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ABSTRACT

China is undergoing a tremendous change which has begun ever since late 1978 when it opened its door to the outside world and gradually implemented the market-oriented economic reform. With the establishment of the Shanghai Stock Exchange in December 1990, China began a well-publicized effort to build a legal regime for regulating the securities market. At present, China's stock exchange trading system reaches all large and medium-sized cities with 2,412 retail branches all over China with the total market capitalization of more than RMB 1,950.5 billion, equivalent to 24.46% of GDP.

Securities regulation was originated from England and had significant developments in the U.S during late 19th century. One of the major objectives of securities regulations is the protection of investors. Requiring issuers to provide investors with the knowledge necessary to facilitate informed investment decisions is one means through which securities regulation attempts to protect the investors.

The securities regulations of China have relatively comprehensive requirements on information disclosure, however, misrepresentation made by listed companies has been rampant in the market. Investors who suffer losses incurred by such misrepresentation have not been compensated for the lack of adequate civil remedy under Chinese securities regulations, which have been considered as an instrument of the leadership to meet political and/or economic ends, and meanwhile reflect unique Chinese legal culture originating from traditional Confucianism.
Having realized the necessity and urgency of civil remedy, Chinese lawmakers have made new legislation to overrule previous “inefficient” judicial decisions, which prohibited the People’s Court to accept misrepresentation related civil suits brought by the investors against listed companies. In addition, securities regulations also need to address lessons learnt by the Western regulatory authorities after the failures of Bre-Xs and Enrons, which are the pursuit of true information disclosure and the advances on corporate governance.

Undergoing the huge economy reform, obviously China has dedicated to the protection of private rights. For example, the first Civil Code of the People’s Republic of China has been drafted. It is reasonable to believe that Chinese are progressing to an era when people enjoy all sorts of civil rights; what's more, their entitlements are well protected by laws.
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China is undergoing a tremendous change which has begun ever since the Third Plenum of the 11th Central Committee Congress in late 1978. It is a reform to all major aspects of Chinese society, from politics, economy, ideology to legislation. This real process of change is neither a direct transfer of social institution from the West, nor a mere disturbance of a traditional equilibrium. Rather, it is the interaction of old traditions and new forces after China's opening to the Western countries. Experiencing those changes everyday, I am urged to help people to realize problems arising from the present day Chinese legal system, for a better understanding of the existing situation will assist in directing the changes towards a desired outcome.

CHAPTER I  Introduction

On December 14, 1998, Ms. Jiang Shunzhen brought a suit against all of the directors of Chengdu Hongguang Industrial Shareholding Company ("Hongguang") as well as all the intermediaries listed in the Prospectus of Hongguang's initial public offering ("IPO"), including the underwriter, the accounting firm and the law firm, alleging that the defendants should be liable for her loss caused by investing in Hongguang's stock upon defendants' misrepresentation.1

Hongguang, a Chinese company specialized in the production of electron vacuum devices such as black-and-white and color television tubes and glass bulbs,2 made its IPO in June

1997. It was found later that the company committed a number of wrongdoings: falsely reported its profits and fraudulently obtained qualifications to publicly issue shares; concealed its major production problems; used capital raised from the offering to pay back bank loans and to make up for past loss, which were not stated in the Prospectus; illegally used funds raised from the public offering to buy and sell its own securities; and was also under suspicion for bribery.³

Hongguang is only one of the misrepresentation cases since breaches of information disclosure regulations have been rampant in the securities markets of China. Hainan Minyuan Modern Agricultural Company, making its IPO on April 30, 1993, fraudulently inflated its accounts by 1.2 billion yuan and was called to stop trading by China Securities Regulatory Commission (hereinafter referred to as the “CSRC”).⁴ Daqing Lianyi Petro-Chemical Co., Ltd. fraudulently obtained anti-dated government approval, Business License, and other necessary documents, which demonstrated that it was set up in 1993, three years earlier than its actual date of establishment. It also forged financial information of 1994, 1995, and 1996, which falsely reported profits of 161,670,000 yuan.⁵ In 2001, Shanghai Tongda Venture Capital Co. Ltd. was fined by the CSRC for false disclosure on transferring of assets between its affiliates and itself.⁶ Bohai Group Co., Ltd. was fined for its misrepresentation that it had been waived a substantial loan by

³ Ibid.
the lender, which was proven false later. Heilongjiang SunField Science & Technology Co., Ltd. made false information disclosure on its acquisition and was find by CSRC as well. Behind those scandals are thousands of individual investors who make their investment decisions based upon the fraud or misleading information disclosed by listed companies and thus suffered losses. Ms. Jiang is only one of these victims.

However, the People’s Court found that it was not certain that Ms. Jiang’s loss was directly caused by defendants’ misrepresentation; and it had no jurisdiction on the present dispute between the plaintiff and the defendants. Therefore, the court denied the case.

A similar suit brought by another investor in April 2000 based on Hongguang’s misrepresentation received the same disappointing court decision.

This was the first civil case on compensation for securities misrepresentation heard by Chinese court while the result was discouraging. Investors suffered from the misrepresentation made by issuers, underwriters and intermediates are not entitled to civil remedy, which is one of the powerful tools for Western investors to fight against listed companies. For example, in Canada, investors who had suffered losses brought litigations against Bre-X Mineral Ltd., its officers and directors to seek compensatory

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9 See Zheng Shunyan, Zheng quan shi chang bu dang xing wein de afu lu shi zheng (Legal Analysis on the Misconducts in the Stock Market of China), Supra 1.
10 Ibid.
In the U.S, after Enron's failure, class actions have been brought on behalf of purchasers of common stocks of Enron, seeking remedies under the Securities Exchange Act of 1934.12

The reality in China is that investors put their money in the stock market but may never get it back – they have few rights under current Chinese securities regulations. It is well known that companies make IPOs in the securities market in order to raise capital to further develop their business. Securities market itself obviously cannot generate money, rather, investors who purchase stocks are the ones to provide funding to meet the demands of those listed companies. Investors are the fundamental of the securities market -- without their investments, both the market and the companies listed there are not able to survive. Therefore, one significant purpose of securities legislation is to protect the investors. Then why Chinese investors are not entitled to proper protection and why should they accept unfair game rules? What's wrong with those listed companies in the securities market? Is there any protection/remedy for the investors? And is such lack of protection of private rights related to the culture/tradition of Chinese society? Those are the issues to be discussed in this essay. Any further development of Chinese securities market is possible only after people realize and resolve current problems.

Chapter II of this essay briefly introduces the requirements of information disclosure in Western securities markets, which are the most significant vehicles to realize the purpose

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11 See discussion under Chapter V.
of investor protection, within the context of the history of securities regulation. Chapter III discusses the misrepresentation cases in Chinese market and the current securities regulation of China, which compared with Western legislation, does not provide adequate protection for the investors suffering losses due to fraudulent information disclosure. Chapter IV examines the historical, political, philosophical and legal background of China to explore the reasons why Chinese society ignores the protection for the private rights. Chapter V analyzes the latest securities regulation released by the Supreme People’s Court of China in light of one aspect of the law and economics thesis, which is based upon the merit of “efficiency”, and discusses the growing trends of strengthening information disclosure and the corporate governance promoted both in major Western markets and in China after the failures of many listed companies, such as Bre-X and Enron, and Chapter VI offers concluding remarks.

1.1 History of Securities Regulation

Securities regulation originated from legislation in England around 1300\(^\text{13}\) and had significant developments in the U.S during late 19\(^{\text{th}}\) century. The U.S Parliament passed "An act to restrain the number and ill practice of brokers and stock jobbers"\(^\text{14}\), which was aimed at unlawful conspiracies to manipulate prices. In 1890 the U.S Parliament passed the Directors Liability Act\(^\text{15}\) (subsequently incorporated into the Companies Act) so as to subject corporate directors and promoters to civil liability for untrue statements in the

\(^{13}\) See Mark R. Gillen, Securities Regulation in Canada, (Toronto: Carswell, 1992) at p.54, note 14.

\(^{14}\) See Louis Loss, Securities Regulations (2\(^{\text{nd}}\) ed) (Boston: Little Brown, 1961).

\(^{15}\) See Louis Loss, Securities Regulations, \textit{supra} 14.
prospectus without proof of scienter.\textsuperscript{16} Successively following the disclosure philosophy, the 1900 Companies Act enforced a certain amount of affirmative disclosure that went considerably beyond the negative injunction against fraud. Most significant development of securities regulation occurred in 20 century; in 1911, Kansas passed the first state securities legislation. The two main objectives of securities legislation are the investor protection and the optimal allocation of financial resources. The underlying purpose of securities regulation is the “protection of the investing public”.\textsuperscript{17}

1.2 Information Disclosure and Protection of Investors

Generally, information disclosure means that companies raising fund in capital markets completely, timely and accurately disclose the information relevant to their activities in the market, including the distribution and trading of stocks to both securities regulatory authorities and shareholders. The purpose of such disclosure is to provide equal opportunities for all investors in the marketplace and to make available on a timely basis all material facts the investors require to make informed investment decisions. Mandatory disclosure is one means through which securities regulation attempts to protect investors since disclosure creates and maintains confidence in capital market by providing an information base from which investment decisions can be made, and from which investment advices can be developed. Disclosure provides information to assess the value of the security. The availability of information also allows the public to commend or condemn the performance of companies and discourage inappropriate

\textsuperscript{16} See Louis Loss, Securities Regulations, \textit{supra} 14.
Requiring issuers to provide investors with the knowledge necessary to facilitate informed investment decisions is seen as furthering the goal of investor protection, whether in connection with the distribution of securities, the trading in secondary markets or specific corporate transactions. Such mandatory disclosure operates directly to protect investors from making investment decisions based on inadequate or incomplete information and therefore, it promotes investor confidence and the integrity of the capital market.

Listed companies shall strictly comply with the information disclosure requirements of securities regulations. Misrepresentations including false information, material omission, and misleading information cannot be the accurate basis to make investment decisions, and may easily cause losses to the investors who purchase stocks upon foregoing misrepresentations. Obviously, securities legislation shall provide a mechanism to punish companies for violating information disclosure regulation and, what’s more important, to compensate investors suffering losses. Under the U.S securities law, investors injured in securities transactions are frequently able to choose among a number of private remedies, including remedies at the common law, and under both statute and deferral securities laws.\(^{19}\) Besides private remedies, there are also administrative sanctions that can be imposed by securities regulatory authorities, such as the Securities Exchange Committee.\(^{20}\) If any violation of criminal law or any special provision in any securities regulation is involved in securities transactions, criminal proceedings may be brought to

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\(^{17}\) See Report on the Attorney- General’s Committee on Securities Legislation in Ontario (Kimber Report), (Toronto: Queen’s Printer, 1965).

\(^{18}\) See Anita Anana, David Johnston, Gregory Peterson, Securities Regulation Case, Notes & Material (Butterworths, 1999) at p.197.
the court. 21 Although both administrative sanctions and criminal proceedings can punish the wrongdoings by listed companies such as fraudulent disclosure and omission of material changes, private remedy is undoubtedly the most effective way for investors suffered damages to get their money back.

1.3 Securities Regulations of China

The national securities regulatory regime of China is consist of the Company Law of the People’s Republic of China (hereinafter referred to as the “Company Law”) 22, the Securities Law of the People’s Republic of China (hereinafter referred to as the “Securities Law”) 23, the Interim Regulation on the Administration of the Issuing and Trading of Shares (hereinafter referred to as the “Interim Regulation”) 24 and other securities regulations. There are three categories of information disclosure under Chinese securities regulations: listing documents, continuous disclosure after listing, and important events that may affect share prices.

The primary form of disclosure requires listed companies to provide certain documents to regulating authority and the public when registering to issue stock publicly. Companies must provide the following documents to the CSRC: a listing report, a resolution passed at the shareholders' meeting concerning the listing application, the company's articles of

19 See Louis Loss, Securities Regulations, supra 14, at p.1623.
20 See Louis Loss, Securities Regulations, supra 14, at p.142.
22 Promulgated by the Standing Committee of National People’s Congress on December 29, 1993 and amended on December 25, 1999.
23 Promulgated by the Standing Committee of National People’s Congress on December 29, 1998.
24 Promulgated by the State Council on April 22, 1993.
association, the company's business license, financial reports from the previous three years or since establishment, a legal opinion and recommendation from a securities company, and the most recent prospectus.

Continuous disclosure of company information is made through semiannual, annual, and material event reports. To some extent, the Securities Law has modified the requirements in the Interim Regulations.²⁵ Additionally, CSRC has released general regulations for these reports, and also responded to particular situations by requesting information for specific reports. As in the Interim Regulations, the Securities Law requires a company to disclose any material event that may affect the stock price.²⁶ An explanation for the event must be provided to the CSRC and the stock exchange. The Securities Law lists eleven types of material events: a major change in the business policies or scope of business of the company; any decisions regarding a major investment or capital purchase; an important contract signed by the company that may have a substantial impact on the assets, liability, rights, interests, and performance of the company; any incurrence by the company of a major debt or default on a major debt; any incurrence by the company of a major loss exceeding ten percent of the net capital of the company; any major change in the external production or business conditions of the company; any change in the chairman of the board, more than one third of the directors, or the manager of the company; any relatively major change in the shareholding of a shareholder who holds more than five percent of the company's shares; any decisions by the company to reduce capital, merge, divide, dissolve the company, or file for bankruptcy; any major litigation

²⁵ Compare Interim Regulations, Art. 57-59, with Securities Law, supra 21, Art. 60-62.
²⁶ Compare Interim Regulations, Art. 60 with Securities Law, Art. 62.
involving the company or the court overturning decisions by shareholders or directors; and any other details as required by law.  

When listed companies like Hongguang or Hainan Mingyuan collapsed, investors who may lose their money overnight are the most vulnerable ones. According to Article 177 of the Securities Law, listed company that fails to disclose relevant information, or the information disclosed by the company is false, misleading or contains important omissions shall pay a fine of certain amount as penalty; Meanwhile, the individuals responsible for such failure of disclosure shall be given a disciplinary warning and a fine. The Company Law has the similar stipulation: if a company provides to shareholders or the general public financial statements which are false or have important omissions, the persons who have direct responsibility shall be fined.  

In addition to aforesaid statutory liabilities, due to the increasing numbers of cases related to misrepresentation in the securities market, the National People’s Congress in March 1997 enacted a special provision penalizing the conduct involving the giving of false information affecting securities transactions. These changes were included in amendments to the Criminal Law of the People’s Republic of China (hereinafter referred to as the “Criminal Law”).  

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27 See the Securities Law, Art. 62.  
28 See the Company Law, Art. 212.  
29 Adopted at the Fifth session of the Standing Committee of the Eighth National People's Congress on March 14, 1997 and amended in 1999.
Notwithstanding severe administrative and even criminal liabilities for listed companies which violate information disclosure regulations, investors who lost money due to misrepresentation, the direct victims of securities misrepresentation cases, have not been remedied, their losses not been covered yet, nor any compensation. As to the civil remedy for investors, Chinese law remains in its infancy, hardly comparable with those of the Western countries', such as the U.S and Canada.

On September 21, 2001, the Supreme People’s Court of the People’s Republic of China (SPC) promulgated the Notice on Temporary Suspension of Securities Related Civil Liability Suits (Famingchuan [2001]406 hao), which prohibited lower courts to accept civil suits for compensation in certain classes of securities cases including fraud, insider trading and manipulation, because the legislative and judicial conditions were not ripe. SPC had made a regrettable decision. Investors who lost money due to false disclosure of listed companies are only the most obvious victims for they may never get their money back. Their interests have to be sacrificed to those of listed companies’. It is an unfair game where one party always gains control while the other party is destined to lose. Without remedy mechanism, without relief to victims as well as punishment to law-breakers, how to implement the protection? Undoubtedly, private remedy should be an essential part of securities legislation.

In contrast with the relatively comprehensive information disclosure system, remedies for investors under current Chinese securities regulation remain infancy; not only the categories of liabilities are inadequate, the stipulations are usually brief and ambiguous,
but also the legal procedures by which investors obtain compensation are restricted. It is hardly to explain the legislative difference between information disclosure and remedies by referring to the lack of legislation experience or expertise, nor merely negligence. The answer lies in the process of policymaking and in traditions, since the remedy for victims reflects the outcome of a society’s unique protection of interests/rights, people’s faith in law and their selections of means to solve disputes.

1.4 Why Lack of Protection of Private Rights in China?

1.4.1 Bureaucratic Politics Analysis

Both the legislation on information disclosure and the remedy for investors, as well as the implementation of those regulations, are government behaviours underlying which are various policies and decisions. It is necessary to examine and illuminate how the bureaucratic structure of the government, policy processing and outcomes are interrelated for a better understanding of protection of private property rights in contemporary China. The bureaucratic politics theory explains how the political leaders and the government proceed when confronted by touch state issues, such as securities legislation. Professor Michel Oksenberg and Kenneth Lieberthal regard the government behaviour as the result of interplays by each member of the top leadership group, rather than a rational choice. Since law is always considered by Chinese as an instrument of leadership to meet political and/or economic ends, the bureaucratic politics analysis will help people understand why Chinese securities legislation lacks of civil remedy for investors. As
long as China's economic reform is proceeding through the socialist political system, legislation reflects the policy debate over economic reform issues, the investor protection will not be regarded as the primary priority by policy makers and thus have to subservient to other competing goals.

1.4.2 Legal Culture Analysis

What legal culture theory studies is the importance of local values and norms in the development of belief system that forms the local legal system. It's about people's attitude toward law; whether they want to solve disputes by lawsuits or not. What kind of professional trainings judges have? How do judges decide cases? What's the relationship between law and religion, law and ethic orthodoxy? What's the social function of law? What's the meaning of law for members of the society, and so on. Answers for those questions will obviously beyond the range of study of legal history or sociology. Legal culture theory will explain law by culture and at the same time examine culture through law. Traditional Chinese have unique opinions toward life, society, and even the universe. Those opinions form the system of Chinese philosophy and culture upon which originated ancient Chinese law. Therefore, exploring the spirits of Chinese culture will be an interesting way to obtain a better understanding for the legal system of China.

Chinese does not have inherent belief in law and the law in ancient China was merely the emperor's instrument for ruling his subjects. People emphasized the individual who implementing the law while ignored the law itself. No one ever challenged the nature
and the function of law as what people did in the Western countries. People’s expectations for wise emperor and honest officials actually reflect the denial to a universal system, and denial to the generally applied law.

Traditional Chinese culture is the culture of family that obscured the identity of individual. The membership in a family was vital to a man to live in the society. The legally equal personality, any new social relationship created by free and independent will, and the absolute personal ownership of property as well as the free transfer of goods could not exist in a giant family-based society. As a result, private law did not emerge in ancient China. During two thousand years, when Westerners struggled to provide as many as possible means to satisfy man’s desires and thus set up deliberate system of civil law, Chinese made great efforts to pursue an unified value system (Yi) under which no private rights (Li), no personal interests, nor any private law could be fully developed. Chinese cherish harmony, and thus applied this natural rule to set up a society and to deal with civil disputes between each other. It was not only necessary, but also possible since people’s spirit was originated and connected with that of the nature. Everyone living a harmony life should not sue for private interests. “No lawsuit” was the realization of harmony spirit.

Under unique Chinese legal culture originating from traditional Confucianism, which emphasizes the wisdom of the ruler, encourages the obligations and cherishes the harmony, law has been used to meet political and/or economic ends in China. However, along with the rapid development of market economy, the protection of the private rights
becomes more and more important in order to fight against the abuse of public power that has caused huge waste and to realize efficient utilization of the social resources.

1.5 New Legislations and the Way Ahead

Since law in China always reflects policy debates over economic issues, "efficiency" has not been regarded as a priority of making new law. Applying the law and economics approach to SPC's September 23 Decision, it should not be considered a piece of efficient legislation for it could not produce the most economical outcome when dealing with misrepresentation in the securities market. Fortunately this inefficient Decision was overrode by both the January 15 Notice and the January 9 Provisions SPC promulgated later, which permits the lower People’s Court to accept misrepresentation related civil cases brought by investors against the listed companies, its directors and/or intermediaries.

Though a critical step forward, January 9 Provision has two obvious loop holes: mandatory prior criminal and/or administrative proceedings and restrictions on the means of litigation, which will make the claim for damages incurred by misrepresentation not as easy as it first looks like. In addition to above loop holes, the January 9 Provision as well as other recent securities legislation of China also need to address other critical lessons learned from the Western markets. After the failures of Bre-Xs and Enrons, the U.S and Canadian lawmakers are working hard to vigorously pursue the timely and accurate disclosure of material information and to strengthen the corporate governance. For
example, the Sarbanes-Oxley Act came out in 2002. Learning from the Western experience of advancing the protection for the investors, China also promulgated the Listed Companies Governance Rules, the Guidance on Establishing the Independent Director System by Listed Companies, and amended a series of regulations on information disclosure as well.

Being an indispensable part of market economy, the thriving of private rights originates from developed economy, and in turn promotes further economic developments. Undergoing the huge economy reform, obviously China has dedicated to promote the protection of private rights. The first PRC Civil Code has been drafted and was submitted to the 31st Meeting of the Standing Committee of the 9th NPC for review on December 23, 2002. The draft Civil Code proposes that the state protects personal deposits, investment and profits generated from such investments. For the first time the draft makes it clear that private property, public property, and state-owned property enjoy equal protection. Among provisions, attentions have been made on laws concerning property, personal rights, legal consequences for civil rights violations, and civil relations involving foreign parties. The first Civil Code as well as other new securities legislations has shed light on the pursuit of more protections of private rights in China. It is reasonable to believe that Chinese are progressing to an era when people can enjoy all sorts of civil rights, and further more, their entitlements are well protected by legislation.
CHAPTER II  Information Disclosure and Remedies for Investors

2.1  History of Securities Regulation

Securities regulation is a relatively recent phenomenon. It followed a generation of national regulation and several centuries of legislation in England. "For the problems at which modern securities regulation is directed are as old as the cupidity of sellers and the gullibility of buyers." There is evidence of the regulation of brokers in the City of London as early as 1285 and there are records of a number of prosecutions against unlicensed brokers before the year 1300. Trading in stocks probably did not develop until many years later. In the post-renaissance period, new trading ventures that were risky and involved large capital expenditures encouraged risk sharing through loans and partnerships. Eventually joint stock partnerships and companies based on crown charters were developed.

Further development of share capital companies was delayed by the "South Sea Bubble". The bursting of the South Sea Bubble ruined thousands in all ranks of society. A committee of secrecy of the Commons found that there had been "robbery as well as

30 See Louis Loss, Securities Regulations, supra 14, at p.3.
31 See Mark R. Gillen, Securities Regulation in Canada, supra 13, at p.54.
32 See Louis Loss, Securities Regulations, supra 14, at p.3.
34 See Fernand Brandel, Civilization and Capitalism, 15-18 Century, supra 33, note 16.
35 The story has often been told of the Mississippi Company, granted a monopoly by the British Government of the trading with South America and the Pacific Islands— and of how the two companies undertook to pay off the French and British public debts. During the eight months of 1719 when this financial "Black Death" hit France, the shares of the Mississippi Company went from 500 livres to 1800 and then down again to 400.
Reputations in the financial and political world were ruined wholesale. And the national disaster was aggravated by the numerous hoaxes that were developed by the imitators. The fiasco resulted in the passing of the “Bubble Act” in 1720. The Act prohibited the sale of shares in joint stock companies unless the company was created according to Crown charter. Crown charters became much more difficult to obtain. The result was that raising capital through the sale of shares in companies was constrained. However, by the late 19th century, pressure for easier access to capital in the midst of the industrial revolution led to the repeal of the Bubble Act in 1825. The pressure for easier access to capital in the industrial revolution led to the enactment of the Companies Act in 1844, which made it easier to organize in a company form. The 1844 Act introduced the principle of compulsory disclosure through the registration of prospectuses inviting subscriptions to corporate shares. But it was not until the Companies Act of 1867 that the contents of the prospectus were in any way specified. That act required disclosure of the dates of, and the names of the parties to, every contract made prior to the issue of the prospectus, and provided that "any Prospectus or Notice not specifying the same shall be deemed fraudulent on the Part of the Promoters, Directors, and Officers of the Company knowingly issuing the same, as regards any

36 See Louis Loss, Securities Regulations, supra 14.
39 Ibid.
40 See Mark R. Gillen, Securities Regulation in Canada, supra 13, at p.54.
41 Ibid.
Person taking Shares in the Company on the Faith of such Prospectus, unless he shall have had Notice of such Contract."\(^{43}\)

Securities regulation had significant developments in the U.S. during late 19th century. In 1890 the U.S Parliament passed the Directors Liability Act\(^{44}\) (subsequently incorporated into the Companies Act), whose purpose was to modify the common law of deceit, as it had been applied by the House of Lords the previous year in *Derry v. Peek*,\(^{45}\) so as to subject corporate directors and promoters to civil liability for untrue statements in the prospectus without proof of scienter.\(^{46}\) In the 1900 Companies Act, the provision in the 1867 Act on disclosure of contracts was repealed in favour of an elaborate prescription of the contents of the prospectus. All directors and prospective directors had to sign it, and it had to disclose such matters as the minimum subscription fixed by the directors as a condition of allotment of the shares, and any interest of a director or promoter in property to be acquired. Inspection of material contracts was required and waivers of liability were outlawed. The 1900 Act had followed the report of the Lord Davey Committee of 1895,\(^{47}\) which is notable for its expression of the disclosure philosophy that marks both the English Companies Act and the American Securities Act to this day:

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\(^{44}\) See Louis Loss, Securities Regulations, *supra* 14.


\(^{47}\) In *Derry v. Peek* an action based on a misrepresentation in a prospectus was dismissed on the basis that the plaintiff had to show fraud and had failed to do so. The court stated that the fraud would be proven when it was shown that the misrepresentation was made (a) knowingly, or (b) without belief in its truth, or (c) recklessly, careless whether it be true or false. This examination of intent made it difficult to sustain an action against directors for misrepresentation in a prospectus. The Director Liability Act dealt with the constraints of *Derry v. Peek*. Directors, promoters and others who authorized the use of their names in the prospectus, directors, promoters and signers of the prospectus were liable, unless they could prove that they had reasonable grounds to believe that statement were true.
“...it must be generally acknowledged that a person who is invited to subscribe to a new undertaking has practically no opportunity of making any independent inquiry before coming to a decision. Indeed, the time usually allowed between the issue of the prospectus and the making of an application does not permit of any real investigation. The maxim of Caveat Emptor has in the opinion of your Committee but a limited application in such cases.

It is therefore of the highest importance that the prospectus upon which the public are invited to subscribe shall not only not contain any misrepresentation but shall satisfy a high standard of good faith. It may be a counsel of perfection and impossible of attainment to say that a prospectus shall disclose everything which could reasonably influence the mind of an investor of average prudence. But this in the opinion of your Committee is the ideal to be aimed at, and for this purpose to secure the utmost publicity is the end to which new legislation on the formation of companies should be directed.”

The 1900 Companies Act was successively strengthened, as the result of reports from a series of committees, by the Companies Act of 1907, 1928 and 1947. Each of these was followed a year later by a consolidated statute. But the British pattern was very well set by the 1900 Companies Act, which was a pattern of enforcing a certain amount of affirmative disclosure going considerably beyond the negative injunction against fraud. Most significant development of securities regulation occurred in 20 century: in 1911

47 See Louis Loss, Securities Regulations, supra 14, at p.6.
48 See Louis Loss, Securities Regulations, supra 14, at p.7.
Kansas passed the first state securities legislation. A number of alleged stock market scandals and the crash of 1929 led to the U.S Federal Securities Act of 1933, which required a registration statement for the sale of securities, and the Securities Exchange Act of 1934, which dealt with secondary market trading.

The two main objectives of securities legislation are the investor protection and the optimal allocation of financial resources. To protect investor, it is crucial to ensure that the investing public has the fullest possible knowledge to make its investing decision. To promote optimal allocation of resources, there are two related objectives, namely, to ensure that capital markets facilitate the mobility and transferability of financial resources and to provide facilities for the continuing valuation of financial assets. In short, securities regulation should promote the efficiency of capital market. Theoretically, the

49 See Louis Loss, Securities Regulations, supra 14.
50 Ibid.

Efficient capital market means new information about a stock market is disseminated so rapidly that possession of such information in advance does not enable an investor to clean up. The implication is not that every stock is correctly valued at every moment in time but that the cost of finding out whether or not it is correctly valued will usually exceed the profit to be made from knowing its true value. In an efficient market, prices reflect any new information about the value of the items sold in that market very quickly. Over the past twenty years, the efficient capital market hypothesis (the Hypothesis) has risen to a prominent position in financial and economic theory. The term “efficient market” is used in at least three senses. The kind of efficiency that is most important in terms of the national economy is so-called “allocational” efficiency. A market that is efficient in this sense allocates capital to users (business, government and individuals) in such a way that those who can make the best use of capital are taken care of first and those who make the poorest use of capital are the last to receive it. This sort of efficiency ensures that savings are channeled into the most productive uses, and maximum economic benefits accrue to the nation as a whole. In its most commonly held form—known as “semi-strong”—the Hypothesis states that the securities markets incorporated all available public information so rapidly that investors cannot develop a trading rule (including one based on research into company or industry fundamentals) that will systematically yield greater returns than the market. Most courts in U.S and legal commentators have committed to the Hypothesis. The Supreme Court, for example, employed the Hypothesis in the influential case Basic Inc v Levinson. In Basic, the Court endorsed the fraud-on-the-market theory in private actions under SEC Rule 10b-5. By assuming the existence of an efficient market, the Court allowed groups of investors to sue without showing individualized reliance upon the fraudulent statement.
optimal allocation of financial resources could be achieved by the maintenance of a free and open securities market.\textsuperscript{52}

The investor protection and the development of financial institutions which assure the optimal allocation of financial resources are closely linked: Establishment of the conditions and practices in the capital market which best serve the investing public will normally be consistent with the best interests of the whole economy. For example, disclosure of financial information which depicts adequately the operations and financial position of companies is vital to the investing public; such disclosure also provides the capital market with the information necessary to make a more satisfactory allocation of resources.\textsuperscript{53}

\section*{2.2 Information Disclosure}

Generally information disclosure means that companies that raise funds in capital markets completely, timely and accurately disclose the information relevant to their activities in the market, including the distribution and trading of stocks to securities regulatory authorities and shareholders. The purpose of disclosure is to provide an equal opportunity for all investors in the market-place, and to make available on a timely basis all material facts that the investors require to make informed investment decision. Disclosure creates and maintains confidence in the capital market by providing an information base from which the investment decision can be made, and from which the

\textsuperscript{52} See Kimber Report, \textit{supra} 17, para 1.08.  
\textsuperscript{53} See Kimber Report, \textit{supra} 17, para 1.07.
investment advice can be developed. The availability of information also allows the public to commend or condemn the performance of companies, and discourages inappropriate corporate behaviors.\textsuperscript{54}

\subsection*{2.2.1 Underlying Philosophy}

When faced with different philosophies, the legislators of securities regulation had considered and rejected a regulatory policy:

"It would be an attempt to throw what ought to be the responsibility of the individual on the shoulders of the State, and would give a fictitious and unreal sense of security to the investor; and might also lead to grave abuses."\textsuperscript{55}

Louis Brandeis, a man who left the greatest philosophical mark of the U.S federal securities regulation, strongly urged in Other People's Money publicity as a remedy for social and industrial diseases generated. At the same time, the law should not try to keep investors from making bad bargains. It should not even undertake except (incidentally) in connection with railroad and public service corporations, the position to fix banker's profits. He cited the Pure Food Law as an example; it does not guarantee quality or price, but it does help the consumer in judging quality by requiring the disclosure of ingredients.\textsuperscript{56} The U.S Securities Act became effective in May 1933. It provided for the

\textsuperscript{54} See Anita Anana, David Johnston, Gregory Peterson, Securities Regulation Case, Notes & Materia, \textit{supra} 18.

\textsuperscript{55} See Louis Loss, Securities Regulations, \textit{supra} 14, at p.123.

\textsuperscript{56} See Louis Loss, Securities Regulations, \textit{supra} 14, at p.123.
filing of a registration statement, the use of a prospectus in connection with the public offering of securities, and subjected the issuer and those connected with the offering to civil and criminal liabilities in the event of material misstatements or omissions.\textsuperscript{57} The disclosure requirement will in itself prevent some fraudulent transactions that cannot stand the light of publicity, and the judgment of those who do understand will be reflected in the market price and will seep down to the investor through his advisers. In addition, the stringent civil liability provisions of the Act are a great advancement over the hyper-technical common law.\textsuperscript{58}

2.2.2 Purposes of Mandatory Disclosure

Mandatory disclosure is one means through which securities regulation attempts to protect the investors. Requiring issuers to provide investors with the knowledge necessary to facilitate informed investment decisions is seen as furthering the goal of investor protection, whether this is in connection with the distribution of securities, trade in secondary markets or specific corporate transactions. Such mandatory disclosure operates directly to protect investors from making investment decisions based on inadequate or incomplete information. It thereby promotes investor confidence and the integrity of the capital market.

In addition to the direct benefit received by the investors from mandatory disclosure, requiring the dissemination of full and timely information into the capital market will

\textsuperscript{57} See Louis Loss, Securities Regulations, \textit{supra} 14, at p.124.
\textsuperscript{58} See Louis Loss, Securities Regulations, \textit{supra} 14, at p.125.
protect the investors indirectly by ensuring the efficient pricing of securities traded in the secondary markets. As referred to the academic literature, the efficient market theory states that an efficient capital market is a capital market in which all relevant and ascertainable information is reflected in the price of securities.59 A perfectly efficient capital market will exist if the prices of securities traded on such market at all times reflect all relevant and ascertainable information about the underlying values, such that there will be no period when a price would not be the best estimate of the underlying value. Furthermore, prices will respond immediately to any new information about the security.60 It is this theory that informs the two basic elements of the Canadian disclosure regime: one, an offering of securities to the public must be accompanied by a prospectus containing “full, true and plain disclosure” of all material facts; two, to assess the value of the security. There are several other benefits of disclosure: the availability of information allows the public to commend or condemn the performance of enterprises. This public response to the business performance can occur in part through the demand for the securities of the enterprise. It may also occur in part through more effective use of voting, and/or other contractual or statutory rights of the security holders. It might also discourage “inappropriate corporate behavior” and facilitate law enforcement by facilitating detection of improper behavior. A further purpose of disclosure is to provide equal opportunity by providing the information that is necessary to take advantage of opportunities.61 However, the most significant role of information disclosure is the investor protection: “... the philosophy underlying the Act, that a disclosure law would

provide the best protection for investors. In other words, if the investor had available to him all the material facts concerning a security, he would then be in a position to make an informed judgment whether or not to buy.  

2.3 Information Disclosure under Canadian Securities Regulation

Since U.S legislation had considerable influence on the development of Canadian Securities regulation, it is possible to take Canadian securities regulations as an example to study the sophisticated information disclosure system established by Western jurisdictions.

Securities regulation of Canada includes legislation, judicial and administrative decisions and blanket orders of the provincial securities commissions. It could also be said to include the by-laws and rules of the stock exchanges, and self-regulatory organizations. In addition, a substantial portion of the Canadian securities regulatory regime can be found in the “policy statements” published by the provincial securities commissions. Some of these policy statements are published separately by each province (the Ontario Securities Commission (OSC) has, for example, published over 60 such policy statements).

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61 See Mark R. Gillen, Securities Regulation in Canada, supra 13, at p.145-146.
62 Ibid.
63 The recommendations of the Kimber Report with respect to disclosure, which were adopted in securities laws throughout most of Canada, emphasized disclosure of the type required by the Securities Exchange Act of 1934.
64 “blanket order” is another source of securities regulations. Securities commissions or other designated administrators are given powers under securities acts and regulations to grant various orders. These orders are normally sought and provided on a case-by-case basis. However, when a similar order has been frequently requested, or when a new policy has been developed for dealing with a particular situation, the commissions may find it advantageous to grant a blanket order. The order applies to anyone who fit the terms of the order and they need not go to the commission to get a separate order. Blanket orders can substantially reduce the workload of a securities commission.
statements) and others are published as national policy statements by the Canadian Securities Administrators (CSA). The CSA is an organization composed of all the provincial securities regulatory authorities including the OSC.

The two main objectives of securities legislation, as expressed in the Kimber Report, are investor protection and optimal allocation of financial resources. The underlying purpose of securities regulation is the “protection of the investing public”. However, the intention is not to provide paternalistic protection of the investor. According to the Kimber Report, although every effort must be made to ensure that the public understands the normal business risks of success or failure, “this is not to suggest that the public must be protected against itself; rather, it is a matter of ensuring that the investing public has the fullest possible knowledge to enable it to distinguish the different types of investment activity available. In such circumstances, the public would have reasonable assurance that its loss is genuine economic loss, just as its gain is genuine economic gain.”

Disclosure standards in the distribution of securities in Canada have evolved to encompass five different models. The classic model, adopted by Ontario in 1907, called for the delivery of a prospectus to qualify a distribution of securities. The requisite standard is one of “full, true and plain disclosure of all material facts” relating to the offered securities and of compliance with prescribed form requirements. Variations on the model, imported from the U.S, include “short-form” and shelf prospectuses.

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65 See Kimber Report, supra 17.
66 Ibid.
67 See Kimber Report, supra 17, at papa. 1.12.
68 See Mark R. Gillen, Securities Regulation in Canada, supra 13, at p.50.
2.3.1 Information Disclosure in Prospectus

Generally, Canadian securities laws prohibit trading in securities when such trading constitutes a “distribution”; unless a preliminary prospectus and prospectus are filed, and receipts are obtained from the applicable securities regulatory authorities. One important consequence to an issuer of obtaining a receipt for a prospectus is that it acquires “reporting issuer” status under the Ontario Securities Act (hereinafter referred to as the “O.S.A”), and the attendant continuous and timely disclosure obligations under applicable securities law.

Comprehensive disclosure requirements applicable to the form and content of a prospectus in Canada are prescribed by the various provincial securities statutes and regulations: the blanket rulings; the orders, rules and policy statements of the provincial issuer’s directors and officers (including their principal occupations for the preceding five years); their addresses and any material interest they have in relation to the issuer. Any holders of more than 10% of the issuer’s voting securities, including the number and percentage of securities held and other material interests relating to the issuer, must also be disclosed.

The prospectus form for an “industrial” issuer also requires comprehensive disclosure of the details of financing details, including details of the underwriting arrangements, the estimated net proceeds and the principal use of such proceeds. The prospectus must contain certain financial information, including audited financial statement prepared in
accordance with Canadian’s Generally Accepted Accounting Principle (GAAP) for five recent financial years in the case of statement of income, surplus and changes in financial position and two years in the case of the balance sheet. If the proceeds of the offering are to be applied to finance the acquisition of a business by a purchase of assets or shares, the historical financial statements of the acquired business and pro forma financial information combining the results of the issuer and the acquired business may be required to be included in the prospectus, where it would be meaningful to investors and where such information is necessary for full, true and plain disclosure of all material facts relating to the securities. The prospectus must also describe all material acquisitions and dispositions of shares or assets during the past two years, and the impact of these transactions on the operating results and financial position of the issuers.\textsuperscript{70} The prospectus must also inform purchasers of their statutory rights to rescind their purchases, and maintain civil action for damages or rescission in respect of any “misrepresentation” contained in the prospectus.\textsuperscript{71} A “disclaimer” is required on the face of the prospectus stating that no securities commission has passed on the merits of the offering.\textsuperscript{72}

### 2.3.2 Information Disclosure in the Secondary Market

Generally, the continuous disclosure regulations in Canadian securities regulation require the timely dissemination of material information by issuers and, in certain cases, by

\textsuperscript{69} See Mark R. Gillen, Securities Regulation in Canada, \textit{supra} 13, at p.79, note 25.
\textsuperscript{70} See O.S.A. s.53 and 56.
\textsuperscript{71} See O.S.A. s. 60.
\textsuperscript{72} See Mark R. Gillen, Securities Regulation in Canada, \textit{supra} 13, at p.81.
shareholder. And periodic disclosure of financial and other information at prescribed
times during the issuer’s financial year.

(a) Timely disclosure

(i) Material change reporting

Public companies have a specific statutory duty to make timely public disclosure of material information. “Material changes” are defined as changes in an issuer’s business, operations or capital that would reasonably be expected to have a significant effect on the market price or value of any of the issuer’s outstanding securities.

(ii) Insider reporting

Mandatory disclosure of material information about the business and affairs of public companies theoretically protects investors by providing them with sufficient information to make informed investment decision, thereby fosters confidence in the capital markets. However, there are often inherent or intentional delays between the occurrence of a material event or circumstance, and the public announcement of that event or circumstance.\(^{73}\)

It is impossible for securities laws to ensure continuous equality of

\(^{73}\) For example, in Re Maple Leaf Gardens Limited (1991) 14 O.S.C.B. 1393, the OSC approved a settlement agreement relating to, among other things, the failure of an issuer’s board of directors to comply with its timely disclosure requirements under the OSA and NP40. In that case, the directors of Maple Leaf Gardens Limited declared a special dividend payable to its shareholders but a press release announcing the special dividend was delayed until a third party holding options on a large block of Maple Leaf Gardens’ share was informed of this development. In the settlement agreement, Maple Leaf Gardens Limited
information between the public and persons in possession of undisclosed material information. As a result, in order to protect investors, the trading activities of corporate officers, directors, majority shareholders and other persons in a position to learn of undisclosed material information are monitored and regulated. Ontario securities laws regulate the behavior of “insiders”\(^\text{74}\) both in terms of the mandatory requirement to report insider trading, and the prohibition of trading on the basis of material non-public information. Any person or company, upon becoming an insider of a reporting issuer, must file within ten days after the end of the month in which person becomes an insider, a prescribed report disclosing any direct or indirect beneficial ownership of securities of the issuer.\(^\text{75}\) Thereafter, if such insider’s ownership changes, the insider must file a subsequent report within ten days following the end of the month in which the change occurred providing details of their change in ownership.\(^\text{76}\)

(iii) Insider trading and tipping prohibitions

The insider trading rules in Ontario prohibit a person in a “special relationship” with a reporting issuer from buying or selling securities of that

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\(^{74}\) “Insiders” include: (i) directors and senior officers of a reporting issuer; (ii) directors and senior officers of a company that is itself an insider or subsidiary of a reporting issuer; and (iii) any person or company who beneficially owns, indirectly or directly, or who exercises control or direction over more than 10% of the voting rights attached to all outstanding voting securities of the reporting issuer. See O.S.A. s.1 (1) definition of “insider”.

\(^{75}\) O.S.A. s. 107(1).

\(^{76}\) O.S.A. s. 107(2).
issuer, with knowledge of an undisclosed material change or material fact and from “tipping” that information to others. These prohibitions extend well beyond insiders to the broadly defined class of persons “in a special relationship”\textsuperscript{77} with a reporting issuer.\textsuperscript{78}

(iv) “Early warning” reporting

The “early warning” disclosure provisions require immediate disclosure of the accumulation of significant blocks of equity or voting securities from the reporting issuer. In Canada, the reporting threshold is 10\% and the triggering event is the acquisition of “beneficial ownership of, or the power to exercise control or direction over” a 10\% block of voting or equity securities. Joint actors are included in calculating the threshold, and convertible securities and other rights to acquire securities are taken into account.\textsuperscript{79} Once triggered, the “early warning” disclosure rules require the shareholder to immediately issue a press release in a prescribed form, disclosing, among other things, the shareholder’s intentions with respect to future acquisitions or dispositions, and to file a report to the same effect within two business days. The shareholder is then generally banned from further acquisitions for one business day period following the filing of the

\textsuperscript{77} persons “in a special relationship” with a reporting issuer include professional advisors and employees of the issuer, insiders and employees of a company proposing to acquire the issuer and any person (that is, a “tippee”) who learns material information concerning the issuer from any other “special relationship” person.

\textsuperscript{78} O.S.A. s. 76(5).

\textsuperscript{79} O.S.A. s. 101.
report, permitting the marketplace to absorb this new information.\textsuperscript{80}

Thereafter, upon each additional acquisition of 2% or more of the outstanding securities of the class or any other significant change in the information reported, an additional press release and report must be issued and filed; the one business day acquisitions moratorium is again imposed.

(b) Periodic disclosure

In Ontario, reporting issuers are required to prepare, file and deliver to their equity security holders both the interim quarterly statements and the annual financial statements.\textsuperscript{81} Interim statements must be filed within 60 days of the end of each fiscal quarter. Interim financial statements must include an income statement and a statement of changes in financial position, but need not be audited.\textsuperscript{82} Audited annual financial statements must be filed within 140 days from the end of the fiscal year. The annual financial statements must include an income statement, statement of surplus, statement of changes in financial position and a balance sheet.\textsuperscript{83}

2.4 Remedies for Investors

\textsuperscript{80} O.S.A. s. 101(3).
\textsuperscript{81} O.S.A. s. 79.
\textsuperscript{82} O.S.A. s. 77.
\textsuperscript{83} O.S.A. s. 78.
People hurt in securities transactions are frequently able to choose among a number of private remedies; including remedies at common law and under both statute and deferral securities laws.\(^{84}\) Besides private remedies, there are also a range of administrative sanctions which can be imposed by securities regulatory department such as the U.S. Securities and Exchange Commission (SEC) and the OSC. If any violation of criminal laws or any special provisions in any securities regulation is involved in securities transactions, criminal proceedings may be brought to the court.\(^{85}\) Although both administrative sanctions and criminal proceedings can punish the wrongdoings by public companies, such as fraudulent disclosure and omission of material changes; private remedies is undoubtedly the most effective way for investors suffered damages to get their money back.

### 2.4.1 Common Law Liability

Common law is the basis upon which a purchaser may bring an action for a false statement in the distribution of securities. The O.S.A states that "the right of action for rescission or damages conferred by this section is in addition to and without derogation from any other right that the purchaser have at law."\(^{86}\) A common law cause of action may be available where an investor has suffered a loss resulting from relying on information that is proven to be untrue or only partially true. There are three main common law actions that may be brought in this area: breach of contract, fraud or deceit, or negligent misrepresentation. An action for fraudulent misrepresentation is also

\(^{84}\) See Louis Loss, Securities Regulations, *supra* 14, at p.1623.
possible if the representation was made with the knowledge that it was false, without an honest belief in, or reckless as to, its truth, upon which it is intended that the purchasers rely.\textsuperscript{87}

(a) Breach of contract

When dealing with an action for this type of breach of contract, the main issue in this situation is whether the misrepresentation was a term of the contract for sale of the securities offered under the prospectus. This may not be the case very often; it is because the contract is not formed until there is an offer to sell and a prospectus, being a disclosure document, may not be considered as such. “The actual contract results from the issuer’s acceptance of the prospective purchaser’s subscription form or offer to purchase.”\textsuperscript{88} There may, however, be an action in contract law if the misrepresentation in the prospectus is included in the purchaser to buy the securities. The test to determine whether a statement made to induce a contract is contractual elusive.\textsuperscript{89} Damages and rescission are the remedies available if the statement qualifies as a common law breach of contract.

(b) Deceit

\textsuperscript{86}See O.S.A. s.130(10) & 131(11).
\textsuperscript{87}See Derry v. Peek (1889), 14 App. Cas. 337 (H.L.).
There are several elements that must be proven in order for the plaintiff to succeed under an action for deceit.

(1) an untrue statement of a material fact, not a mere promise, prediction or expression of opinion must have been made;

(2) the statement was a positive misstatement or an intentional omission which gave a misleading impression;

(3) the omission or misstatement was material;

(4) the defendant intended that the plaintiff, or a class of which the plaintiff is a member, rely upon the misstatement;

(5) the person who made the statement knew it was false or they made it recklessly; and

(6) damages resulted from the plaintiff’s actual reliance on the statement, although the statement need not be the only reason that the plaintiff made their decision to invest.90

The requirements of deceit were discussed and applied in Bell v. Source Data Control Ltd.91 (“Bell”) In order to establish deceit, it is necessary, for that the plaintiff to establish a false representation of fact, whether words or conduct, had been made by the defendants; or that the representation was made with the knowledge of its falsity; that the representation was made with the intention it be acted upon by the appellants; and that the appellants did in fact act in reliance upon the representation, which they

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sustained damage in so doing. The Supreme Court of Canada held in *Nesbitt, Thomson & Co. Ltd. V. Pigott & Pigott Construction Co. Ltd.* that damages in an action for fraud and deceit will not flow unless the false representation in a prospectus or circular was “…made knowingly, or without belief in its truth, or with reckless disregards of whether it is true of false.”

(c) Negligent misrepresentation

An investor may bring an action against someone for negligent misrepresentation at common law. The validity of this action was established in *Hedley Byrne v. Heller & Partners Ltd.* ("Hedley Byrne") by the House of Lords. In an action for negligent misrepresentation, the plaintiff must establish that the defendant owed him a duty of care, the existence of justifiable reliance on a misstatement, the defendant negligently made the misstatement, and the plaintiff’s reliance resulted in damage to him. As in any tort action, the plaintiff must prove that his reliance caused damage to him.

### 2.4.2 Statutory Civil Liability

The Statutory civil liability for misrepresentation is the expansion of the common law liability, and expanses considerably beyond the common law. First, it applies to misstatements or omissions. Second, it makes the question of reliance, negligent and

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causation defences rather than elements of the claim that the plaintiff must establish. This substantially reduces the burden of proof on the plaintiff.

“A key difference between common law and statutory liability is that actual reliance must be proven at common law whereas reliance is deemed to exist under the Securities Act and need not be proven.”

The plaintiff bringing action for misrepresentation in a prospectus must only prove (i) a purchase of the security was offered under the prospectus, (ii) the purchase was made during the period of the distribution, and (iii) there was a “misrepresentation” in the prospectus. “Misrepresentation” is defined to be an untrue statement of a material fact or an omission of a material fact that is required or necessary to make a statement not misleading in light of the circumstances in which it was made. Subject to various defenses, the plaintiff is then entitled to rescission or damages. The plaintiff does not have to prove reliance. Instead, the plaintiff is deemed to have relied on the misrepresentation, if it was a misrepresentation at the time of the purchase. Since the action is provided for a purchase of the security offered under the prospectus during the period of distribution, it applies to secondary market purchaser as well; therefore, secondary market purchaser would have an action for damages.

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96 See Mark R. Gillen, Securities Regulation in Canada, supra 13, at p.156.
97 O.S.A. s. 1 (1).
98 O.S.A. s.130 (1).
99 Ibid.
The person liable for damages for misrepresentation in a prospectus are the issuer (or the selling security holder, if it is a distribution from the holdings of a control person),\textsuperscript{100} the underwriters,\textsuperscript{101} the directors,\textsuperscript{102} any expert who consented to the use of their expert opinion in the prospectus,\textsuperscript{103} the chief executive officer, the chief financial officer and anyone else who signed the prospectus.\textsuperscript{104} The issuer (or the selling security holder in a distribution from the holdings of a control person) and the underwriters are subject to an action for rescission for misrepresentation in a prospectus.\textsuperscript{105}

There is no statutory civil liability for misrepresentation in the secondary market disclosure documents such as, financial statements, proxy circulars, material change reports and insider trading reports. Proposals for a statutory civil liability sanction for misrepresentations in continuous disclosure documents have been made in the past.\textsuperscript{106} These proposals have been supported on the notion that without a statutory civil liability provision for secondary market disclosure, there will be discrepancies between the standard of care given to the preparation of primary and secondary market disclosure documents, and inconsistence remedies available for misrepresentations in primary and secondary market disclosure documents.\textsuperscript{107} The proposals were also supported on the basis of advancing the goal of integrating primary and secondary market disclosures; and on the basis of the importance of secondary market, reliance on secondary market disclosure documents.

\textsuperscript{100} O.S.A. (a).
\textsuperscript{101} O.S.A. (b).
\textsuperscript{102} O.S.A. (c).
\textsuperscript{103} O.S.A. (d).
\textsuperscript{104} O.S.A. (e).
\textsuperscript{105} Ibid.
\textsuperscript{106} See Mark R. Gillen, Securities Regulation in Canada, supra 13, at p.210, note 194.
\textsuperscript{107} 7 O.S.C.B. 4910.
disclosure and the consequent need to promote investor confidence in secondary market disclosure. ¹⁰⁸

In spite of the lack of specific statutory civil sanctions for misrepresentations in secondary market disclosure documents, there can be statutory civil liability for misrepresentations in secondary market disclosure documents if the secondary market disclosure documents is incorporated by reference in a prospectus. When secondary market disclosure documents are incorporated by reference in a prospectus, any misrepresentations contained in those documents become subject to the civil liability provisions for misrepresentations in a prospectus.

2.4.3 Public remedies

(a) Administrative sanctions

Administrative sanctions are the most frequently used sanctions. In the O.S.A., for example, these sanctions are conveniently grouped together as “Orders on the public interest” in s. 127. The Commission may make one (or more) of these orders if it concludes it would be in the public interest. They are: (1) Sanctions against the license: the Commission may suspend, restrict, terminate, or impose terms and conditions on a person’s registration or recognition. Therefore, this covers registrants and self-regulatory organizations. This is a powerful tool, as registration is one of key methods of regulating the securities industry. (2) Cease
trading orders: the Commission can order trade in securities to be halted temporarily or permanently. This can be used either to stop a particular person from trading in any securities, or to stop the securities of a particular issuer from being traded. This sanction is blunt, not discriminating. Its breadth and effect make it powerful. (3) Denials of exemptions. (4) Reviews of practices and procedures. (5) Orders to provide, not to provide, or to amend any document; and (6) reprimands. The Commission may impose any terms and conditions on any of these orders.\(^{109}\) All of these administrative sanctions are subject to the same procedural requirements. Such an order requires a hearing, although temporary orders are possible if the time to hold a hearing would prejudice the public interest.\(^{110}\)

(b) Criminal Code Offences

Prosecution under the criminal code is the most severe sanction in the securities regulatory regime. A criminal conviction has harsher penalties, greater social stigma and a criminal record. Criminal prosecution will be undertaken where the accused conduct has been flagrant or persistent, or clearly indicates malice. In addition, severe loss or damage stemming from the accused actions may contribute to a decision to prosecute.

\(^{109}\) O.S.A. s. 127 (2).
\(^{110}\) See David L. Johnston, Canadian Securities Regulation, (Toronto: Butterworths, 1977) at p.211.
It can be seen from Canadian securities legislation that the primary goal of the securities laws is to promote honest and efficient markets and informed investment decisions through full and fair disclosure. It is critical that all public companies provide an understandable, comprehensive and reliable portrayal of their financial condition and performance. However, if any listed company breaches the information disclosure requirements, making misrepresentations and resulting in losses of investors, it should be, on one hand, subject to the administrative sanction and/or criminal prosecution; on the other hand, it shall be liable for all the losses suffered by the investors. Both such public and civil remedies serve the purpose of prevent and punish the wrongdoings. However, for the investors who have thrown their money out in the market, civil remedy is doubtless the most important part of the securities regulation. Compared with current situation of China, Canadian legislation provides quite comprehensive protection for the investors.
CHAPTER III  
China’s Securities Market and Securities Regulation

Before early 1950s China had once the Asia’s largest stock market.\footnote{111 In 1869, foreign firms created the Shanghai Stock Market [Shanghai Gufen Gongsuo], which was the first stock market in China. In 1918, Japan set up the Shanghai Securities Branch [Shanghai Quyin Suo] with its headquarters in Osaka, Japan. China issued its first stock in 1872 by the Shanghai General Bureau of Shipbuilding and Commerce. In 1914, the Chinese government enacted Laws for the Stock Exchange Market. Between 1918 and 1920, China established three large securities markets. The securities trading was interrupted for cause of Chinese-Japanese war broke out in 1930s and the World War II. In 1946 the Nationalist government set up the Shanghai Securities Exchange. See Andrew Xuefeng Qian, Riding Two Horse: Corporatizing Enterprises and the Emerging of Securities Regulatory Regime in China, 12 UCLA PAC. BASIN L.J. 62, 64 & note 6-8.} During 1940’s Shanghai Securities Exchange was the largest stock exchange in Asia and more influential and internationally supported than that of Hong Kong.\footnote{112 See Ann P. Vandevelde, Realizing the Re-Emergence of the Chinese Stock Market: Fact or Fiction? 30 Vand. J. Transnat’l L. 579, 583.} In 1949 when Chinese Communist Party established the People’s Republic of China, it began to institute a centrally planned economy in mainland China and finally eliminated securities activities together with any other private ownership in 1959.\footnote{113 See Minkang Gu & Robert C., securitization of state ownership: Chinese securities law, 18 Mich. J. Int’l L. 115, 117.} With the end of the Culture Revolution, since 1978 under the leadership of Deng Xiaoping, China has gradually implemented market-oriented economic reform. By 1980 some collective enterprises were allowed to issue corporate stocks to their own employees.\footnote{114 See Todd Kenneth Ramey, China: Socialism Embraces Capitalism? An Oxymoron for the Turn of the Century: A Study of the Restructuring of the Securities Markets and Banking Industry in the People’s Republic of China in an effort to Increase Investment Capital, 20 Hous. J. Int’l L. 451-467.} In 1981, coming under a lot of debate, debt securities appeared when the State Council (the central government of China) issued national treasure bonds (Guo ku quan) trying to make use of this “capitalist instrument” to raise money to finance its budget deficit, which signalized the official endorsement of the re-emergence of the securities market.\footnote{115 See Andrew Xuefeng Qian, Riding Two Horse: Corporatizing Enterprises and the Emerging of Securities Regulatory Regime in China, 12 UCLA PAC. BASIN L.J. 62, 64 & note 6-8.} The historical first issuance was largely successful because its subscriptions were mandatory.
Following the first issuance were several other kinds of national bonds, including bonds issued by the Ministry of Finance (bonds for key construction projects and finance bonds starting in 1987 and 1988 respectively) and bonds issued by several other national bureaus and organizations.\textsuperscript{116} In 1984, China began experimenting with the idea of establishing Joint Stock companies,\textsuperscript{117} and the first public offering was made in the same year when a small joint stock company in Shanghai, Feile Audio, was permitted to issue shares publicly. With the opening of the Shanghai Stock Exchange in December 1990, China began a well-publicized effort to build a legal regime for regulating securities market. Then Shenzhen Stock Exchange was opened shortly thereafter.

Currently, stock issuance is subject to the approval by the CRSC. According to Article 11 of the Securities Law\textsuperscript{118}, a public stock issuance shall meet the conditions as stipulated in the Company Law and be submitted to the CRSC for verification. To ensure the fairness and quality of stock issuance examination and verification, a Public Offering and Listing Review Committee was set up by the CSRC in 1993. At present, China's stock exchange trading system reaches all large and medium-sized cities with 2,412 retail branches all over China.\textsuperscript{119} By the end of 1998, the total market capitalization was RMB 1,950.5 billion, equivalent to 24.46% of GDP, the outstanding capitalization RMB 574.5 billion, 7.2% of GDP; and the annual turnover was RMB 2,354.4 billion. By the end of 1998, 851 companies had been listed in Shanghai and Shenzhen stock exchanges with

\textsuperscript{115} Ibid.
\textsuperscript{118} Promulgated by the Standing Committee of National People's Congress on December 29, 1998.
\textsuperscript{119} See <www.csdc.gov.cn/CSRCSite/eng/esmintr.htm> (visited on March 1, 2003).
252.677 billion shares, among which 825 are A-share Companies, 106 are B-share companies, 80 are companies issuing both A-share and B-share, and there are also companies issuing both A-share and H-share. In addition to different categories, shares in China are also divided into the untradable and the tradable share. By the end of 1998, the total untradable equity of the listed companies was 166.484 billion shares, 65.89% of the total equity of the listed companies, 86.551 billion owned by government, 71.617 billion owned by legal persons and 8.317 billion owned by employees and others. Outstanding tradable shares totaled 86.193 billion shares, 34.11% of the total equity of the listed companies, of which 60.803 billion are A shares, 13.395 billion are B shares and 11.995 billion are H shares. By the end of 1998, investors had opened 39.107 million investment accounts, of which 155,800 were in the name of institutional investors and 38,951,200 in the name of individual investors.

3.1 Legal Framework of Securities Legislation and Information Disclosure Requirements

The national securities regulatory regime is consist of the Company Law, the Securities Law, the Interim Regulation and other securities regulations. There are three categories

120 A Shares are the common shares issued by PRC companies and traded in both Shanghai and Shenzhen Stock Exchanges. B Shares are foreign-invested shares issued domestically by PRC companies. B Shares are also known as Renminbi Special Shares. B Shares are issued in the form of registered shares and carry a face value denominated in Renminbi. B Shares are subscribed and traded in foreign currencies and are listed and traded in securities exchanges inside China. The B Share Market came into existence in 1991. By the end of April 1999, there were totally 107 B Share issuers. There were 54 B Share companies listed in Shenzhen with a total capitalization of RMB10.94 billion whereas there were 53 B Share companies listed in Shanghai with a total capitalization of RMB9.778 billion. The B Share Market has attracted a considerable amount of foreign investors. The Market provides an additional channel for foreign capital thereby enhancing the progress of the evolution of PRC's securities market. B Shares are issued by PRC companies while traded in Hong Kong Stock Exchange.
of information disclosure under Chinese securities law: listing documents, continuous
disclosure after listing, and important events that may affect share prices.

3.1.1 IPO Information Disclosure

The primary form of disclosure requires companies to provide certain documents to
regulating authorities and the investing public when making IPO. Companies must
provide the following documents to the CSRC: a listing report, a resolution passed at the
shareholders' meeting concerning the listing application, the company's articles of
association, the company's business license, financial reports from the previous three
years or since establishment, a legal opinion and recommendation from a securities
company, and the most recent prospectus.\textsuperscript{121} After the stock exchange consents to list the
company, the company must make documents related to the approved share listing
available for public inspection five days prior to listing.\textsuperscript{122} In addition to those
documents, the company must also publicly announce the following facts: the date
trading starts; the ten largest shareholders and the amount of their holdings; and the
names of directors, advisors, managers, and other high officials, and whether these
individuals hold stocks or bonds in the company.\textsuperscript{123} The Securities Law provisions with
respect to disclosure during registration are meant to be consistent with the Company
Law\textsuperscript{124} and generally mirror the Interim Regulations.\textsuperscript{125}

\textsuperscript{121} See the Securities Law, Art. 45.
\textsuperscript{122} See the Securities Law, Art. 47.
\textsuperscript{123} See the Securities Law, Art. 48.
\textsuperscript{124} See the Securities Law, Art. 11.
The CSRC has passed regulations on disclosure requirements concerning the listing of shares. These regulations go beyond the requirements of the Securities Law and Company Law in their breadth and specificity. In particular, the Securities Law does not address the contents of the prospectus. The CSRC regulations dictate the required content and form of the prospectus. They also specify numerous types of information to be included in the main text of the prospectus, for example: company background, information related to the public offering, financial statistics, the interpretation section, the names of relevant parties in the issue, the investment risks, an explanation of how the capital is to be utilized, the policies on the allocation of share interests, an abstract of the company articles, information regarding the issuer's directors, advisors, and high-level managers, previous company performance, an asset valuation report, financial and accounting information, litigation involving the company, verification of other investments, and the company plan for further development.\textsuperscript{126}

The CSRC has also issued guidelines for the legal opinion that must be prepared by a company applying for IPO. The CSRC regulations stipulate the form and content of the lawyer's opinion and report. Some of the matters a lawyer must investigate regarding a company's issue and listing of shares include: the lawfulness of the enterprise, the articles of association, the completeness and truthfulness of the prospectus, ownership of main assets, environmental protection standards, the legality of the share issue, and financial

\textsuperscript{125} Compare Art. 23 of the Interim Regulations with Art. 45 & 48 of the Securities Law.

\textsuperscript{126} Zhong guo zheng quan jian du guan li wei yuan hui guan fa bu gong kai fa xing gu piao gong si xin xi pi lu de nei rong yu ge shi di yi hao \textless Zhaogu Shuomingshu De Neirong Yu Geshi\textgreater de tong zhi (Notice of the CSRC on Rule No. 1 on the Content and Form of Information Disclosed by Companies Publicly Issuing Shares "Content and Form of Prospectus") (Jan. 6, 1997), available in CSRC Website <http://www.csrc.gov.cn/csrc/statute/1997/f0466.htm> (visited on Feb. 2, 2000).
matters. Legal opinions regarding the allocation of rights and interests are also subject to guidelines, and the opinions include much of the same information as an opinion on a company's issue and listing of shares. Specific regulations for Chinese securities lawyers provide a necessary check on the uneven quality of China's developing legal industry.

Under the Securities Law, a company must make a listing announcement prior to the IPO. Under the CSRC regulations promulgated prior to the Securities Law, the listing announcement must include information about the offering; the offering company; the public distribution and underwriting of the shares; the shareholding of company directors, supervisors, and senior managerial staff; the affiliates of the company; the organization of the company's shareholding; the financial and accounting situation; pledges by the directors to act truthfully and legally; important items that could influence the shares; and other documents connected with the share listing. The regulations also provide a particular format for the listing announcement.

3.1.2 Continuous Information Disclosure

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127 See Zhong guo zheng quan jian du guan li wei yuan hui guan yu fa bu gong kai fa xing gu piao gong si xin xi pi lu de nei rong yu ge shi zhun ze di liu hao de tong zhi (Notice of the CSRC on Rule No. 6 on the Content and Form of Information Disclosed by Companies Publicly Issuing Shares) (Oct. 28, 1996) [hereinafter referred to as “CSRC Rule No. 6”].
128 Ibid.
129 See the Securities Law, Art. 47-48.
Chinese securities regulations include provisions for continuous disclosure of company information through semiannual, annual, and material event reports. The requirements in the Interim Regulations have been modified to some extent by the Securities Law.\textsuperscript{131} Additionally, CSRC has released general regulations for these reports and also responded to particular situations by requesting information for specific reports. Companies with publicly traded stocks must release semiannual reports within two months after the first half of every fiscal year, usually by the end of August.\textsuperscript{132} Information that companies should submit to CSRC and the stock exchange includes: the financial reports and business situation, major litigation involving the company, the particulars of any changes in the shares or corporate bonds already issued, any major matters submitted for consideration by the shareholders' general meeting, and other matters as required by CSRC.\textsuperscript{133} CSRC has demanded other information from listed companies for particular semiannual reports. For example, after CSRC released regulations prohibiting state-owned enterprises and listed companies from stock speculating, CSRC required that the 1997 semiannual report include the results of internal investigations conducted by listed companies.\textsuperscript{134} Within four months of the end of the fiscal year, companies must submit an annual report to CSRC and the stock exchange, usually by the end of April.\textsuperscript{135} The annual report must include: a report of the company's general circumstances; the company's financial and accounting reports and business situation; the resumes and details of the shareholdings of the directors, advisors, managers, and other high-level

\textsuperscript{131} Compare Art. 57-59 of the Interim Regulations with Art. 60-62 of the Securities Law.
\textsuperscript{132} See Securities Law, Art. 60.
\textsuperscript{133} Ibid.
officials; the stock situation including the ten largest shareholders and the amount of shares held by each; and other information as required by State Council regulatory authorities. The Securities Law streamlined the contents of the annual report as required by the Interim Regulations, reducing the number of items from fourteen to five, emphasizing financial data. Gone from the Securities Law are requirements to disclose such information as the company's main products or services, a brief summary of the trade that the company engages in, a brief summary of major factories, mines, real estate, and other assets owned by the company, and a comparative financial report of the last two fiscal years.

CSRC has announced administrative regulations regarding annual reports in recent years, which, like the requirement for documents required to issue shares, are more detailed than the Securities Law. The CRSC rule stipulates the form and content of annual reports. Some of the required information includes: an introduction of the company; a summary of accounting and business statistics; changes in the shareholding of the company; a brief overview of shareholding; a report from the directors and advisors; a business report; a report on the company's financial situation; a financial statement; a report on the use of capital; and major events. CSRC also has released guidelines for reports of particular years. For example, with respect to the 1996 annual report, CSRC

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135 See Securities Law, Art. 61.
136 Ibid.
137 Ibid.
instructed companies to clearly explain the conditions of issuing new shares to existing shareholders and other financial matters.\textsuperscript{141}

3.1.3 Material Events Disclosure

As in the Interim Regulations, the Securities Law requires a company to disclose any material event that may affect the price of the stock.\textsuperscript{142} An explanation of the event must be provided to CSRC and the stock exchange. The law lists eleven types of material events: a major change in the business policies or scope of business of the company; any decision regarding a major investment or capital purchase; any important contract signed by the company that may have a substantial impact on the assets, liability, rights, interests, and performance of the company; any incurrence by the company of a major debt or default on a major debt; any incurrence by the company of a major loss exceeding ten percent of the net capital of the company; any major change in the external production or business conditions of the company; any change in the chairman of the board, more than one third of the directors, or the manager of the company; any relatively major change in the shareholding of a shareholder who holds more than five percent of the company's shares; any decision by the company to reduce capital, merge, divide, dissolve the company, or file for bankruptcy; any major litigation involving the company or the court overturning decisions made by shareholders or directors; and any other detail

\textsuperscript{140} Ibid.
\textsuperscript{142} Compare Art. 60 of the Interim Regulations with Art. 62 of the Securities Law.
as required by law.\textsuperscript{143} The Securities Law removes an exception that previously exempted a company from disclosure if in its own judgment the disclosure would be detrimental to the company and meanwhile would not affect the market price, and the stock exchange agrees to relax the disclosure requirement.\textsuperscript{144} One commentator suggested that companies were given broad discretion under the old rule and were able to take advantage of this provision by not disclosing major events.\textsuperscript{145} If there is honest and timely reporting, in this respect, investors will be better protected under the Securities Law than under the Interim Regulations.

In addition to the major events listed above, an investor who holds five percent of a listed company through trading at a stock exchange must submit a written report to CSRC.\textsuperscript{146} The report must contain the name and domicile of the shareholder, the description and quantity of the shares held, and the date on which the shareholding or the increase or decrease in the shareholding reached five percent.\textsuperscript{147} If an investor holds thirty percent of the issued shares of a listed company through trading on a stock exchange, the investor must make a tender offer to all the shareholders of the company.\textsuperscript{148} Before making the offer, the investor must make a report to CSRC.\textsuperscript{149}

Since the proponents of expanding China’s securities market and regulatory system have been strongly influenced by a variety of foreign jurisdictions, most notably the U.S. and

\begin{footnotes}
\textsuperscript{143} See the Securities Law, Art. 62.
\textsuperscript{144} See the Interim Regulations, Art. 60.
\textsuperscript{146} See the Securities Law, Art. 79.
\textsuperscript{147} See the Securities Law, Art. 80.
\textsuperscript{148} See the Securities Law, Art. 81.
\end{footnotes}
Chinese experts most closely associated with the securities regulatory system had been educated in U.S and have continued to look to the NYSE and the SEC system as models for markets and regulatory regimes,\textsuperscript{150} it is not surprising to find provisions on information disclosure in securities regulation that reflects ideals drawn from the U.S regulatory regime.\textsuperscript{151} Nonetheless, China's securities market is less transparent, less supervised and even "tough and tumble"\textsuperscript{152}.

3.2 Securities Fraud/Misrepresentation Cases

In spite of sophisticated stipulations on information disclosure under securities regulations, there are many listed companies making misleading or fraudulent information disclosure in Chinese securities market.

3.2.1 Hainan Minyuan

Hainan Minyuan Modern Agricultural Company made its public offering on April 30, 1993.\textsuperscript{153} In 1996 and 1997, a series of public disclosures pushed the price of Minyuan's stock to new heights. The company's 1995 yearly report indicated a profit of 0.001 yuan

\textsuperscript{149} See the Securities Law, Art 82.
\textsuperscript{153} See Zhu Jun, Shui wei oiongminyuan fuze? (Who Is Responsible for Hainan Minyuan?), \textit{supra} 4, at p.12-21.
per share and a stock price around 3.65 yuan. The 1996 semiannual report reported a profit of 0.227 yuan per share, an improvement of 837 times the previous year's report. Minyuan's stock price was 6.92 yuan at the time the profits were announced. The company explained that an investment in Beijing had entered a profitable period. A month later the board of directors reported that a Beijing company expressed that Minyuan was improving itself in the area of high technology and was quickly progressing towards internationalization. Minyuan's stock price rose to 12.98 yuan. Another announcement of a partnership with a Singapore company by the board on October 22, 1996 pushed the price of Minyuan's shares to about 21 yuan. On January 22, 1997, the company announced a profit in 1996 of 0.867 yuan per share, an improvement of 1290.68 times over profits in 1995. Minyuan's price again rose, reaching 26.18 yuan.

While Minyuan's stock rose, the company could not escape doubts about the annual report. No one knew of any Minyuan project that could result in such high profits, and the company was suspected of trading its own shares. The company released a mysterious "supplemental report" on February 1, 1997. The report changed some of the company's financial indicators. Shareholders' doubts and regulators' inquiries led Minyuan to request that trading of the company's stock be suspended after trading closed on February 28, 1997. In March, five directors who approved the false reports resigned and disappeared.155

Responding to requests from investors, an investigation into Minyuan's financial reports was launched on March 5, 1997.156 The investigation went on for more than a year and included five regulatory bodies: the State Council Securities Committee, CSRC, State Auditing Administration, and People's Band Of China (PBOC).157 On April 29, 1998, CSRC published findings of a year-long investigation. CSRC found that the company had fraudulently inflated accounts by 1.2 billion yuan from illegal real estate transactions in Beijing. A commentary in China Securities Newspaper labeled this scandal as "the most serious case of securities fraud" on China's securities markets.158

3.2.2 Chengdu Hongguang

Chengdu Hongguang Industrial Shareholding Company (hereinafter referred to as "Hongguang") specialized in the production of electron vacuum devices such as black-and-white and color television tubes and glass bulbs.159 When Hongguang made its IPO in June 1997, investors had ample reason to be excited. The company had reported substantial profits for the previous three years.160 More importantly, the company was the main supplier to Changhong, one of the largest producers of television sets in China and the darling of the Shanghai Securities Exchange. At the time of Hongguang's initial

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158 See Foo Choy Peng, Deng's Son Linked to Securities Fraud Case, supra 157, at 1.
159 See Lao Zhao, Hongguang to Pump Up Tube Output, supra 2.
160 According to Hongguang's prospectus, the company's profits for the three years before its public offering were:

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Profits (in yuan)</th>
<th>Profit/Share (in yuan)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>60,000,000</td>
<td>0.38</td>
</tr>
<tr>
<td>1995</td>
<td>78,000,000</td>
<td>0.49</td>
</tr>
<tr>
<td>1996</td>
<td>54,000,000</td>
<td>0.339</td>
</tr>
</tbody>
</table>
public offering, Changhong was the most profitable stock in China per share; and in the previous year, the price of the stock had more than quadrupled. Investors hoped that Hongguang would have similar success. In May 1997, the company issued seventy million A shares which raised 410.2 million yuan.\footnote{See Tube Firm Shares, China Daily, May 25, 1997, at p.3.} Events soon after the IPO indicated that this optimism was unfounded.

Suspicion was generated by the great disparity between Hongguang's projected profits in its prospectus and the actual profits after its IPO. In its prospectus, Hongguang announced that it expected an after-tax profit of 0.37 yuan per share. However, in its 1997 annual report, the company reported a loss of 0.86 yuan per share. The main reason behind this astonishing change of fortune was a problem with a production line. An investigative report published in *Sichuan Finance and Investment Newspaper* uncovered that the production problems began prior to Hongguang's public offering, a fact not disclosed by the company in the prospectus. The article quoted a report by the Chairman of the Board of Directors as explaining that the company needed to keep up the appearance of continuing production in order to secure a 230 million yuan bank loan.\footnote{Ibid.} According to the author of the special report, the appearance of a normal production was also important for the public offering to go forward.\footnote{Ibid.} Six directors, the chairman of the board, and the general manager resigned at the board meeting in April 1998. In early

\footnote{161 See Tube Firm Shares, China Daily, May 25, 1997, at p.3.}
\footnote{162 Ibid.}
\footnote{163 Ibid.}
June, the company announced that it predicted a loss of 160 million yuan for 1998 and that its production lines had stopped.¹⁶⁴

The results of the CSRC's investigation were made public on November 20 and depicted one of the most flagrant cases of fraud to hit the Chinese market in its young history.¹⁶⁵ CSRC found that: 1) the company falsely reported its 1996 profits and fraudulently obtained qualification to publicly issue shares; 2) the company underreported its 1997 deficit, which defrauded investors; 3) the company concealed a major event when it did not disclose production problems; 4) the company used capital raised from the offering to pay back bank loans and make up for past losses, the uses of funds were not in the company prospectus; 5) the company illegally used funds raised from the public offering to buy and sell its own securities in 217 individual securities accounts; and 6) the company was also under suspicion for bribery because 1.66 million yuan could not be accounted for.¹⁶⁶ CSRC fined Hongguang, its underwriter and accounting firm, and securities companies. Directors and other high-level officers were either banned from ever holding high-level positions in publicly traded companies or received warnings.

3.2.3 Daqing Lianyi

Daqing Lianyi Petro-Chemical Co., Ltd. (hereinafter referred to as “Daqing Lianyi”) was established in 1996 by Daqing Lianyi General Factory and made its IPO in 1997. A company to publicly issue shares should have validly existed for at least three years before IPO. In order to make its IPO as soon as possible, Daqing Lianyi fraudulently obtained anti-dated government approval, Business Licence, and other necessary documents to demonstrate that Daqing Lianyi was established in 1993, three years earlier than its actual date of establishment. Daqing Lianyi also forged its financial information of 1994, 1995 and 1996, which falsely reported profits of RMB 161,670,000 to meet the qualification set forth in the Securities Law, requiring that the company going public should be continuously profitable for the latest three years.\(^{167}\) After its successful IPO, Daqing Lianyi continued making its story. It falsely reported profits of RMB 28,488,900 in its annual report of 1997, most of which was created by tricky book-keeping.\(^{168}\) Meanwhile, Daqing Lianyi did not invest the money raised by IPO to the four projects disclosed in the Prospectus. Rather, the company transferred RMB 257,000,000 to Daqing Lianyi General Factory as cash flow and lent RMB 50,000,000 to Shenyi Wanguo, a securities company, to buy and sell stocks in the market; although it stated in its annual report of 1997 that all the fund raised by public offering had been fully invested in the four projects disclosed in the Prospectus.\(^{169}\) CSRC fined Daqing Lianyi, its underwriter, accounting firm, law firm and officers who should be responsible for Daqing Lianyi’s misconducts.\(^{170}\)

\(^{166}\) Ibid.
\(^{167}\) See Guan yu daqing lianyi shi hua you xian gong si wei fan zheng quan fa gui xing wei de chu fa jue ding (Decision on Punishment for Daqing Lianyi Petro-Chemical Co., Ltd’ s Breach of Securities Law), Supra 5.
\(^{168}\) Ibid.
\(^{169}\) Ibid.
\(^{170}\) Ibid.
Violations to information disclosure regulations have been rampant in Chinese securities market. In 2001, Shanghai Tongda Venture Capital Co. Ltd. was fined by CSRC for false information disclosure on transferring of assets between its affiliates and itself.\textsuperscript{171} Bohai Group Co., Ltd. was fined for its information disclosure that it had been waived a substantial loan by the bank, which was proved false later.\textsuperscript{172} Heilongjiang SunField Science & Technology Co., Ltd. made false information disclosure on its acquisition and therefore was find by CSRC as well.\textsuperscript{173}

3.3 Liabilities for Breaches of Information Disclosure Regulations

3.3.1 Statutory and Criminal Liabilities

As seen from above, listed companies that make misrepresentation as well as their officials and intermediaries responsible for such misrepresentation shall be fined by CRSC.

According to Article 177 of the Securities Law, listed companies that fail to disclose relevant information, or the information disclosed by it is false, misleading or contains important omissions shall pay fines of certain amount as penalties. Meanwhile, the

\textsuperscript{171} See Guan vu daqing lianyi shi hua you xian gong si wei fan zheng quan fa gui xing wei de chu fa jue ding (Decision on Punishment for Daqing Lianyi Petro-Chemical Co., Ltd' s Breach of Securities Law), Supra 5.

\textsuperscript{172} See Guan vu shanghai yuehai qi ye fa zhan gu fen you xian gong si wei fan zheng quan fa gui xing wei de chu fa (Decision on Punishment for ShanghaiYuehai Enterprise Development Joint Stock Co., Ltd' s Breach of Securities Law), Supra 6.

\textsuperscript{173} See Guan vu heilongjiang shengfang ke ii you xian gong si wei fan zheng quan fa gui xing wei de chu fa jue ding (Decision on Punishment for Helongjiang SunField Science & Technology Co., Ltd’ s breach of Securities Law), Supra 8.
individuals responsible for such failures of disclosure shall be given disciplinary
warnings and fines. The Company Law has the similar stipulation: If a company
provides to shareholders the general public financial statements that are false or have
important omissions, the individuals who have direct responsibility shall be fined.\textsuperscript{174}

In addition to aforesaid statutory liabilities, due to the increasing numbers of cases related
to misrepresentations in securities market, in March 1997 the National People's Congress
enacted a special provision penalizing the conduct involving the giving of false
information affecting securities transactions. These changes were included in the
amendments to the Criminal Law.\textsuperscript{175} For the conduct of forgoing and passing false
information affecting securities transactions, when made by an enterprise, the enterprise
shall be fined of at least 10,000 yuan, and the individuals who are responsible for such
conduct shall be given a penalty of imprisonment of no more than 5 years or criminal
detention of no more than six months.\textsuperscript{176}

3.3.2 Civil Liability

Notwithstanding severe administrative and even criminal liabilities for listed companies
that violate information disclosure regulations, investors who lose money due to such
misrepresentation, the direct victims of securities misrepresentation cases, have not been
remedied, their losses not been covered yet, nor any compensation. As to the civil

\textsuperscript{174} See the Company Law, Art. 212.
\textsuperscript{175} Adopted at the Fifth session of the Standing Committee of the Eighth National People's Congress on
March 14, 1997 and amended in 1999, hereinafter referred to as the Criminal Law.
\textsuperscript{176} See the Criminal Law, Art. 181.
remedy for investors, Chinese law remains in its infancy, hardly comparable with those of the Western countries’, such as the U.S and Canada.

On December 14, 1998, Ms. Jiang Shunzhen, one of the investors suffered damages caused by Hongguang’s misrepresentation, bought a suit against all of the directors of Hongguang Industrial Co. Ltd., as well as all the intermediaries listed in the prospectus, such as the underwriter, the accounting firm and the law firm, alleging that the defendants should be liable for her loss. Ms. Jiang made her decision of purchasing stocks of Hongguang upon Hongguang’s misrepresentation. After Hongguang was penalized by CSRC in 1998 for its breach of securities regulations, its stock price dropped; therefore Ms. Jiang had to sell her Hongguang stocks at the price lower than her purchasing price and her total loss was 3136.50 yuan.177 In its prospectus, the broad of director and all directors of Hongguang undertook that they should respectively and related be liable for truths of the information disclosed in the prospectus. Therefore, the defendant should indemnify all the loss of the plaintiff caused by defendant’s misrepresentation.

After reviewing the facts and hearing the case, the People’s Court found that it was not certain that plaintiff’s loss was directly caused by defendants’ misrepresentation; and it had no jurisdiction on the present dispute between the plaintiff and the defendants. Therefore, the court denied the case.178 A similar suit brought by another investor in April 2000 based on its misrepresentation received the same disappointing court

177 See Zheng Shunyan, Zheng quan shi chang bu dang xing wei de fa lu shi zheng (Legal Analysis on the Misconducts in the Stock Market of China), supra 1, at p.175.
178 Ibid.
decision.\textsuperscript{179} It was the first civil case on the compensation for misrepresentation heard by Chinese court and the result was upsetting. Investors suffered from the misrepresentation made by issuers, underwriters and intermediates did not receive direct legal protection.

In spite of the failure of the first case, more lawsuits against listed companies upon misrepresentations have been brought to People’s Court since 2000. On September 21, 2001, the Supreme People’s Court of the People’s Republic of China (SPC) released the \textit{Notice on Temporary Suspension of Securities Related Civil Liability Suits} (Famingchuan [2001] 406 hao) (hereinafter referred to as the “September 21 Decision”), which prohibited lower courts to accept civil suits related to misrepresentation, including fraud, insider trading and manipulation, because the legislative and judicial conditions were not ripe.

Investors who lose money due to false disclosure of listed companies are only the most obvious victims: they may never get their money back. Their interests have to be sacrificed to those of public companies’. It is an unfair game where one party always gains control while the other party is destined to lose. Such scenario entirely conflicts with one fundamental purpose of securities legislation -- protection of investors’ interests, which should be the top priority of the CSRC according to r. Zhou Xiaochuan, the ex-chairman of the CSRC.\textsuperscript{180} Without civil remedy mechanism, without relief to victims, it is impossible to implement the appropriate protection. Although Chinese securities regulation has rather complete and detailed stipulations on information disclosure to

\textsuperscript{179} \textit{Ibid.}

\textsuperscript{180} See <www.csirc.gov.cn/CSRCSite/default.htm> (visited on May 23, 2001).
provide true, complete and timing information for investors, it has not provided adequate means to cover investors’ losses. Civil remedy, undoubtedly, should be an essential part of securities legislation.

In contrast with relatively comprehensive information disclosure system, provisions on remedies for investors who suffered losses caused by the misrepresentation made by listed companies are far from satisfying: not only the categories of liabilities are inadequate, the stipulations are usually brief and ambiguous, but also the legal tools by which investors obtain compensation are restricted. It is hardly to explain the legislative difference between information disclosure and remedies of securities regulation as well as the lack of pragmatic protection of private rights by referring to short of legislation expertise, nor merely negligence. The answer lies in the interesting process of policymaking and in unique Chinese traditions since the civil remedy for victims reflects both people’s faith in law and their selections of means to solve disputes.
CHAPTER IV Why Lack of Protection of Private Rights in China?

4.1 Bureaucratic Politics Analysis

It is very interesting to review the September 21 Decision and other Notices released by SPC in recent year on misrepresentation related civil disputes for they not only demonstrate the development of legislation, but also disclose the process of policymaking and the rational underlying it. Both the legislation on information disclosure and the remedies for investors, as well as the implementation of those regulations, are government behaviors underlying which are various policies and decisions. It is necessary to examine and illuminate how the bureaucratic structure of the government, policy processes and outcomes are interrelated in order to have a better understanding of the protection of private rights in contemporary China. When confronted by a tough national issue such as economic reform or securities legislation, how do they proceed? To be specifically, how do political leaders or government officials make their decisions? The bureaucratic politics theory will help people understand why Chinese securities legislation lacks of civil remedy for investors, which should be an essential part of the protection of private interests.

According to Michel Oksenberg and Kenneth Lieberthal, the leaders of top organizations are not a monolithic group, rather, each individual in this group is a player in a central competitive game. The name of the game is politics, bargaining along regularized

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circuits among players positioned hierarchically within the government. Government behaviour can be understood as results of these bargaining games. The bureaucratic politics model sees no unitary actor but rather many actors as players—players who focus not on a single strategic issue but on many diverse intra-national problems as well; players who act in terms of inconsistent set of strategic objectives, but rather according to various conceptions of national, organizational, and personal goals; players who make government decisions not by a single rational choice, but by the interaction of pulling and hauling of power. Each national government constitutes a complex arena for the intra-national game. Political leaders at the top of such mechanism are joined by individuals who occupy positions on top of major organizations to form a circle of central players. Those who join the circle come with some independent standing. Since the spectrum of policy problems faced by a government is so broad, decisions have to be decentralized—giving each player considerable discretion.

“A policy outcome explained by the bureaucratic politics model is like: policy X resulted from a bargain among Ministries A, B and C and province D either 1) brokered by one or more top leaders; 2) arranged by coordinating staffs acting in the name of one or more top leaders; or 3) negotiated by the supra-ministry coordinating agency, and ratified through routine procedures by the top leaders. Disgruntled ministries E and F, losers in the deal, planned to pursue strategies to erode the

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182 Ibid.
183 Ibid.
agreement. The bargain sought to reconcile the conflicting organizational missions, structure, and resources allocation of the ministries involved.¹⁸⁴

Therefore, policies are not necessarily either coherent and integrated response to perceived problems, or part of a logical strategy of a leader or faction to advance power and principle. For analytical purpose, a package or bundle of policies is best disaggregated into its individual or separate policies. While some of those policies may result from the initiative of top leaders, others are best seen as a temporary agreement arranged by the top leaders among contending and powerful bureaucracies with diverse purposes, experiences and resources. Other political hypothesis accept the notion that policy is shaped primarily at the top and that the leaders seek a purposeful outcome, and neither approach considers the structure of the bureaucracy as necessary for understanding the policy outcome.¹⁸⁵ Neither approach examines the way in which bureaucracies alter, bend, or distort the external impulses such as information about economic development; neither carefully examines the differentiated linkages between each of the top leaders and the bureaucracies they lead. The neglect of bureaucracy structure frequently leads to questionable assumptions about the policy process.¹⁸⁶ For example, analysts search for logical coherence in policy and assume it must have an underlying, logical consistency. Therefore, it is more pragmatic to apply the bureaucratic politics model to analyse the securities legislation in China as well as the government behaviours that leaded to the black letters.

¹⁸⁴ Ibid.
¹⁸⁵ See Michel Oksenberg and Kenneth Lieberthal, Policy Making In China, Leaders, Structures, and Processes, supra 181, at p.8.
¹⁸⁶ Ibid.
The legal system of China is the product of policy decisions by the Party/State to build an institutional framework to support economic growth. At the Third Plenum of the 11th Central Committee Congress in late 1978, the top leaders got to a tentative consensus to introduce market mechanism to the state-planned economy. The economic reform policies granted economic activities and their participants limited autonomy. The need for relatively formal and predictable legal institutions was recognized by the Party/State. Therefore, the legal reform effort has been marked by political and policy disagreements over broader issues of economic reform. However, to some Western scholars’ surprise, China’s economic reform carries on within the existing social system, without introducing a political reform at the same time. The security, a form of private property and the securities market, a typical product of market economy, were accepted and developed right through the same political system that has existed in China since 1949 when the China Communist Party took over the country. Thus, such unique economic reform as securities market should be regarded not merely as the trial-and-error attempts of Chinese leaders to find a pattern that works or as the reflection of debates among economists over policy design. So does the legal reform, which stems out of and serves the dynamic economic reform. The real challenge was the political one. From the bureaucratic politics’ perspective, it is possible to understand why remedies for investors in securities market are in poor conditions, whereas provisions for investor protection such as information disclosure are relatively adequate.

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Applying the bureaucratic politics model to China's political arena, the policy making in China has become a pluralistic process involving hundreds of officials from various Party and government departments. At the end of 1970's, after almost 30 years of planned economy and more than 10 years' of chaotic Culture Revolution, serious economic problems threatened the Party/State. Chinese people carried on a set of market reforms to improve living standards. However, the question why the Party/State chose to advocate market economy reform among many economic ideas and various policy solutions available can not be answered simply by pointing to the poor condition of China's prior planned economy system. The plausible cause of the 1978 initiative was the political contest between top leaders.\textsuperscript{190} The winner acted as political entrepreneur, using innovation in economic policy to discredit incompetent one and attract supporting allies. Thus, from its very beginning, China's economic reform bore the mark of political competition. The further progress of the reform in 1980's and 1990's consistently followed the same pattern: politicians who want carry their own agendas obtained supports of peers and subordinates by selectively granting them special economic treatment through reform.\textsuperscript{191}

As noted above, the legal system of China is the product of policy decisions by the Party/State to build an institutional framework to support economic growth. Hence, issues of legislation go to the heart of the transition from the state planned economy to market economy, where economic players have greater autonomy. Not surprisingly,

\textsuperscript{189} Political reform was implemented in 1990's, far behind the onset of economic reform.\textsuperscript{190} See Susan Shirk, The Political Logic of Economic Reform In China (University of California Press, 1993) at p.37.\textsuperscript{191} Ibid.
legislation inevitably reflects the debates over economic policy and represents the compromise between market economy reform and existing political system. For example, the Unified Contract Law entails policy compromises between proponents of conflicting principles of contract autonomy and state control.\textsuperscript{192} Similarly, securities, a form of private property, has directly affected ideological and policy norms concerning public and private ownership of business enterprises in Chinese economy. The fundamental issue was whether a socialist society as China could incorporate capitalist mechanisms such as securities markets, which fostered private ownership.\textsuperscript{193} The resulting policy compromises saw enactment of an interim series of national regulations in 1992-1993 on the issuance and trading of securities. Actually, the securities market was a controversial "experiment" at its beginning stage; the regulatory authority could close it down whenever it was regarded as a wrong attempt.\textsuperscript{194} However, the role of securities market dramatically changed in the 16\textsuperscript{th} Central Committee Congress in 1997: "...securities market was favored by incumbent seems overnight...".\textsuperscript{195} Moreover, policy makers even added such heavy burdens as raising fund for the state owned enterprises (SOE) reform upon the securities market.\textsuperscript{196} Consequently, although it should be the legislation devoted to regulating the capital market, the Securities Law reflects the priorities to protect the legal rights and interests of investors, safeguard social economic

\textsuperscript{192} See Michel Oksenberg and Kenneth Lieberthal, Policy Making In China, Leaders, Structures, and Processes, \textit{supra} 181, at p.42.
\textsuperscript{193} See Michel Oksenberg and Kenneth Lieberthal, Policy Making In China, Leaders, Structures, and Processes, \textit{supra} 181, at p.85, note 267.
\textsuperscript{194} From Deng Xiaoping's South Tour Speech, see Zheng Shunyan, \textit{Zheng quan shi chang bu dang xing wei de fa lu shi zheng} (Legal Analysis on the Misconducts in the Stock Market of China), \textit{supra} 1, at p.45, note 1.
\textsuperscript{195} \textit{Ibid.}
\textsuperscript{196} It is naturally to connect the former political competition between profit contracting and tax-for-profit with the sudden promulgation of securities market although we have not obtained any conclusion on what's behind the stage.
order and public interests, and promote the development of economy. Therefore, the rights and interests of investors were once again subjected to the limitation of lawfulness which, in Chinese context, will reflect current Party policy as well as the needs of social economic order, public interests, and economic development. Mr. Zhou Zhengqing, the Chairman of CSRC indicated that since the commission had “basically completed the work of rectifying illegal stock trading beyond the stock market, the Securities Exchange Center, securities operation organizations, and the futures market, and the work of checking up on and setting standards for original investment funds is proceeding smoothly.” The chief aim of the law was to provide conditions for sustained development of securities markets under a unified set of rules and procedures.

An obvious example is SPC’s three pieces of judicial interpretations on misrepresentation relating civil law suits. SPC promulgated the September 21 Decision to prohibit “lower courts to accept civil suits for compensation in certain classes of securities cases including fraud, insider trading and manipulation, because the legislative and judicial conditions were not ripe”. Investors who suffered from misrepresentation had to wait until the conditions became ripe. Two months later, on January 15, 2002, SPC overruled the former decision and allowed lower courts to accept securities related civil law suits. The only official explanation for the change of law was that Chinese court needed time to prepare for hearing cases appropriately. The rights and interests of investors do not inherently deserve protection, rather, they are granted by the regulatory authority.

depending on external circumstance, but may be announced void at any time upon any reason, such as policy change, condition unripe and so on.

Different from securities markets of Western countries such as NYSE, the listed companies in China’s securities market during the first decade were mainly SOEs, many of which were functionally insolvent while expect to raise money by capital market. The issuances of stocks by those SOEs were the result of competition and lobby for IPO quota allotted by the CSRC to each province. Since those SOEs were usually the major local enterprises, the pride of local industry and would become the “milking cow” for local finance ministry once listed; local officials were happy to promote the establishment and proceeding of the securities market. However, any further concern including investor protection as well as any more strict implementation of regulation such as information disclosure which may challenge the unlawful activities by the listed SOEs, and therefore may threaten the vested interests of local officials would not be welcomed by them. To make things worse, local officials, even to a certain degree, tolerated or concealed those violations to regulations including misrepresentation. The relationship between local governments and their listed SOEs were so close and reciprocal that protection of investors had to be sacrificed for local profits and interests.

Interestingly, Chinese government is both the player and the referee in the securities market. On one hand, central government is the biggest shareholder in the market since major companies listed are SOEs more than half of whose shares that cannot be transferred are owned by the state represented by central government. In Shenzhen Stock
Exchange, for example, such non-transferable and state-owned shares account for more than 65% of all shares while investing public owned the rest 35%. In Shanghai Stock Exchange, the percentage of state-owned share is even as high as 75%. On the other hand, government establishes the supervising system consisting of CSRC, local CSRC branches and stock exchanges. Those regulatory authorities are responsible for the approval of issuance, supervising exchange activities including the information disclosure and implementing administrative punishments. Such double functions of the central government put it under an embarrassed situation with obvious conflicting interests. Just as one can not supervise his own behavior, it is hard for the government to have an objective judgment to the activities of SOEs. When confronted by violations of securities regulations by listed SOEs, or securities companies that are directly or indirectly owned by provincial government, state-owned banks or investment trust, CSRC always finds itself in a dilemma. Contrary to the government's deep involvement with the securities market, the investors, after throwing their money into the market, have to stand by and watch the game that should have been played by themselves. Here comes their question: who cares whom? It seems that investors can turn to nobody for protections.

Law is always considered by Chinese as an instrument of the leadership to meet political and/or economic ends. As long as China's economic reform is proceeding through the socialist political system, legislation reflects the policy debate over economic reform issues, the investor protection will not be regarded as the primary priority by policy makers and thus has to be subservient to other competing goals.

4.2 Legal Culture Analysis

As discussing the question why Chinese law lacks of civil remedy for investors in the securities market or generally, lacks protection of private rights, it is necessary to explore the traditional Chinese culture for a better understanding. Confucianism (to a much greater degree than Buddhism or Taoism) can truly be said to have molded Chinese civilization in general.\(^{200}\) This characteristic is based on ethical principles of self-cultivation that undergird a properly functioning society.\(^ {201}\) The extended family may have priority over the state.

4.2.1 Rule of Man v. Rule of Law

It is about the faith in law, the fundamental issue of studying legal culture. Chinese society is neither built upon a constitution and a system of laws derived from it, nor on a theory of rights that is independent of interests, but by the "internalization of Confucian ethical principles" as the result of thousands of years of socialization.\(^ {202}\) In an inversion of what is commonly said about the Western legal system, in China the rule of man trumps the rule of law.\(^ {203}\)


\(^{201}\) See Tu Wei Ming, Confucian Thought: Selfhood as Creative Transformation (State University of New York Press, 1985) at p.123.

\(^{202}\) See Francis Fukuyama, The Social Virtues and the Creation of Prosperity, supra 200, at p.84.

If every member of the society including the leader agrees that there should be a certain set of rules to regulate people's behavior, to set up daily life standards, to punish wrongdoings and to compensate victims, the rules they decide become law, which is beyond all moral standards and customs. Traditional Chinese had different perspectives on how to set up and supervise social orders underlying which are the virtues of human being. Chinese thought that the origin of human was Shan (virtues), which meant kind, generous, honest and courageous. Everyone was born with virtues, but as he grew up, he learned bad behavior such as cheating and greediness; he might even act wrongly. However, once he realized that what he had done does not comply with Shan, he would look for the virtues deep in his heart and therefore gave up bad behaviors. Such interesting self-judging, self-educating, and self-improving process was highly praised in China because people believed in their inner moral strength. According to a famous Chinese thinker, Zhu Xi, the nature of man was like a pearl: when putting into dirty water, it could not shine; but pearl was always pearl, once taken out of the water, and cleaned, it was still beautiful. Constant self-cultivating was exactly cleaning the pearl, which helped people return to his nature—Shan.

Unique Chinese philosophy taught people that man's inner moral strength was strong enough to overcome any difficulty, and make himself a perfect part of the outside world. This achievement was obtained without violating any natural rule, and man could eventually be in a wonderful harmony with the world. Applying this philosophy to politics, the social order was assumed to be established upon moral ethics and politics

\[204\] Fox example, Mencius thought the man was born shan (ren zhi chu, xing ben shan).
thus became the implementation of Confucian orthodoxy. Moreover, law was merely tools to assist the emperor who was destined to possess virtues (de zhu xing fu). Mencius was the first one who brought out foregoing ideas, it was then developed and studied afterwards during next two thousand years. The self-cultivating model he advocated became the ideal of traditional politics which was well articulated in another Confucianism classics Da Xue. The influence of self-cultivating was so great that even ruling an empire depended on improvement of the emperor’s moral standards; this goal only could be obtained by educating himself and exploring Shan deep inside himself. Furthermore, the extremely powerful moral principles even accommodated all political issues—it was impossible to discuss politics without referring to moral ethics. People believed that they could solve all social problems by complying with moral standards. This philosophy has deeply-rooted in actually every part of Chinese society, in people’s daily life, and people’s pattern of reasoning; both in the olden days and in today.

Since man had virtues and could improve himself constantly as well, Chinese thought that the stability of the country and the development of the society were all determined by the emperor, his ability of self-improvement, and his moral standards. The great Emperor of Tang Dynasty, Tang Tai Zong once said: “The emperor has to ensure that his behavior comply with the moral standards so as to handle the social problems.”

206 See Liang Zhiping, Xun qiu ziran zhi xu zhong de he xie (Pursuing the Harmony of the Nature), (China University of Political Science and Law Press, 1997) at p.45.

206 See Liang Zhiping, Xun qiu ziran zhi xu zhong de he xie (Pursuing the Harmony of the Nature), Supra 205, at p.51.
sympathy, wisdom and courage were the origins of stability in the society.\textsuperscript{207} The prime minister of Ming Dynasty, Zhang Juzheng also suggested that his emperor should become the moral model for people all over the country by practising self-cultivating constantly which was the primary means of ruling.\textsuperscript{208} The most competent Emperor of Qing Dynasty, Emperor Kang Xi had following admonish: A wise ruler, rather than laws, is the primary factor for ruling a country; the law and regulations can be ignored whereas honest and devotion of the officials’ are more important.\textsuperscript{209} 

Obviously, the belief in man’s moral strength, belief in ruling by man, instead of by laws, or systems, had been the theme of traditional politics in China. The Confucius ideals represented by Confucius and Mencius in early history, and later by Dong Zhongshu and Zhu Xi were accepted by almost every emperor of ancient dynasties. The Confucius theory was officially promulgated all over the country. The Confucius classics were used as textbooks from the ancient equivalent of elementary schools to universities. Confucianism orthodoxy was deemed truth for two thousand years. On the contrary, law in ancient China did not receive the respect it deserved. Law was made by people and it could be changed anytime; it was explained by people so it had ambiguous meanings; it was implemented by people but the judges’ opinion might vary from place to place; to make things even worse, it was not universally applied. The effectiveness of law were limited to ordinary people whereas the emperor himself and some high-rank officials

\textsuperscript{207} \textit{Ibid.}
\textsuperscript{208} \textit{See} Liang Zhiping, \textit{Xun qiu zi ran zhi xu zhong de he xie} (Pursuing the Harmony of the Nature), \textit{Supra} 205, at p.56.
\textsuperscript{209} \textit{Ibid.}
were exempted, that is, they could do anything they wanted without the fear of being punished (xin bu shang da fu).

“The dominance of social hierarchy was incorporated into legal norms that permitted law to be applied subjectively based on social standing. Thus, criminal sanctions were conceived and enforced differently based on the identity of the parties involved and their position in the social hierarchy.”

They were beyond law, they could be neither regulated, nor supervised. The emperor's power was granted by the “God” and the officials’ power were originated from the emperor, rather than delegated by law. As a result, whether these exceptional officials comply with law or not depended on their virtues, self-disciplining, and self-cultivating. Law was merely some black letters without definite meanings, nor predictable. Confucius held a low view of law. He believed that law can convict and execute people, but that it cannot teach them humanity, kindness, benevolence and compassion. He taught that if people are ruled by Confucian ethics, law is not necessary. The following are quotes from his Analects:

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210 See Michel Oksenberg and Kenneth Lieberthal, Policy Making In China, Leaders, Structures, and Processes, supra 181, at p.9.
212 See Michel Oksenberg and Kenneth Lieberthal, Policy Making In China, Leaders, Structures, and Processes, supra 181, at p.21.
213 Ibid.
I can hear a court case as well as anyone. But we need to make a world where there's no reason for a court case.\textsuperscript{214}

If you use government to show them the way and punishment to keep them true, the people will grow evasive and lose all remorse. But if you use integrity to show them the way and ritual to keep them true, they'll cultivate remorse and always see deeply into things.\textsuperscript{215}

When Chinese were carrying on ruling by the emperor and officials, Aristotle was exploring his belief in law; his idea represented the belief of Western society. How could they establish such belief? It came from the assumption that man is born with sins originated from the ancestor of human being. "That nature is corrupt, proved by nature itself."\textsuperscript{216} Only the God could judge man's behavior and save man. Man could not improve his moral standards by self-improving; thus the bad nature of man could not be the source of the politics and the government, which was organized by people, was only the means to regulates people's behavior in order to keep social order. Pascal put it as the "Misery of man without God."\textsuperscript{217}

Living with such doubt or even denial of human's nature, Montesquieu thought that "...but it has eternally been observed that any man who has power is led to abuse it."\textsuperscript{218}

\textsuperscript{215} See Confucius, The Analects, supra 214, at p.11.
\textsuperscript{217} Ibid.
Locke also had similar statement: “For everyone in that state being both Judge and Executioner of the Law of Nature, Men being partial to themselves, passion and revenge is very apt to carry them too far, and with too much heat, in their own cases; as well as negligence, and unconcernedness, to make them remiss, in other Men”219

Therefore, the solution was to restrain the man’s power. According to Montesquieu, “In each state there are three sores of powers: legislative power, executive power over the things depending on the right of nations, and executive power over the things depending on civil right.”220 Such design tried to set up an institutional political structure to maintain the independence of law, to prevent the abuse of power, and to protect the political rights. There was no demand for a wise emperor, no demand for the officials meeting moral standards, nor any expectations for any human beings. All they need was the law, the sophisticated legal system to realize their ideal society.

Overall, law in ancient China was merely the emperor’s tool for ruling his subjects. People emphasized the individual who implementing the law while ignored law itself. No one ever challenged the nature and function of law as people did in the West. It had been a barrier upon ideology, which no one could overcome. People expected wise emperor and honest officials and there had been many anecdotes about good ones. However, both these expectations and stories actually reflected the denial to a universal system and denial to law. An idiom for good official widely used by Chinese is

220 See John Locke, Two Treatises Of Government, supra 219, at p.156.
“parenting officials” (*fu mu guan*) which means that the official is as good as people’s own parents, loving and diligent. Even today, Chinese are calling for such parenting officials, adding all their hopes for good life upon such official. However, they forgot that people’s moral strength varies from person to person, whereas only a well-established and universally applied system is something they can rely on.

4.2.2 Private Rights

In B.C 451-450, the first written code in Roman history, the Decemviral Code was inscribed in the Twelve Tables. What made it so significant were its provisions on ownership — subject that was stipulated in “private law” which contrasted with the “public law” regulating the state and public interests. Since then the Roman private law developed prosperously, and the entire Western world had been nourishing from it. As Maine put it: “The most celebrated system of jurisprudence known to the world begins, as it ends, with a Code. From the commencement to the close of its history, the expositors of Roman Law consistently employed language which implied that the body of their system rested on the Twelve Decemviral Tables and therefore on a basis of written law.”221 In fact, not only theories on Western society, system and sciences, but also Western people’s ideology and life style had been significantly affected by Roman private law. In such a society, almost everything could be discussed and solved by the principle of law.222

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“I know nothing more wonderful than the variety of sciences to which Roman Law, Roman contract-law more particularly, has contributed modes of thought, courses of reasoning, and a technical language. Of the subjects that have whetted the intellectual appetite of the moderns, there is scarcely one, except Physics, which has not been filtered through Roman jurisprudence. The science of pure Metaphysics had, indeed, rather a Greek than a Roman parentage, but Politics, Moral Philosophy, and even Theology, found in Roman Law not only a vehicle of expression, but a nidus in which some of their profoundest inquiries were nourished into maturity.”²²³

Around the same time when the Decemviral Code was made, and when the Roman private law influenced every aspects of the Western society, ancient China also had its first code *Fa Jing* written by Li Kui.²²⁴ But all provisions of this Chinese code were on criminal law, on relationship between the emperor and his subjects. No private law issues were contained in the code, which was the major difference between Chinese law and Western law. Until Tang Dynasty, almost one thousand years after *Fa Jing*, another important code *Tang Lu* came out and contained regulations on residence, marriage and other civil subjects. However, rather than regulating the civil rights between equal parties, these regulations were mainly about criminal punishments for violations of laws.

²²² See Liang Zhiping, *Xun qiu zi ran zhi xu zhong de he xie* (Pursuing the Harmony of the Nature), *Supra* 205, at p.98.
²²³ See Liang Zhiping, *Xun qiu zi ran zhi xu zhong de he xie* (Pursuing the Harmony of the Nature), *supra* 205, at p.329.
²²⁴ See Liang Zhiping, *Xun qiu zi ran zhi xu zhong de he xie* (Pursuing the Harmony of the Nature), *supra* 205, at p.94.
It is not surprising that a famous historian, Chen Yinque, regarded all ancient Chinese codes as “criminal codes”.

The Roman private law was based upon the general recognition of the broad range of “private rights” by the society and the function of law was to establish those rights, and to protect the equal exercise of them by each member of the society regardless of his status and wealth. In *The Social Contract*, Rousseau created the Social Contract -- his famous form of society which would simultaneously defend the person and goods of each member, yet preserve the freedom and liberty each man enjoyed prior to unity. The central principle of the Social Contract was one of mutual and reciprocal commitment, where a citizen who enjoyed the benefits of society could not extricate himself from the contract absent the dissolution of the society itself. The essential assumption underlying the social contract: independent individual who could freely control his own property and had relation with others as an equal party.

Unfortunately, ideas such as private right and equal party were never brought out in ancient China. From the beginning, law was about crime and punishment, and about the order. It was the tool of the emperor to rule people and its implementation was merely political as well as moral actions.

In the early stage of history, there was inevitably a period of family-clan society during which the family was the basic unit of the society. Family’s dealt with very

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225 See Liang Zhiping, *Xun qiu zi ran zhi xu zhong de he xie* (Pursuing the Harmony of the Nature), *supra* 205, at p.100.
broad range of matters including religion, economy, education, administration and enforcement of law. Individual was invisible in his family. However, after the family stage, ancient China and Roman had distinctively histories. In Roman, the power of family was restrained to a narrow range and instead, individual obtained more and more rights.

"Late in the Imperial period we find vestiges of all these powers, but they are reduced within very narrow limits. The unqualified right of domestic chastisement has become a right of bringing domestic offences under the cognisance of the civil magistrate; the privilege of dictating marriage has declined into a conditional veto; the liberty of selling has been virtually abolished, and adoption itself, destined to lose almost all its ancient importance in the reformed system of Justinian, can no longer be effected without the assent of the child transferred to the adoptive parentage. In short, we are brought to very close to the verge of the ideas which have at length prevailed in the modern world."

In contrast with the development of Roman law, Chinese family became more and more powerful: they could not only punish, sell their children, decide their marriages, but also could control their property. The family played an important role in ancient Chinese society. It not only executed many social functions, but also was necessary in moral and legal aspects. Without his family, man could not exist in the society. The basic rule for

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226 See Liang Zhiping, Xun qiu zi ran zhi xu zhong de he xie (Pursuing the Harmony of the Nature), supra 205, at p.113.
227 See Maine, Henry Sumner, Ancient Law, supra 221, at p.133.
living with his parents and many older relatives was Xiao, which meant respecting and obeying older family members. Children should respect and obey their parents, and their lives should be controlled by their parents as well. There was no room for personal opinions, personal values, nor for personal rights. His major identity was a member of his family. Most of his personalities, private rights, ideas, and feelings had to be compromised to his social status and moral obligations. Only the head of the family could deal with collective property according to family rules.

In China, property rights operated against a backdrop of a legal culture that emphasized collective interests over individual identity. The role ascribed to private property rights in the West, as a source of economic utility and protector of individual liberty, was not generally evident in traditional China's discourse of property. More recently, the socialist ideology of Maoism directly and explicitly repudiated the notion of private property rights and entrenched the Party/state as the guardian of public welfare. The early post-Mao period saw a gradual introduction of imported notions of private autonomy in the acquisition and management of property; but always subjected to the overarching political imperative of collective and public interests. In the absence of relatively autonomous norms and effective institutions to restrain state action, China's adoption of the liberal private property right regime remains incomplete. In ancient China, the interests of the individual were subordinate to those of the collective. The interests of the extended family–clan structure took precedence over those of each individual member, while the state's relation to society was viewed as an extension of the collective dynamic of the family. The subordination of the individual to collective interests has been drive largely by social and historical traditions derived from Confucianism, and its assumptions
about authority and hierarchy in social organization. While there is significant evidence
to suggest that the role of the individual was once highly prized, and later came gradually
to be suppressed as a result of the political and ideological imperatives of the Chinese
state, the collective tradition remains a dominant feature of Chinese legal culture. Thus,
while private property rights were recognized, the situs of these rights was the collective
rather than the individual. For example, the dian contracts permitting use of land title as
security prohibited the creditor from selling the mortgaged property, thus creating a
relationship of mutual obligation between the creditor and debtor, and underscoring their
collective interest in the debt and the underlying land. In ancient China, commercial
contracts and property relations were generally guaranteed and enforced through
community organizations such as clan and guild.

On the other hand, an opposing school of Chinese thought, the Legalists, held that a
nation needed to be held together by strict laws with harsh punishments.\textsuperscript{228} Law was
"compulsive and punitive."\textsuperscript{229} Such thought was exemplified by Emperor Qin
ShiHuang, who constructed the Great Wall and emphasized the cruel and excessive
punishment of those who dared to show even the slightest resentment.\textsuperscript{230} Justice was
meant to be certain, swift and harsh.\textsuperscript{231} When China adopted both a Confucian and

\begin{verbatim}
\textsuperscript{228} See Xin Ren, Tradition of the Law and the Law of the Tradition: Law, State, and Social Control in China, supra 211, at p.21.
\textsuperscript{229} See M. Scott Donahey, Seeking Harmony - Is the Asian Concept of the Conciliator/Arbitrator Applicable in the West? 1995 J. Disp. Resol. 74, 75.
\textsuperscript{230} See Wang Chenguang, Zhang Xianchu eds, Introduction to Chinese Law, Supra 203.
\end{verbatim}
Legalist view of law, laws were limited and when they were applicable, and penalties were harsh.232

Overall, it can be concluded that ancient Chinese culture was the culture of family which denied the existence of individual. The membership in a family was vital for a man to live in the society. Therefore, it was impossible to find the legally equal personality, any new social relationship created by free and independent will, nor the absolute personal ownership of property, and the free transfer of goods. As a result, private law did not emerge in traditional China, nor could it fully develop in contemporary China.

4.2.3 Obligation (Yi) v. Interest (Li)

The most unique feature of Chinese culture is about Yi, which means personal obligation, moral obligation. The word of the opposite meaning to Yi is Li, which is private interest. Confucius identified several cardinal relationships that needed to be honored for a stable social order.233 They were father and son, ruler and subject, husband and wife, elder and younger brother, and friend and friend.234 Li, or propriety, arose from the observance of these right relationships.235 Everyone played different roles in different social relationships, for example, an officer was also a husband, a father, and a son at home. But whatever role he played, he had to refer to the determined obligations set by

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233 Ibid.
234 Ibid.
Confucius orthodoxy like an officer should be honest, a father should be strict with children, a son should respect parents, a wife should be faithful to her husband and brothers should love each other. These were the rules of life. Whenever an action had been justified by \( Yi \), one should try to make it without any concern about \( Li \) since private interests had been suppressed for thousand years, even talking about it publicly would be despised by others. Similarly, money, business or any profits gained were the taboos. Confucian philosophers blamed people’s desire for wealthy and comfortable life, scored working for self-interests, and persuaded people to give up all selfish demands. There was no place for \( Li \); any “personal” matters had to be ignored, denied, and given up. Under such unique value system, any private interest had to be compromised or even scarified with moral obligations, and collective interests. As a result, when judging a civil case, local administrative officers\(^\text{236}\) also complied with the rules of \( Yi \). The following is an interesting case illustrating the way how a Chinese officer made his decision:

The dispute was to divide collective property between two brothers. In the court, the local officer in charge of this case did not hear details of the case as usual, instead, he asked the brothers to call each other’s nick name loudly just as they always did when they were young. After calling for a short while, both of the brothers stopped and cried for they were deeply touched by the brotherhood between them. Finally, they agreed to withdraw their claims and cancelled the case. The wise officer wrote in his decision that


\(^\text{236}\) In ancient China, there were no professional judges, while administrative officers who had no prior legal training took the responsibility of enforcing laws. Therefore, when lack of specific civil laws, these officers
brothers were dear family members like hands and feet, so brothers should love and take care of each other as required by Yi. Both parties of this case violated the fundamental rule of Yi for not cherishing brotherhood and even bringing lawsuit for dividing collective property. Therefore, all the collective property should be attributed to the elder brother and the younger should assist him. The case ended by returning to the brotherhood, avoided dividing collective property, and protecting the private interests. That was the typical way most civil cases were decided. Confucian orthodoxy was deemed as civil law to deal with the disputes, while the private right did not receive the emphasis it deserved.

During two thousand years, when Westerners struggled to provide as many as possible means to satisfy man’s desires and thus set up deliberate system of civil law, Chinese made great efforts to pursue an unified value system (Yi) under which no private rights (Li), no personal interests, no individual, nor any private law existed.

4.2.4 No Lawsuit—Harmony With Nature

It is better to die of starvation rather than to become a thief; it is better to be vexed to death rather than to bring a lawsuit (E si bu dang zei, yuan si bu gao zhuang).238

had to apply the general Confucian orthodoxy including the rule of Yi combining with their respective education, belief, and experience to decide cases.

237 See Liang Zhiping, Xun qiu zi ran zhi xu zhong de he xie (Pursuing the Harmony of the Nature), supra 205, at p.180.

238 Chinese proverb.
Any society inevitably has many property disputes and other civil lawsuits. However, Chinese’s attitude toward the lawsuit was: to make great efforts to minimize the lawsuit (Bi ye shi wu song). This attitude was stemmed from Lao Zi, who insisted that man should pursue the natural order of the world—the harmony.

Chinese did not confront with the natural order; rather, they tried to understand the rule of Nature in order to stay with it harmonically. Since human being was also a part of Nature, he should comply with it and obey its orders. Such philosophy directed people how to handle relationship with Nature, as well as among people. According to Lao Zi, everything in the world had its own appearance given by Nature and lived naturally; therefore, man should also learn the spirits of Nature. Nature itself was harmony and perfect, so man might apply such rule to solve social problems in order to realize the harmony of the world, the ideal world. Man was a part of Nature and was born with the peaceful spirits of Nature, thus he should live peaceful life as the way of Nature. However, disputes that broke the harmony between people involved with the lawsuits obviously drove people away from the natural spirit inside himself. The government, even the whole society then was responsible for educating and persuading people to avoid disputes so as to keep the peaceful social order. That’s the cornerstone of Chinese legal culture: no lawsuit — harmony was what Chinese pursued.

240 See Liang Zhiping, Xun qiu zi ran zhi xu zhong de he xie (Pursuing the Harmony of the Nature), Supra 205, at p.126.
241 See Liang Zhiping, Xun qiu zi ran zhi xu zhong de he xie (Pursuing the Harmony of the Nature), Supra 205, at p.218.
To realize the ideal of “no lawsuit”, people had to be peaceful minded to tolerate, and not to argue or fight. Once a dispute happened, minimizing the disagreement so as to end up the dispute was more important than regulating behaviors of the both parties and deciding private interest in accordance with the law. The function of the law was not to provide a vehicle to solve the problems; on the contrary, it tried to suppress people’s demands in order to restore the “harmony”. Therefore, the implementation of the law turned out to be moral lecture and punishment. Suing neighbors or family members for so called “trivial” matters such as money and land was a condemned bad behavior although ordinary people were easily involved in those daily disputes. Those “troublesome” people who brought civil suits gave the local officers much headache, so the primary duty of the officers was to constantly admonish people to be nice, tolerate and peaceful and finally give up ideas of suing. Lawyer as a profession could not exist at all in such a society in ancient China for it promoted arguments that violated the harmony of the society. Most of the time, neighbors and the elders of the family negotiated with the both parties and tried to reconcile the dispute and finally gave concession before the legal process.

Chinese cherished harmony and thus applied such rule of the Nature to set up a society and to deal with the civil disputes between each other. It was not only necessary, but also possible because people’s spirit was originated and connected with that of Nature. There was no need to learn, Nature was right inside everyone and was the source of all feelings, ideas and moral strength of man. Everyone living in a harmony life should not sue for private interest. “No lawsuit” was the realization of the harmony spirit.
Under unique Chinese legal culture originating from traditional Confucianism, which emphasizes the wisdom of the ruler, encourages the obligations and cherishes the harmony, law had been used to meet political/economic ends in China. However, along with the rapid development of market economy, the protection of the private rights becomes more and more important in order to fight against the abuse of public power, which has caused huge waste and to realize efficient utilization of the social resources.
CHAPTER V New Legislation and the Way Ahead

5.1 January 9 Provisions and the Law & Economics Analysis

The Neoclassical law and economics approach to law is to review the law from an economic perspective. It is an interesting way to explore the rational underlying legislations and judicial decisions, apart from those well-known merits of law such as fairness and justice. By applying one aspect of the law and economics approach to the latest securities legislation in China and North America, people will have a profound understanding for these developments.

5.1.1 Law & Economics Approach to Law

Economics is the science of human choices in a world where resources are limited in relation to human needs. It explores and tests the implications of an assumption that man, to his satisfaction, will rationally maximize of his ends in life.242

“Everyone recognizes that the economic approach assumes maximizing behavior more explicitly and extensively than other approaches do, be it the utility or wealth function of the household, firm, union, or government bureau that is maximized. More over, the economic approach assumes the existence of markets that with varying degrees of efficiency co-ordinate the actions of different participants—

individuals, firms, even nations—so that their behavior becomes mutually consistent." 243

A reasonable individual tends to utilize resources to realize the most value when the surroundings change. Under the circumstance that resources are being employed where the greatest value is obtained, it can be concluded that efficiency has been achieved. "Technically, efficiency means exploiting economic resources in such a way that human satisfaction as measured by aggregate consumer willingness to pay for goods and service are maximized". 244

The "law and economics approach to law" is a method to analyze the consequences of judicial decisions. 245 When applying the foundations of the economic approach to law, it is necessary to address questions such as what is economic efficiency? For example, what does it mean to say that a law is efficient? Does the principle of efficiency have explanatory merits? 246 How should law be formulated to promote efficiency? Should the

243 Ibid.
245 Ibid.
246 Prof. Posner pointed out that efficiency is the standard of judging people's choice, but he didn't answer the No. 2 question: what is the merit of efficiency? There are several scholars challenges this principle such as Ronald Dworkin in his "Is Wealth a value?" and "Why Efficiency?" The critique is that efficiency criterion's exclusive focus on the collective sums of gains and losses obscures an important fact—that the individual losers from the change may be very bad off indeed. Further discussion of this paper has to establish upon this debated principle of "efficiency". Should we take "efficiency" for granted, it would be easier for understand the capital market because the concept of efficient market is the essential assumption underlying the securities regulation, particularly in mandatory information disclosure and the design of statutory civil remedy for investors.
law pursue economic efficiency? According to Richard Posner, economic is a powerful tool of normative analysis of law and legal institutions.

"Although the economist is not the ultimate arbiter of social choice, neither can he tell society whether it should seek to limit crime, he can show that it would be inefficient to allow unlimited crime. Or, taking a good of limiting crime as a given, the economist may be able to show that the means by which society has attempted to attain that good are inefficient—that society could obtain more preventive, at lower cost, using different methods. Since efficiency is a widely regarded value in the world of limited resources, a persuasive showing that one course of action is more efficient than the alternatives may be an important factor in shaping public choices."

That's the reason why it is possible and advisable to apply the law and economics approach in this paper to discover the philosophy underlying the current securities legislation. The current concept of an efficient securities market is an essential assumption, emphasizing the need to make more information about securities publicly available, in another word, mandatory disclosure.

5.1.2 SPC's New Solution for Misrepresentation Related Civil Disputes

248 See Richard A. Posner, Economic Analysis of Law, Supra 244.
249 The law and economics theory is very complex and nuance and I only use one small aspect of this literature, which is focus on the concept of "efficiency".
“Efficiency” has not been regarded as a priority of making new laws and regulations in China. For example, the September 23 Decision cannot be considered a piece of efficient legislation for it does not produce the most economical outcome when dealing with misrepresentation in securities market.

It is well known that the purpose of establishing stock market in China is to promote economic development by facilitating the exchanges of capital raised from investors, particularly individual investors. However, since many listed companies are abusing the rules of the market by breaching information disclosure regulations, the foregoing purpose has not been realized for the economy cannot benefit from misconducts that incur loss to the investors. These listed companies are not producing values for the society. On the contrary, they cause huge wastes to the limited social resources such as confidence and money -- resources that should have been utilized efficiently in a developing country like China. If legislation allows, or does not curb, rampant illegal practice such as misrepresentation in the market, investors will lose confidence for the securities market, and therefore choose to leave. Without incoming capital resources, how can listed companies raise fund, and how to realize the goals of promoting economic development through the stock market? Obviously, from the economic point of view, it is inefficient to allow misrepresentation by listed companies in the securities market. Then what is the most efficient way, effective while at a lower cost, to prevent misrepresentation? Complete and practical regulations on information disclosure are essential parts of the prevention measures. However, these regulations have to be supplemented by civil remedy for the investors, in another word, civil liabilities born by
the wrongdoers, for huge compensation will become a heavy financial burden for listed companies. Needless to say, having understood such uncomfortable outcome, few companies are willing to take the risk of violating information disclosure regulations. Without civil remedy, information disclosure regulations are only “paper tigers” laws, which cannot effectively deter listed companies from making misrepresentation. Civil remedy becomes the teeth of “paper tigers”. The September 23 Decision did not solve the remedy problem, rather, it delayed the proper process of handling securities misrepresentation related civil disputes by People’s court. To a certain extent, the September 23 Decision has aggregated the losses of investors, and thus become a waste of social resources.

Fortunately this inefficient Decision was overridden later by new regulations of the SPC. Having recognized the necessity and urgency of civil remedy, several months after suspending of hearing civil disputes related to stock trading fraud, the SPC reversed its previous decision, and started to accept such cases from January 15, 2002. This was done through issuing the Notice on Issues Relating to Civil Liability Cases Arising from Misrepresentations in Securities Market (hereinafter referred to as the “January 15 Notice”). According to Mr. Li Guoguang, vice president of the SPC, the September 23 Decision had given some time for Chinese court to prepare for appropriated handling of such cases. January 15 Notice is aimed at protecting the legitimate rights and interests of individual investors. Curbing rampant illegal practices in China’s fledgling securities market, the January 15 Notice contains six brief clauses covering issues such as the scope

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of jurisdiction, court jurisdiction, means of litigation, and statute of limitation. But litigants may bring their case to the court only after the CSRC, or its branche, decides that a fraud had been committed.

A real breakthrough on securities civil disputes came out in 2003 when SPC announced the Several Provisions on Trail of Civil Compensation cases Arising from False Representation in the Securities Market, a judicial interpretation of a civil compensation concerning the breach of stock market standards on information disclosure on January 9, 2003 (hereinafter referred to as the “January 9 Provisions”). It is the first systematic judicial interpretations regarding applicable laws for the hearing of securities related to civil liability cases, as well as the first time for China's top court to expressly protect investors' interests against false information released by listed companies, most of which are SOEs. The January 9 Provision states that the People’s Court should accept cases filed by an investor against such defendants as the issuer, controlling shareholder, listed company, and securities distributor for false representation. False representation includes false information, misleading representation, material omission, and inappropriate information disclosure made by listed companies. January 9 Provisions also stipulates how to determine the causal relationship between misrepresentation and loss; then further details the forms of litigation, determination of false representation, reasons for liability or exemption, joint tort liability, and determination of losses.

251 Ibid.
252 Inappropriate information disclosure refers to information that is not disclosed during period required by law or not disclosed in legal means.
January 9 Provisions is an important legal guideline, and a bold move designed to add bite to the existing law. It allows investors to bring lawsuits with court, to calculate losses and eventually obtain compensations whenever they are hurt by listed companies. Now they feel more comfortable to put their money in the market. When confident investors actively participate in stock trading, funds are channeled to promising companies and thus assisting them to make more money, which consequently produces more values for the society. Good securities regulation provides protection for the investors, and also promotes the allocation of limited social resources at the same time. That is the idea of “efficiency”; a result which can be achieved by legislation.

It is too early to conclude that “efficiency” has become the rational underlying current securities legislation; however, it is at least exciting to see that inefficient legislation has been taken place by more efficient ones. Actually, the question of “efficiency” of China’s securities legislation is a complex issue due to Chinese securities market’s unique double functions: on one hand, it performs semi-administrative functions of helping SOEs raise funds to develop, like a government organization; while on the other hand, it is a market place where investors are exchanging stocks to realize the maximization of benefits. Facing these two competing priorities, helping SOEs and developing the market, policy makers decided to provide more protections for the investors so as to promote the development of the economy.

5.1.3 Deficiencies of January 9 Provision
Though a critical step forward, the January 9 Provision has two obvious loop holes: a mandatory prior criminal and/or administrative proceedings; and restrictions on procedures of litigation, which will make claims for damages incurred by misrepresentation not as easy as it seems.

According to Article 6 of January 9 Provision, when bring misrepresentation related civil law suit to the court, plaintiff has to submit administrative penalty decision issued by the CSRC, or its branches, or criminal penalty decisions issued by the People’s Court, with a decision of that misrepresentation committed by the defendant. Such stipulations actually mandate administrative and/or criminal proceedings prior to civil litigation.

The People’s Courts may have good reasons to require prior administrative and/or criminal decisions; for it might be easier for them to investigate the facts of the case, and to decide the causal relationship between the misrepresentation and the loss after prior proceedings. However, the People’s Courts’ convenience may become the investors’ obstacle since it usually takes a long time for CSRC to complete its investigation and decide administrative penalty, and criminal case hearing may even take longer. Investor who suffered from misrepresentation thus has to painfully wait for a long time to collect the necessary evidences in order to bring civil lawsuit for compensation. It is unfair for investors to undergo such unhappy experience. What’s more, timing is also crucial in terms of compensation for the investors: After paying heavy fines enforced by CSRC, are these listed companies making misrepresentation, most of which are not in good financial conditions, capable of paying full compensation to the investors? Complying
with the January 9 Provision while witnessing the diminishing of recovery of losses, investors can do nothing to protect themselves but wait.

The January 9 Provision allows plaintiffs to solely or jointly bring lawsuits against defendants who made misrepresentation; however, the number of plaintiffs has to be verified before starting a trial in the case of joint litigation. The procedure under Article 55 of the Civil Procedure Law of the People's Republic of China for litigation having uncertain number of plaintiffs cannot be applied, which is similar to the class action under the U.S. and Canadian securities regulation. A class action is a representative action where one or more plaintiffs actually named in the complaint, along with their counsel, pursue a case for themselves and the defined class against one or more defendants. The claims of the "class representatives" must arise from facts or law common to the class members. Both the U.S. and Canadian laws provide the class action litigation for investors to claim damages incurred by misrepresentation. For example, various representative plaintiffs have commenced intended class proceedings both in the U.S. and Canada on behalf of proposed classes of persons who had purchased shares of Bre-X Mineral Ltd. and suffered a net loss to seek compensatory damages.253 In Canada, a nationwide class action has been brought by the law firm of Sutts, Strosberg LLP in Windsor, Ontario on behalf of Canadian Bre-X investors against Bre-X, its officers, and directors, and other persons related to the company. The claims advanced were for conspiracy, fraudulent misrepresentation, negligent misrepresentation, and breach of the Competition Act, R.S.C. 1985, c. C-34.254 The case already has been certified for class

253 See facts of Bre-X case under Para. 5.2.1.
254 Ibid.
action status for a class limited to Canadian purchasers of Bre-X stock that held their shares as of March 26, 1997. A class action has also been brought to Texas Eastern District Court, namely, McNamara v. Bre-X Minerals Ltd. on behalf of U.S class members who purchased Bre-X shares during the Class Period from January 17, 1994 to March 26, 1997 for recoveries for damages. Class action is a powerful means of litigation for any member of the class shall generally be bound by the results of the litigation provided that he/she does not choose to “opt-out”. Unfortunately, in China investors have not been provided with such efficient tool. In order to get their money back, Chinese investors have to go through the torturous process of litigation by themselves.

In addition to above loop holes, the January 9 Provision as well as other recent securities legislation also need to address critical lessons recently learned by the SEC and the OSC. While China is importing theories, practice and system from the Western markets, it is more important to particularly pay attention to their tragic experience in order to avoid similar mistakes. After the failures of Bre-Xs and Enrons, the U.S and Canadian lawmakers are working hard to improve the legal system to provide better and safer protection for investors.

5.2 Bre-X, Enron and Latest Developments of Securities Regulations

The U.S and Canadian markets have been regarded as the model of sophisticated securities system for a long time, a system that is followed closely by China’s market; it

\(^{255}\)Ibid.
includes the well-established information disclosure system, efficient supervision as well as strict civil and criminal liabilities. However, stock market scandals are happening in those established markets, even though lawmakers have made great efforts to enhance the transparency of the market and to protect their investors.

5.2.1 Bre-X and Vigorous Pursuit of True Information Disclosure

Bre-X Minerals Ltd. (hereinafter referred to as the "Bre-X") was incorporated in Alberta in 1988 as a junior mining resource company engaged in the exploration and development of gold-mining properties. On May 6, 1993, Bre-X signed an agreement to purchase the option to drill for gold in an area of Indonesia known as the Busang. Then contemporaneously issued a press release stated that the study showed gold in sufficient quantities to yield an annual after-tax cash flow of US$10 million for the company. Bre-X raised $1.3 million from the public through the sale of shares in 1993 and during the first five months of 1994. Throughout 1994 and 1995 Bre-X continued to issue positive press releases indicating progressively increasing estimates of the gold reserves on the properties it controlled. By the end of 1995, Bre-X stock on Alberta Securities Exchange was trading at $53 per share as compared to $0.50 per share in 1993. In 1996, numerous favorable press releases were issued by Bre-X. On April 23, 1996, Bre-X shares began trading on the Toronto Stock Exchange. The opening price on the TSE was approximately $192 per share. On August 19, 1996, the shares began trading through the NASDAQ system in the U.S.; and on September 3, 1996, the shares were listed for trading on the Montreal Stock Exchange. However, on March 26, 1997, tests conducted
by independent experts revealed that the Bre-X drilling samples had been tampered with, and that there were no significant amounts of gold in Busang. The price of Bre-X shares was plummeted. On May 7, 1997, Bre-X shares were de-listed by the Toronto Stock Exchange.

Shocked by the failure of Bre-X, as well as other listed companies including, Cartaway, Timbucktoo, Rotyal Trustco, etc., Canadian securities law makers decide to make vigorous pursuit of true and complete information disclosure in order to “slow the erosion of confidence in the minds of existing and potential stock market investors”256.

“Bre-X in particular seems to offer the potential for the Commission to demonstrate its commitment to ordinary people who have been wronged while participating in Ontario's securities markets. Bre-X provides the Commission with an opportunity to mount a vigorous investigation of the facts and a relentless pursuit of any wrong-doers.”257

One action the OSC proposed to take is to requiring listed companies to establish and maintain internal, disclosure controls and procedures; it also requires CEOs and CFOs to provide certifications related to internal controls, and to disclosure controls and procedures.258 British Columbia has also circulated draft legislation to replace the current

258 See The enforcement amendments to the Ontario Securities Act and Commodity Futures Act, effective on April 7, 2003.
Securities Act with a new model: listed companies must make all material information available to investors at all times. In the U.S., the Sarbanes-Oxley Act of 2002 authorizes the SEC to require reporting public companies in the disclosure of “rapid and current basis” information concerning changes in the issuer’s financial conditions or operations.

China has also dedicated to promote information disclosure; for example, CSRC and the State Economy and Trade Commission promulgated the Listed Companies Governance Rules (hereinafter referred to as the “Governance Rules”) in January 2002. According to the Governance Rules, listed companies shall, besides mandatory information disclosure, voluntarily and timely disclose any other information which may materially affect shareholders’ investment decisions, and will also ensure that all shareholders have equal opportunity to obtain aforesaid information. Current CSRC requirements have already been very close to the spirit of “all material information at all times” model as well as “rapid and current basis” standard as proposed by the Canadian and U.S. securities lawmakers. In 2003, CSRC further amended a series of regulations to set forth the minimum requirements on information disclosure for issuing shares, and for quarterly and annual reports released by listed companies. In addition to the minimum standards, CSRC also states that “notwithstanding anything to the contrary to the contents of


259 See BC circulates draft legislation as part of its deregulation project, supra 256.
260 See SOA s. 409.
261 See Art. 88 of the Governance Rules.
regulations, listed companies shall disclosure all information which may have material influence on investors’ business decisions.\textsuperscript{262}

The reason why both Western and Chinese law makers are vigorously pursuing true information disclosure is that they have realized that restoring investor confidence is of great importance to the securities markets. Investor confidence is not an issue unique to the U.S. or Canada. Another way to achieve such goal is by strengthening corporate governance.

5.2.2 Enron and Advances on Corporate Governance

Enron was a company based in Houston, Texas. They were a provider of products and services to wholesale and retail customers; things like natural gas, electricity, and communications. It had been one of the most successful companies, a fortune 10 company, and was once highly praised for its dynamic entrepreneurship. However, in December 2001, it filed the largest bankruptcy in the United States -- Enron collapsed. Although there may be various factors contributing to Enron’s failure, such as an overly ambitious business expanding strategy, it is obvious that the most serious problem is in its lack of timely and transparent statement about its material changes; in another word, its weak information disclosure. Enron hide many important business transactions from the public. Its major financial problem, which eventually leaded to its failure, was covered by “creative book keeping” while thousands of investors threw millions of

\textsuperscript{262} See Art. 3 of the Governance Rules.
dollars for this “promising” stock recommend by enthusiastic Wall Street analysts.\textsuperscript{263} And suddenly the giant collapsed, truth disclosed, and money evaporated overnight. Both the investing public and the capital market are shocked by this energy giant’s debacle: how could such a tragedy happen just under the eyes of numerous investors, auditors, lawyers, financial analysts, and even under the SEC without being discovered earlier? What went wrong with the U.S securities market – the symbol pride of Americans, and has long been considered the best in the world?\textsuperscript{264}

The consequences of Enron’s fraudulent information disclosure are obviously tragic: thousands of investors’ money, billions’ of dollar, evaporated in the market; so did those of many Enron employees who invested their life savings by purchasing stocks. The more far-reaching effect is that it shook investors’ confidence on the financial reports and the capital market. “...practically overnight, a system we'd all come to believe in has been exposed as plagued with weaknesses.”\textsuperscript{265} All those seemed cliché in securities regulation textbooks, such as, “Sunlight is said to be the best of disinfectants; electric light the most efficient policeman”\textsuperscript{266} and “full disclosure would...reduce fraud...”\textsuperscript{267} are proved by the shocking reality. It is time to look carefully at the adequacy of the current


\textsuperscript{264} “Our financial reporting system has long been considered the best in the world and is one of the underpinnings of our capital markets, which are the deepest and most liquid in the world.” by Robert K. Herdman see <http://www.sec.gov/news/testimony/021402tsrkh.htm>.


\textsuperscript{266} See L.D Brandeis, Other People’s Money and How the Bankers Use It, (Washington, National home library foundation, 1933).

\textsuperscript{267} See Louis Loss, Securities Regulations, Supra 14, at p.123.
system of securities regulations. Then comes the Sarbanes-Oxley Act of 2002 (hereinafter referred to as the "SOA").

The SOA has become law effective on July 30, 2002, which is an intensely thoroughgoing law intended to affect all public companies. The SOA strengthens the role of directors as representatives of stockholders, and reinforces the role of management as stewards of the stockholders’ interest. The features of the SOA include:

(i) Board independence

The role of directors is to monitor and oversee situations on behalf of stockholders. There will always be a natural tension between directors as business advisors – a vital role – and their role as monitors of management on behalf of the stockholders’ ownership interests. The “independence” of board members is not a new concept in the U.S. As early as 1972, the SEC recommended audit committees of “outside directors”. In 1976 a Congressional committee reported a need for directors that are “detached” from “management and from any other conflict of interest”. More recently, a SEC-led committee on improving the effectiveness of audit committees recommended that all audit committee members be independent from corporate management. The SOA requires all covered companies to have

268 “The circumstances surrounding the Enron failure and the billions lost by Enron’s investors have highlighted many aspects of our financial reporting process that are in need of attention.” By Robert K. Herdman see <http://www.sec.gov/news/speech/spch536.htm>, (visited on June 10, 2003).
audit committees comprised solely of independent and unaffiliated directors who are “independent” from company management, and do not accept any consulting, advisory, or other compensatory fee from the company.\textsuperscript{269}

(ii) Management certification and assessment of internal controls.

According to the SOA, CEO’s and CFO’s must certify that they have read the annual and quarterly report, and that to their knowledge, it does not contain any material misstatements or omissions; the financial statements, and other financial information in the report, “fairly present” in all material respects the company’s results of operation and financial condition. The SOA also requires that each annual report must contain an "internal control report," in which senior management analyzes and explains their procedures for internal financial controls; which is based on standards set by the Public Company Accounting Oversight Board. The certifying officers are responsible for establishing and maintaining the company’s internal controls. The certification must report the officers’ conclusions regarding the effectiveness of the internal controls; that they have reported to the auditors and the audit committee all significant deficiencies and material weaknesses in the controls, and any fraud, “whether or not material,” involving management or other employees who have a significant role in controls. Finally, whether there were significant changes in the internal controls subsequent to their evaluation date.

\textsuperscript{269} See SOA, s. 301.
(iii) Tough penalty for violations

Under the SOA, potential penalties for violations include fines up to Five million USD, and jail time of 20 years, which strengthen the Act. The SOA also creates new offenses such as a new crime of “Securities Fraud,” and gives the SEC further enforcement authority in order to effectively implement laws.

SEC Commissioner Paul Atkins believes that the SOA acknowledges the importance of stockholder value. “Without equity investors and their confidence, our economic growth and continued technological innovations would be slowed.”270 That’s the lesson to be studied by China as well. Notwithstanding China has also made progress in corporate governance, compared with stringent requirements set forth in the SOA, the CSRC, as well as other policy makers still need to continue their efforts.

The independent director system, a relatively new concept to Chinese market, has become mandatory since 2001 as CSRC promulgated the Guidance on Establishing the Independent Director System by Listed Companies (hereinafter referred to as the “Guidance”). The Guidance requires that no less than one-third of directors of listed companies should be independent directors, which means, a person who "take no positions other than as a board director, and have no relationship with the company or its major shareholders that may affect independent and objective decision-making"; it also requires that at least one of the independent directors should be a professional accountant. The independent directors are authorized to submit

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proposals to the shareholders’ meetings, retain or dismiss outside auditors, invite in independent auditors, and offer independent financial reports apart from their normal duties as board members. They are also free to give independent opinions on major transactions with affiliated institutions, on assignment and payment of the managerial staff, and to object in the cases that the interests of minority shareholders might be injured. The establishment of the independent director system in China is crucial for enhancing the corporate governance of listed companies; however, different from requirements of the SOA, according to the Governance Rules, audit committee is not mandatory in China. The board of directors may decide whether to set up an audit committee or not; they may also take the responsibility of audit committee if there is not such a committee at all, which means that directors are directly involved in outside audit issues.

Apparently, under such circumstances, there are always chances for scandals like Enron and Arthur Anderson to happen. What’s more, unlike the SOA requirements that audit committee should be comprised solely of independent directors, the Guidance mandates at least one. The result of such stipulation is that the audit committee cannot detach entirely from management, which easily cause trouble.

Finally, one of the most significant aspects of the SOA is to expand the role and responsibilities of audit committees. That committee, with independent counsel and advisors of its choice, and has its own budget, will be responsible for the outside auditor relationship, including the responsibility for the appointment, compensation, oversight of a company’s outside auditor, and resolve financial reporting disagreements, and must establish complaint and whistle-blower procedures ensuring anonymity and
confidentiality. In China, the scope of responsibilities of audit committee is much less than those under the SOA, which mainly includes proposing to the board of directors in order to retain or change outside auditor, supervising corporate internal audit, and reviewing corporate internal control. Obviously, the significance of the audit committee has not been fully recognized or at least, has not been reflected in Chinese legislation.

CSRC sets forth requirements for the board of directors and all directors of listed companies similar to the management certification under the SOA.\(^{271}\) CSRC has also introduced the internal control to Chinese listed companies; however, the responsibility of supervising internal control would be taken by the audit committee rather than the whole management\(^{272}\) and the Governance Rules does not provide detailed stipulations on the internal control which makes it hard to implement. Without enforceable contents and requirements, internal control in China is merely a concept rather than a practical means to promote the corporate governance of listed companies.

Different from the harsh stipulations of the SOA, the latest Chinese securities legislation looks more like self-discipline rules since neither the Guidance nor the Governance Rules set forth any penalty for violations by listed companies or management. If even such sophisticated markets as the U.S. and Canada, which has been closely followed by China, dedicate to create new offenses and increase existing penalties, why shouldn’t China? In the emerging and chaotic Chinese market, securities regulations with enforceable and tough penalties are absolutely necessary.

\(^{271}\) For example, Art. 18 of IPO, and Art. 15 of issuance new shares.

\(^{272}\) See the Governance Rules.
Driven by the initiative of vigorous pursuit of true information disclosure and strengthening the corporate governance, China has made some progress in the protection of investors, which includes enforcing mandatory information disclosure, establishing independent directors system, introducing audit committee, and internal control; although it is still not enough when dealing events like the recent developments in the U.S. and Canadian markets. The most encouraging statement is expressly made by CSRC in the Governance Rules that investor are entitled to protect their legitimate interests by civil litigation or other legal means. It’s the fundamental change in the policy. Just as an old Chinese saying “the way ahead is promising though full of difficulties,” the protection of private rights has become a more and more significant issue in China.

5.3 The Way Ahead

Being an indispensable part of market economy, thriving of private rights originated from developed economy, and in turn promotes further development. Undergoing the huge economy reform, obviously China has dedicated to the protection of private rights. For example, the first Civil Code of the People’s Republic of China has been drafted and was submitted to the 31st Meeting of the Standing Committee of the 9th NPC for review on December 23, 2002. The draft Civil Code contains nine volumes including marriage law, property law, adoption law, and contract law. The draft offers basic regulations on almost every activity that a corporation may take, such as trade, leasing, transportation, storage, fund-raising, settlement, and the development of new products. It also offers guidelines in respect of the individual in relation to food, clothing, shelter, and transportation -- the
basic necessities of life and recreation, marriage and family - among other daily activities. The draft proposes that the state protects personal deposits, investments, and profits generated from such investments. For the first time the draft makes it clear that private property, public property, and state-owned property enjoy equal protection. Among provisions, attentions have been made on stipulations concerning property, personal rights, legal consequences for civil rights violations, and civil relations involving foreign parties. According to the draft, victims whose civil rights were violated are entitled to seek moral compensation. The draft also has a chapter on protecting the right to human dignity, which clarifies for the first time in China that individuals enjoy the right to privacy, plus rights to a healthy life, protection of name, image, reputation, honor and credit.

The most significant feature of the draft is its emphasis on the protection of civil rights. Mr. Wang Jiafu, a member of the NPC Standing Committee, stated at a panel discussion on the draft that: "The civil code is the basic law regulating the market economy and people's social activities, and it is also a declaration for civil rights," Mr. Wang Liming, a renowned civil law expert of China, expressed a similar opinion; he believed that the draft confirmed the full protection for the right to human dignity, and would give people a powerful legal weapon to fight any kind of illegal interference and violation of their personal rights.274

274 Ibid.
One step ahead, the first Civil Code as well as the SPC Provision, as well as other related latest regulations have shed light on the endeavors of pursuing more protections of private rights in China. It is reasonable to believe that Chinese are progressing to an era when people enjoy all sorts of civil rights; what's more, their entitlements are well protected by laws.
Conclusion

The progress of private rights protection is an interesting part of Chinese legal system: it reflects the development of the information disclosure system and the remedy for investors under securities regulations; however, it is determined by unique social-political institution and by Chinese value system. Meanwhile, it also reflects the interaction of traditions and new forces after China's opening to the Western countries along with the trend of "globalization" (the contemporary spread of liberal ideals of free markets, and private law relations around the world), particularly after China's accession to the WTO in 2001. New legislation and amendments of existing laws will be pushed by constantly changing local conditions caused by rapid economic growths, while the WTO membership requires far-reaching reforms that will provide more protection for private interests and rights in all the areas of law. With such process in mind, we will be able to have better understandings for current legislation on information disclosure, on the remedy for investor, and thus have more reasonable expectations for furthermore legal developments. That real change will be neither a direct transfer of social institution from the West, nor a mere disturbance of a traditional equilibrium. Rather, it is a process of selective adaptation leaded by the interplay between local conditions including social-political conditions, economic growth, legal culture, and the external factors, such as liberal ideas and laws borrowed from the Western countries.
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