thin to monitor all disclosure. There is no indication that other agencies are likely to add significant additional resources to the task of securities law enforcement, which they are unlikely to regard as relevant to their core missions.

Indeed, now that imposing administrative sanctions for bad disclosure can unleash private securities litigation, the CSRC and other agencies are likely to be more reluctant to impose such penalties. All administrative penalties concerning disclosure—presumably even negligible fines and mere warnings—can now trigger follow-on private litigation. This seems to effectively narrow the spectrum of penalties for bad disclosure the CSRC has at its disposal; whatever penalty the CSRC imposes, private securities litigation can follow in the wake of the CSRC action. The CSRC will no doubt consider this before imposing penalties. Also, defendants will no doubt contest CSRC investigations more strenuously, knowing an adverse determination authorizes private litigation. Because the stakes are now higher than simply whatever penalty the CSRC (or another agency) imposes, it seems likely enforcement actions will be less common.

Making government action a prerequisite for private securities litigation also underscores a potential conflict of interests arising from the ownership structure of most PRC listed companies. Most listed companies in China are government-owned corporations. Therefore, the requirement of enabling government action mandates that the government essentially agree

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151 See Cai, supra note 17, at 138-39 (noting the limited resources of the CSRC by stating that only 27 of its approximately 300 employees work in enforcement).
152 See supra note 56 and accompanying text.
153 See supra note 57 and accompanying text.
to let itself be sued, or at least allow a political subdivision to be sued.

This does not mean there will not be administrative penalties enabling private securities litigation in China. There is a potential conflict of interest, but the policy dynamics are complex. The Chinese Communist Party, which under the PRC Constitution has the ultimate authority to govern China, has been pursuing market-oriented reforms for more than twenty years. There are clearly reform-minded officials who wish to establish robust capital markets in China. For these and other reasons, the interests of the CSRC and other agencies that might impose administrative penalties may not be aligned with the interests of other government entities that own listed companies. The PRC state is hardly monolithic. There is a spectrum of ideology among leaders and competition among regulatory institutions, as well as central-versus-local power dynamics that can influence government actions. In some instances, these dynamics may foster rather than retard the use of private securities litigation. Perhaps central authorities will find that unleashing private securities litigation (through CSRC or other administrative enabling action) is a useful tool when they need to reign in a particular provincial government.

Also, regulatory agencies may seek to take actions that enable private securities litigation to be used as a weapon in inter-agency or intra-governmental conflict. The PSL Rules do not specify which agencies beyond the CSRC may take actions that enable private securities litigation, nor do they require that the enabling administrative penalty come from a central government agency.

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156 See KAITUO ZHONGGUO ZHENGQUAN SHICHANG XIN JUMIAN [DEVELOPING THE NEW PHASE OF CHINA'S SECURITIES MARKETS] (Zhou Zhengqing ed., 2002) (containing speeches by PRC officials expressing hopes for growth in PRC securities markets); see also Inside the CSRC: Gao Xiqing, CHINA L. & PRAC., Mar. 2000, at 35-39 (containing an interview with the former CSRC vice-chairman in which he expressed hopes that in twenty years PRC capital markets will "be a major force in the world").

157 PSL Rules, supra note 2, art. 5(2) (stating that the limitations period shall run from "the date on which the Ministry of Finance of the People's Republic of China, or another administrative authority or an authority with the power to impose administrative penalties, publishes its decision to punish the misrepresenting party").
Thus, some agencies could become entrepreneurial in this regard, creating interesting conflicts. One can imagine scenarios in which one province or agency takes actions designed to unleash private securities litigation against entities that are controlled by its rivals. However, the PSL Rules require that suits be brought in the defendant’s home jurisdiction, where the connections among local courts, local listed companies, and local governments suggest that plaintiffs cannot easily prevail. Therefore, such tactics are unlikely to be very effective. Moreover, the Chinese Communist Party retains macro-level authority over both provinces and agencies. It could quash such internecine warfare.

Overall, it seems likely that the interests of the Chinese state as a shareholder in listed companies will depress regulatory enforcement efforts. Given the choice, the Chinese state will most likely not authorize massive litigation against itself or its assets on a routine basis. Thus, the requirement that government action precede private securities litigation will probably significantly decrease the amount of such litigation. There are at least two unfortunate results caused by decreased private securities litigation. First, some defrauded investors will probably be unable to recover damages because they lack the enabling government action. Second, the capacity of private securities litigation to encourage compliance with China’s securities laws will be diminished.

3.4. Lack of U.S.-Style Class Actions

Another factor that may diminish the effectiveness of private securities litigation in China is the absence of an effective class

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158 See Law of the People’s Republic of China on Administrative Penalties, art. 11 (providing that local regulations can be the basis for administrative penalties), at http://www.isinolaw.com/jsp/law/LAW_Articles.jsp?CatID=23&LangID=0&StatutesID=10379&ChapterID=-1# (last visited Sept. 30, 2003); see also PSL DRAFTERS’ COMMENTARY, supra note 18, at 191 (discussing the power of provincial governments to impose penalties that can be the basis for private securities litigation).

159 See infra Section 3.5 (discussing how jurisdictional requirements in the PSL Rules favor defendants).

160 Of course, the moral hazard or rent-seeking opportunities of CSRC and other administrative officials will increase under the PSL Rules. Because any penalty they impose for bad disclosure can unleash private securities litigation, there is a danger that listed companies seeking to avoid such litigation risks will bribe CSRC officials or other regulators to avoid the imposition of administrative penalties that trigger such litigation.
The PSL Rules permit private securities litigation to be brought as individual actions (dandu susong) or as joint actions (gongtong susong). These joint actions permitted under the PSL Rules do resemble a U.S.-style class action in some respects but fall short of the U.S. model in other critical ways. Many commentators, including the drafters of the PSL Rules, distinguish the joint actions available under the PSL Rules from U.S.-style class actions (jituan susong).

China’s approach is similar to a U.S.-style class action suit in that private securities litigation can ostensibly involve large numbers of plaintiffs with lead plaintiffs representing the “class”

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161 Prior to promulgation of the PSL Rules, the absence of an effective class action mechanism was discussed as a general problem. See Cai, supra note 17, at 148 (contending “the skeletal nature of such [PRC class action] provisions has led to the reluctance of Chinese courts to hear class action cases. Effective enforcement by private action requires a wholesale reform of the current system”).

162 See PSL Rules, supra note 2, art. 12 (“The plaintiffs in securities-related civil damages cases covered hereby may choose to institute either individual or joint actions.”).

163 There has been some confusion in the international press over the issues of whether and what type of collective litigation China permits with respect to private securities litigation. The Economist Intelligence Unit incorrectly reported that “joint suits have not been permitted in China. Up until January this year [2003] each investor had to file his case individually and courts were expected to judge each on its own merit.” Economist Intelligence Unit, supra note 31, at 2. Actually, joint suits were permitted even under the January 15, 2002 PSL Notice, supra note 25, sec. IV, that initially authorized private securities litigation for disclosure fraud. In the same piece, the Economist Intelligence Unit did correctly report that China’s joint actions under the PSL Rules are not the equivalent of U.S-style class actions. Economist Intelligence Unit, supra note 31, at 2 (quoting Professor Donald C. Clarke). Dow Jones described the acceptance of one suit as China’s first class action for securities fraud. China Court Accepts First Class Action Shareholder Suit, DOW JONES INT’L NEWS, Feb. 17, 2003. A subsequent version of the story, quoting the Author of this Article, backed off that characterization. James T. Areddy, China Shareholder Case Falls Short Of Class Action, DOW JONES INT’L NEWS, Feb. 18, 2003 (on file with author). But see Nailene Chou, Supreme Court to Issue Guidelines on Shareholder Lawsuits, S. CHINA MORNING POST, Dec. 16, 2002 (distinguishing correctly between PRC joint actions and class actions in other jurisdictions) (on file with author).

PRC sources acknowledge the PSL Rules do not permit full-blown U.S-style class actions. See Renmin Wang, Shouliu Zhengquan Gongtong Susong Fayuan Shouliu Daqing Lianyi Minshi Peichang [First Joint-Action Civil Compensation Securities Litigation Accepted by Court Against Daqing Lianyi], PEOPLE’S DAILY ONLINE, Feb. 18, 2003 (noting that joint actions may in time lead to the development of class actions) (on file with author).

164 See PSL DRAFTERS’ COMMENTARY, supra note 18, ch. 7, at 205-17 (discussing PRC gongtong susong and a U.S. jituan susong in detail).
China’s securities markets are dominated by retail investors, therefore aggregating many small claims is necessary to make private securities litigation viable for many plaintiffs. Having a small number of lead plaintiffs should facilitate the logistics of such actions. PRC lawyers have been aggressive in rounding up plaintiffs for private securities litigation with several hundred plaintiffs being listed in some of the first actions to be filed. However, at least two PRC courts have already required that joint actions be split into smaller groups. One court even required a group of only sixty-one plaintiffs to be split into groups of no more than ten plaintiffs each—not because of any similarity in their damage claims or other issues, but simply as a requirement for accepting the litigation. In practice, it is unclear how much utility joint actions will have for aggregating claims in private securities litigation.

Even if courts allow lawyers to group many claims in a joint action, a more potent form of class action could make the PSL Rules more effective in encouraging good disclosure. In a U.S. class action, lead plaintiffs can represent (and the results of the litigation can bind) claimants not specifically before the court as

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165 Article 12 of the PSL Rules provides that actions may be brought individually or jointly. PSL Rules, supra note 2, art. 12. Litigants in joint actions may select lead plaintiffs, and there is no express limit on the number of cases that can be joined in joint actions. In these respects, the PSL Rules will permit a large number of claims to be gathered into a single action. Concerning class action litigation in China, see generally Note, Class Action Litigation in China, 111 HARV. L. REV. 1523 (1998). Concerning the mechanics of class certification in U.S. private securities litigation, see Kermit Roosevelt III, Defeating Class Certification in Securities Fraud Actions, 22 REV. LITIG. 405 (2003).

166 For example, one early suit against KPMG, as auditor, and the underwriter of PRC-listed Jinzhou Port sought damages of only USD 1880. See KPMG Faces Suit from Minority Shareholders, supra note 4. The drafters of the PSL Rules acknowledged that most investors will have small claims. See PSL DRAFTERS’ COMMENTARY, supra note 18, at 211.

167 See Wang, supra note 163 (reporting acceptance by Harbin Intermediate People’s Court of private securities litigation involving 381 plaintiffs seeking RMB 10,221,826.11 in compensation in a joint action). See also PSL DRAFTERS’ COMMENTARY, supra note 18, at 202.

168 See Zhengquan Minshi Susong Xin Wenti: Gongtong Susong Yuangao Renshu Shou Xian [A New Problem in Securities Civil Litigation: The Number of Plaintiffs in Joint Actions are Limited], ZHENGQUAN SHIBAO [SEC. TIMES] (reporting that courts in Qingdao and Harbin are already limiting the number of cases lawyers can aggregate), available at http://www.people.com.cn/GB/jinji/35/159/20030409/966783.html (last visited June 1, 2003).

169 Id.
name plaintiffs. Under the U.S. approach, claimants may need to opt out of litigation to avoid being bound by the results. However, the PSL Rules require that claimants opt in to specific litigation before the trial commences. While this reduces the danger that claimants will be bound by results they may not like, the opt-in requirement will make it harder to aggregate a massive number of claims (e.g., all of the persons trading a company's shares in a particular time) into a single action. Litigation on behalf of fewer plaintiffs will probably result in litigation that seeks smaller damages. This may reduce issuers' fears of private securities litigation and thus reduce the effectiveness of such litigation in prompting good disclosure. Another possible consequence is the reduction of incentives for lawyers to bring the suits.

Prior to adoption of the PSL Rules, many people advocated that China should permit U.S.-style class actions for private securities litigation. Yale School of Management professor Chen Zhiwu published a law review article in China prior to the adoption of the PSL Rules that provided a detailed explanation of the U.S. model and advocated that the U.S. model be adopted. Several PRC-based commentators made similar arguments. The drafters of the PSL Rules directly consulted with Professor Chen prior to the adoption of the PSL Rules, and a commentary on the PSL Rules written by the drafters displays a thorough understanding of U.S.-style class actions and its advantages over PRC joint actions of the kind adopted. The absence of a U.S.-style class action is thus not due to a lack of knowledge. Drafters of the PSL Rules claimed that the time was not ripe for class actions in China and that such an innovation would not have had a legal basis under Chinese law. However, these reasons seem disingenuous. The drafters of the

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171 Id. at 23(c)(2).
172 PSL Rules, supra note 2, art. 14.
174 See, e.g., Xuan, supra note 129, at 111 (reporting that CSRC assistant chairman Jesse Wang Jianxi told a gathering of accountants in Hong Kong, "[o]ther than the existing enforcement mechanisms, we should introduce class-action lawsuits").
175 See PSL DRAFTERS' COMMENTARY, supra note 18, at 205-09.
176 See id. at 207-08.
PSL Rules did not choose the most potent form of multi-plaintiff action even though it falls within the range expressly authorized by PRC Civil Procedure Law. PRC Civil Procedure Law provides for two kinds of joint actions with lead plaintiffs—one with a definite number and one with an indefinite number of plaintiffs at the time the action is filed. However, the PSL Rules prohibit joint actions in which a litigation representative acts on behalf of an unascertained number of plaintiffs. The PSL Rules permit joint actions only with a definite number of plaintiffs who explicitly opt into the litigation before a trial commences. Moreover, the Supreme People’s Court, by its own description, was “filling in a gap in PRC legislation” with the PSL Rules. Given that the Supreme People’s Court acted as a legislature in creating the PSL Rules, filling in gaps in procedural legislation to fashion a more robust class action remedy would not have been a conceptual breakthrough had the court been inclined to do so. Why would “interpreting” the class action mechanism provided for in the recondite PRC Civil Procedure Law be different than “interpreting” the right to civil compensation found in the PRC Securities Law? The Supreme People’s Court boldly imposed an initial temporary ban on all private securities litigation claims, and later imposed a “prior government action” requirement on all plaintiffs. Neither action has a basis in PRC Securities Law. Thus, the failure of the PSL Rules to provide a more robust class action mechanism does not stem from a lack of knowledge or the Supreme People’s Court’s perception of its institutional authority to interpret laws.

The explanation for the failure to adopt the U.S.-style class action mechanism is more likely economic and political in nature. Large class actions could expose state-owned listed companies to massive private securities litigation judgments. This exposure may be reduced by limiting the number of claims that can be

177 See PRC Civil Procedure Law, art. 54-55 (on file with author).

178 See PSL Rules, supra note 2, art. 14 (mandating that the number of plaintiffs be decided before the hearing). A more potent form of litigation would have been achieved had the PSL Rules allowed joint actions with lead plaintiffs representing an unascertained number of claimants. Still, that form of PRC litigation falls short of a U.S.-style class action because each “unascertained” plaintiff must still opt into the litigation by registering his or her rights (dengji quanli) or suing individually. See PSL DRAFTERS’ COMMENTARY, supra note 18, at 216.

179 See infra note 297 and accompanying text.
aggregated to parties who specifically opt into specific litigation. Beyond the economic incentive, political unease is another reason for the lack of a U.S.-style class action mechanism. The organization of interest groups, through the approximation of class actions permitted under the PSL Rules, has the potential to sharpen conflict between dispersed individual investors (san hu) and the state. The concentration of large numbers of aggrieved shareholders into an organized group triggers anxiety in a regime lacking popular legitimacy through sufferage. Prior to the release of the PSL Rules, Professor Chen and others met with members of the Supreme People’s Court urging them to adopt potent class action mechanisms. However, Supreme People’s Court judges expressed anxiety regarding the political risks associated with creating groups of aggrieved investors.\textsuperscript{180} A Supreme People’s Court judge told Professor Chen, “[t]he word ‘class’ is in the name of this legal device. You are going to get all the angry shareholders organized in one class. That is politically too dangerous.”\textsuperscript{181} As one commentator has stated, “limiting the scope of the ‘class’... contains the general social impact of such suits, preventing the spread of a more general shareholder activism that could be politically threatening.”\textsuperscript{182} With respect to private securities litigation, class struggle—which Maoist revolutionary ideology so emphasized in other forms\textsuperscript{183}—is shackled by Chinese political and economic legacies that elevate the interest of the Communist Party and its state above individual rights.

3.5. Jurisdictional Requirements Likely to Favor Defendants

The PSL Rules include jurisdictional provisions that are likely

\textsuperscript{180} See Susan V. Lawrence, Shareholder Lawsuits: Ally of the People, FAR E. ECON. REV., May 9, 2002 (discussing meetings about private securities litigation in China in which Chen Zhiwu, Yale School of Management professor, and Guo Feng, Beijing lawyer and Renmin University professor, encouraged adoption of a class action system) available at \url{http://www.feer.com/articles/2002/0205_09/p026\_china.html} (last visited June 1, 2003). The drafters of the PSL Rules acknowledge that Professor Chen provided background on U.S.-style class actions. See PSL DRAFTERS’ COMMENTARY, supra note 18, at 206.

\textsuperscript{181} PSL DRAFTERS’ COMMENTARY, supra note 18, at 206.

\textsuperscript{182} Posting of Matthew C.J. Rudolph, to clnet@u.washington.edu (Feb. 19, 2003) (discussing with Author the press reports about private securities litigation in China) (on file with author).

\textsuperscript{183} See generally STUART SCHRAM, THE THOUGHT OF MAO TSE-TUNG (1989) (discussing the influence of Maoist thought on China throughout the twentieth century).
to discourage plaintiffs as well. Under the PSL Rules, plaintiffs must sue a listed firm in an intermediate-level people's court located in a provincial capital, specially designated city or special economic zone.\textsuperscript{184} If a plaintiff sues multiple defendants such as investment banks, accounting firms, or individual directors in addition to the listed firm as permitted by the PSL Rules,\textsuperscript{185} then the suit must be brought in the intermediate-level people's court where the defendant is located.\textsuperscript{186} For example, a suit against the maker of Tsingtao Beer ("Tsingtao" is also Romanized as "Qingdao") and its directors would have to be brought in the Qingdao Intermediate People's Court. This is consistent with the PRC General Principles of Civil Procedure Law.\textsuperscript{187} However, this jurisdictional provision is likely to disadvantage plaintiffs because local courts and many listed companies in China are essentially subsidiaries of the same local government. In other words, when a plaintiff files private securities litigation in China, the majority shareholder of the defendant is likely to have substantial leverage over the adjudicating court.\textsuperscript{188}

Until 2001, the PRC employed an explicit quota system for

\textsuperscript{184} PSL Rules, \textit{supra} note 2, art. 8.

\textsuperscript{185} \textit{Id.} art. 7.

\textsuperscript{186} \textit{Id.} art 9.

\textsuperscript{187} See, e.g., \textit{Id.} note 16.

\textsuperscript{188} An early private securities litigation case anecdotally suggests the likelihood of difficulty. A group of investors sued a Chengdu-based listed company in the Chengdu Intermediate People's Court. The case languished for nearly four years without resolution, but the litigants agreed to court-directed mediation shortly before the Supreme People's Court issued the PSL Rules. The national business press paid considerable attention to the case. At least three major PRC financial papers and five national television stations sent reporters to cover the proceedings. Local media, however, appeared uninterested. A reporter for China's \textit{International Finance} paper noted the disparity between national and local coverage and quoted a source's explanation that "[i]t is not that the local press is uninterested, but in general they are \textit{not permitted to report}" on such proceedings. See \textit{Id.} note 16 (reporting that eleven plaintiffs settled claims through mediation against the former Hong Guang Company after three years of litigation, jointly obtaining RMB 220,000).

Prior to promulgation of the PSL Rules (and before promulgation of the PRC Securities Law), Matthew D. Latimer recognized the difficulty of enforcing shareholder rights because of the affiliation between local governments and local enterprises and the lack of independence of courts. See Matthew D. Latimer, \textit{Note, Gilding the Iron Rice Bowl: The Illusion of Shareholder Rights in China}, 69 WASH. L. REV. 1097, 1109-11 (1994) (discussing how the political influence of large SOEs can interfere with judicial enforcement of shareholder rights).
determining which companies' securities could be listed. Each provincial government was given an allotment of listing opportunities—an IPO quota, determined by central authorities in accordance with economic plans (creating the paradox that stock markets, a putatively market-oriented reform, were built through central planning, the system which is ostensibly being abandoned). Such capital market access provided the enticing ability to raise capital at comparatively low cost with no payback requirement and no significant loss of control to firm managers or owners. During this era of IPO quotas, the allotment of listing quotas predictably went to favored provincial industries which were often substantially owned by the provincial governments.

This ownership structure has generally remained in place after the IPOs of companies which were awarded the listing slots. The drafters of the PSL Rules acknowledge that generally two-thirds of the shares of a listed company are illiquid, unlisted shares. These unlisted shares are generally directly held by government divisions as state shares (guoyou gu), or indirectly as legal person shares (faren gu) through other government-controlled corporations, as described above in the "Special Characteristics" Section. Thus, defendant listed companies will likely be substantially government-owned, often by the provincial governments which also control the courts adjudicating private securities litigation.

In China, a fundamental obstacle to the progress of the rule of law is that local courts are subject to the control of local governments. Local governments in China appoint judges to local courts and control the promotion of such judges. Local governments in China also control the budgets of local courts. Beyond the powers of appointment and budget, Chinese courts are

189 See Liu, supra note 56 (reporting quota system scrapped in 2001). But see Li Wenfang, More Non-State Firms to be Listed, CHINA DAILY, Dec. 4, 2001 (Hong Kong ed.) (reporting that the quota system was abolished in 1998 but quotas given out previously were used through 2001), available at http://www.chinadaily.com.cn/en/doc/2001-12/04/content_96640.htm (last visited Sept. 30, 2003).

190 See generally WALTER & HOWIE, supra note 78, at 112-14 ("This [quota system] also makes clear why non-state enterprises are extremely unlikely to have the opportunity to list. They do not belong to the state, but the quota does.").

191 See PSL DRAFTERS' COMMENTARY, supra note 18, at 26.

192 Supra Section 2.3.

193 See BROWN, supra note 48, at 33 ("The State Council [has] responsibility to fund the Court and to decide its staffing levels.").

194 Id. at 37 (describing how the Ministry of Finance funds all courts).
subject to oversight by political-legal committees which are comprised of extra-judicial personnel. Thus, the intermediate-level people’s court judges who will adjudicate private securities litigation cases against government-owned corporations are subject to substantial influence from government cadres at the same level. These judges, lacking in meaningful independence, may find that it is not in their interest to grant relief to plaintiffs, regardless of the merits of the fraudulent disclosure claims.

Under China’s Civil Procedure Law, litigants dissatisfied with an initial judgment can appeal to a higher level court. However, the PSL Rules have placed initial jurisdiction with the intermediate-level people’s courts. Thus, appeals will be to the higher-level people’s courts within the same province. In other words, the appeal will be to a higher court controlled by the same government that controlled the court of the first instance and which is likely to often be a substantial owner of the defendant company. Local trials of cases against local listed companies may not, then, be impartially adjudicated before a plaintiff’s remedies are exhausted.

To reduce such moral hazards, an alternative, in lieu of the much-needed structural reform of PRC courts, is to create a national special court or courts specifically for securities litigation, staffed by experts not controlled by local governments. This would reduce the likelihood of partiality when the listed company is provincially-owned. For the largest listed companies that are held at a national level, the structural problem could persist, but specialized courts may be better able to fend off interference. Given the institutional weakness of Chinese courts, this suggestion might seem appropriate for almost every category of significant

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195 Id. at 34 (noting the committees which “supervise” the courts).
196 See PRC Civil Procedure Law, supra note 177, art. 147.
197 See PSL Rules, supra note 2, art. 8 (explaining that securities litigation is under the jurisdiction of “intermediate people’s courts”).
198 See PRC Civil Procedure Law, supra note 177, art. 18 (“The basic people’s courts shall have jurisdiction as courts of first instance over civil cases, unless otherwise provided in this Law.”).
199 It would also not reduce the rent-seeking opportunities of individual judges, though monitoring would be easier if high-stakes litigation were centralized. There is a general lack of an independent judiciary in China. See, e.g., What’s Law Got To Do With It?, supra note 86, at 57-64 (discussing problems and effects of non-independent Chinese judiciary); Power and Politics in the Chinese Court System, supra note 84, at 6-15 (describing the general structure of the Chinese court system).
cases—intellectual property claims, administrative litigation, and serious criminal cases might all benefit from specialized, central courts. It would be problematic to create specialized central courts for every kind of action. However, the argument has special force with regard to private securities litigation. These cases are likely to have vast numbers of plaintiffs and the amounts in controversy are likely to be exceedingly large. Thus, PRC officials should investigate this option for private securities litigation.

3.6. Will Private Securities Litigation Flourish in China?

Based on the foregoing, the PSL Rules seem to be a fragile weapon—plaintiffs must sue government-owned companies in government-controlled courts, the ability to leverage claims through class actions is limited, relief can only be sought for disclosure fraud, not insider trading or market manipulation, and some victims of disclosure fraud will be denied relief. In addition to this list of weaknesses, no private right to sue exists unless a division of the PRC government takes action to enable it. Given these obstacles, the PSL Rules may not stimulate the type of lawyer-driven "entrepreneurial litigation" that has helped, if not caused, the private securities litigation which flourishes in the United States.

200 See PSL DRAFTERS' COMMENTARY, supra note 18, at 27 (noting that the absence of obstacles to the ease of bringing private securities litigation could have negative social affects).


Recently, substantial attention has been given to how lead counsel—i.e., the leading fee earner if plaintiffs are successful—is chosen in U.S. private securities litigation. See, e.g., AnaLisa Valle, Comment, To the Lowest Bidder? The Private Securities Litigation Reform Act and Auctioning the Role of Lead Counsel, 74 U. COLO. L. REV. 359 (2003) (presenting problems related to how lead counsel is chosen in lawyer-driven litigation); James L. Tuxbury, Note, A Case for Competitive Bidding for Lead Counsel in Securities Class Actions, 2003 COLUM. BUS. L. REV. 285, 300 (2003) (addressing criticisms about competitive bidding in securities class actions).
In deciding whether or not to pursue private securities litigation, Chinese lawyers and plaintiffs will evaluate the chances of succeeding in relation to the costs of bringing the action and the amount, if any, they can recover if successful. Plaintiffs who have lost money because of declines in the value of a company's publicly traded securities may face negligible costs if lawyers offer to pursue claims on a contingency fee basis. The Supreme Court has held that plaintiffs who have lost money because of declines in the value of a company's publicly traded securities may face negligible costs if lawyers offer to pursue claims on a contingency fee basis.

Economic analysis is a powerful tool for understanding the world, but some find it unattractive because of the way it flattens human decision-makers into rational analyzers of costs and benefits. Some have inveighed that such analysis can misconstrue behavior because humans do not always act in, or know what is in, their own narrowly-defined self-interest. See, e.g., Behaviourists at the Gates: How Economists Are Using Psychology to Question Orthodox Policy Prescriptions, The Economist, May 10, 2003, at 67 (discussing behavioral economics, including the effort to offer an alternative to the traditional undergraduate neoclassical course at Harvard University).

However, even requirements that initially appear to be de minimis may influence the willingness of some plaintiffs to pursue private securities litigation. For example, the PSL Rules require that plaintiffs provide to the court their original national identification card (shenfen zheng) or a notarized (jing gongzheng) copy. PSL Rules, supra note 2, art. 6(1). To most foreigners, this seems like an innocuous requirement, but some PRC commentators on the PSL Rules have indicated it will be a barrier sufficient to deter some plaintiffs. It is not practical to turn one's identification card over to a court for an extended period; one must show one's identification to purchase a plane ticket, check into a hotel, and do a large number of routine things in China. However, providing the alternative notarized copy can be problematic as well. First, there is a fee involved. The fee in Beijing for obtaining a notarized copy of a national identification card is RMB 80, or about USD 10. Second, travel may be required to obtain a notarized copy of one's identification card. China has an internal residency permit (hu kou) system; PRC citizens do not automatically have the right to move wherever they wish within the PRC mainland. For example, a person from Hefei in Anhui province may not, without official consent, change the status of their hu kou and move to Beijing. In practice, this system has broken down somewhat, with millions of people now constituting a floating population that works and resides in places other than the official residences reflected on their hu kou. However, PRC identification cards reflect official residences and a Beijing notary will generally refuse to notarize an identification card showing a non-Beijing address. Id. In such a situation, to obtain a notarized copy of his or her identification card, an investor might have to return to the place listed on his or her hu kou. Xuan Weihua, a Shanghai lawyer who has written a book on private securities litigation in China and is active in bringing these suits, states that about 20% of potential plaintiffs calling her office live in a location that is different from their official
People’s Court drafters of the PSL Rules anticipate that Chinese lawyers will bring cases on a contingency fee basis and, if successful, potentially reap large rewards by taking a percentage of the judgment or settlement awarded to plaintiffs as their compensation. Indeed some lawyers may find that the requirement of prior government action imposed by the PSL Rules, though eliminating many potential plaintiffs’ claims, increases the incentives for bringing suits when such government action has occurred. CSRC or other government action will have already established that there has been a violation of disclosure duties, easing the lawyers’ burden to establish some key facts. However, if other obstacles to the success of plaintiffs identified above are perceived as making the potential for success too low in relation to the costs of pursuing relief, Chinese lawyers and plaintiffs will not bring private securities litigation even when authorized to do so.

Lawyers offering to champion these claims will incur up-front expenses with respect to organizing and bringing the litigation. The joint actions allowed under the PSL Rules require that the
number and identity of plaintiffs be determined before trial, so lawyers seeking to gather claims must pay for public announcements or advertisements to gather plaintiffs. Resources will then be required to screen potential plaintiffs, ask eligible plaintiffs to sign a power of attorney, gather documentary evidence of each eligible plaintiff’s losses, and keep plaintiffs informed of the progress of the case. Substantial court filing fees may have to be paid. In addition to these up-front monetary costs, resolution of private securities litigation cases is likely to require substantial time. Recall that in the absence of a criminal judgment, administrative action is required to enable private securities litigation in China. To avert an onslaught of private securities litigation, defendants will probably seek to exhaust all remedies against the imposition of an administrative penalty. Under Chinese administrative law, those upon whom administrative sanctions are imposed may apply for administrative review or bring administrative litigation. Some PRC lawyers predict that this process could take three to four years, and the PSL Rules provide that litigation can be suspended while appeals of administrative action are pending. Such delays further impinge on the incentives for bringing these suits because they could reduce the value in real terms of any recovery and increase the associated opportunity costs to lawyers.

Even if ultimately successful in establishing a defendant’s

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206 PSL Rules, supra note 2, art. 14.

207 See XUAN, supra note 129, at 71 (commenting that in the Daqing Lianyi case the court permitted fees to be delayed); Jiedu Zhengquan Minshi Peichang Sifa Jieshi, Xin Guiding Yinfa Xin Wenti [Explanation of the Securities Civil Compensation Interpretation, New Rules Cause New Problems], SHANGHAI ZHENGQUAN BAO WANGLUOBAN [SHANGHAI SEC. TIMES ONLINE EDITION], Jan. 10, 2003 (noting comments of lawyer Yang Zhaoquan who stated that it is not clear if court fees can be reduced, avoided, or paid after a case is tried); see also Class Action Litigation in China, supra note 165, at 1534 (discussing PRC court filing fees based on the amount in controversy as a possible obstacle to joint actions, though noting courts have the power to reduce filing fees under the Civil Procedure Law of the PRC).

208 See Xingzheng Fuyi Fa [PRC Administrative Reconsideration Law], art. 6 (1999) (providing right to apply for shenqing [administrative reconsideration] of administrative acts); Xingzheng Susong Fa [PRC Administrative Litigation Law], art. 2 (1989) (providing right to contest administrative actions through litigation).

209 PSL Rules, supra note 2, art. 11.

210 The PSL Rules provide for interest to be paid on losses, but as described below, it is likely plaintiffs will recover only a portion of their actual losses, even without taking attorney fees into account, so the net present values of funds eventually recovered will be reduced by extensive time delays.
liability, the amounts plaintiffs will recover are likely to be at a substantial discount to actual losses, if recoverable at all. The PSL Rules provide that plaintiffs may recover actual damages equal to the difference between the price at which a security was bought and its market value after the bad disclosure is revealed (disregarding any price decline attributable to systemic market factors or other influences besides the false disclosure). The PSL Rules expressly “encourage” mediation and settlement of private securities litigation, and some defendants facing staggering judgments might be eager to settle. However, many defendants may find that time is on their side. By dragging out proceedings, defendants may induce plaintiffs to accept steep discounts from their actual losses. Given the defendant-friendly jurisdictional requirements of the PSL Rules, defendants may be successful in employing such tactics. Moreover, regardless of settlement or judgment awarded, the defendant listed companies in these actions may be on the verge of bankruptcy. Of the actions currently pending, most are against companies that have been designated “ST”, or special treatment, meaning the companies are in danger of being delisted by the securities exchange because of successive years of losses or other problems.

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211 See PSL Rules, supra note 2, arts. 29-30 (describing payment of damages and the scope of liability for damages to be borne by the misrepresenting party). The PSL Rules also allow the recovery of the portion of commissions and stamp taxes paid because the share price was inflated by bad disclosure. Id. art. 30.

212 See id., art. 4 (“When hearing securities misrepresentation civil damages cases, the People’s Courts shall emphasize and encourage conciliation by the parties.”).

213 Companies can be designated special treatment (“ST”) after two consecutive years of losses. ST firms trade only 4.5 hours per day and their prices may fluctuate no more than 5% per day, less than the 10% fluctuation cap for other listed firms. Formerly, companies could also be designated as particular treatment (“PT”). Such companies were subject to even more onerous restrictions such as trading only on Fridays. However, the CSRC has eliminated PT status and indicated that it will be strict regarding delisting firms that lose money for more than three consecutive years. See Kuisun Shangshi Gongsi Zanting Shangshi he Zhongzhi Shangshi Shishi Banfa (Xiu ding) [Implementing Measures for the Temporary Listing Suspension and Final Listing Termination of Loss-Generating Listed Companies (amended)], China Securities Regulatory Commission, Nov. 30, 2001; Guanyu Zhixing “Kuisun Shangshi Gongsi Zanting Shangshi he Zhongzhi Shangshi Shishi Banfa (Xiu ding)” de Buchong Guiding [Supplemental Regulations Concerning Application of the “Implementing Measures for the Temporary Listing Suspension and Final Listing Termination of Loss-Generating Listed Companies (amended)”), China Securities Regulatory Commission, Mar. 18, 2003. Delisting under-performing companies is allowed by the PRC Securities Law and PRC Company Law. See PRC Securities Law, supra note 6, art. 49 (authorizing delisting based on CSRC decision); PRC
"judgment proof," the provisions of the PSL Rules allowing plaintiffs to seek recovery against directors and executives of the listed firm as well as professional firms such as investment banks, accounting firms, appraisal firms, and law firms (and individual professionals within these firms) may be of use. However, while issuers are subject to strict liability for bad disclosure under the PSL Rules, these other potential defendants can escape liability even when there has been disclosure fraud provided they can demonstrate that they were not themselves at fault. Even if such fault for one of the members of this larger group of defendants is established, judgments against such a defendant, like a judgment against a listed company itself (even when solvent), may be difficult to enforce. Failure to enforce judgments has been a chronic problem of the PRC judicial system.

Furthermore, analysis of the PSL Rules reveals that many obstacles to the development of private securities litigation in China have deep roots. Giving investors tools for self-protection through private securities litigation is a reform in conflict with important political and prudential concerns. Class actions touch upon political nerves in China because they can create organized interest groups of citizens in opposition to the state in its guise as the dominant shareholder of listed companies and arbiter of the judicial system. Prudential concerns arise because if cases are routinely successful, private securities litigation could exert pressure on listed companies, threatening current market prices and inhibiting the capital-raising and reform process of SOEs which China’s securities markets are designed to assist. Thus,

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214 See PSL Rules, supra note 2, art. 7 (listing eligible defendants).
215 See id., art. 21 (providing exculpation for the listed company’s faultless directors, supervisors, and senior executives if they produce evidence showing they were not at fault (wu guocuo de), but denying this exception to an issuer or listed company itself); id. art. 23 (providing exculpation for the underwriter’s faultless directors, supervisors, and senior executives); id. art. 24 (providing exculpation for faultless professionals in intermediary service organizations); see also PSL DRAFTERS’ COMMENTARY, supra note 18, at 128-29 (discussing strict liability for issuers and possible exculpation for other potential defendants).
216 See generally Power and Politics in the Chinese Court System, supra note 84 (exploring the effects of non-enforcement of civil judgments on legal rules).
besides underscoring the widely-recognized need for structural reform of PRC Courts, the PSL Rules indicate the need for structural reform of China’s securities markets.\footnote{Substantial government control of courts would be less of a problem in this context if defendant listed companies were not substantially government-owned. Changing either side of the equation would lessen the problem with respect to private securities litigation. Government controlled courts might fairly adjudicate cases against private companies, or independent courts might fairly adjudicate suits against government-owned companies. Ideally, though, both halves will be reformed so that both PRC courts and PRC capital markets would become less subject to government control. More independent courts are likely to better serve the interest of justice, and more independent stock markets will better serve the long-term developmental goals of the Chinese government. Companies able to conduct IPOs on the basis of full disclosure and acceptance by investors with meaningful choices, rather than on the basis of alignment with central planning that favors government ownership, are more likely to contribute to China’s long-term development.} Fundamental reform of Chinese courts and securities markets, however, does not appear imminent.

With many factors that seem to disadvantage plaintiffs and favor defendants, one could conclude the PSL Rules are highly unlikely to have any meaningful effect.\footnote{This was the conclusion reached by one informed commentator about the prospects for private securities litigation in China prior to promulgation of the PSL Rules. \textit{See} Cai, supra note 17, at 143 (asserting that “the current civil system in China is riddled with structural impediments so numerous as to make securities civil actions virtually nonexistent. Unless those impediments are removed, civil actions will not pose a real threat to securities violators.”).} However, there are reasons to be less pessimistic. Contemporary PRC society is too pluralistic to assume automatic outcomes. There are multiple actors in China with a variety of agendas. The mere existence of the PSL Rules indicates some willingness to allow private securities litigation in certain situations. Despite the disincentives described above, entrepreneurial lawyers have been aggressive in organizing private securities litigation.\footnote{See, \textit{e.g.}, Leggett, supra note 122, at C1 (reporting on efforts of a PRC lawyer from Beijing Zhonglun Jintong Law Firm to orchestrate private securities litigation); see also infra notes 32018-22 and accompanying text (discussing the impact of entrepreneurial lawyers in China).} The financial press in China has
paid close attention to the development of these suits.\footnote{See Zhengquan Minshi Peichang Sifa Guiding Deng Tai Liangxiang [Judicial Rules on Civil Securities Compensation Take the Stage] (demonstrating that the People’s Daily maintains a collection of press accounts concerning the PSL Rules and their implementation), at http://www.people.com.cn/GB/jinji/222/10110/index.html (last visited June 1, 2003).} Press attention should increase awareness of the cause of action and may help stimulate fair adjudication of claims. Recent regulatory changes discussed in Section 4 below open PRC securities markets to greater foreign participation and may produce investors willing to seek relief in court when their interests are harmed. The growth of the funds industry in China may also produce institutional investors with greater incentives and willingness to exercise shareholder rights. Furthermore, promoting the development of securities markets is officially part of the PRC agenda. Robust capital markets, including mechanisms for investor protection such as private securities litigation, are perceived by some to be part of the package that supports China’s development goals. Competition among agencies and central-versus-local power struggles may also abet the development of private securities litigation.\footnote{Central-versus-local power struggle has long been a theme of the Chinese political economy. For a recent treatment, see Richard Baum & Alexei Shevchenko, The “State of the State”, in THE PARADOX OF CHINA’S POST-MAO REFORMS 333, 334-38 (Merle Goldman & Roderick MacFarquhar eds., 1999) (chronicling the development and effects of China’s political decentralization in the 1980’s); James Feinerman, The Give and Take of Central-Local Relations, CHINA BUS. REV., Jan.-Feb. 1998, at 16 (discussing the ongoing political decentralization in China and its effects).} If private securities litigation proves too anemic under the PSL Rules, further reforms may be made.

Even as they exist, the PSL Rules are not devoid of plaintiff-friendly provisions. Although the joint actions provided for by the PSL Rules fall short of U.S.-style class actions, they do allow lawyers to leverage multiple claims. The possibility of agglomerating many individual claims in joint actions and earning large net rewards through contingency fees may induce lawyers to aggressively bring private securities litigation. Also, the PSL Rules adopt the U.S. “fraud on the market” theory so that eligible plaintiffs do not have to prove individual reliance on false promulgation; Wang Jianhui, a lawyer with the Fuyuan Law Firm in Fujian province who filed suit against ST Dongfang and was forced by the Qingdao Intermediate People’s Court to sever a joint action of sixty-one plaintiffs into seven smaller claims; and Guo Feng, a People’s University Law School scholar and editor of China’s Securities Law Review.
statements. As discussed above, the PSL Rules establish a rebuttable presumption of causality between a plaintiff’s losses and fraudulent disclosure, though the availability of the presumption does not operate as broadly as it should. Other provisions of the PSL Rules are less significant but nonetheless potentially helpful to plaintiffs. As discussed, the PSL Rules broaden the types of government action that can enable private litigation. Criminal sanctions as well as penalties imposed by agencies other than the CSRC can be the basis for private securities litigation. This is a liberalization of the January 15, 2002 PSL Notice allowing private securities litigation, which previously required CSRC action as the basis for private claims. The PSL Rules also have a more plaintiff-friendly method for calculating the two-year statute of limitations period for bringing a suit. This two-year statute of limitations period is standard under Chinese law. However, the January 15, 2002 PSL Notice provided that the statute of limitations period for bringing an action would begin to run when the CSRC issued an administrative penalty. The PSL Rules changed this practice so that the two-year statute of limitations period will begin to run when the administrative action is publicly announced. This is

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222 See PSL Rules, supra note 2, art. 18 (stating the requirements for causation, which do not include individual reliance, thereby adopting the “fraud on the market” theory). The U.S. Supreme Court sanctioned the “fraud on the market” theory in Basic Inc. v. Levinson, 485 U.S. 224, 247 (1988). The idea is that because a security’s market price reflects information disclosed by the issuer, purchasers have relied on that information in purchasing the security and thus need not otherwise prove personal, direct reliance on disclosure provided by the issuer. However, an assumption that PRC market prices reflect disclosed information about a company—under the efficient capital market hypothesis—is a presumption that could be contested. See Gu & Art, supra note 60, at 120 (noting highly speculative behavior of PRC investors who buy shares without specific analysis concerning the company and who lack appreciation for risk of loss).

223 See PSL Rules, supra note 2, arts. 5-6 (noting that investors can bring proceedings “based on the relevant authority’s administrative penalty decision or the people’s court criminal judgment”).

224 See id. (denoting that investors who institute securities misrepresentation proceedings shall submit “the administrative penalty decision or public notice or the written criminal judgment of the People’s Court”).

225 PRC General Principles of Civil Law, supra note 18, art. 135.

226 January 15, 2002 PSL Notice, supra note 25.

227 See PSL Rules, supra note 2, art. 5(1) (showing that the statute of limitation can start on the date of publication of administrative penalty by CSRC); id. art. 5(2) (showing that the statute of limitation can start on the date of publication of administrative penalty by the Ministry of Finance or other administrative authority).
helpful because PRC regulatory bodies do not always publicly reveal their actions when taken. Indeed, the PSL Rules themselves were adopted by the Supreme People’s Court on December 26, 2002 but not publicly revealed until January 9, 2003.228

One should also bear in mind that private securities litigation was not engineered from the top down in the United States. Rather it evolved in a fashion that was probably not expected by the drafters of the 1933 Securities Act or of subsequent regulations. For example, Rule 10b-5 was the workhorse of U.S. private securities litigation.229 The same might be said of many other provisions of U.S. law, including now-treasured notions of equality. Though the institutional context for legal innovation in the PRC is radically different, one cannot entirely discount the possibility that private securities litigation in China may amount to more in practice than one might anticipate from a skeptical reading of the PSL Rules. Private securities litigation may be inconsequential in the PRC, or it may break through the considerable constraints outlined.230 If it takes the innovative role,

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228 Some PRC commentators refer to the PSL Rules by the date of this press conference, not the date of their adoption by the Supreme People’s Court.

229 Recently Enron, Arthur Andersen, WorldCom, Tyco, Sunbeam, Waste Management, Adelphia, Xerox, and Global Crossing have all been sued based on alleged violations of Rule 10b-5. Concerning the unexpected development of Rule 10b-5, see Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975) (affirming the existence of private right of action under Rule 10b-5 and describing the rule as a “judicial oak which has grown from little more than a legislative acorn.”); Kardon v. Nat’l Gypsum Co., 73 F. Supp. 798, 802-03 (1947) (finding an implied private right of action under Rule 10b-5). For a critical view of the legacy of this development, see Saikrishna Prakash, Our Dysfunctional Insider Trading Regime, 99 COLUM. L. REV. 1491, 1493 (1999) (calling U.S. insider trading law “astonishingly dysfunctional”).

230 It will be interesting to observe the development of PSL in China. Forward-looking questions to monitor include: how will “class struggle” play out with respect to private securities litigation? What will the judicial responses be to the entrepreneurialism of lawyers in gathering claims for joint litigation, or gongtong susong? Will investment funds or institutional investors initiate significant private securities litigation in China? Will foreign participation—through joint venture fund management companies or the QFII system—make a difference? Will having to sue listed companies in their “home courts” discernibly affect outcomes? Will the provision in the PSL Rules enabling administrative penalties imposed by organizations other than the CSRC prompt some government actors to authorize private securities litigation as a competitive weapon? Will the CSRC’s enforcement of disclosure rules decrease now that administrative sanctions for bad disclosure will unleash private securities litigation? Will the scope of permitted private securities litigation expand beyond disclosure fraud so that suits based on insider trading and market manipulation become possible? More generally, will courts become more independent in
private securities litigation in China could have consequences in a number of critical areas, as Section 4 next explores.

4. THE POTENTIAL IMPORTANCE OF PRIVATE SECURITIES LITIGATION IN CHINA

At first glance, private securities litigation in China may appear to be an esoteric subject. Chinese securities markets have largely been cut off from world capital flows, so the international impact of private securities litigation in China may seem insignificant. Even domestically, the subject may appear marginal. Despite their rapid growth, China’s securities markets make relatively minor contributions to corporate finance within the Chinese mainland’s economy. Most enterprises continue to fund their development through bank loans and cash generated from their own operations. Several aspects of the PSL Rules that will impede the development of private securities litigation in China have been identified above. What are the PSL Rules, then, but regulatory miasma from an unimportant stock market? Actually, the PSL Rules are potentially significant for many reasons.

4.1. Importance to PRC Domestic Investors and Securities Industry Participants

China’s rules on private securities litigation are of considerable domestic importance. Securities markets have been developing with official sanction in the PRC for more than a decade. There are now more than 1,200 companies listed on China’s two securities exchanges. About 70 million securities brokerage

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231 See PSL DRAFTERS’ COMMENTARY, supra note 18, at 17 (estimating that 70% of financing for Chinese SOEs comes from bank loans and only 1% comes from securities markets, while 20% of financing for U.S. enterprises comes from securities markets); see also Karby Leggett, China’s Success Doesn’t Lift Stocks, WALL St. J., Dec. 27, 2002, at B7 (noting that the PRC stock market declined in 2002 despite the overall growth of the PRC economy).

232 See supra Section 3.

233 See Hutchens, supra note 5, at 36 (stating that “China has been developing securities markets for over a decade,” and that Chinese stock markets have grown rapidly).

accounts have been opened in China, most of them by individual rather than institutional investors. Firms listed on the two mainland exchanges have raised capital through initial or secondary public offerings, and daily trading volumes on the secondary markets averaged RMB 297.271 billion (USD 35.9 billion) in January 2003. PRC sources claim that market capitalization has reached RMB 4.253 trillion (USD 513.65 billion). These statistics, though requiring important qualification, accurately suggest that China's securities markets have grown rapidly and have achieved a noteworthy scale. In 2002, the Sixteenth Party Congress of China's Communist Party adopted a platform calling for the energetic promotion of the shareholding system, suggesting that China's securities markets

235 Id.


237 CSRC Statistical Report System, supra note 234. These routinely-cited numbers should be qualified in important ways. For example, the market capitalization figure is accurate only insofar as unlisted shares are valued at listed share prices. Recent experience in trying to unload state-owned shares suggests this is not a fair valuation method, because the prices of liquid shares would collapse if unlisted shares came on to the market. See generally GUOYOUGU JIANCHI TOUSHI [EXAMINATION OF THE REDUCTION OF STATE-OWNED SHARES] (Fang Jun ed., 2003). The market capitalization of listed shares in China is RMB 1.3825 trillion (USD 166.97 billion)—still an impressive number, but significantly smaller than the USD 500 billion figure. CSRC Statistical Report System, supra note 234. Similarly, the number of stock-trading accounts does not clearly suggest the number of market participants. This number may be overstated because investors must open separate accounts to trade on the Shanghai and Shenzhen exchanges. Many accounts are inactive until IPOs are issued, and some investors open multiple accounts in an attempt to manipulate the market or disguise their trading for other reasons. The cited number of accounts, conversely, may understate the number of investors, because many accounts are established by groups of people who pool their resources to meet minimum account levels or to, in effect, create an unauthorized investment fund. Nonetheless, these numbers do accurately suggest that China’s stock markets have grown rapidly and have achieved noteworthy scale. Stock markets in China are now an important economic and cultural phenomenon.

238 “Cong wu dao you” [from nothing to something], as PRC commentators sometimes describe the progression.

239 See Shiliu Da Yu Zhengquan Shichang [The Sixteenth Party Congress and the
will continue to play an important role in Chinese economic reforms. All the key participants in China’s developing securities markets—investors, issuers, investment banks, accounting firms, law firms, and individuals within these organizations—may now become involved in private securities litigation. Thus, China’s approach to private securities litigation is potentially significant because it may impact important parts of the large and rapidly growing Chinese economy.

4.2. Importance to Foreign Investors

In addition to the possible impact on domestic PRC actors, the potential for foreign investors to be affected by private securities litigation in China is substantial and growing. The Chinese arm of KPMG, the international accounting firm, has already been named as a defendant in such litigation in connection with its audits of a listed Chinese company. Underwriters can also be named defendants in Chinese private securities litigation. For example, Morgan Stanley is a significant stakeholder in one of the leading Chinese investment banks. In addition to being stakeholders in entities that can be defendants in Chinese private securities litigation, some foreign investors will likely become

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240 See PSL Rules, supra note 2, art. 7 (listing entities who may be defendants in private securities actions).

241 China has for many years been a magnet for foreign direct investment ("FDI"). Total FDI inflows to the PRC reportedly reached USD 53 billion during 2002 and totaled USD 450 billion overall by the end of 2002. PRC Ministry of Commerce, Statistics about Utilization of Foreign Investment in 2003 (1-4) [hereinafter Statistics about Utilization], available at http://english.mofcom.gov.cn/article/200305/20030500090069_1.xml (last visited Aug. 27, 2003). Alongside this enormous inflow of foreign capital, China’s securities markets have grown rapidly. Already, China’s stock markets are the third largest in Asia, behind only Japan and Hong Kong. Whenever foreign investment and Chinese securities markets intersect, the potential for foreign entanglement in Chinese private securities litigation is created.

242 See KPMG Faces Suit from Minority Shareholders, supra note 4 (reporting private securities litigation in the PRC against KPMG for its role as auditor for the PRC-listed company Jinzhou Port; the plaintiff also sued Jinzhou’s underwriter and the chairman of the company); Ma, supra note 144 (reporting that a Chinese investor sued KPMG for disclosure of misleading information).

243 Specifically, the Author here refers to China International Capital Corporation ("CICC").
plaintiffs in such litigation as well. More than one hundred PRC companies have issued B-shares, a type of stock traded in China that is denominated in foreign currency and was previously sold only to foreign investors. Now domestic investors may use foreign currency to buy B-shares. Under China’s rules on private securities litigation, investors in B-shares will be able to, in some cases, sue issuers for bad disclosure. Besides these existing foreign investments, recent regulatory changes create new possibilities for foreign involvement in private securities litigation in China. At least five new avenues have been created within just the last two years.

4.2.1. Qualified Foreign Institutional Investors

Regulations adopted in November 2002 allow foreign institutional investors to seek approval to invest in China’s securities markets as Qualified Foreign Institutional Investors (“QFIIs”). Such designation permits investment in A-shares.

244 See Rules of the State Council on Foreign Capital Stock Listed in China by Joint Stock Limited Companies (listing the rules that standardize the issuing and trading of China-listed foreign capital stock), at http://www.isinolaw.com/jsp/law/LAW_Chapters.jsp?LangID=O&StatutesID=134065&CatID=231 (last visited Sept. 23, 2003). China’s stock markets include B-shares, which are denominated in foreign currencies and which were originally intended for foreign investors.

245 If the CSRC issues an administrative penalty against the company for false disclosure, its B-share shareholders will have the right to bring private securities litigation against the firm under the PSL Rules. See, e.g., Shares Drop Slightly in Absence of Fresh Leads, CHINA DAILY, Feb. 28, 2003 (reporting the decline in trading price for B-shares of Shandong Zhonglu Company after the company revealed that it is under CSRC investigation), available at http://www1.chinadaily.com.cn/en/doc/2003-02/28/content_156230.htm.


247 QFIIs may buy and sell A-shares, but there are restrictions to reduce speculation or foreign capital flight. If a QFII brings foreign currency into China, the currency will not be allowed out for one to three years, at which point it can only be taken out incrementally. Also, the amount of money a QFII can invest must be approved by China’s Ministry of Foreign Exchange Control (“SAFE”), and no QFII may acquire more than ten percent of the shares of a particular issuer. See Interim Provisions on Administration of Foreign Exchange of Qualified Foreign Institutional Investors Investing in Domestic Securities, SAFE Public Announcement (Dec. 1, 2002) (PRC) [hereinafter QFII Forex Provisions]
the most common type of shares on China’s stock markets.\textsuperscript{248} Leading foreign financial firms, such as Morgan Stanley, intend to obtain QFII status.\textsuperscript{249} As holders of A-shares, QFIIs could become plaintiffs in private securities litigation in China or hold economic interest in companies that are defendants in such litigation.

Also, the PSL Rules may affect the ability of the QFII system to function in the way PRC policy makers expect it to function. Many PRC commentators expect that QFIIs will have a salutary impact on PRC securities markets because QFIIs are expected to employ fundamental analysis in making investment decisions. PRC commentators also suggest investment behavior based on such analysis is preferable to the speculative behavior of many current PRC retail investors. However, the anemic nature of private securities litigation under the PSL Rules may encourage QFIIs not to model reliance on fundamental analysis, but to act more like existing PRC retail investors.\textsuperscript{250} PRC retail investors probably do not give great weight to publicly disclosed information when making investment decisions, because such information is not perceived as reliable. The PSL Rules seem unlikely to create new incentives for PRC-listed companies to comply honestly with

\textsuperscript{248} Denominated in RMB, the PRC’s own currency, A-shares were previously off-limits to foreign investment. An online investor education module by the Shanghai Securities Times discusses the impact of foreign participation through the QFII system or other methods. Refer to the cnstock.com webpage at http://www.cnstock.com/sq/school/bgyjj/200301020660.htm (last modified Jan. 2, 2003).

\textsuperscript{249} See, e.g., James Kynge, Renminbi-Denominated Shares: Wider Access to China for Foreigners, FIN. TIMES, May 27, 2003, at 24 (reporting approval of QFII status for UBS, a leading Swiss bank, and for Nomura Securities, a leading Japanese firm). In addition, Morgan Stanley, Goldman Sachs, Deutsche Bank, and Merrill Lynch submitted applications for QFII approval, while the PRC operations of three other foreign banks, Citibank, HSBC, and Standard Chartered have been approved to serve as the required custodians for QFII funds. See Karby Leggett, U.S. Banks Seek A-Shares of China, WALL ST. J., Mar. 6, 2003, at C14 (reporting that Goldman Sachs and Morgan Stanley have applied to the CSRC to establish class A-share investment funds as QFIIs); Morgan Stanley Confirms Has Applied For China QFII Status, DOW JONES, Mar. 25, 2003 (reporting Morgan Stanley’s confirmation of its application for QFII status).

\textsuperscript{250} Of course, QFIIs may find other ways to evaluate listed companies—perhaps through investing in research that probes non-public sources. However, “fundamental analysis” that relies on non-public information again seems unlikely to cause retail investors to make the analysis of public disclosure a more common trading strategy.
disclosure requirements. The absence of effective enforcement mechanisms should tend to foster notions that disclosure is unreliable. If public disclosure is not perceived as reliable, QFIIs are no more likely to rely on it than existing PRC retail investors.

4.2.2. Foreign-Invested Fund Management and Securities Companies

In accordance with China's commitments for World Trade Organization accession,\textsuperscript{251} in 2002 China enacted regulations that allow foreign investors to become minority shareholders in fund management and securities companies that operate inside China.\textsuperscript{252} Many of the world's largest financial firms have eagerly pursued these opportunities.\textsuperscript{253} Foreign-invested securities companies can become entangled in private securities litigation through their roles as underwriters and analysts.\textsuperscript{254} Foreign-invested fund


\textsuperscript{253} See, e.g., Hutchens, supra note 5 at 35 (providing a list of announced deals for the establishment of such ventures); James Kyenge, ABN On Course to Join China's A-Share Market, FIN. TIMES, Feb. 27, 2003, at 29 (reporting on the agreement of Dutch ABN Amro Asset Management to acquire a stake in Shanghai-based Xiangcai Hefeng Fund Management, among other deals to establish foreign-invested fund management companies in the PRC).

\textsuperscript{254} See PSL Rules, supra note 2, arts. 7(2), 7(3), 7(7) (identifying issuers of listed companies, securities distributors, and other organizations as potential defendants); see also id. art. 7 (describing who can make misrepresentations in civil damages cases).
management companies\textsuperscript{255} could become entangled in such litigation through their roles as shareholders or as issuers of funds with disclosure duties.\textsuperscript{256}

4.2.3. Foreign Investment in Unlisted Shares in Chinese Listed Companies

Under regulations promulgated in November 2002 that reverse a policy in place since 1995,\textsuperscript{257} foreign investors may now acquire unlisted legal person shares ("faren gu") in Chinese-listed companies.\textsuperscript{258} Purchasers of unlisted shares do not have any remedies as plaintiffs under China's rules on private securities litigation.\textsuperscript{259} Thus, purchasers of such shares are likely to be concerned with the possibility that any listed company in which they invest may be a defendant in private securities litigation. For example, in May 2003, the International Finance Corporation ("IFC"), the World Bank's private finance arm, announced plans to acquire a stake in Minsheng Bank, one of the four banks currently

\textsuperscript{255} Foreign-invested securities companies, however, cannot make trades with their own accounts, so they are therefore unlikely to be plaintiffs under Foreign-Invested Securities Company ("FI-SC") Rules.

\textsuperscript{256} Foreign-invested fund management companies could become plaintiffs (or hold economic interest in defendants) through their roles as shareholders of listed companies. See PSL Rules, supra note 2, art. 7(1) (providing that controlling shareholders (konggu gudong) can be defendants in private securities litigation). However, funds are limited in the PRC to holding a maximum of ten percent of the shares of any single listed company, so a controlling position is unlikely. See QFII Forex Provisions, supra note 247, art. 26 (describing the maximum investment amount for close-ended funds).

\textsuperscript{257} See Guanyu Zanting Jiang Shangshi Gongsi Guojai Gu De Faren Gu Zuanrang Gei Waishang De Qingshi De Tongzhi [Notice Regarding Request for Instructions Concerning Temporary Halt on Transfer of State-owned shares and Legal Person Shares to Foreign Commercial Interests], State Council, Sept. 23, 1995 (PRC).

\textsuperscript{258} See Guanyu Xiang Waishang Zhanrang Shangshi Gongsi Guoyougu He Farengu Youguan Wenti De Tongzhi [Issues Relevant to the Transfer of State-owned Shares and Legal Person Shares in Listed Companies to Foreign Investors Circular], China Sec. Regulatory Comm'n, the Ministry of Fin., and the State Econ. and Trade Comm'n, CHINA L. & PRAc., Dec. 2002-Jan. 2003, at 57 (Nov. 1, 2002) (authorizing the transfer of state-owned shares and legal person shares in listed companies to foreign investors).

\textsuperscript{259} See PSL Rules, supra note 2, art. 3 ("These provisions shall not apply to civil actions arising from ...share transactions occurring outside stock exchanges...."). This does not mean purchasers would be without relief. Agreements to acquire such shares will presumably contain standard representations and warranties from sellers that could be a basis for contract claims.
listed on the PRC's stock exchanges. In January 2003, Citibank acquired 5% of Pudong Development Bank, another PRC-listed bank, and San Francisco-based Newbridge Capital attempted to purchase a significant stake in PRC-listed Shenzhen Development Bank.

China's putative legislature, the National People's Congress, met in early March 2003 and approved reforms that may make sales of unlisted shares in state-owned firms more common. Therefore, all deals in which foreign investors acquire unlisted shares in PRC-listed and state-owned companies link the interests of foreign investors to PRC private securities litigation.

In addition to purchasing unlisted shares in companies already listed, foreign investors may also acquire interests in Chinese companies that are preparing to list in China. In response, some

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260 See Christine Chan, World Bank Buys Stake in Minsheng, S. CHINA MORNING POST, May 14, 2003, at 3 (reporting that the Orient Group is selling part of its 7.51% stake in China Minsheng Bank to the IFC).

261 See Tom Holland & Paul Beckett, Citigroup's New China Front: Stake in Local Partner is Unusual Shift in Strategy, WALL ST. J., Mar. 4, 2003, at A12B (counting Citigroup's USD 67 million acquisition of 5% of Shanghai Pudong Development Bank). Newbridge's deal to gain exclusive control of Shenzhen Development Bank collapsed, resulting in litigation. See Christine Chan, Newbridge Insists on SDB Deal, S. CHINA MORNING POST, May 13, 2003, at 1 (reporting that Newbridge's interim management structure plan would be canceled because of the failure to reach an agreement with shareholders concerning the transfer price, though Newbridge claimed that the cancellation would violate the agreement related to the acquisition); Christine Chan, Newbridge Near China Deal, S. CHINA MORNING POST, Feb. 26, 2003 (reporting that Newbridge said it was close to a deal to buy "nearly 20 percent of Shenzhen Development Bank"); Newbridge's China Deal, WALL ST. J., May 23, 2003, at C3 (reporting on the collapse of the deal and the resulting lawsuit Newbridge launched against Chinatrust Commercial Bank of Taiwan for tortious interference).


263 See Allen T. Cheng, New Streamlined Government Wins Congress Approval, S. CHINA MORNING POST, Mar. 11, 2003, at 7 (reporting the legislative creation of a new State Asset Management Commission, which, if implemented fully, would act as a privatization ministry, giving outright ownership of SOEs to private individuals at various levels); Stephen Green, Wen Has to Roll Back the Chinese State, FIN. TIMES, Mar. 5, 2003, at 13 (describing the new State Asset Management Commission as a mechanism that may thwart or help the cause of privatization); James Kynge, China Ushers in Era of New Leadership and Political Reform, FIN. TIMES, Mar. 4, 2003, at 12 (reporting on the commencement of the 10th National People's Congress that "will pave the way for the redistribution and sale of some state company assets" and the establishment of the State Asset Management Commission).
Chinese banks and insurance companies that have absorbed or plan to absorb significant amounts of foreign investment are seeking to conduct IPOs. This, too, may eventually entangle foreign investors in private securities litigation in China.

4.2.4. Listing of Foreign-Invested Enterprises on China's Domestic Stock Exchanges

Few companies listed on China's stock exchanges have significant amounts of foreign investment. Nonetheless, since 1995, it has been theoretically possible to establish a foreign-invested enterprise in a format eligible for listing on China's domestic stock exchanges. PRC officials periodically indicate

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264 As China prepares for greater foreign market access under the terms of its WTO accession, it has sought to strengthen certain domestic enterprises by both attracting foreign capital and listing shares on domestic or overseas stock exchanges. See, e.g., Christine Chan, China Life Secures Four Banks to Co-ordinate Global Share Listing, S. CHINA MORNING POST, Mar. 20, 2003, at 3 (reporting that CICC is among four investment banks tapped to lead the China Life Insurance IPO); Christine Chan, China Re Adding Expertise Ahead of Listing, S. CHINA MORNING POST, Mar. 5, 2003, at 1 (reporting efforts of major PRC insurance companies to attract foreign investors and to prepare for IPOs); Christine Chan, Ping An Moves on Rivals in Listing Race, S. CHINA MORNING POST, Feb. 15, 2003, at 2 (reporting on the reorganization of Ping An Insurance in anticipation of the IPOs of the three largest PRC insurers: Ping An, China Life Insurance, and People's Insurance Co. of China); Shan Jinliang, Cold Dawn for CITIC Securities, BEIJING YOUTH DAILY ONLINE (Jan. 10, 2003) (reporting on the weak IPO of CITIC securities and quoting an analyst saying that four to five other mainland securities companies hope to conduct IPOs in 2003), at http://www.bjyouth.com/article.jsp?oid=2076539; Shan Jinliang, State-owned Banks Talk Listing, BEIJING YOUTH DAILY ONLINE (Jan. 31, 2003) (reporting that Agricultural Bank of China, Industrial and Commercial Bank of China, China Construction Bank, and Bank of China have all expressed IPO intentions and that "listing plans come in light of China's WTO commitment to further open its financial markets and the large-scale entry of foreign banks"), at http://www.bjyouth.com/article.jsp?oid=2118499; Mark O'Neill & Eric Ng, HSBC Eyes No. 5 Mainland Bank, S. CHINA MORNING POST, Mar. 3, 2003, at 1 (reporting Hong Kong-based HSBC Holdings is in talks to acquire fifteen percent of China's Bank of Communications).

265 That is, presuming such IPOs are listed on the two mainland stock exchanges. Overseas listings do not create causes of action in the PRC. See PSL Rules, supra note 2, art. 2 (defining "securities market" for the purposes of the PSL Rules as one approved by the PRC government).

266 See Clark T. Randt, Jr. & Shawn X.Y. Li, Foreign Acquisition of SOE's, In Buying a Business In the PRC, ASIA L. & PRAc. (1998) (mentioning Ford's purchase of an 80% equity stake of Jiangling Motor Corporation's B-shares as an exception to the general difficulty of acquiring controlling blocks of stock in Chinese companies).

267 See Provisional Regulations on the Establishment of Foreign-Funded Joint Stock Companies Limited, PRC Ministry of Foreign Trade and Econ. Cooperation
that more foreign-invested enterprises will soon be permitted to list in China. In November of 2001, the CSRC and Ministry of Foreign Trade and Economic Cooperation ("MOFTEC") went so far as to issue new rules concerning listings on China's stock markets by foreign-invested enterprises. The CSRC subsequently issued special rules concerning the disclosures it would require in a foreign-invested enterprise's IPO prospectus. Recently, the first of these "foreign" enterprises was approved for listing on the Shanghai stock exchange, and other foreign-invested firms have indicated interests in conducting IPOs in China. If China does begin to allow more foreign-invested enterprises ("FIEs") to list securities on domestic exchanges, these issuers can be sued


MOFTEC has been merged into a new Ministry of Commerce in accordance with a decision by the NPC on March 10, 2003. See China Briefing: The Commerce Ministry Takes Over, FAR E. ECON. REV., Mar. 20, 2003, at 22 (reporting on the PRC government reorganization that replaced the Ministry of Foreign Trade and Economic Cooperation and the State Economic and Trade Commission with the Ministry of Commerce).


See Ningbo Firm Breaks New Ground in Share Sales, S. CHINA MORNING POST, Apr. 14, 2003 (reporting that Ningbo Tongmuo New Materials gained CSRC approval to issue A-shares and that HSBC Holdings, Unilever, Bank of East Asia, and other firms are interested in doing the same).

A significant number of FIE listings could threaten the status quo of China's stock markets, which are designed to feed capital into SOEs. It thus seems unlikely that there will be more than a trickle of FIE listings in the near-to medium-term. See Mark O'Neill, Outbreak Delays Listing of Foreign-invested Joint Ventures in China, S. CHINA MORNING POST, May 3, 2003, at 3 (reporting that the
under the PSL Rules, creating another avenue for international entanglement in Chinese private securities litigation.

4.2.5. Individual Foreign Entanglement in Chinese Private Securities Litigation

China's rules on private securities litigation allow not only firms, but also individuals, to be named as defendants. Such individual defendants can include a listed company's executives, directors, supervisory board members, and controlling shareholders. Responsible individuals in professional service firms, such as investment banks and accounting firms, can also be sued under the PSL Rules. Thus, individual foreign entanglement in private securities litigation could arise when an individual foreigner takes a board seat or a senior management position in a PRC firm that violates its disclosure duties. Foreigners working in professional services firms can also become entangled in private securities litigation in China if their clients are involved in disclosure fraud.

4.3. Importance for Academic Discourse

Besides its importance to foreign and domestic interests,
China's approach to private securities litigation offers rich material for comparative law scholars. In recent years, there has been a robust debate concerning how securities markets and their regulatory regimes develop, as well as what constitutes an optimal corporate finance system. That discussion has largely ignored the important case of China. Perhaps this results from the lack of English publications thus far about PRC stock markets, coupled with a lack of securities law scholars who can read Chinese. Although major laws such as the PRC Company Law and Securities Law are readily available in translation, the stream of

277 Economists, political scientists, and others who theorize and advise about the appropriate sequencing, pace, and scope of reforms for transition economies and developing economies should also find developments in China's securities markets of interest.


279 See John W. Head, Codes, Cultures, Chaos, and Champions: Common Features of Legal Codification Experiences in China, Europe, and North America, 13 DUKE J. COMP. & INT'L L. 1, 3-4 (2003) (speculating that the prior dearth of attention to China in "comparative codification" literature arose from a lack of materials on traditional Chinese law that are available in Western languages, and noting the current availability of such materials); Dale A. Whitman, Chinese Mortgage Law: An American Perspective, 15 COLUM. J. ASIAN L. 35, 36 n.2 (2001) (citing English translations of PRC laws that allowed the author to engage in comparative work without reading Chinese).
regulatory enactments that pours forth from the CSRC is often not readily accessible in translation. Also, prior to the raft of changes with respect to foreign participation, China’s securities markets were largely sealed off from world capital flows due to the inability to convert China’s currency. This suppressed international interaction with, and perhaps academic interest in, China’s securities markets. Whatever the reasons for the dearth of academic attention, China is a useful test case for hypotheses on how to develop and optimally regulate a securities market. China can be used to test hypotheses such as: whether having a common law legal system is helpful in developing robust capital markets; whether capital markets will flourish or perish in the absence of investor protections needed to overcome information asymmetries; and whether economic development depends on having legal institutions that support secure property and contract rights.280

In addition to providing a test case for theories concerning market regulation, Chinese private securities litigation is also a useful entry point for studying contemporary Chinese law and society. The PSL Rules are embedded in a network of other legal enactments, including PRC Corporate and Securities Laws, Civil Procedure Law, and Administrative Law.281 Additionally, to understand private securities litigation in China, one must understand the capital structure of the majority of listed companies in China, the demographics of participants in China’s securities markets, and the structure and control of Chinese courts. Thus, China’s approach to private securities litigation provides a window into contemporary Chinese society. Section 5 elaborates on this point more specifically, contending that China’s treatment of private securities litigation not only constitutes an important development in the regulation of Chinese financial markets but also illuminates a number of general characteristics of China’s developing legal system.

5. MATERIAL DISCLOSURE ABOUT THE CHINESE LEGAL SYSTEM?

This part expands the analysis into a discussion of what the PSL Rules and China’s handling of private securities litigation

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280 See Donald C. Clarke, Economic Development and the Rights Hypothesis: The China Problem, 51 AM. J. COMP. L. 89 (2003) (arguing that the PRC’s recent history challenges the notion that reliable contract enforcement is a prerequisite for economic development).

281 See infra Section 5.3.
suggest about China's developing legal system.\textsuperscript{282} The hypothesis
is that several observations gleaned during study of the PSL Rules can be
generalized, providing material disclosure about the status
of China's legal system. In some cases, the validity of generalizing
these observations will be obvious. For example, the assertion that
China now possesses a substantial legal and regulatory context
into which new enactments are placed underscores a material
difference from twenty or even ten years ago; however, that is
unlikely to be a controversial assertion. In other cases, further
evidence is required to confirm whether one of these "material
disclosure" propositions is characteristic not only of China's
handling of private securities litigation, but also whether it is an
apposite characterization of China's overall legal system.

5.1. Ignorance Plays a Limited Role

The PSL Rules have many deficiencies, but none of those
identified herein appear to be the fruit of ignorance. For example,
the drafters of the PSL Rules are aware of how class actions and
private securities litigation function in the United States and other
jurisdictions.\textsuperscript{283} It is easy to buy books in China that catalog the
approaches of various jurisdictions to particular legal problems.
Also, China has many knowledgeable comparative law scholars.
These scholars often advise on, or participate in, the drafting of
new legislation. Thus, it appears that PRC lawmakers do not
generally act out of ignorance, at least not at a national level.
When Chinese legal enactments fall short of what outside
observers would like, it is rarely because China has failed to
observe the outside world.\textsuperscript{284} It is more likely that perceived
deficiencies in Chinese law arise from political and prudential

\textsuperscript{282} Whether China even has a "legal system" is a contested issue. Without
becoming engrossed in these nuanced theoretical debates, in this analysis, "legal
system" means the collection of state-sponsored or approved texts and
institutions designed to regulate social and governmental activities in China. That
is a sweeping definition, but it is serviceable for the list of observations made.

\textsuperscript{283} PSL Drafters' Commentary, supra note 18, at 205-07.

\textsuperscript{284} For example, the general absence of reliance on civil enforcement in
China's securities law is not from lack of knowledge that such tools are important
elsewhere in the world. See, e.g., Zhang, supra note 80, at 1011, n.200 (citing
Richard M. Phillips et al., Enforcement of Securities Law in the United States
and Canada (Chinese translation of a presentation to the International Forum on
Securities and Futures Trading Law held during Jan. 9-17, 1997 in Beijing)
(showing that the Chinese are aware the U.S. considers private actions to be an
effective means of assuring compliance with securities laws).
constraints.

5.2. Commitment to State Control Persists

China’s approach to private securities litigation, both the substance of the rules and the process by which they were developed, discloses a commitment in Chinese law to the principle of “wei jing pizhun bu ke,” or “you can do nothing without government approval.” This principle is reflected in the PSL Rules by the requirement of enabling government action allowing private litigation, and by similar requirements in many other areas in Chinese law.\(^2\) For millions of Chinese, changes made in the reform era have expanded space for their private lives and added to their prosperity, but Chinese law continues to limit the exercise of private discretion. Chinese law tends to preserve state discretion.\(^2\) Incorporating a business, issuing shares to the public, forming a non-governmental organization, or establishing a charitable trust are all matters subject to government approval. The government’s broad discretion to intervene in commercial affairs has been a frequent complaint of foreign investors\(^2\) and has hampered the development of the domestic PRC economy by distorting markets.\(^2\)

\(^{25}\) See, e.g., PRC Company Law, supra note 35, arts. 152(1), 153-54 (requiring government approval for IPOs); id. art. 139 (requiring government approval for secondary offerings); PRC Securities Law, supra note 6, art. 10 (mandating government approval for IPOs); Xintuo Fa [PRC Trust Law] art. 62 (requiring government approval to establish a charitable trust). See generally Peter Howard Corn, Foreign Investment in China: The Administrative Legal System (1997) (noting that governmental influence permeates the courts’ decision-making processes and undermines their value as a supervisory institution).

\(^{26}\) See Susan V. Lawrence, Navigating the Shake-up, FAR E. ECON. REV., Feb. 20, 2003, at 27 (reporting the observation of a Chinese academic that “the central government now handles some 28,000 matters, such as permits, approvals and registrations. It needs to cut that to 3,000 within 20 years ... to bring China in line with international standards.”).

\(^{28}\) See Christian Murck, Rule of Law and Business Conditions in China, Testimony Before the Congressional-Executive Commission on China (June 6, 2002) (noting that in the reform process since 1979, the National People’s Congress has typically written broad legislation stating general principles to be later amplified by implementing regulations issued by the relevant Ministry or other agency, and stating that the implementing regulations often contained not objective standards, but rather subjective standards that could only be applied to specific facts by recourse to government personnel on a case-by-case basis), available at http://www.cecc.gov/pages/hearings/060602/murck.php.

\(^{288}\) See James Miles, A Dragon Out of Puff, ECONOMIST, June 15, 2002, at 4 (giving examples of China’s history of disturbing markets).
5.3. A Substantial Legal Framework Exists

While China's handling of private securities litigation demonstrates that a commitment to state control persists, it also shows that a substantial legal framework has grown to shape the exercise of that power. The PSL Rules are embedded in a network of existing laws and regulations, reflected by explicit reference in the PSL Rules to the PRC General Principles of Civil Law, PRC Civil Procedure Law and PRC Securities Law. China's handling of private securities litigation also implicates the PRC Criminal Law, a large array of CSRC regulations, and various administrative laws governing administrative penalties. Industry-specific government regulators such as the China Insurance Regulatory Commission, the People's Bank of China, and the State Administration of Drug Administration have enacted regulations that may also become relevant for private securities litigation. This expansive network of laws and regulations connected to the PSL Rules suggests that a codification explosion has occurred in

Where once China was able to boost the economy by releasing the pent-up power of sectors restrained by Maoist folly (first agriculture, then small private and mixed-ownership enterprises), it has now run out of easy sources of new growth potential. It must get the marketplace to deploy labour and capital much more efficiently. Both are still being stifled by government interference.

Id.

See PSL Rules, supra note 2, pmbl. ("These provisions are formulated in accordance with such laws and regulations as the PRC Civil Law General Principles, the PRC Securities Law . . . ."); see also id. art. 6 (making reference to the application of civil procedure law in determining jurisdiction).

See PRC Administrative Litigation Law, supra note 208 (stating that the law is intended "for the purpose of ensuring the correct and prompt handling of administrative cases by the people's courts"); PRC Administrative Reconsideration Law, supra note 208 (discussing the Administrative Reconsideration Law's "preventing and setting right illegal and inappropriate administrative acts"); Zhongguo Zhengquan Jiandu Guanli Weiyuanhui, Zhongguo Zhengquan Shichang Xinxi Pilu Guifan [Disclosure Requirements of China's Securities Market], China Securities Regulatory Commission (2002) (compiling more than 400 pages of relevant laws and regulations).

Regulations from these agencies could create disclosure duties directly or could govern when interaction between the listed company and agencies should be disclosed, for example when companies apply for a license to sell a particular type of insurance, or submit an application to market a drug. Additionally, the PSL Rules provide that administrative penalties imposed by government organs other than the CSRC can be the basis for private securities litigation. Therefore, these agencies could conceivably supply the required government enabling action for private securities litigation. See PSL Rules, supra note 2, art. 6.
China in recent years.\textsuperscript{292} While merely printing laws and regulations is insufficient to create the rule of law, China’s mass of laws does more than just consume paper; it influences life of the citizenry in China.\textsuperscript{293} Increasingly, law is shaping the behavior of the Chinese people, as a 1999 amendment to the PRC’s slogan-laden constitution directs.\textsuperscript{294}

5.4. Courts Remain Weak

For a foreign observer, the timidity with which PRC courts approach private securities litigation is striking. PRC judges dismissed the first private securities suits brought in China. They held that the CSRC is the government department responsible for securities markets and that plaintiffs have no right to relief through private litigation, despite provisions of the PRC Securities Law and PRC General Principles of Civil Law that would seem to provide a

\textsuperscript{292} See The X-Files, supra note 82, at 38 (“New laws and regulations are being issued at breakneck speed, old laws and regulations are amended continually, and whole new regulatory regimes and institutions are being created.”).

\textsuperscript{293} The numbers of ordinary PRC citizens (laobaixing) one sees reading and often scribbling notes from law books in large Chinese bookstores provide some anecdotal evidence. Although personal connections continue to be important in China, the actions of these PRC citizens suggest law is at least a factor in the way things get done in contemporary China. See id. at 79 (describing the relevance of courts, law, and the possibility of law sometimes outweighing personal relationships and connections).

\textsuperscript{294} The NPC amended the PRC Constitution in 1999 to indicate the emphasis on law. Article 5 of the constitution provides that “the People’s Republic of China practices ruling the country in accordance with the law and building a socialist country of law.” PRC Constitution, supra note 154, art. 5.

In addition to some greater use of law in governance, China’s constitution also calls for the adherence to Marxist-Leninist-Maoist thought, Deng Xiaoping theory, democracy, and the dictatorship of the proletariat. There are obvious conflicts in this list of ideologies.

On the PRC Constitution, see, e.g., Puzzling Observations, supra note 98, at 105 (observing that the PRC Constitution might best be conceptualized as a “National Declaration,” providing aspirational statements such as the right to the “pursuit of happiness” found in the U.S. Declaration of Independence); William C. Jones, The Constitution of the People’s Republic of China, 63 WASH. U. L. Q. 707, 710 (1985) (“The constitution seems to bear no relation to the actual government of China.”). But see Shen Kui, Is It the Beginning of the Era of the Rule of the Constitution? Reinterpreting China’s “First Constitutional Case,” 12 PAC. RIM L. & POL’Y J. 199 (2003) (discussing and offering an English translation of the Supreme Court’s Reply No. 25, issued on August 13, 2001, which indicated that a plaintiff’s invocation of rights to education under the PRC Constitution was actionable).
basis for fashioning such a remedy. In January 2002, the Supreme People’s Court authorized lower PRC courts to accept private securities litigation based on false disclosure. However, during the year following that notice, not one PRC court rendered judgment in a private securities case. They waited for further instructions from the Supreme People’s Court concerning the calculation of damages and other particulars.

Li Guoguang, the Vice President of the Supreme People’s Court, said in a press conference on January 9, 2003, that the PSL Rules “fill in a blank” in Chinese litigation. Xi Xiaoming, another Justice of the Supreme People’s Court, cited the lack of detail in the liability provisions of the PRC Securities Law as an example of a common problem of over-generality in PRC legislation. The PSL Rules provide more details than any prior legal provision on how to adjudicate private securities litigation. However, it is unclear if a judge would be acting beyond the scope of his or her powers if he or she provided relief based on the PRC Securities Law, or some other legal provision that existed before the PSL Rules, when faced with a claim for relief based on false disclosure. PRC judges, for example, routinely impose criminal

295 See supra notes 6, 18, and accompanying text.
296 See PSL Rules, supra note 2, art. 1.
298 See Xinhua Fangtan, “Liang Hui” Xilie [2003], Teyao Jiabin: Gao Famin Er Ting Zhongxi Xiaoming Boshi, Fangtan Zhuti: Renmin Fayuan Jin Nian Lai Jinrong Anjian Shenli Qingkuang [Xinhua Discussions: The NPC and Chinese People’s Political Consultative Conference Meetings Series 2003, Dr. Xi Xiaoming, Presiding Judge of the Second Division, Supreme People’s Court (Honored Guest)/The Handling of Financial Cases by People’s Courts in Recent Years (Discussion Topic)] (commenting on what he would like the NPC and CPPCC to do, Justice Xi said it would facilitate the application of laws by courts if legislation were more specific and less “in principle.” He cited the Securities Laws as an example, noting it provides for compensation in some instances, but does not provide a method for the calculation of damages or the causal relationship that must exist between false disclosure or insider trading and investor losses), at http://www.xinhuanet.com/zhibo/fangtan/20030303/wz.htm (last visited Sept. 24, 2003).
penalties based on provisions of the criminal code that are notoriously vague. The provisions of the PRC Criminal Law that are related to securities market disclosure fraud provide simply that false disclosure can constitute a crime in cases with "serious consequences, or [cases] of a serious nature" (houguo yanzhong). Therefore, providing a specific formula for civil damages already authorized by the PRC Securities Law seems like much less of a leap than imposing criminal liability when circumstances are "serious."

There are a number of explanations for the reluctance of PRC courts to try cases prior to the promulgation of the PSL Rules. First, judges who make the wrong decision in China may face graver consequences than those who do nothing. Chinese law has tended to rely heavily on administrative and criminal penalties and has put less emphasis on civil liability, perhaps making courts particularly hesitant to grant relief to plaintiffs in private securities litigation. Also, PRC local courts are not administratively independent from local governments, which could have led to reluctance on the part of judges to allow suits against companies owned by local governments. Some courts might have dodged complex private securities litigation because they lacked adequate human resources to handle such cases. PRC judges are usually not trained lawyers; a significant number are former military officers with no legal training prior to assignment to the bench. However, this explanation seems flawed because some of the cases were dismissed in Shanghai and Beijing, where court personnel with legal training are commonly available. It is likely that PRC courts are themselves subject to the tendency to seek approval before acting, which is a theme of Chinese law—the wei jing pizhun bu ke principle.

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300 See PSL DRAFTERS' COMMENTARY, supra note 18, at 183.
301 See Class Action Litigation in China, supra note 165, at 1533 (noting that the complexity of class actions and lack of trained court personnel may make courts reluctant to accept class action cases).
302 See China's Legal System, supra note 139, at 108 (reporting estimates that only about 10% of PRC judges have a degree in law); see also What's Law Got to Do With It?, supra note 86, at 10 (noting that many of China's judges and legal officials have little or no professional training in law). But see The X-Files, supra note 82, at 78 (noting a reduction in the number of untrained and former military judges).
303 See infra note 305 for an example of the application of the wei jing pizhun bu ke principle.
In other systems, legal innovations often percolate up from lower courts, with higher courts functioning to review specific cases and to harmonize the approaches developed by the lower courts. For example, in the United States, the development of private securities litigation has often exemplified Justice Marshall's axiom that it is the "duty of the judicial branch to say what the law is." This is quite different from the wei jing pizhun bu ke principle, which requires inaction pending approval. These two maxims epitomize a fundamental difference in legal systems and the role of courts within them.

Whatever the reasons for the failure of PRC courts to adjudicate claims for securities disclosure fraud prior to enactment of the PSL Rules, the failure suggests that PRC courts are far from ideal forums for the weak and the oppressed seeking to vindicate their rights.

5.5. Black Box Rulemaking is Common

While lower PRC courts appeared frozen until the Supreme People's Court enacted the PSL Rules, the process that the Supreme People's Court itself used to develop the PSL Rules discloses another material aspect of China's legal system: non-transparent, black box rulemaking is common. Note that although the PSL Rules are issued by the Supreme People's Court, they take the form of legislation or regulations rather than a case decision. They were not a result of a case decision, and there was no specific plaintiff or defendant before the Supreme People's Court when it considered the PSL Rules. The issuance of regulations by a court is curious to a U.S. lawyer, because U.S. courts generally cannot engage in rulemaking without adjudicating specific cases or controversies. China has nothing equivalent to the "cases and

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304 Marbury v. Madison, 5 U.S. (1 Cranch) 137, 177 (1803).
305 Although the PSL Rules are issued by the Supreme People's Court, it is not clear that the court was free to enact the rules without interference from other departments of government. The drafters of the PSL Rules acknowledge that the court had extensive consultations with other departments of the PRC government before issuing the PSL Rules. While these "consultations" may have simply been the court's diligent attempts to gather information, they also could have been meetings in which the court sought instructions, not input. See PSL DRAFTERS' COMMENTARY, supra note 18, at 22.
306 See U.S. Const. art. III, § 2 (limiting the judicial power to "all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made" and various specific circumstances such as diversity or alienage jurisdiction). See generally Lea Brilmayer, Jurisprudence of Article III:
controversies” clause of the U.S. Constitution to bar such action, and China does not purport to be a common law jurisdiction. In fact, China’s Supreme Court routinely issues judicial interpretations (sifa jieshi) that have the appearance of legislation.\textsuperscript{307} Although there is no direct ban on this practice under the PRC Constitution, there is also no explicit basis for it. The PRC Constitution vests lawmaking authority in the National People’s Congress and its Standing Committee.\textsuperscript{308} Furthermore, the PRC Legislation Law does not contemplate such rulemaking by the Supreme People’s Court.\textsuperscript{309} The Legislation Law specifically provides that it is the duty of the NPC Standing Committee to make laws more specific and to provide instructions on their application in practice.\textsuperscript{310} The Organic Law of the People’s Courts, adopted by the NPC, gives the Supreme People’s Court power to interpret laws in a fashion which is to be binding on lower courts, though the parameters of this power are not spelled out.\textsuperscript{311}

Whatever its basis in Chinese law and constitutional theory, a weakness of the Supreme People’s Court’s approach is that concerned parties, such as advocates for small investors in the case


\textsuperscript{307} See Supreme People’s Court, \textit{supra} note 84, at 188, 190 (discussing the proliferation of this practice by the Court and its uncertain legal basis).

\textsuperscript{308} See PRC Constitution, \textit{supra} note 154, art. 62(3) (giving the NPC authority to enact laws); \textit{id.} art. 67(2) (giving the NPC Standing Committee power to enact laws except “those which should be enacted by the [NPC]”); \textit{id.} art. 67(4) (giving the NPC Standing Committee power to interpret laws); \textit{id.} art. 67(7) (giving the NPC Standing Committee power to annul regulations that violate laws or the PRC Constitution).

\textsuperscript{309} See Lifa Fa [PRC Legislation Law], art. 7 (Mar. 15, 2000) (vesting legislative power in the NPC and its Standing Committee); \textit{id.} art. 42 (vesting power of legal interpretation (falü jieshi quan) in the NPC Standing Committee); \textit{id.} art. 43 (authorizing the Supreme People’s Court, among others, to request that the NPC Standing Committee provide a legal interpretation (falü jieshi)).

\textsuperscript{310} \textit{id.} arts. 42(1), 42(2).

\textsuperscript{311} Organic Law of the People’s Courts of the PRC, arts. 32, 33 (1983). For a discussion of judicial interpretation by the Supreme People’s Court, see generally Peter H. Corne, \textit{Creation and Application of Law in the PRC}, 50 AM. J. COMP. L. 369, 409-11 (2002), noting that judicial interpretations “could represent, in effect, an encroachment on the legislative power bestowed by the Legislation Law on the legislative and the executive, in which there is no mention of the [Supreme People’s] Court’s own power to interpret law.”
of the PSL Rules, may not have an opportunity to brief the court before rules are issued. Because there were no contending parties before the court in making the PSL Rules, the Supreme People's Court did not capture the advantages of an adversarial (or even inquisitorial) dispute resolution system. Meanwhile, the Supreme People's Court was not bound by and did not, on its own initiative, observe any public process in drafting the PSL Rules. In fact, this black box rulemaking could have occurred even if the PSL Rules had been drafted by the CSRC or some other agency. China lacks an administrative procedure law, and no "notice and comment" process is required when PRC agencies make rules. Thus, the process of issuing judicial interpretations seems to combine the disadvantages of being neither an adequate dispute resolution process nor a good public rulemaking process. Unfortunately, this black box rulemaking is common in China.

In the case of the PSL Rules, the Supreme People's Court did act with careful deliberation. The Court consulted a number of PRC and foreign experts during the drafting process of the PSL Rules. It examined approaches to private securities litigation in the United States, England, Japan, and Germany. It also consulted many interested PRC parties. However, this process was not obligatory and those outside of the process had no way to influence it, give input, or even know that it was occurring. The absence of procedural safeguards to rulemaking means that the Chinese legal system may or may not produce rules on the basis of broad and thorough input.

312 In stark contrast to the PRC Supreme Court's approach, when the U.S. Supreme Court addressed a controversial issue with significant economic and political repercussions, briefs were submitted not only by direct litigants but also by many other interested parties. See Peter Schmidt, Hundreds of Groups Back U. of Michigan on Affirmative Action, CHRON. OF HIGHER EDUC., Feb. 28, 2003 (noting a deluge of amicus briefs in the recently decided Michigan affirmative action cases), available at http://chronicle.com/weekly/v49/i25/25a02401.htm (password required).

313 See Peerenboom, supra note 89, at 161 (discussing China's efforts to create a modern administrative law regime over the last twenty years).

314 See, e.g., Brian Palmer, The View From China: Big Business Confronts China's Huge Potential -- and Problems, FORTUNE, Nov. 8, 1999, at 211, 214 (reporting on the Fortune Global Forum held in Shanghai where in discussing China's future, "[t]he need for transparency and the rule of law, in particular, was mentioned repeatedly").

315 PSL DRAFTERS' COMMENTARY, supra note 18, at 22.

316 Id.

317 Id.
5.6. Entrepreneurial Lawyers Influence Developments

The process leading to the PSL Rules and their subsequent implementation shows that entrepreneurial lawyers have become a factor in shaping Chinese legal developments. Lawyers seeking to specialize in bringing these kinds of cases actively lobbied the Supreme People’s Court during the drafting of the PSL Rules.318 Entrepreneurial lawyers have publicized the new cause of action by running advertisements to gather potential plaintiffs.319 At least one book on private securities litigation has been published by members of the emerging private securities litigation plaintiffs’ bar in China.320 Song Yixin, a lawyer who wrote one of these books, also maintains a website with extensive information regarding private securities litigation, including lists of companies subjected to administrative sanctions so as to make them eligible defendants.321 The emergence of an enterprising and tenacious legal profession in China may encourage further positive reforms of the legal system and contribute to the development of civil society in China.322

5.7. Public Discourse is Vibrant and Critical with Respect to Certain Matters

Although the formal process of rulemaking in China leaves much to be desired, the development of the PSL Rules discloses a salutary development in the Chinese legal system: public discourse in certain areas is vibrant, critical, and substantially

318 See, e.g., Lawrence, supra note 180, at 26-28 (reporting that Guo Feng actively lobbied the Beijing No. I Intermediate Court and the Supreme People’s Court regarding private securities litigation).

319 See PSL DRAFTERS’ COMMENTARY, supra note 18, at 202 (noting lawyers have advertised in newspapers to gather clients for private securities litigation); see also Clay Chandler, In China, Stock Scams Burn Small Investors, WASH. POST, Sept. 3, 2001, at A1, A16 (reporting that Beijing lawyer Guo Feng placed advertisements on the Internet and in China’s financial press to gather plaintiffs for shareholder lawsuits prior to the PSL Rules).

320 See XUAN, supra note 129.

321 See Song Yixin’s website for the list of companies, at http://www.syxlawyer.com.cn/111.htm (last visited June 1, 2003).

322 Law professors have also become active in lobbying for change. See Erik Eckholm, Petitioners Urge China to Enforce Legal Rights, N.Y. TIMES, June 2, 2003, at A3 (reporting on the petition to the NPC Standing Committee filed by three young law professors urging revocation of laws on detention of migrant laborers that violate PRC Constitutional provisions on individual rights).
unfettered by political constraints.

It is not always safe to publicly criticize government policies in China. Though criticism is tolerated more now than at previous points in PRC history, intolerance persists in many politically sensitive areas.\textsuperscript{323} For example, it is very difficult to find mass media discourse critical of Jiang Zemin's three representations (san ge daibiao) political theory.\textsuperscript{324} Public endorsements of the Fa Lun Gong spiritual sect, Taiwanese independence, and the withdrawal of PRC troops from minority regions such as Xinjiang and Tibet are virtually non existent. Stock market policy, on the other hand, is an area where civil discourse is tolerated, even when harshly critical of government policies. With respect to the PSL Rules, a number of lawyers and academics have published critical reviews.\textsuperscript{325} There are other examples of harsh public criticism of government policy regarding securities markets.\textsuperscript{326} In certain other limited areas, public discourse is comparatively robust. This is not to suggest that China has an adequate right to freedom of speech; clearly it does not.\textsuperscript{327} Even when critical speech is tolerated, organized opposition is not.\textsuperscript{328} However, many people outside of


\textsuperscript{324} The Sixteenth Party Congress of the China's Communist Party ("CCP") changed the Party's Constitution to incorporate Jiang Zemin's awkward-sounding "three representations" policy, which asserts that CCP should represent the most advanced forces of culture and production, and the broad interests of the masses.

\textsuperscript{325} See Bei Hu, Lawyers Criticise China's Rules for Shareholder Suits, S. CHINA MORNING POST, Jan. 10, 2003, at 3 (reporting for attribution criticism of the PSL Rules by PRC lawyer Xuan Weihua).

\textsuperscript{326} Government efforts to sell state-owned shares, which contributed to the loss of 40\% of the market capitalization of China's two securities changes between June 2002 and January 2003, inspired public vitriol. See Sebastian Heilmann, China Analysis No. 15: The Chinese Stock Market: Pitfalls of a Policy-driven Market (Sept. 2002) (discussing the robust public criticism regarding securities market policies), available at http://www.chinapolitik.de/studien/china_analysis/no_15.pdf. James Miles reported one colorful comment that China's stock markets are the "congenitally deformed children born after the rape of capitalism by socialism." See Miles, supra note 288, at 4.

\textsuperscript{327} See, e.g., Cong. Exec. Comm'n on China, Information Control and Self-Censorship in the PRC and the Spread of SARS (May 7, 2003) (arguing that lack of press freedom aided the spread of Severe Acute Respiratory Syndrome), available at http://www.cecc.gov/pages/news/prcControl_SARS.pdf. It is noteworthy that the SARS crisis has been linked frequently with a lack of transparency in China. Private securities litigation is a tool to enforce the transparency mandated by China's disclosure rules for listed companies.

\textsuperscript{328} Organized opposition groups or even groups perceived as potential opponents of the Party-state are not tolerated.
China do not appreciate the degree of critical speech that does exist there.

5.8. Complex Policy Dynamics Reflect Fundamental Tensions in Chinese Reforms and Make Forecasting Difficult

The dynamics of legal reform in China are complex. There are multiple actors with different agendas, and specific organizations and individuals are subject to competing imperatives. Often, the next stage of reform in China calls for a greater relaxation of state control. This puts China's reform ambitions in tension with political intransigence and prudential concerns. This complex dynamic gives reform an ambiguous character. Just as there are evident impulses to cling to state control, there are also efforts to broaden the space for private, non-governmental action, making it difficult to predict how things will unfold.

The PSL Rules provide an example of these complex dynamics and their uncertain fate. As discussed earlier, there are many reasons to be skeptical that private securities litigation will flourish in China, but there are other reasons to harbor some hope that the PSL Rules will herald further changes. For private securities litigation to advance, courts and stock markets require greater independence. However, those changes would implicate political power and prudential concerns over current market valuations and the reform of SOEs. The PSL Rules compromise between greater reform and no reform, granting private investors some rights to sue, but limiting such rights in critical ways.

This leitmotif is detectable with respect to private securities litigation as well as in the general regulatory dynamics of PRC.

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329 An article in THE ECONOMIST provides an example:

Cleaning up the stockmarket may have done much to take the steam out of rising share prices, but therein lies the [CSRC's] dilemma. It is alarmed by the inflated valuations of domestic shares... At the same time, the Communist Party has a much broader concern: that middle-class dissatisfaction with stockmarket losses, coupled with working-class anger at the continuing wave of lay-offs at state enterprises, could threaten the legitimacy of the party's rule.


330 See PSL DRAFRERS' COMMENTARY, supra note 18, at 84 (noting that the Supreme People's Court considered the contradiction (maodun) between balancing market rectification (guifan) with stable development (wending fazhan) in drafting the PSL Rules).
securities markets. The PRC government asserts extensive control over China's securities markets, but there are market-oriented reform pressures as well. Competition among underwriters to bring companies to market and the capital thirst of entrepreneurs can be expected to exert pressures for reform. Some PRC leaders want to develop robust capital markets, and the CSRC has pushed reform ahead aggressively, at least more so than during the preceding few years. Clearly some PRC officials want to foster innovation, create companies that can compete globally, and use resources efficiently. Although central planning does not readily accomplish those goals, embracing alternatives would not be easy either. Allowing private companies to list their securities on the securities market without government approval might result in better resource allocation, but it would also lessen the power of central authorities and likely siphon funds away from the reforming SOEs that China's securities markets have been developed to serve. If investors could buy shares in private companies, the market value of current shares might also deflate, causing losses for millions of current investors. These "externalities" are more than theoretical dilemmas for PRC policy makers. Even if changes will be positive in the long run, their near-term effects can be daunting.

A specific example of this pattern can be seen in China's establishment of a high-tech stock market. In recent years, there has been extensive discussion in China about establishing a Nasdaq-like second board to aid high-tech companies. In 2000, it seemed this new market would soon be established. In fact, the CSRC drafted regulations for this new market. The PRC Company Law was amended to allow for a market with less stringent listing requirements. A-share IPOs were halted on the

331 See Casino Capital, supra note 329, at 11 (noting that the CSRC is "a body of refreshingly modern-minded officials" who are "only too aware of the shortcomings" of PRC capital markets).


333 See Zhongguo Xiugai Gongsi Fa (Tebie Baodao) [China Amends Company Law (Special Report)], PEOPLE'S DAILY (Overseas ed.) (reporting on the December 25,
Shenzhen Stock Exchange in anticipation of the establishment of the new board and the consolidation of the main boards in Shanghai. However, the drive to establish this second board or stock market for start-ups (er ban or chuanye ban) stalled. Changes in the global economy, such as the bursting of the “dot com” bubble are proffered as part of the explanation, but it is also likely that regulators realized the second board could woo investors away from the shares of SOEs listed on the main boards, harming the interests of those who currently hold main board shares and the prospects of SOEs hoping to conduct IPOs or secondary issuances. Securities regulation, like other areas of Chinese law, is subject to countervailing impulses, as China’s development agenda calls for reforms requiring a greater loosening of state control, giving rise to economic and political risks.

Securities law developments are only one group of reforms in an overall scheme of reforms spanning the last twenty-four years in China. The social and economic consequences of these incremental, calibrated reforms have been enormous. Millions of Chinese citizens now enjoy greater prosperity and individual liberty than they have at any time in PRC history. However, China’s reforms have intentionally been restricted to economic

1999 amendments to the PRC Company Law by the NPC Standing Committee, including the addition of a clause to Article 229 which allows the State Council to formulate rules for the listing of high technology companies).

See Shenzhen – Listings, CHINA DAILY, May 30, 2003, at 6 (reporting that the IPO halt that was instituted in September 2000 in anticipation of the founding of the PRC’s second board will be rescinded by October, 2003).

See No Timetable for QDII and CDR, CHINA DAILY, Nov. 22, 2002 (reporting comments of the then-chairman of the CSRC, Zhou Xiaochuan, stating that establishment of the second board requires “further study” and has mainly been delayed because of the crash of the technology market in 2002).

Id.


For engaging accounts of the complex social transformation of Chinese society after Mao, see generally NICHOLAS D. KRISTOF & SHERYL WUDDUNN, CHINA WAKES: THE STRUGGLE FOR THE SOUL OF A RISING POWER (1994), which describes both the Chinese boom-state and the tottering dictatorship; PERRY LINK, EVENING CHATS IN BEIJING: PROBING CHINA’S PREDICAMENT (1993); and ORVILLE SCHELL, DISCOS AND DEMOCRACY: CHINA IN THE THROES OF REFORM (1989), which discusses social and cultural developments in China post-Tiananmen Square.
changes; fundamental political reforms have been quashed.\footnote{The CCP, as evidenced by a titular communist party promoting the market structure, does not base its legitimacy on the economic ideology of its founding revolutionaries. Though the CCP is now almost entirely desiccated of Marxism, it remains firmly committed to Leninism. The Party has been intolerant of organized dissent, or even the threat of it, whether that perceived threat be from labor unions, democracy activists, Protestants, Catholics, or devotees of the Falun Gong spiritual sect. \textit{See generally U.S. State Dep't, 2002 Country Reports on Human Rights Practices—China (released Mar. 31, 2003)} (detailing PRC human rights violations in 2002), \textit{available at http://www.state.gov/g/drl/rls/hrrpt/2002/18239.htm}.} The Chinese Communist Party maintains sole authority to govern China.\footnote{See PRC Constitution, \textit{supra} note 154, pmbl. (describing the governing structure of China according to China’s history).} Notwithstanding the success of its market-oriented economic reforms, the Party remains unwilling to subject itself to political competition. Despite falling short of liberal hopes, this pattern of gradual economic reform and political stability has been hailed by some as a model superior to the shock therapy or rapid political change pursued by some other transitional economies.\footnote{See \textit{generally} Lan Cao, \textit{The Cat That Catches Mice: China’s Challenge to the Dominant Privatization Model}, 21 \textit{Brook. J. Int’l L.} 97 (1995) (comparing PRC reforms with “shock therapy” approaches applied in Eastern Europe).} The Chinese economy continues to grow at an enviable pace and attracts stunning amounts of foreign investment.\footnote{See Statistics about Utilization, \textit{supra} note 241 (providing statistical information on the enormous inflow of foreign capital through foreign direct investment).} China’s approach to reform, however, may have delayed rather than avoided certain fundamental and painful restructuring issues. Latent difficulties seem to abound.\footnote{For a superb general introduction to the collection of challenges facing the PRC and an assessment of the Chinese government’s capacity to deal with them, see John Bryan Starr, \textit{Understanding China: A Guide to China’s Economy, History, and Political Culture} (2001); see also Baum & Shevchenko, \textit{supra} note 221 (examining the impact of the PRC’s economic reform on Chinese politics, culture, and society); Nicholas R. Lardy, \textit{China’s Unfinished Economic Revolution} (1998) (describing threats to the PRC economy from the build-up of non-performing loans in the banking sector); Edward S. Steinfield, \textit{Forging Reform in China: The Fate of State-Owned Industry} (2000) (discussing the failure of repeated reforms to fundamentally address the problems of SOEs because of the lack of hard budget constraints, and noting that the SOE crisis threatens to drag down the entire economy). The foregoing books are based on thorough research and thoughtful analysis. For a polemical and largely derivative popular account, see Gordon G. Chang, \textit{The Coming Collapse of China} (2001).} Indeed, to continue to grow economically, many observers contend that China must further
liberalize politically. If this does not require embracing multi-party democracy, it seems to at least require the continuation of allowing the balance of power to shift from state to society. This further development of civil society seems to call for greater reliance on a system of effectively administered impartial rules. Building a legal system has indeed been an integral component of China's reform efforts. However, further establishment of the rule of law and allowing further growth of civil society could threaten the cardinal principle of one-party rule and generate social instability. In this way, reform demands, in general,

344 See, e.g., James A. Dorn, Creating Real Capital Markets in China, 21 CATO J. 65 (Spring/Summer 2001) (arguing that political reform will be necessary for the development of capital markets in China).

345 See, e.g., Chinese Privatization, supra note 48, at 16 ("Whether current privatization efforts can work [in China] will depend on the government's ability to muster the will necessary to relinquish political control and allow the rudiments of the market to function.").

346 See Cindy A. Schipani & Junhai Liu, Corporate Governance in China: Then and Now, 2002(1) COLUM. BUS. L. REV. 1, 69 (2002) ("Good corporate governance in China, however, will not result from mere changes in the Corporate or Securities Laws. Good corporate governance will also depend heavily upon the successful reform of government agencies and the legal system."); Chen Zhiwu, Fazhi Shuiping bu Gao shi, Buyi Dui Gongzhong Zhengquan Qiwang Guoduo [High Hopes Inappropriate for Public Securities Markets Without a High Degree of the Rule of Law], 73 CAIJING (2002) (arguing that the development of capital markets requires a strong legal system and an independent media).

347 For material discussing PRC legal reforms, see STANLEY B. LUBMAN, BIRD IN A CAGE: LEGAL REFORM IN CHINA AFTER MAO 4 (1999), which states that "Chinese reforms, economic and legal, have begun to do nothing less than redefine basic relationships among state, economy, and society"; RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW (2002); Power and Politics in the Chinese Court System, supra note 84, at 2, which discusses how law, courts, and court judgments are part of the framework within which economic reforms are being carried out in China; and What's Law Got to Do With It?, supra note 86, at 57, which describes how legal rules affecting enterprise incentives were often ineffective, and examines Chinese societal institutions affecting legal rules. For a useful overview by a non-specialist, see generally Eric W. Orts, The Rule of Law in China, 34 VAND. J. TRANSNAT'L L. 43 (2001), which discusses the meaning and purpose of law in Chinese history and tradition.

348 The Four Cardinal Principles, expressed in the preamble to the PRC Constitution, are: the leadership of the Communist Party of China; the guidance of Marxism-Leninism and Mao Zedong Thought; the people's democratic dictatorship; and the socialist road; see also Deng Xiaoping Upholds the Four Basic Principles, speech translated in SOURCES OF CHINESE TRADITION 492 (Wm. Theodore de Bary & Richard Lufrano eds., 2000). Concerning the stress on social stability, see Hu Jintao zai Quan Guo Zhenxie Xinri Xinnian Chahuahu Sheng de Jianghua [Hu Jintao's Speech at the Chinese People's Political Consultative Conference New Year Reception], PEOPLE'S DAILY, Jan. 1, 2003 (stating that Hu Jintao, a senior leader named PRC President in March, commented on the importance of social stability).
contradict political intransigence and prudential concerns.

It is impossible to be oracular concerning where these complex dynamics will lead. There is no assured outcome with respect to private securities litigation, much less with respect to the overall political evolution of China. At a minimum, however, it is clear that any prognostication, whether trumpeting China’s inevitable triumph or its assured demise, is badly uninformed if it ignores China’s current complexity.

6. CONCLUSION

“Investor protection” is routinely claimed as a reason for the enactment of securities laws and regulations. The first sentence of the PSL Rules repeats this investor protection mantra. Nonetheless, the PSL Rules create many daunting obstacles for investors seeking to protect their interests through private securities litigation. Consequently, it seems doubtful that such litigation will create meaningful incentives for compliance with China’s disclosure laws, and many harmed investors will not obtain economic relief.

Still, the complexity of contemporary PRC society bespeaks caution to those wishing to make predictions. A variety of new and potentially powerful actors have emerged during China’s recent decades of economic transition. Masses of stock investors, entrepreneurial lawyers, investment bankers, and market-oriented

349 Whether and how economic reform leads to political liberalization is unclear. See MARGARET M. PEARSON, CHINA’S NEW BUSINESS ELITE (2000) (finding that the PRC’s business elites did not form a nascent civil society, but were likely to seek alliances with the existing political structure).

350 The unexpected often emerges to make prognostication a humble business. For example, no advance commentary on the recent PRC leadership transition from Jiang Zemin, Zhu Rongji, and Li Peng to Hu Jintao, Wen Jiabao, and Wu Bangguo (President, Premier, and Chairman of the National People’s Congress Standing Committee, respectively) contemplated the impact of SARS. See Erik Eckholm, Rude Awakening, N.Y. TIMES, May 13, 2003, at A1 (noting that a short time ago, “[n]o one, neither critics nor partisans of the Communist Party, imagined that a viral disease was about to cause the equivalent of a national train wreck,” and reporting that the crisis has humbled some PRC officials concerning the PRC’s system and approach to reforms), available at http://www.cnn.com/2003/us/05/13/nyt.eckholm/; Minxin Pei, Don’t Hold your Breath for Openness in China, FIN. TIMES, May 7, 2003, at 21 (discussing the political implications of the SARS crisis, noting that “[t]he resulting disunity within the elite could create an opening for real change,” and quipping “[i]f that happens, China will score a victory against a different strain of SARS—‘sclerotic authoritarian regime syndrome’”.

regulators did not exist in the PRC twenty years ago. While it is unclear what will arise from the interaction of these new groups with existing institutions, it is clear that the "special characteristics" of China's securities markets will continue to influence development. It is also obvious that private securities litigation could become significant to many domestic and foreign investors in China if it breaks free of the constraints imposed by the PSL Rules. Finally, it is clear that private securities litigation provides a useful entry point for the study of contemporary China; specifically, the PSL Rules provide material disclosure about China's rapidly changing legal system.