Civil Litigation Arising from False Statements on China's Securities Market

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I. Introduction

China’s securities market emerged in late 1980s, and the

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establishment of Shanghai and Shenzhen stock exchanges followed in 1990 and 1991, respectively. In their wake, China’s securities regulatory authority and Chinese courts faced the problem of how best to tackle various forms of securities fraud in order to protect the interests of investors and to maintain the integrity of China’s securities market. Between September 2001 and January 2003, the Supreme People’s Court (SPC) issued three circulars instructing local people’s courts on how to deal with civil compensation claims arising from securities market fraud.¹ On January 15, 2002, intermediate people’s courts designated by the SPC began to accept and hear civil compensation cases arising from false statements on China’s securities market, marking the beginning of civil litigation in the people’s court in relation to these claims.² This development, welcomed by the market and investors, makes it possible for investors to claim losses suffered as a result of false statements. However, there are problems and limitations in the circulars issued by the SPC, which raise serious concerns among judges, academics, and practitioners. This paper primarily examines the procedural rules prescribed by the third circular of the SPC, “Several Provisions of the Supreme People’s Court on Hearing Civil Compensation Cases Arising from False Statement on the Securities Market,” with a focus on the limitations of these rules.³

China’s securities regulatory authority has been active in the

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¹ Zuigao remin fayuan guanyu she zhengquan minshi peichang anjian zan buyu shouli de tongzhi [The Notice of the Supreme People’s Court on Temporary Refusal of Filings of Securities-Related Civil Compensation Cases] (Sept. 21, 2001); Zuigao renmin fayuan shouli zhengquan shichang yin xujiachengshu yinfà de minshi qinian jiufen anjian youguan wenti de tongzhi [The Notice of the Supreme People’s Court on Relevant Issues of Filing of Civil Tort Dispute Cases Arising From False Statement on the Securities Market] (Jan. 15, 2002); Zuigao renmin fayuan guanyu shenli zhengquan shichang yin xujiachengshu yinfà de minshi peichang anjian de ruogan guiding [Several Provisions of the Supreme People’s Court on Hearing Civil Compensation Cases Arising From False Statement on the Securities Market] (Jan. 9, 2003).

² The Second Circular of the SPC designated certain intermediate people’s courts to accept and hear civil compensation cases arising from false statement, starting from January 15, 2002, the effective date of the Second Circular of the SPC.

past decade, tackling various forms of securities fraud on the market by means of administrative penalties and criminal charges, with an aim to protect investors and the integrity of the securities market.\(^4\) The 1993 Provisional Measures on Prohibition of Securities Fraud were introduced specifically to deal with insider trading, market manipulation, false disclosure of information, and other forms of securities fraud.\(^5\) Similar provisions were promulgated in the 1993 Provisional Regulations on Share Issuing and Trading,\(^6\) the 1993 Company Law,\(^7\) and the 1998 Securities Law,\(^8\) along with other securities rules and regulations issued by the China Securities Regulatory Commission (CSRC) and Shanghai and Shenzhen stock exchanges. For the first time, the revised 1997 Criminal Law created securities-related criminal offenses that principally targeted various forms of securities fraud.\(^9\) As a result, many firms and individuals who committed securities fraud have been investigated and punished by the CSRC, the principal regulator of the securities industry in China.\(^10\)

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\(^5\) Promulgated by then-Securities Committee of the State Council on September 2, 1993, and was effective immediately.

\(^6\) These measures were promulgated by then-Securities Committee of the State Council on April 22, 1993, and became effective immediately. According to Article 72, those who commit insider trading are subject to a fine between 50,000 to 500,000 yuan in addition to confiscation of illegal gain (as of October 21, 2005, 1 Chinese yuan is equal to 0.123741 U.S. dollars) [1993 Provisional Regulations on Share Issuing and Trading].

\(^7\) Adopted by the Standing Committee of the 8th National People's Congress (NPC) on December 29, 1993, effective from July 1, 1994, and amended by the Standing Committee of the 9th NPC on December 25, 1999. Article 212 states that where companies provide shareholders and the public with false financial reports or conceal material facts, the person in charge or other directly responsible person shall be fined between 10,000 and 100,000 yuan and charged where crimes are committed.

\(^8\) Adopted by the Standing Comm. of the 9th NPC on December 29, 1998, and effective July 1, 1999. Article 5 states generally that securities fraud, insider trading and market manipulation is prohibited [hereinafter 1998 Securities Law].

\(^9\) The 1979 Criminal Law was revised by the 8th NPC on March 14, 1997, and became effective on October 1, 1997 (it was later amended in December 1999, August 2001, December 2001, December 2002, and most recently February 2005). Articles 160, 161, 180, 181, and 182 are concerned with offenses of false disclosure, insider trading and market manipulation.

criminal offenses are committed, detected, and tried, offenders found guilty are subject to punishments by criminal courts.\textsuperscript{11}

On the other hand, these laws and regulations have not provided adequate protection for the rights and interests of investors who suffered economic losses as a result of securities fraud.\textsuperscript{12} This remains a fundamental weakness of the system. Compared with the comprehensive administrative sanctions for securities fraud, there are very limited provisions in the 1993 Provisional Regulations on Share Issuing and Trading that involve civil liability and civil compensation when dealing with securities fraud.\textsuperscript{13} Although the 1998 Securities Law strengthened the regulation of securities market and, as the first securities law in China, brought the national securities market and the regulation into a new stage, it failed to strengthen provisions concerning civil liability and civil compensation.\textsuperscript{14} In the meantime, the number of listed companies on the Shanghai and Shenzhen stock exchanges dramatically increased from less than twenty in the early 1990s to 851 in 1998.\textsuperscript{15} Additionally, the number of market investors

\textsuperscript{11} According to Li Guoguang, the deputy president of the Supreme People’s Court, forty-six securities fraud cases—including cases involving false statement, insider trading and market manipulation—were charged and tried by the people’s courts between 1997 and the end of 2001 in accordance with the revised 1997 Criminal Law. \textit{See} Li Guoguang, \textit{Gaofa Fuyuanzhang Li Guoguang Xishuo Guojia Jinrong Anquan de Sifa Baozhang} [Deputy President of the Supreme People's Court Li Guoguang Talks in Detail about Judicial Protection for the State Financial Safety], \textit{NEWS WEEKLY}, July 23, 2002, \url{http://www.ccmt.org.cn (Zhongguo Shewai Shangshi Haishi Shenpan Wang)} [China Foreign-Related Commercial and Maritime Trial Website].

\textsuperscript{12} The provisions found in these laws and regulations are thin and incomplete concerning civil liabilities of securities fraud and civil compensation to the investors who suffered economic losses as a result of securities fraud. \textit{See infra} notes 13 and 14.

\textsuperscript{13} Article 77 in the 1993 Provisional Regulations on Share Issuing and Trading is the only article that touches on the issue of civil liability and compensation, stating: “where the provision of this regulation is violated and losses are caused to others, it shall bear liabilities for civil compensation according to law.”

\textsuperscript{14} Articles 67 to 71, 183, and 184 in the 1998 Securities Law deal with market manipulation and insider trading, which have no stipulations on related civil liabilities. Only Article 63 expressly mentions civil liability and compensation of losses caused by the false recording, misleading statement, and material omission made by issuers and securities companies.

\textsuperscript{15} \textit{CSRC, Introduction to China's Securities Market}, \url{http://www.csrc.gov.cn}. 
expanded from about two million in 1992 to approximately forty million in 1998. This rapid development was inevitably accompanied by a rise in the number of securities fraud cases and victim investors, whose losses were compounded by the indifference and apathy of courts which refused to hear the victims’ claims. Lawyers, academics, and investors alike lobbied to the SPC, calling for the people’s court to accept and hear these cases.

In response, the first circular of the SPC, issued on September 21, 2001, instructed local people’s courts to continue to ignore all civil compensation claims arising from insider trading, market manipulation, and other securities frauds. The reason given by the SPC for not accepting such cases was that “the people’s courts do not have necessary conditions to accept and hear such cases due to current legislative and judicial limitations.” The second circular, issued four months later, partially reversed the position of the first circular by instructing local intermediate people’s courts to accept and hear cases arising from false statement, but not those arising from insider trading or market manipulation. The third circular, issued on January 9, 2003, expanded on the second circular, setting out more detailed procedural rules for dealing with false statement cases. These procedural rules, in conjunction with the relevant provisions in the 1991 Civil Procedure Law, the

16 Id.
17 According to Li Guoguang, deputy president of the SPC, none of the civil claims brought and filed in the people’s courts between 1991 and 2002 as a result of insider trading, market manipulation and false statement was continued to the stage of substantial hearing. Li Guoguang, supra note 11.
18 Guo Feng, a Beijing-based lawyer and academic who participated in drafting the Securities Law in early 1990s, actively took part in the campaign together with others on behalf of aggrieved investors calling for the people’s court to accept and hear civil compensation claims arising from securities frauds. See Susan V. Lawrence, Shareholder Lawsuits: Ally of the People, FAR ECON. REV., May 9, 2002, at 27.
19 See The Notice of the Supreme People’s Court on Temporary Refusal of Filings of Securities-Related Civil Compensation Cases, supra note 1.
20 Id.
21 See The Notice of the Supreme People’s Court on Relevant Issues of Filing of Civil Tort Dispute Cases Arising From False Statement on the Securities Market, supra note 1.
22 See Rules of the SPC, supra note 3.
23 Adopted by the 7th NPC on April 9, 1991, effective the same day. It replaced
1998 Securities Law, and other relevant laws and regulations, finally provided local intermediate people's courts with the guidelines necessary to address compensation claims arising from securities-related false statements.

This paper will first explore the elements of a false statement and liability under the Rules of the SPC. An analysis of the details of the Rules of SPC from an investor-plaintiff’s point of view will follow, highlighting the procedural steps of the claim and the restrictions imposed by the Rules of the SPC. This is followed by an examination of the defendant’s liabilities and the manner in which investors’ losses are calculated and compensated—the central concern of the Rules of the SPC. Finally, this paper considers the limitations of the Rules of the SPC as they pertain to investor protection, the future development of China’s securities market, and market regulation.

II. False Statements and the Defendant

The Rules of the SPC begin by defining the widely used phrase “civil compensation cases arising from false statement on the securities market” (zhengquan shichang yin xujia chenshu yinfa de minshi peichang anjian). Because the “false statement” (xujia chenshu) is the central basis that gives rise to a cause of action for civil compensation, it is essential to understand what constitutes a “false statement” in China’s securities market under the Rules of the SPC and who can be held liable for involvement in making such false statement.

A. False Statement

According to Article 17 of the Rules of the SPC, a “false statement on the securities market” is defined as a false recording (xujia jizai), misleading statement (wudaoxing chenshu), material omission (zhongda yilou) or improper disclosure (bu zhengdang pilou), all of which are made against the true fact of major events.
by those who have a duty to disclose information on the securities market.\(^{25}\) Article 17 further defines these four types of false statements: (1) a false recording occurs when those who have a duty to disclose information present non-existing facts in disclosure documents; (2) the misleading statement is made by wrongdoers in disclosure documents or announcement to the media which influences investors to act, resulting in significant detriment to their investments; (3) a material omission is the failure to disclose, either wholly or partially, required information by one with the duty to have done so; (4) improper disclosure occurs when one who has a duty to disclose information, but fails to do so within an appropriate time frame or in the appropriate manner prescribed by law.\(^{26}\) According to Article 17 of the Rules of the SPC, major events (zhongda shijian) should be determined by referring to relevant provisions of 1998 Securities Law.\(^ {27}\)

Both the 1998 Securities Law and the 1993 Provisional Regulations on Share Issuing and Trading identify three types of false statements—namely, false recordings (xujia jizai), misleading statements (wudaoxing chenshu) and material omissions (zhongda yilou)\(^ {28}\)—that are identical to the aforementioned three types of false statement under the Rules of the SPC. Unlike the Rules of the SPC, the 1998 Securities Law does not define these three types of false statements.\(^ {29}\) Likewise,
the case for the 1993 Provisional Regulations on Share Issuing and Trading identify the same three types of false statement, but are without their respective definitions. Therefore, it is helpful that the Rules of SPC not only reiterate the position of the 1998 Securities Law and 1993 Provisional Regulations on Share Issuing and Trading but also provide further definitions, albeit brief, for the three types of false statement. Improper disclosure is not prescribed by the 1998 Securities Law and 1993 Provisional Regulations on Share Issuing and Trading. It is an offense unique to the Rules of the SPC, where it is included in the definition of false statement with the original three elements.

As a result, the issue is whether improper disclosure alone can be treated as a “false statement,” thus constituting independent grounds for civil compensation action by investors. In other words, should the definition of “false statement” be broadly or narrowly interpreted? There is no clear indication in the Rules of the SPC that improper disclosure alone can constitute a false statement giving rise to a civil compensation action by investors. What remains to be determined is whether the Rules of the SPC intend improper disclosure to be an integrated element of the definition of “false statement” or a separate ground for civil action. There is no doubt that an essential requirement of the 1998 Securities Law is that disclosures should be timely and made in a manner prescribed by applicable law and regulations. However, it is beyond the scope of the 1998 Securities Law definition of false statement when an action is brought to the people’s court.

30 1993 Provisional Regulations on Share Issuing and Trading, supra note 6, arts. 17, 21, 73, and 74.
31 In other words, improper disclosure is the delay or outright failure to disclose required information in a manner not prescribed by law and regulations.
32 The term “improper disclosure” is not found throughout the 1998 Securities Law and the 1993 Provisional Regulations on Share Issuing and Trading.
33 Article 61 of the 1998 Securities Law requires listed companies to submit their annual reports within four months from the end of a financial year, while Article 62 requires listed companies to make a prompt report of major events to the CSRC and the stock exchange. Article 63 of the 1993 Provisional Regulations on Share Issuing and Trading requires listed companies to disclose information to the national newspapers designated by the CSRC. Rules of the SPC, supra note 3, art. 17, ¶ 6.
34 Rules of the SPC, supra note 3, art. 17.
35 See 1998 Securities Law, supra note 8, arts. 61, 62, 110, and 177.
36 This must be in accordance with Article 17 of the Rules of the SPC.
claiming false statement based either on a defendant’s failure to disclose required information within an appropriate time limit, or on a failure to disclose in newspaper designated by CSRC. 37  

Looking at both cases dealt with by the CSRC and at cases brought to the people’s court to date, punishable false statements normally fall into the three categories of false statement listed by the 1998 Securities Law. 38  

There are different scholarly views on the definition of “false statement” under China’s securities law, and such views depart on the nature, manner, and classification of false statements. 39  One point equally emphasized by scholars is that false statements should relate to major or material events. 40  Such events should include: (1) existing material facts that may affect the price of securities, (2) material changes to existing facts or situations that may affect the price of securities, and (3) material information.

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37 See supra note 28 and accompanying text.

38 Consider the case involving Chengdu Hongguang Industrial Shareholding Company as an example. It is a typical case dealt with by the CSRC. Hongguang company specialized in the production of electron vacuum devices such as black and white and color television tubes and glass bulbs. When Hongguang made its public offering in June 1997, the company issued seventy million A shares that raised 410.2 million yuan. Suspicion was generated by the great disparity between Hongguang's projected profits in its prospectus and actual profits after its IPO. In October 1998, the CSRC imposed sanctions upon the company and thirteen directors after an investigation, which found that at the time of applying for listing, the company falsely reported its 1996 profits and concealed a major event when it did not disclose problems relating to a key production line. After the listing, the company defrauded investors by underreporting the company’s losses in its 1997 interim and annual reports and misusing capital raised from the offering. In the prospectus it was stated that all the capital raised would be used for expansion of color television tube production line; in fact, only 16.5% of the capital raised was used for this purpose with the remaining portion used for paying back bank loans and making up for past losses. The company never disclosed this as a major event. The CSRC fined Hongguang one million yuan, confiscated 4.5 million yuan, and permanently banned He Xingyi, chairman of the board of directors, from serving at the senior management level any listed company or securities company. See Daniel M. Anderson, Taking Stock in China: Company Disclosure and Information in China’s Stock Markets, 88 GEO L.J. 1919, 1931-33 (2002). For the CSRC's penalty decision, see Chufa Jueding [Penalty Decision] (promulgated by the CSRC, Oct. 26, 1998), CSRC investigation series number [1998] 75, http://www.csrc.gov.cn.


40 Id. at 22-23.
composed of material facts and material changes that may affect the price of securities.\textsuperscript{41} Article 17 of the Rules of the SPC indicates that false statements are related to material events.\textsuperscript{42} The three-fold significance of this connection is as follows: (1) it clarifies the position of the 1998 Securities Law, since the false recording and misleading statements are not clearly prescribed to the terms of material event; (2) it sets out criteria for plaintiffs and defendants to argue before the court when debating the existence of a causal link between false statements and losses; and (3) it could have a positive effect on the securities market, because companies and investors would focus on key information and reduce other unnecessary information on the market, which could reduce the cost incurred by companies after disclosing information.\textsuperscript{43}

\textbf{B. Defendants}

Those who make false statements directly or indirectly could be liable to investors in a civil suit. Article 7 of the Rules of the SPC, in accordance with relevant provisions of 1998 Securities Law and 1993 Provisional Regulations on Share Issuing and Trading,\textsuperscript{44} provides a specific list of possible defendants. This list includes a wide range of companies, organizations, and individuals.\textsuperscript{45} It is noteworthy that promoters, controlling

\textsuperscript{41} See, Guo Feng, \textit{Xujia Chenshu Qingquan de Rending ji Peichang [Determination of Tort of False Statement and Compensation], Zhongguo Fauxe [2 China Legal Science]}, at 96 (2003).

\textsuperscript{42} Rules of the SPC, supra note 3, art. 17, ¶¶ 1 and 2.

\textsuperscript{43} See Guo Feng, supra note 41, at 97.

\textsuperscript{44} 1998 Securities Law, supra note 8, arts. 24, 63, 72, 161, and 202; Provisional Regulations on Share Issuing and Trading, supra note 6, art. 17.

\textsuperscript{45} Article 7 of the Rules of the SPC, supra note 3, states:

The defendants to the civil compensation claims arising from securities-related false statement should be those who make false statements, including (1) promoters, controlling shareholders and the like who exercise actual control; (2) issuers or listed companies; (3) securities underwriters; (4) securities listing sponsors; (5) professional intermediaries including accountant firms, law firms and asset valuation firms; (6) responsible directors, supervisors, managers and other senior management personnel of the issuers, listed companies, securities underwriters, or securities listing sponsors; directly responsible persons of professional intermediaries; and (7) other organisations or individual persons who make false statements.
shareholders, and those who exercise actual control over the company are named at the top of the list; this is an important provision that would have a significant impact in practice.\textsuperscript{46} It is significant that directors, supervisors, managers, and other senior management personnel employed by issuers, listed companies, securities underwriters, or securities listing sponsors could become defendants if they are responsible for making false statements.\textsuperscript{47} The same duty to refrain from making false statements binds persons in accounting, law, or asset-evaluation firms.\textsuperscript{48} The Rules of the SPC do not specifically mention the position of those companies or organizations involving foreign parties, such as joint ventures, but they could become defendants in the same way, in accordance with Article 7 of the Rules of the SPC.\textsuperscript{49}

Compared to the Second Circular of the SPC—where possible defendants are not named in a specific list but only mentioned briefly in the context of courts' jurisdictions over such civil lawsuits—the current Rules of the SPC are broader in scope and provide a clearer list of possible defendants.\textsuperscript{50} Investors may, according to the Rules of the SPC, sue any one of the possible defendants on the list as an individual defendant, or sue all of them

\begin{itemize}
\item \textsuperscript{46} Jia Wei, a judge of the Supreme People's Court who participated in the drafting of the Rules of the SPC, thinks that it has a positive and practical significance to highlight promoters and controlling shareholders on the list as defendants to be sued by investors. \textit{See} Jia Wei, \textit{Zhengquan Shichang Qinquan Minshi Zeren zhi Faren—Jiexi ‘Guanyu Shenli Zhengquan Shichang Yin Xujia Chenshu Yinfa de Minshi Peichang Anjian de Ruogan Guiding’ [The Commencement of Civil Liability for the Tort on the Securities Market—Explanation and Analysis of ‘Several Provisions of the Supreme People's Court on Hearing Civil Compensation Cases Arising from False Statements on the Securities Market’]}, \textit{FALU SHIYONG [3 APPLICATION OF LAW]}, at 9 (2003).
\item \textsuperscript{47} \textit{Id.} at 7.
\item \textsuperscript{48} Rules of the SPC, \textit{supra} note 3, art. 7, ¶ 5; \textit{supra} note 45.
\item \textsuperscript{49} Beijing KPMG Zhenhua, a joint venture accountant firm, and Hong Kong KPMG accountant firm became defendants in Jinggang B share case filed to the Intermediate People's Court of Shenyang City on February 9, 2003, for their involvement in Jingzhou Gangwu Company's false statement, whose B share was listed on the Shanghai Stock Exchange in May 1998. \textit{See} Shenyang Zhongyuan Shenli Jinggang B Gu An, Bimawei Fenzhi Jigou Cheng Beigao [Shenyang Intermediate People's Court Hear Jinggang B Share Case, KPMG Branch Office Becomes Defendant], Feb. 11, 2003, http://www.chinacourt.org [hereinafter Shenyang].
\item \textsuperscript{50} \textit{See} The Notice of the Supreme People's Court on Relevant Issues of Filing of Civil Tort Dispute Cases Arising From False Statement on the Securities Market, \textit{supra} note 1, art. 5.
\end{itemize}
as joint defendants. Significantly, Article 7 of the Rules of the SPC leaves the list open by concluding with the phrase, "other organizations and individual persons who make false statements." In other words, whoever makes false statements should be held liable. This leaves courts with substantial leeway. Obvious cases include newspapers, television, or other media who knowingly participate in making false statements to the public. Difficulty may arise in deciding less obvious cases—for example, where the role played by organizations or individuals is indirect. Under such circumstances, it may not be easy for a local intermediate people’s court to draw a clear line for determining who should be made a defendant without further guidelines from the SPC. Nevertheless, the Rules of the SPC's provision on possible defendants, together with the provisions on defendants' liability, will certainly benefit investors. In addition, they could play a preventative function by sending out a warning signal to those who are involved in securities-related disclosure of information one way or another.

III. Procedural Rules

Before investors go to the people’s courts to claim compensation for their losses resulting from false statements, there must be an administrative penalty decision or a criminal court judgment made against the wrongdoers for their false statements. On this basis, the people’s court is afforded jurisdiction to hear investor’s cases. After this initial procedural step, claimant investors face a series of issues addressed by the Rules of the SPC, including the following:

(1) Under what conditions will the people’s courts accept their cases?
(2) Which courts have jurisdiction to hear their claims?
(3) What is the relevant statute of limitations period and how is it calculated?

51 Rules of the SPC, supra note 3, art. 12.
52 Rules of the SPC, supra note 3, art. 7, ¶ 7; supra note 45.
54 See the discussion under “Defendants’ Liability and Compensation of Investors’ Losses”; see infra Part IV.
55 Rules of the SPC, supra note 3, art. 6.
(4) What are the forms of action claimant investors can choose for their lawsuits?
(5) What is the role of mediation in their respective proceeding?

A. Administrative Penalty Decision and Criminal Court Judgment

One of the restrictive provisions stipulated in the Second Circular of the SPC was that the people's court could not accept civil compensation lawsuits by investors arising from securities-related, false statements. The only exception is if the CSRC or its regional office already investigated the alleged false statements and imposed an administrative penalty on which investors could rely as a factual basis for their actions. This restrictive rule has not been changed under the current Rules of the SPC, except that criminal judgments by the people's courts and administrative penalty decisions made by authorities other than the CSRC or its regional offices are now recognized. Therefore, the people's court may hear such civil compensation actions in addition to the administrative penalty decision made by the CSRC or its regional offices.

In accordance with the Rules of the SPC, investors can go to the people's court if the alleged false statement has been investigated by one of these authorities and a sanction has been

56 The Notice of the Supreme People's Court on Relevant Issues of Filing of Civil Tort Dispute Cases Arising From False Statement on the Securities Market, supra note 1, art. 2.
57 Id.
58 Rules of the SPC, supra note 3, art. 5. Administrative penalty decisions made by authorities other than the CSRC and its regional offices include the decision made by the Ministry of Finance as well as decisions made by other authorities and institutions that have power to impose administrative penalties. In accordance with Articles 16, 17, and 18 of the Administrative Penalty Law, whether an organization has power to impose administrative penalty, except those which limit personal freedom, is primarily a matter decided by the State Council, provincial or autonomous region governments. Further, the organization has to be one with a function to administer public affairs. Law of the People's Republic of China on Administrative Penalty (promulgated by the 8th Nat'l People's Cong., Mar. 17, 1996, effective Oct. 1, 1996), translated at LexisNexis PRCLEG 1148 (2005) [hereinafter Admin. Penalty Law].
59 Id.
imposed.\textsuperscript{60} This rule has both procedural and evidentiary effects. Procedurally, investors may commence litigation if there is an administrative or criminal sanction, regardless of the content of sanction documents.\textsuperscript{61} Evidentially, the effect is that the facts concluded in the sanction documents are treated as evidence in civil litigation.\textsuperscript{62} It has no conclusive effect with regard to the scope of defendants not named in sanction documents, and plaintiffs can decide who to sue as defendant in addition to the named defendants. In other words, administrative or criminal sanctions are treated only as a basis for the court to accept cases, not as a basis for determining defendants in the civil suit. This is regarded as beneficial to investors by allowing them to choose who to sue and who not to sue. Therefore, the investor may enlarge or limit the number of defendants beyond the sanction document.\textsuperscript{63}

Although it is a positive step that the Rules of the SPC have expanded the reach of authorities whose penalty decisions are recognized as a prerequisite for acceptance of civil actions by the people’s courts, this prerequisite rule—together with its original format stipulated in the second circular of the SPC—has nevertheless suffered a great deal of criticism. The main criticism is that allowing angry shareholders to flood the people’s court may have adverse social and political repercussions.\textsuperscript{64} Others criticize

\begin{itemize}
\item \textsuperscript{60} The majority of cases filed in the people’s court so far are based upon the penalty decisions of the CSRC and its regional offices or criminal court judgments. Jinggang B share case which was filed to the Intermediate People’s Court of Shenyang City on February 9, 2003, is the first case based upon a penalty decision made by the Ministry of Finance in September 2002 against Jingzhou Gangwu Company for the false statement it made in connection with the listing of its B share in 1998. For the news report of the case, see \textit{Shenyang, supra} note 49.
\item \textsuperscript{61} See Song Yixing, \textit{Xuji Chenshu Minshi Peichang Susong Zhidu Ruogan Wenti de Sikao [Thoughts on Several Issues of the Litigation System for Civil Compensation Arising from False Statements]}, \textit{FALU SHIYONG [4 APPLICATION OF LAW]}, at 9 (2003) (discussing more on the procedural and evidential effects of the rule).
\item \textsuperscript{62} See \textit{id}.
\item \textsuperscript{63} \textit{Id}.
\item \textsuperscript{64} See Lawrence, \textit{supra} note 18, at 27 (stating that “so for many officials, angry shareholders organizing themselves into nationwide networks for the purpose of lawsuits spells trouble”). See also William I. Friedman, \textit{One Country, Two Systems: The Inherent Conflict Between China’s Communist Politics and Capitalist Securities Market}, 27 \textit{BROOK. J. INT’L LAW} 515 (2001-2002) (describing “stock fever” in China and citizens on several occasions have taken to the streets and rioted against police for the mere
the rule from a legal and procedural point of view. In their view this restrictive rule actually reduces the civil litigation process based on the availability of administrative decisions or criminal court judgments. Further, critics assert that the expanded rules deprive investors of the right to bring a civil claim supplementary to a criminal proceeding in accordance with the 1996 Criminal Procedure Law. In both critiques, the SPC is chastised for exceeding its judicial interpretation power.

One of the possible consequences of this rule is that it encourages makers of false statements to use either social connections or bribery to influence the administrative investigation in order to escape civil litigation and civil compensation. It is true that administrative processes in China are not as transparent as court proceedings where cases are tried openly. It is therefore possible that an administrative investigation process may be influenced behind-the-scenes by personal connections, local protections, or political forces. For example, it has been noted that the timing of the investigation and the inability of the CSRC to pursue five directors involved in the case of Hainan Minyuan Modern Agricultural Company was suspect for political reasons, as well as personal connections. The process can even be


67 See, e.g., Yin Jie, supra note 65, at 111.

68 This is where a case is investigated by an administrative authority and an administrative penalty decision is subsequently made.

69 Two of the largest shareholders of Hainan Minyuan Modern Agricultural Company apparently had ties to China's senior leader at that time. Hainan Minyuan Modern Agricultural Company made its public offering on April 30, 1993. The company's 1995 yearly report indicated a profit of 0.001 yuan per share and a stock price around 3.65 yuan. In January 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 rose to 26.18 yuan. The company released a mysterious "supplemental report" on
hijacked by wrongdoers or their accomplices without being noticed by the public and grieved investors. The abuse of the administrative investigation process could be prevented if the civil court plays an active and decisive role in deciding whether a given statement or an activity amounts to false statement, and whether it is subject to civil compensation. This could only happen if the prerequisite rule is lifted by an amendment of the Rules of the SPC.

On the other hand, some authors—particularly judges—support the prerequisite procedure set out by the Rules of the SPC. They argue that the procedure is necessary for the time being for three reasons. First, it is in line with the current limited judicial sources of the people's court; it is otherwise difficult for the people's court to cope with a situation of a "securities litigation time bomb." Second, it can help plaintiffs collect evidence and reduce their burden of proof; therefore, it is good for the protection of investors. Third, it is in line with the current provision of the 1998 Securities Law with regard to the power of the administrative regulator and the role of administrative

February 1, 1997, which changed some of the company's financial indicators. Towards the end of February 1997, trading of the company's stock was suspended and in March 1997, five directors who approved the false reports resigned and disappeared. Responding to requests from investors, an investigation into Minyuan's financial reports was launched on March 5, 1997. After a year-long investigation, the CSRC found that the company had fraudulently inflated accounts by 1.2 billion yuan from illegal real estate transactions in Beijing. Minyuan audaciously refused to help the CSRC find the five directors, and the CSRC later released a notice stating that it was searching for the five directors but that Minyuan was under "no obligation" to help. See more details in Daniel M. Anderson, Taking Stock in China: Company Disclosure and Information in China's Stock Markets, 88 Geo L.J. 1919, 1934-35 (2002).

In the case of Hainan Minyuan Modern Agricultural Company, a question was asked whether the five fugitive directors had behind-the-scenes protectors that were able to stop the CSRC from compelling Minyuan's help in the investigation. Id. at 1935.

See Kong Lin & Ye Jun, Zhengquan Shichang Yin Xujia Chenshu Yinfa de Minshi Peichang Anjian de Shouli Tiaojian [Conditions for Acceptance of Civil Compensation Cases Arising from False Statements on the Securities Market], Falü Shiyong [4 Application of Law], at 21, 22 (2003) (one of the authors is from the Supreme People's Court). Sheng Huanwei & Zhu Chuan, Zhengquan Xujia Chenshu Minshi Peichang Yinguo Guanxi Lun [On Causal Link of Civil Compensation Cases Arising from Securities-related False Statements], Fauxe [6 Legal Science], at 102 (2003) (both authors are from the primary Intermediate People's Court of Shanghai).

Kong Lin & Ye Jun, supra note 71, at 21.

Id.
penalty. The 1998 Securities Law gives administrative regulators a strong overall power to monitor the securities market and the administrative penalty occupies a central place for the regulation of China’s securities market. Consequently, proponents argue that it is appropriate to rely upon the role of the administrative regulator and administrative penalty before making use of judicial process and the exclusive role played by civil litigation in compensating victims. While arguing for the prerequisite procedure, these authors also acknowledge that there is a defect in the system—specifically, when an alleged false statement is not punished by an administrative regulator or criminal court for one reason or another, those investors who suffered losses as a result of the false statement will not be able to get remedies through civil compensation litigation.

B. Acceptance of Case by the Court

In accordance with Article 6 of the Rules of the SPC, the people’s court should accept a suit by investors if it is brought under two presumptions: (1) if the losses suffered by investors themselves result from a false statement on the securities market, and (2) if the case complies with the four provisions for the initiation of a civil lawsuit set out in Article 108 of the 1991 Civil Procedure Law. At the heart of Article 6 of the Rules of the SPC is the requirement that investors must have suffered losses as a result of false statements and the victims must be the investors

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74 Id.
75 Id.
76 Id. at 22.
77 Id.
78 See Civ. Proc. Law, supra note 23, art. 108. These four conditions include: (1) plaintiffs are those individuals, legal persons, or other organizations whose interests are directly related to the lawsuits; (2) there are specific defendants; (3) there are specific claims, facts, and reasons; (4) it is within the scope of civil litigation matters the people’s court accept and within the jurisdiction of the court concerned. In accordance with the Opinion on Questions Concerning Application of the Civil Procedure Law (Supreme People’s Court, issued on July 14, 1992), arts. 139, 141, and 142 (P.R.C.), if the case does not comply with these four conditions, the people’s court shall make a ruling not to accept the case, or, where applicable, transfer the case to the court that has jurisdiction. If the claimant applies again and the application complies with these conditions, the people’s court shall accept the case. Id.
themselves. Apart from a copy of any relevant administrative penalty decisions or criminal court judgments, claimants are required to submit certified documents proving their identities, as well as any evidence of their investment loss, such as trading receipts. There must be an effective administrative penalty decision or a criminal court judgment on point at the time when the civil litigation is brought to the people’s court.

"Investor" is defined as a natural person, legal person, or other organization that subscribes and trades securities on the securities market. The "securities market" is defined as: (1) a market where shares are issued to the public; (2) a trading market where securities are traded openly; (3) a transferring market where securities are transferred by securities companies acting as agents; and (4) other securities markets established with the approval of the government. If investors enter into transactions in these markets and suffer losses as a result of false statements, they can

79 Rules of the SPC, supra note 3, art. 6.

80 Id. The purpose of the requirement for submission of certified documents showing the identity of claimants is said to make sure that plaintiffs are those genuine investors who suffered losses as a result of false statement. But see Tu Binhua, supra note 66, at 96 (arguing that such a requirement is an unnecessary burden for investors since their identities have already shown on original documents of accounts or settlement of securities).

81 For example, in the Jiuzhou case the claimant was rejected by the people’s court because the administrative penalty decision in question had not become effective. The Jiuzhou group, a listed company from Fujian province, and its thirteen responsible staff were sanctioned by the CSRC on October 26, 2001, for the false statements it made concerning the company’s profits in 1996, 1997, and 1998, respectively. Mr. Cao, a shareholder of the company who suffered a loss of 104 thousand yuan, filed a case in the people’s court. In examining whether his application satisfies the requirement that there must be an effective administrative penalty decision, the court found that three directors of the company had never received the administrative penalty decisions from the CSRC and the CSRC and, when questioned, could not provide evidence to prove the delivery of the decision to the directors. In accordance with the Admin. Penalty Law, supra note 58, arts. 40-41, and The Notice of the Supreme People’s Court on Relevant Issues of Filing of Civil Tort Dispute Cases Arising From False Statement on the Securities Market, supra note 1, art. 2, the court ruled that since the decision was not delivered to all the parties concerned, it did not become effective. Mr. Cao’s application was therefore turned down by the court. See Yang Limao and Chen Chaoyang, Zhengquan Qinquan Susong Qianzhi Chengxu de Tantao [Discussion on Prerequisite Procedure in Securities Tort Litigation], http://www.chinacourt.org [ZHONGGUO FAYUAN WANG], Nov. 25, 2002.

82 Rules of the SPC, supra note 3, art. 2.

83 Id.
sue the makers of false statements for compensation under the Rules of the SPC. Beyond this, the Rules of the SPC are not applicable. Two kinds of transactions are explicitly excluded from the application of the Rules of the SPC: (1) transactions illegally concluded outside the securities market established by the government, and (2) transactions concluded on the securities market established by the government but through an agreement of assignment—a transaction directly negotiated between the parties.

C. Statute of Limitation and Suspension of Proceeding

The Rules of the SPC stipulate that the limitation period for such civil suits is two years from the date when an administrative penalty decision is announced, or when a criminal court judgment becomes effective. The two-year period is standard for most civil actions. If there are more than two administrative decisions concerning the same false statement but different false statement makers, the period is calculated from both the date when the first administrative decision is announced and—if there is both an administrative penalty decision and a criminal court judgment—from the date when the criminal court judgment becomes effective, if this comes before the administrative penalty decision. Since the calculation is based on administrative penalty decisions or criminal court judgments, it is crucial that the decision or judgment in question is final. The situation may become complicated if an administrative penalty decision is subject to an administrative review or administrative litigation or

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84 Id. arts. 1-2.
85 Id. art. 3.
86 Id. art. 5.
87 General Principles of the Civil Law, (promulgated by Order no. 37 of the President, Apr. 12, 1986, effective Jan. 1, 1987), art. 135, translated at LexisNexis PRCLEG 1165, 2005 (P.R.C.); see also General Principles of the Civil Law, arts. 137 and 140 [hereinafter Gen. Principles of Civ. Law]. This further provides that under special circumstances the people’s court may extend the limitation period; the limitation period shall be discontinued if a suit is brought or if one party makes a claim for or agrees to fulfillment of obligations and a new limitation period shall be counted from the time of the discontinuance. The two-year period generally starts on the day when the plaintiff knows or ought to have known that his or her rights have been infringed. Id.
88 Rules of the SPC, supra note 3, art. 5.
if the criminal court judgment is subject to a supervision procedure set out in Articles 203 to 207 of the 1996 Criminal Procedure Law.\[^{89}\]

With regard to administrative penalties, Article 11 of the Rules of the SPC provides that after the civil court begins to hear a case it may suspend the hearing if the defendant applies for an administrative review or initiates administrative litigation against the administrative penalty he received and, if the penalty in question is cancelled the court should end the hearing.\[^{90}\] However, Article 11 does not provide further guidance as to who will bear the cost of a cancelled proceeding if the hearing comes to an end because the administrative penalty in question is cancelled.\[^{91}\]

The Rules of the SPC provide no further procedural guidance regarding criminal judgments. If a defendant appeals against the criminal judgment in accordance with the supervision procedure of Articles 203-207, this gives rise to several questions. Assuming a civil court starts to hear a case and the defendant appeals against the criminal judgment, should the civil court suspend the hearing in the same way as it suspends the cases involving administrative penalty decisions? Or should the court continue to hear the case until the judgment is overturned by the criminal appeal court, which giving civil court a reason to end the hearing? Under such circumstances, who is going to bear the cost of failed civil proceeding? The defendant or his representative can appeal at any time against an effective and final judgment if there exists one of the circumstances prescribed by Article 204 of the 1996 Criminal Procedure Law (i.e., as if new evidence emerges with an error in

\[^{89}\] According to the 1999 Administrative Review Law (promulgated by Standing Comm. of the People's Cong., Apr. 29, 1999, effective Oct. 1, 1999), art. 9 (P.R.C.) [hereinafter 1999 Admin. Rev. Law], a defendant can apply for an administrative review of the penalty decision made by the CSRC or other administrative authorities within sixty days from the date of the receipt of the decision. Alternatively, he can, in accordance with art. 39 of the 1989 Administrative Procedure Law, directly apply within three months to the people's court for an administrative litigation unless it is required by administrative regulation that he has to go through the administrative review process first. 1989 Administrative Procedure Law (promulgated by the Standing Comm. Nat.'l People's Cong., Apr. 1, 1989, effective Oct. 1, 1990), art. 39, translated at LexisNexis PRCLEG 1204 (2005) (P.R.C.) [hereinafter 1989 Admin. Proc. Law].

\[^{90}\] Rules of the SPC, supra note 3, art. 11.

\[^{91}\] Id.
judgment regarding the fact of the case). It is therefore necessary for the Rules of the SPC to provide further guidance regarding the situation that arises when a criminal court judgment is subject to a supervision procedure.

D. Jurisdiction of the Court

Intermediate people’s courts are the courts designated by the Rules of the SPC as courts of first instance to hear such lawsuits. They include the intermediate people’s courts that are located: (1) in the cities where provincial governments or autonomous region governments are located; (2) in the four metropolitan cities; (3) in the cities that have a separate planning arrangement; and (4) in the cities of special economic zones. The second level intermediate people’s courts, in accordance with the 1991 Civil Procedure Law, have jurisdiction as first instance courts over three categories of civil cases: (1) cases involving foreign parties; (2) the cases that are significant to local jurisdictions; and (3) the cases that are designated by the SPC. Cases arising from securities-related false statements are complicated and of wide significance, so it is anticipated that the SPC would, in accordance with the provisions of the 1991 Civil Procedure Law, designate intermediate people’s courts as the primary court to deal with these cases. This arrangement is criticized because it “may prevent defrauded investors from getting timely judicial remedies

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92 Other circumstances prescribed by Article 204 of the 1996 Criminal Procedure Law include where the law is found to have been wrongly applied and where the judge who tried the case is found to have accepted bribery.

93 Rules of the SPC, supra note 3, art. 8.

94 There are twenty-seven cities where provincial governments and autonomous regional governments are located, such as Guangzhou in Guangdong province and Lasha in the Tibet autonomous region.

95 These four metropolitan cities are Beijing, Tianjing, Shanghai, and Chongqing.

96 These are the cities that are separated from other cities in terms of budgetary arrangement, investment priority, appointment of administration, etc. They are often those few big and important cities of a province or autonomous region apart from their capital cities.

97 They are Shenzhen, Zhuhai, and Shantou in Guangdong province and Xiamen in Fujian province.


99 See Rules of the SPC, supra note 3.
due to the limited number of intermediate level courts and the potentially large number of suits."  

Regarding jurisdiction of the court, the Rules of the SPC distinguish between issuer or listed company defendants and other defendants. Where the defendants are issuers or listed company defendants, the intermediate people's court at the location of issuers or listed companies shall have jurisdiction over the case, as designated by the Rules of the SPC. Where the defendants are an organization, individuals other than issuers, or listed companies, the intermediate people's court located at the residence of the defendants shall have jurisdiction over the case, in accordance with the Rules of SPC. The basic principle regarding the so-called geographical jurisdiction (diyu guanxia) is prescribed by Article 22 of the 1991 Civil Procedure Law. Article 22 provides that the people's court that is located at the residence or domicile of defendants, whether an individual or legal person, is the court that has jurisdiction over the civil action at issue. Where there are several defendants in an action with residences in multiple jurisdictions, the people's courts in these different jurisdictions shall all have jurisdiction over the action. According to Article 35 of the 1991 Civil Procedure Law, the plaintiffs can start the action at any one of these courts. If the plaintiffs commence the action at more than one of these courts, the court that first accepts the case shall have the jurisdiction over the action.

According to the Rules of the SPC, where the defendants are not issuers or listed companies, the intermediate people's court that has jurisdiction and has accepted the case may, upon application by the parties involved or consent by all the plaintiffs, add relevant issuers or listed companies as defendants to the

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100 Guiping Lu, supra note 65, at 794.
101 Rules of the SPC, supra note 3, art. 9.
102 Id.
103 Id.
105 Id.
106 Id.
107 Id. art. 35.
108 Id.
However, that court must transfer the case to the intermediate people's court located at the residence of the issuer or listed company defendants. On the other hand, if no application has been put forward by the parties, no consent has been obtained from the plaintiffs, and if the court regards it as necessary to add relevant issuers or listed companies as defendants, the court may then notify the issuer or listed company to join the litigation as defendants, though the court may not transfer the case thereafter.

The problem with the distinction made by the Rules of the SPC between issuer and listed company defendants and other defendants and the priority given to the intermediate people's courts situated at the location of issuers or listed companies is that it may leave plaintiff shareholders and other defendants in a disadvantageous position. This is because the local intermediate people's courts in proximity to an issuer or listed company have a tendency to make rulings or judgments in favor of these large issuers or listed companies and against small and distant plaintiff shareholders. To protect themselves, the plaintiff shareholders may, in accordance with Article 10 of the Rules of the SPC, refuse to give consent to the court to add a relevant issuer or a listed company as an additional defendant; therefore, the court may not transfer the case to the local court of issuers or listed companies. Note that the court can freely add issuers or listed companies as defendants if the court deems it necessary. In effect, this provision gives plaintiff shareholders a limited degree of procedural protection. The same is true for the defendants who prefer to have their case heard at their residence rather than to be transferred to the local court of the issuer or listed company defendants.

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109 Rules of the SPC, supra note 3, art. 10.
110 Id.
111 Id.
112 See Walter Hutchens, infra note 134, at 640 (arguing that the Rules of the SPC require that suits be brought in the defendant's home jurisdiction, where the connections among local courts, local listed companies, and local governments suggest that plaintiff cannot easily prevail).
113 Rules of the SPC, supra note 3, art. 10.
E. Forms of Action Available to Investors

The second circular of the SPC ruled out class action suits (jituan susong) as an acceptable form of action for civil compensation cases arising from securities-related false statements. This continues to be the position in the current Rules of the SPC. The form of action available for plaintiffs to bring compensation claims to the court is instead limited to individual action (dandu susong) or joint action (gongtong susong). In accordance with the 1991 Civil Procedure Law, joint action refers to an action where one or both parties consist of two or more persons with an object of action being the same or of the same category. The people's court considers that, with the consent of the parties, the action can be combined into one trial. Since joint actions, particularly those with a large number of parties on either side, have representatives to manage the case on behalf of other participants, they are also commonly called a representative action (daibiaoren susong). As the number of claimants involved in a securities-related false statement case tends to be large, it follows that the joint action should be a dominant form of action for this type of case.

This is reflected in the Rules of the SPC, which contain further detailed rules regarding joint action and when priority is given to joint rather than individual action. Thus, when there are both

114 The Notice of the Supreme People’s Court on Relevant Issues of Filing of Civil Tort Dispute Cases Arising From False Statement on the Securities Market], supra note 1, art. 4.
115 Rules of the SPC, supra note 3, art. 12.
116 Id.
117 The same category (tongyi zhonglei) means the rights and obligations in an action fall into a same type. For example, three different and unconnected defendants owe a plaintiff rent of various amounts. The rent and obligation to pay it fall into same category. Instead of dealing with these three suits individually, the court may combine them into one joint action. See Liu Jiaxing, Minshi Susong Jiaocheng [Textbook on Civil Litigation] 85 (1982), Beijing Daxue Chubanshe [Beijing University Press].
119 See Tu Binhua, supra note 66, at 97; see also Note, infra note 129, at 1523 n.2 (noting “although formally called daibiaoren susong (representative lawsuits), many Chinese commentators and press accounts use the terms jituan susong or jituanxing susong (class action), especially when referring to suits in which the number of plaintiffs is not fixed.”).
120 Rules of the SPC, supra note 3, arts. 13, 14, 15, and 16.
individual and joint actions initiated by different plaintiffs suing the same defendants based on the same false statement they made, the court may order the individual action plaintiff to join the joint action.\textsuperscript{121} Similarly, when more than one joint action involves the same defendants based on the same false statement, the court may consolidate the claims into one joint action.\textsuperscript{122} The number of plaintiffs in a joint action should be determined before the hearing, and where the number of plaintiffs is large, two to five representatives may be elected as litigation representatives.\textsuperscript{123} These litigation representatives, through a special power of attorney granted to them by the other plaintiffs, represent the plaintiffs in court, change or cancel claims made by the plaintiffs, and settle or reach a mediation agreement with defendants.\textsuperscript{124} Each of the litigation representatives may entrust one or two legal representatives with the action.\textsuperscript{125} Where the case involves a large number of plaintiffs, the court may assign a total amount of compensation in the judgment itself, with an attached appendix that lists the names of every plaintiff and the compensation awarded to each of them.\textsuperscript{126} The Rules of the SPC came into effect on February 1, 2003, and the first joint action case involving several hundred plaintiffs was accepted in that month by the Intermediate People’s Court of Ha’erbin City.\textsuperscript{127} This has since been followed by more joint action cases coming into the people’s court.\textsuperscript{128}

\begin{itemize}
\item \textsuperscript{121} Id. art. 13.
\item \textsuperscript{122} Id.
\item \textsuperscript{123} Id. art. 14.
\item \textsuperscript{124} Id. art. 15.
\item \textsuperscript{125} Id. art. 14.
\item \textsuperscript{126} Rules of the SPC, supra note 3, art. 16.
\item \textsuperscript{127} See Ma Shiling, Gongtong Susong Diyi An Jian, Daqing Lianyi An Suopei Yu Qianwan [The First Joint Action Case Was Filed, Daqing Lian Case Compensation Over Ten Million yuan], Zhongguo Fayuan Wang, Feb. 11, 2003, http://www.chinacourt.org. On February 9, 2003, the Intermediate People’s Court of Ha’erbin City formally accepted a case represented by the Guohao Law Firm’s Shanghai office involving an initial group of 107 plaintiffs and another 300 or more plaintiffs to be added to the case by the middle of that month. In March 2002, the Guohao Law Firm’s Shanghai and Beijing offices were entrusted respectively by five representatives on behalf of 679 investors to sue Daqing Lianyi, a listed company, for the losses caused by the false statement it made. However, the case was not accepted by the court until after the Rules of the SPC became effective. Id.
\item \textsuperscript{128} See Jinan Gumin Zhuanggao Dongfang Dianzi, Suopei Jin E Da 300 Yu
Articles 54 and 55 of the 1991 Civil Procedure Law separate joint actions into two categories: (1) cases in which the number of parties is fixed, and (2) cases in which the number of parties is not known at the time the case is filed. Since Article 55 allows the court’s rulings or judgments to be applied to those who have not registered with the court at the time the case is filed but who later bring lawsuits within the prescribed statutory limitation period, a joint action under Article 55 may accommodate a potentially large number of plaintiffs, compared with the joint action under Article 54, in which definite parties are determined.

Wanyuan [Jinan Shareholders Sue Dongfang Dianzi, Claiming Figure Reaches Over 3 Million Yuan], July 10, 2003, http://www.chinacourt.org [ZHONGGUO FAYUAN WANG]; Yinchuanshi Zhongyuan Zhengshi Shouli Yinguangxia Minshi Qinquan Peichang An [Yinchuan City Intermediate People’s Court Formally Accepted Yinguangxia Civil Tort Compensation Case], Aug. 1, 2002, http://www.chinacourt.org [ZHONGGUO FAYUAN WANG]. The Dongfang Dianzi case was filed to the Intermediate People’s Court of Qingdao City in July 2003, which involved an initial group of 141 shareholder plaintiffs with more to join. After four individual cases suing Guangxia (Yinchuan) Industrial Limited Company were accepted by the Intermediate People’s Court of Yinchuan City on July 31, 2003, the lawyers representing the case prepared more documents involving about 1,000 plaintiffs. Id.


See 1991 Civ. Proc. Law, supra note 23. Article 54 impacts cases in which the number of parties is fixed at the time the case is filed. It provides that if the number of parties on either side of the litigation is large, such parties may choose representatives to carry out the litigation. Article 55 also impacts cases in which the number of parties is not fixed at the time the case is filed. It provides that if many parties have similar claims but the actual number of parties is not known at the time the case is filed, the court may issue a notice detailing the case and the claims and notifying all persons whose rights are similarly affected to register with the court within a specified period. The parties who have registered may select representative. If the parties fail to do so, the people’s court may choose representatives in consultation with the registered parties. Article 55 also provides that the court’s ruling or judgment is binding on all those who have registered with the court, and is applicable to those who have not registered with the court but who have brought lawsuits within the prescribed limitation period. Both Articles 54 and 55 provide that the acts of the representatives are binding on the parties whom they represent. However, if the representatives change or abandon claims, accept the claims of the opposing party, or settle the case, they must seek the consent of the parties whom they represent. According to Articles 59 and 62 of the Supreme People’s Court Opinions on “Several Issues Relating to Application of the Civil Procedure Law of the PRC,” “large” parties are generally meant to be more than ten parties and, two to five representatives may be elected and they may entrust one or two persons as their legal representatives. Id.
and filed to the court before the case is heard. Because Article 14 of the Rules of the SPC requires that the number of plaintiffs in a joint action be determined before the hearing, it effectively limits such litigation to the first category of joint action prescribed by Article 54 of 1991 Civil Procedure Law. One of the negative consequences of this limitation from a point of view of investor claimants is that they have to bear a burden to make sure that they join the action before the hearing; otherwise, they may not be compensated or could incur unnecessary costs if they later bring individual actions. Some criticize this limitation as a substantial procedural hurdle to investors’ access to judicial recourse because it could lead to judicial inefficiency and injustice to small investors.

The joint action permitted under the Rules of the SPC resembles a U.S. class action in some respects, though it differs in regards to the registration requirement, the right of plaintiffs, the power of representatives, and the binding effect of the court’s rulings or judgments. Some Chinese scholars advocate that the U.S.-style class action is more economical and better for this type of litigation and the SPC should adapt it for such litigation, subject to further amendments to the 1991 Civil Procedure Law. Others, particularly judges from the people’s courts, argue that conditions are not ripe for such a move. They posit that since

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131 Id.

132 Rules of the SPC, supra note 3, art. 14.

133 See Guiping Lu, supra note 65, at 798-801.

134 See Tu Binhua, supra note 66, at 97. The author explains the difference between a class action and a Chinese representative action in three respects: (1) registration; (2) the power of representatives; and (3) the application of the court’s rulings or judgments. See generally Walter Hutchens, Private Securities Litigation in China: Material Disclosure about China’s Legal System? 24 U. P.A. J. INT’L. ECON. L. 599, 641 (2003). See also Note, supra note 129, at 1525 (stating that “in the case of class actions, China appears to have drawn heavily on the American experience”).

135 See Hutchens, 24 U. P.A. J. INT’L. ECON. L. at 643; Lawrence, supra note 18, at 27; Tu Binhua, supra note 66, at 97.

China at present has no organization similar to the intermediaries in the United States who register thousands of investors and calculate their losses, it is unrealistic to rely upon only the people’s courts to make announcements, register plaintiffs, and undertake work in relation to application of judgments. It is therefore necessary to draw a distinction between a joint action with fixed plaintiffs and a joint action with a large number of indefinite plaintiffs, which is in line with the current conditions of the people’s court and the securities market. To a certain extent, their arguments explain the reason why the Rules of the SPC have adopted the joint action with a fixed number of plaintiffs as the most suitable form of action for this type of litigations.

Critics view the failure to adapt the U.S.-style class action in China for private securities litigation as economic and political in nature: large class actions could expose state-owned listed companies to massive private securities litigation judgments as well as cause political unrest, because the large concentration of aggrieved shareholders into an organized group has the potential to trigger anxiety and sharpen conflict between dispersed individual investors and the state. A study of the development of class actions in China both before and after the enactment of the 1991 Civil Procedure Law—including suits in the area of low-quality products, consumer fraud, environmental pollution, economic contracts, local government actions, and securities law violations—evince the increasing prevalence of class actions as one aspect of the explosion in civil litigation over the past decade.

This increase in class action civil litigation provides an insight into fundamental tensions in the Chinese legal system: such tensions exist between the government policy of increasing the importance of the courts, in part to force local officials to obey the law, and the legal system’s responsiveness to plaintiffs. Tension also exists between government’s desire to harness a

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137 Id.
138 Id.
139 Id. Jia Wei, author of the articles, is a judge of the Supreme People’s Court and participated in the drafting of the Rules of SPC. Supra note 46.
140 See Hutchens, supra note 134, at 644-45; see also Lawrence, supra note 18, at 27.
141 See Note, supra note 129, at 1523.
market-driven legal profession to further implementation of the law and its desire to continue to tightly regulate lawyers. Additionally, there is tension between government efforts to shape the legal system and the plurality of factors that contribute to the evolution of that system.\textsuperscript{142} The fact that only a limited form of joint action is allowed by the Rules of the SPC as a platform for the civil litigation arising from securities-related false statements reflects yet another tension between an urgent need to accommodate efficiently a large number of such cases and the people's courts economic and political limitations.

\textbf{F. The Role of Judicial Mediation and Settlement by the Party}

The Rules of the SPC instruct the people's courts to stress (zhaozhong) mediation while adjudicating cases, and to encourage parties to settle their disputes.\textsuperscript{143} The principles and procedures describing how the people's courts should conduct mediation in civil proceedings are set out in the 1991 Civil Procedure Law, which emphasizes the consent (ziyuan) of the party concerned.\textsuperscript{144} It is required that the people's court engage in mediation on a voluntary basis and distinguish right from wrong based on clear facts.\textsuperscript{145} Mediation can be conducted by the court before trial or at any stage prior to judgment,\textsuperscript{146} but if it does not result in an agreement or if one party withdraws before the delivery of the written mediated agreement, the court should adjudicate promptly.\textsuperscript{147} A mediated agreement becomes legally binding once it has been delivered to and signed by the parties.\textsuperscript{148} However, if one party can prove that a legally effective mediated agreement was entered into in violation of the principle of voluntariness or its

\textsuperscript{142} Id. at 1523-41.

\textsuperscript{143} See Rules of the SPC, supra note 3, art. 4.

\textsuperscript{144} See 1991 Civ. Proc. Law, supra note 23, arts. 85-91. Apart from Chapter Eight, there are few relevant articles concerning mediation in other chapters of the 1991 Civil Procedure Law.

\textsuperscript{145} Id. art. 85. Consequently, a mediated agreement must be produced based on the willingness of both parties and should not violate the law. Id. art. 88.

\textsuperscript{146} Id. art. 128.

\textsuperscript{147} Id. art. 91.

\textsuperscript{148} Id. art. 89.
content has violated the law, the same case can be retried.\footnote{149} Although the Rules of the SPC do not reiterate these provisions,\footnote{150} there is no doubt that these are the procedures that must be adhered to when the people’s courts conduct mediations in cases involving securities-related false statements.

Judicial mediation could play an important role in handling the large number of securities-related false statement cases. The people’s courts have limited resources, and judicial mediations could help ensure timely and efficient proceedings. Needless to say, judicial mediation should be conducted fairly and lawfully in accordance with the procedure set out in the 1991 Civil Procedure Law. Most importantly, it must be conducted on a voluntary basis.

It is reported that Chengdu Intermediate People’s Court successfully mediated S.T. Hongguang case, the first securities-related false statement civil case mediated by the people’s court.\footnote{151} Before the enactment of 1991 Civil Procedure Law, which replaced the 1982 Civil Procedure Law (Trial), coercion and unlawfulness were the most noteworthy problems associated with judicial mediation.\footnote{152} Although the 1991 Civil Procedure Law emphasizes the principle of voluntary submission to mediation and compliance with the law in mediating cases, there is still widespread abuse of the judicial mediation system.\footnote{153} The stress

\footnote{149 See 1991 Civ. Proc. Law, \textit{supra} note 23, at 180.}

\footnote{150 There is only one brief article in the Rules of the SPC which deals with the issue of judicial mediation. \textit{See} Rules of the SPC, \textit{supra} note 3, art. 4.}

\footnote{151 A court mediation agreement was reached between eleven plaintiffs and two defendants, with ninety percent of the plaintiff claims compensated. \textit{See} ST Hongguang Suopeian Tiaojie Chenggong [ST Hongguang Claim Case Successfully Mediated], \textit{ZHONGGUO ZHENGQUAN BAO [CHINA SECURITIES DAILY]}, Nov. 26, 2002, at 1.}


\footnote{153 See Fu Weiwei & Zhang Xuliang, \textit{Lun Xianxing Fayuan Tiaojie Zhidu de Biduan he Gaige [On the Problem and Reform of Current Judicial Mediation System]}, \textit{FALU SHIYONG [4 LAW APPLICATION]} at 12 (2000). To illustrate the point that the judicial mediation system was seriously abused, the author cited an example: a total of 34,567 administrative cases were filed in 1994 to the people’s courts at all levels of first instant courts, out of which 15,317 (44\%) were withdrawn as a result of judicial mediation where plaintiffs were persuaded to withdraw their cases.
on the role of judicial mediation by the Rules of the SPC may lead to abuses of the proceedings by some local people’s courts in handling these types of cases. There are cases in which the parties have settled their disputes under encouragement from the judges and the cases have been withdrawn from the people’s court.\(^{154}\) It is still too early to say whether this is a positive development and whether it is the future trend of private securities litigation in China. It is certain that the people’s courts and judges will follow the Rules of the SPC to encourage parties to settle their disputes.\(^{155}\)

### IV. Defendants’ Liability and Compensation of Investors’ Losses

Any company, organization, or individual involved in making false statements about the securities market is liable for the loss suffered by investors as a result of those statements.\(^{156}\) Different rules apply to determine the liability of different defendants; some are subject to strict liability, while others are subject to a fault-based liability.\(^{157}\) Investor compensation for losses is limited to the amount of the actual losses.\(^{158}\) In order to claim compensation, investors must first establish a causal link between false statements and their losses.\(^{159}\) The court then sets a cut-off date, which determines a reasonable period for the calculation of losses,  


\(^{155}\) See Rules of the SPC, supra note 3, art. 4 (instructing local courts that they should stress on mediation, and encourage parties to settle).

\(^{156}\) Id. arts. 7, 21-28.

\(^{157}\) Id. arts. 21-25. See infra Table 1. Parties Subject to Strict Liability, and Table 2. Parties Subject to Fault-based Liability.

\(^{158}\) Id. art. 30.

\(^{159}\) Id. art. 18.
and applies one of two different formulas to calculate actual losses suffered.160 These formulas depend upon the time when the investors sold their affected securities.161

A. Defendants’ Liability

Issuers, listed companies, and their promoters (or controlling shareholders) are central targets of the Rules of the SPC. The Rules hold issuers or listed companies liable if they make false statements and cause investor loss.162 Promoters are also liable if they make false statements and cause losses to investors.163 When promoters provide guarantees regarding the disclosures made by issuers, they are jointly liable with those issuers.164 When controlling shareholders165 manipulate issuers or listed companies to violate securities law and make false statements using the name of the issuers or listed companies, it can cause losses to investors. These losses are to be compensated by the issuers or listed companies.166 These issuers or listed companies then claim payment from the controlling shareholders or those who have actual control over the company.167 Where controlling shareholders or those who have actual control over issuers or listed companies make false statements, it constitutes a violation of Articles 4, 5, and 188 of the 1998 Securities Law.168 Because of the loss incurred by the investors, the aforementioned responsible party

160 Id. art. 33.
161 See Rules of the SPC, supra note 3, arts. 31 and 32. See infra Table 6: Formulas for the Calculation of Actual Losses.
162 Rules of the SPC, supra note 3, art. 21.
163 Id.
164 Id. art 26.
165 This also includes those who have actual control over issuers or listed companies.
166 Rules of the SPC, supra note 3, art. 22.
167 Id.
168 Article 4 of the 1998 Securities Law emphasizes on the principle of good faith in issuing and trading of securities, while Article 5 prohibits fraudulent and insider trading and manipulation of the securities market. Article 188 states that anyone who disrupts the order of the securities trading market by fabricating and disseminating false information that affects securities trading shall be fined and subject to criminal liability where applicable. See supra note 8.
shall bear responsibilities to compensate investors.\textsuperscript{169} Responsible directors, supervisors, and managers of the issuers and listed companies shall bear a joint liability for the losses caused by their companies unless they can show that there is no fault on their part.\textsuperscript{170}

Securities underwriters and securities listing sponsors who are similarly involved in making false statements and causing losses to investors bear liability for compensation, unless they can show that it occurred through no fault on their part.\textsuperscript{171} If they know or ought to know of the false statement made by issuers or listed companies, and neither correct them nor issued a statement of reservation, they are regarded as having committed a common tort (gongtong qinquan).\textsuperscript{172} Therefore, the securities underwriters and securities listing sponsors bear joint liability with the issuers or listed companies.\textsuperscript{173} Moreover, responsible directors, supervisors, and managers of securities underwriters and securities listing sponsors bear a joint liability with their companies unless they can show no fault on their part.\textsuperscript{174}

Accounting firms, law firms, and asset valuation organizations and their direct staffs are directly responsible and bear liability if they are involved in making false statements.\textsuperscript{175} The resulting losses to investors are a violation of Article 161 and 202 of the

\footnotesize{\textsuperscript{169} Rules of the SPC, supra note 3, art. 22.}
\footnotesize{\textsuperscript{170} Id. art. 21.}
\footnotesize{\textsuperscript{171} Id. art. 23.}
\footnotesize{\textsuperscript{172} Id. art. 27.}
\footnotesize{\textsuperscript{173} Id. Article 130 of the 1986 General Principles of Civil Law generally stipulates that when two or more persons jointly infringe upon another person's rights and cause him damage, all shall be jointly liable.}
\footnotesize{\textsuperscript{174} Rules of the SPC, supra note 3, art. 28.}
\footnotesize{\textsuperscript{175} Rules of the SPC, supra note 3, arts. 24 and 7, \S 6. There is no provision in the Rules of the SPC that defines "directly responsible persons" (zhijie zeren ren) of professional intermediaries. From Article 7, Paragraph 6 of the Rules of the SPC where it states: "responsible directors, supervisors, managers and other senior management personnel of the issuers, listed companies, securities underwriters, or securities listing sponsors; directly responsible persons of professional intermediaries," it could assume that "directly responsible persons" of professional intermediaries would normally include partners and senior management personnel of accountant firms, law firms, and asset valuation organizations, equivalent to directors, supervisors, managers and other senior management personnel of the issuers, listed companies, securities underwriters, or securities listing sponsors. See supra note 45.}
1998 Securities Law. The absence of fault will again exculpate those charged. If accountant firms, law firms, or asset valuation organizations know or ought to know the false statement made by issuers or listed companies, but neither correct the statements nor issue a statement of reservation, they will be regarded as committing a common tort. Therefore, they will bear a joint liability with the issuers or listed companies.

Article 28 of the Rules of the SPC explains the circumstances under which the responsible directors, supervisors, and managers of issuers, listed companies, securities underwriters, and securities listing sponsors are to be held liable for making false statements jointly with their companies. This includes: (1) participation in making false statements; (2) knowing or having the responsibility to know about the false statement but never making an objection; and (3) all other circumstances under which they should bear responsibility for the false statement and its effects. This last “catch-all” provision could lead the court to exercise its discretion to hold directors, supervisors and managers of issuers, listed companies, securities underwriters, and securities listing sponsors liable for the false statement made by their companies.

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176 Article 161 of the Securities Law imposes an obligation on professional institutions and individuals who produce documents such as audit reports, asset appraisal reports, and legal opinions for the issuance or listing of securities. They also impose an obligation for securities trading activities to check and verify the truthfulness, accuracy, and completeness of the contents of the reports to be produced by them. Furthermore, they bear joint and several liability for the parts of such reports for which they are responsible. Article 202 prescribes the penalties for the above professional institutions and individuals if they make false statements, including confiscation of illegal gains, fine, suspension of business, and disqualification, compensation for losses, and criminal liability.

177 See Rules of the SPC, supra note 3, art. 24.

178 Id. art. 27.

179 Id.

180 Id. art. 28.

181 Id. For a general discussion on liabilities of company directors to shareholders for false statements, including the theoretical basis, constitutional element, behavior, intention, and gross negligence, etc., see Cui Zhennan, Ma Mingsheng, Xujia Chenshu Zhong Dongshi Dui Gudong Zheren Yanjiu [A Study on Liabilities of Directors to Shareholders for False Statements], ZHONGGUO FAUXE [2 CHINA LEGAL SCIENCE] at 96 (2003).

182 A typical provision found in other laws and regulations of the PRC.
In total, promoters, issuers, listed companies, and their controlling shareholders or those who exercise actual control over the company are subject to a strict liability (see Table 1), while securities underwriters, securities listing sponsors, accounting firms, law firms, and asset valuation organizations are subject to a liability based on fault (see Table 2). The same applies to responsible directors, supervisors, managers of issuers, listed companies, securities underwriters and securities listing sponsors, and direct responsible persons of accounting firms, law firms, and asset valuation organizations (see Table 2). Joint and several liability applies to promoters; securities underwriters, securities listing sponsors, accountant firms, law firms; and asset valuation organizations, and directors, supervisors, managers of issuers, listed companies, securities underwriters, and securities listing sponsors (see Table 3). In addition, other organizations or individuals who made false statements in violation of Articles 5, 72, 188, and 189 of the 1998 Securities Law and cause losses to investors are liable for compensation.

The Rules of the SPC clarify some of the ambiguities found in the provisions of the 1998 Securities Law as pertaining to liabilities for making false and misleading statements. Securities underwriters and their responsible directors, supervisors, and managers are now held liable under the Rules of the Provisions, on the basis of fault liability. Moreover, the same applies to

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183 See Sec. Law, supra note 8, arts. 5, 72, 188, and 189. Information disseminated by any mass medium is required to be truthful and objective according to the 1998 Securities Law. Any organization or individual is prohibited from fabricating and disseminating false information or misleading information to affect securities trading. This includes stock exchanges, securities companies, securities registration and clearing institutions, securities trading service organizations, intermediary organizations, securities associations and the securities regulatory authority, state functionaries, news media, and their employees or staff members thereof and other persons concerned. The penalties for violating organizations and individuals if they make false or misleading statements, including fines, and additional administrative sanctions for state functionaries and criminal liability. Id.; see also supra note 168.

184 See Rules of the SPC, supra note 3, art. 7, 25.

185 These are the provisions in Articles 61, 161, and 202 of the 1998 Securities Law. 1998 Securities Law, supra note 8, art. 61, 161, and 202.

186 1998 Securities Law, supra note 8, art. 63. If an issuer or securities underwriter announces a prospectus, measures for offer of corporate bonds, finance or accounting report, listing document, annual report, interim report, or ad hoc report which contain or
responsible directors, supervisors and managers of issuers, and listed companies under Article 63 of the 1998 Securities Law.\textsuperscript{187} The liability of accounting firms, law firms, asset valuation organizations, and their staff members who would be directly responsible is also interpreted as a fault liability under Articles 161 and 202 of the 1998 Securities Law.\textsuperscript{188} The 1998 Securities Law and the 1993 Provisional Regulations on Share Issuing and Trading both contain provisions requiring companies applying for listing, to submit to the CSRC and stock exchanges recommendation letters from securities companies and members of stock exchanges.\textsuperscript{189} However, neither of the regulations have provisions regarding the liability of securities companies for making false statements in their capacity as securities listing sponsors.\textsuperscript{190} The Rules of the SPC now add securities listing sponsors to the list of possible defendants.\textsuperscript{191} This details their liability when making a false statement, which covers the aforementioned omissions of the 1998 Securities Law and the 1993 Provisional Regulations on Share Issuing and Trading.\textsuperscript{192} It is important to note that the Rules of the SPC include controlling shareholders and those who have actual control over issuers or listed companies in the list of possible defendants, holding them to the standard of strict liability.\textsuperscript{193}

\textsuperscript{187} Id.

\textsuperscript{188} Securities Law, supra note 8, arts. 161 and 202; supra note 176.

\textsuperscript{189} See Securities Law, supra note 8, art. 45.

\textsuperscript{190} See id. arts. 45 and 63.

\textsuperscript{191} Rules of the SPC, supra note 3, art. 7, § 4, and arts. 23, 27, and 28.

\textsuperscript{192} See Jia Wei, supra note 46, at 9.

\textsuperscript{193} Id. Rules of the SPC, supra note 3, art. 7, § 1, and art. 22.
Table 1. Parties Subject to Strict Liability

<table>
<thead>
<tr>
<th>Parties</th>
<th>Liable for losses caused to investors by their false statements (Article 21)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Promoters</td>
<td></td>
</tr>
<tr>
<td>Issuers</td>
<td></td>
</tr>
<tr>
<td>Listed companies</td>
<td></td>
</tr>
<tr>
<td>Controlling shareholders or those who have actual control over issuers or listed companies</td>
<td>1. Liable if they manipulate issuers or listed companies and make false statements in violation of securities law using the name of the issuers or listed companies and cause losses to investors, which shall be compensated by the issuers or listed companies first, who then make claims from the controlling shareholders or those who have actual control over the company (Article 22)</td>
</tr>
<tr>
<td></td>
<td>2. Liable if they make false statements in violation of Article of 4, 5, and 188 of the 1998 Securities Law and cause losses to investors (Article 22)</td>
</tr>
</tbody>
</table>

Table 2. Parties Subject to Fault-based Liability

<table>
<thead>
<tr>
<th>Parties</th>
<th>Liable for the losses caused to investors by false statements unless they can show that there is no fault owing to them (Article 23)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities underwriters</td>
<td></td>
</tr>
<tr>
<td>Securities listing sponsors</td>
<td></td>
</tr>
<tr>
<td>Intermediaries (accountant firms, law firms, asset valuation organizations, and their direct responsible persons)</td>
<td>Liable for the part for which they are responsible if they make false statements in violation of Article 161 and 202 of the 1998 Securities Law and cause losses to investors unless they can show that there is no fault owing to them (Article 24)</td>
</tr>
<tr>
<td>Responsible directors, supervisors and managers of issuers, listed companies, securities underwriters, and securities listing sponsors</td>
<td>Bear a joint liability for the losses caused to investors by their companies unless they can show that there is no fault owing to them (Articles 21, 23)</td>
</tr>
</tbody>
</table>
Table 3. Parties Subject to Joint and Several Liability

<table>
<thead>
<tr>
<th>Promoters</th>
<th>Liable jointly with issuers for the losses caused to investors, if they provide guarantees for the disclosure made by the issuers (Article 26)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities underwriters, securities listing sponsors, accountant firms, law firms, and asset valuation organizations</td>
<td>Liable jointly for the losses caused to investors, if they know or ought to know the false statement made by the issuer or listed company but neither correct them nor issue a statement of reservation (Article 27)</td>
</tr>
<tr>
<td>Responsible directors, supervisors and managers of issuers, listed companies, securities underwriters, and securities listing sponsors</td>
<td>Liable jointly with their company for the losses caused to investors if they: 1. Participate in making false statements; 2. Know or ought to know the false statement but make no objections; and 3. Other circumstances under which they should be held responsible (Articles 28)</td>
</tr>
</tbody>
</table>

There are valid criticisms and suggestive comments about the provisions of the Rules of the SPC regarding defendants’ liabilities. In contrast to the view that securities underwriters and their responsible directors, supervisors, and managers should be held liable for false statements on a fault basis, some authors argue that strict liability should be applied to securities underwriters in the same way it applies to issuers.\(^{194}\) This is because the current China securities market needs to strengthen and not weaken underwriters’ liabilities to prevent them from assisting issuers from making false statements and harming investors.\(^{195}\) Regarding the application of fault liability, some authors criticize the Rules of the SPC for not providing clear criteria by which to determine fault.\(^{196}\) These authors also suggest that the doctrine of duty of care should be applied when determining the defendants’ fault.\(^{197}\) It is also argued that joint and several liability should not be

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194 See Bai Yan, Fu Jun, Xujia Chenshu Qinquan de Peichang Zheren [Compensation Liability for the tort of False Statement], ZHONGGUO FAUXE [2 CHINA LEGAL SCIENCE], at 104 (2003).
195 Id.
196 See Tu Binhua, supra note 66, at 94-95.
197 Id. at 95.
strictly applied unless plaintiffs can prove that defendants acted intentionally or conspired prior to their actions.\textsuperscript{198}

\textbf{B. Causal Link between False Statement and Investors' Losses}

Defendants' liabilities are limited to actual losses suffered by investors.\textsuperscript{199} For the calculation of actual losses, there first must be a causal link (\textit{yinguo guanxi}) between the false statement and the loss suffered by investors.\textsuperscript{200} To establish a causal link between the false statement and investors' losses, the court must find that: (1) the investments were securities directly connected with the false statement; (2) the purchase date of the securities was between the date on which the false statement is made and the date on which the false statement is exposed or corrected; and (3) that investors suffered losses as a result of selling securities on or after the date on which the false statement was exposed or corrected, or as a result of continued ownership of the securities after the false statement was exposed or corrected.\textsuperscript{201}

The date on which the false statement is exposed (\textit{xujia chenshu jieluri}) refers to the date it is first exposed by the mass media that is circulated or broadcasted nationwide, such as newspapers, radio, or television.\textsuperscript{202} The dates on which the false statement is corrected (\textit{xujia chenshu gengzhengri}) refers to the date that the person who made the false statement voluntarily corrects it and communicates the connection to the public through the media.\textsuperscript{203} This correction shall adhere to regulatory formalities for the suspension of trading, and it shall be broadcast through the media designated by the CSRC.\textsuperscript{204} Although the Internet is not mentioned by the Rules of the SPC, it should presumably be treated as a platform for the purpose of the application of the Rules.\textsuperscript{205} The date on which the false statement is made, exposed,

\begin{itemize}
  \item \textsuperscript{198} Id.
  \item \textsuperscript{199} Rules of the SPC, supra note 3, art. 30.
  \item \textsuperscript{200} Id. art. 18.
  \item \textsuperscript{201} Id. art. 18, ¶ 1-3.
  \item \textsuperscript{202} Id. art. 20.
  \item \textsuperscript{203} Id.
  \item \textsuperscript{204} Id.
  \item \textsuperscript{205} National newspapers and specialist securities newspapers are now found online,
or corrected is crucial when determining the causal link between the false statement and investors’ losses—this, in turn, determines whether an investor is entitled to compensation.\(^\text{206}\)

Table 4 illustrates this causal link with an example of a listed company who has a share listed on Shanghai Stock Exchange on July 1, 2003, makes a false statement on July 1, 2003, and is exposed (or corrected) on July 31, 2003. Investor A, B, C, and D purchased and sold the company’s shares on different dates. In accordance with the Rules of the SPC, Investors A and B are entitled to claim compensation as there is a causal link between the false statement and their losses. Investors C nor D could not establish a causal link or claim compensation as well, even though they may have suffered losses as a result of the false statement.

Table 4. Causal Link between False Statement (FS) and Investors’ Losses

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td></td>
<td>Purchased on July 2 and 30</td>
<td>Sold on July 31 and suffered loss</td>
<td>Sold on Aug. 15, 20, and 28, respectively, and suffered loss</td>
<td>√</td>
</tr>
<tr>
<td>B</td>
<td></td>
<td>Purchased on July 2 and 30</td>
<td>Held until July 31 and suffered loss</td>
<td>Still holding and suffered loss</td>
<td>√</td>
</tr>
<tr>
<td>C</td>
<td>Purchased on June 30</td>
<td>Sold on July 30</td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>D</td>
<td>Purchased on July 2 and sold on July 30</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
</tbody>
</table>

for example, RENMIN RIBAO [PEOPLE’S DAILY] (http://www.people.com.cn) and ZHENGQUAN RIBAO [SECURITIES DAILY] (http://www.zqrb.com.cn.).

Academics, practitioners, and judges have criticized these causation rules as cumbersome because they require the plaintiff to have purchased shares in reliance on false statements as shown by purchasing them after the statement was made. 207 These rules also require the plaintiff to sell or continue to hold the shares until after the false statement has been publicly exposed or corrected. 208 Some criticize the rules on the grounds that false statements can be optimistic or pessimistic statements (youduo or youkong) and either may purposely defraud the market and investors. In one such example, the purpose of a false pessimistic press release issued by one listed company was to benefit the directors and senior management members by allowing them to have a low stock option exercise price. 209 Thus, arguments show that it is incorrect to presume that no causal link exists if investors sell their securities before the exposure or correction day. 210 These causation rules should be interpreted more widely in order to reach situations in which investors are misled by fraudulent pessimistic statements and suffer losses as a result. 211 Some criticize the rules from a market practice point of view. They argue that, often before a false statement is exposed, rumors start to appear on the market and prices start to fall; therefore, it is unfair to exclude those investors who sell their securities and suffer losses in order to stop falling prices before the exposure day. 212 These critics

207 Rules of the SPC, supra note 3, art. 18.

208 Id.

209 See Guiping Lu, supra note 65, at 803-04 (explaining that the author uses this hypothetical situation to argue that the provisions of the Rules of the SPC deny recovery to investors who are in the same situation as the investor in this hypothetical situation, and who also suffered losses as a result of the listed company’s false pessimistic press release).

210 See Guo Feng, supra note 41, at 99.

211 See Sheng Huanwei & Zhu Chuan, supra note 71, at 102 (arguing that Article 18 of the Rules of the SPC only applies to optimistic false statements, but that there is a need for judges to interpret this rule more broadly in order to apply it to pessimistic false statements); see also Yin Jie, supra note 65, at 112 (arguing that at present, all of the cases brought to court are cases involving optimistic false statements made to enlarge profits and conceal losses; however, as the market develops and becomes more sophisticated, pessimistic false statements are inevitable and investors will be affected by them).

suggest that a flexible criterion such as "the date on which false statements are widely known by the market and investors" should replace the current rigid requirement of "the date on which false statements are exposed for the first time by national newspapers, radio, or [television]."\textsuperscript{213}

Article 18 of the Rules of the SPC does not require investors to prove that a causal link exists between their investment and the false statement.\textsuperscript{214} If they can show that they purchased relevant securities after the date on which the false statement is made and that they sold or held them until after the public exposure or correction of the false statement, then they have established a causal link.\textsuperscript{215} In other words, the court assumes that all the investors who purchase relevant securities during the prescribed period have made their investment in reliance on the false statement and thus are affected. These investors are then exempted from proving a causal link.\textsuperscript{216} The presumption of reliance can be rebutted if defendants prove one of the following: (1) the plaintiff sold the relevant securities before the date on which the false investment was exposed or corrected; (2) the plaintiff purchased the relevant securities on the date on which the false statement was exposed or corrected or thereafter; (3) the plaintiff knew the existence of the false statement but nevertheless made the investment; (4) all or part of the losses suffered by the plaintiff were caused by other risk elements of the securities market; or (5) the plaintiff made the investment in bad faith in order to manipulate the price of the securities.\textsuperscript{217} The defense of "other risk elements of the securities market" may be problematic because it is difficult for defendants to prove such risks to the court.\textsuperscript{218} In other words, it is difficult for the defense to discharge their burden of proof that the losses of investors are caused by other market risk elements—specifically, proving that the loss was

\textsuperscript{213} Id.
\textsuperscript{214} Rules of the SPC, supra note 3, art. 18.
\textsuperscript{215} Id. art. 18, ¶ 1-3.
\textsuperscript{216} Rules of the SPC supra note 3, art. 18; Kong Lin & Ye Jun, supra note 71, at 23, Guiping Lu, supra note 65, at 804 (discussing fraud on the market theory in the United States and its influence on the Rules of the SPC).
\textsuperscript{217} Rules of the SPC, supra note 3, art. 19.
\textsuperscript{218} See Jiao Jinhong, supra note 212, at 114.
not caused by their false statement. It is suggested that a system should be established that enables expert witnesses to appear regularly before the court to assist judges when making this decision. Given that the “other risk element” defense is often replied upon by defendants, the use of expert witnesses and quality evidence will assist in the decision-making process of the people’s court.

C. Calculation of Actual Losses of Investors

There are three aspects to actual losses (shiji shunshi) suffered by investors resulting from false statements: (1) the difference of their investment; (2) the commission, charge, and stamp duty connected with their lost investment; and (3) the interest lost for their investment as calculated according to bank deposit rates for the relevant period. To calculate the loss actually suffered by investors, the court must first determine a date (jizhunri) upon which the calculation is based. Article 33 of the Rules of the SPC provides the following guidelines for the court to determine such a cut-off date. It is defined as a date prescribed to determine a reasonable period for the calculation of losses, thus limiting the compensation to investors for the losses caused by false statements.

First, the cut-off date should be the date on which aggregated trading volumes of the security affected by the false statement reach 100% of its tradable volumes. This is after the date when the false statement is exposed or corrected, disregarding all large volume trading through agreements. Second, if the court is unable to determine the cut-off date in accordance with the above

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219 Id.


221 Rules of the SPC, supra note 3, art. 33.

222 Id. art. 33.

223 Id. art. 33, ¶ 1-4.

224 Id. art. 33.

225 Id. art. 33, ¶ 1.
criterion before the hearing, the cut-off date should be the thirtieth trading date after the false statement is exposed or corrected.\(^\text{226}\) Third, where the security affected has been de-listed from the trading market, the cut-off date should be the trading day preceding the day that the security was de-listed.\(^\text{227}\) Fourth, where the security affected has been suspended from trading, the cut-off date should be the trading day preceding the day that the trading of the security was suspended.\(^\text{228}\) Finally, where the trading has been restored, the cut-off date should be determined in accordance with the aggregated trading volumes of the affected security as mentioned above.\(^\text{229}\)

Table 5 takes the same example used in Table 4\(^\text{230}\) to illustrate the cut-off date determined in accordance with the guidelines set out by Article 33 of the Rules of the SPC.\(^\text{231}\) Depending upon the position of the defendant company,\(^\text{232}\) there could be four cut-off dates.

As shown in Table 5, the primary method used by the court to determine the cut-off date is aggregation of trading volumes of the security affected by the false statement. The cut-off date is calculated as when the aggregated trading volume of the security affected by the false statement reaches 100% of its tradable volume, after the date on which the false statement was exposed or corrected.\(^\text{233}\) Scholars have expressed views that this method may not necessarily reflect the true picture of market demand and supply movements when the market, as a whole, is improving.\(^\text{234}\)

\(^{226}\) Id. art. 33, ¶ 2.

\(^{227}\) Rules of the SPC, supra note 3, at art. 33, ¶ 3.

\(^{228}\) Id. art. 33, ¶ 4.

\(^{229}\) Id.

\(^{230}\) See Table 4: Causal Link between False Statement and Investors’ Losses.

\(^{231}\) Compare Rules of the SPC, supra note 3 (showing no clear indication as to whether or not to disregard a public holiday when calculating the thirtieth trading day), with General Provisions of Civil Law, art. 154 (1986) (P.R.C.) (providing that if the last day of a time period falls on a Sunday or an official holiday, the day after the holiday shall be taken as the last day).

\(^{232}\) The position of trading volumes of the defendant company’s share, and whether the share is de-listed or suspended. See infra Table 5: Cut-off Date for the Calculation of Actual Losses of Investors.

\(^{233}\) The Rules of the SPC, supra note 3, art. 33 (1).

\(^{234}\) See Guo Feng, supra note 41, at 99.
Instead, it would be proper to take an average closing price of each trading day during a reasonable bounce back period as the basis for calculation of losses.\textsuperscript{235} Others argue that this method is vulnerable to abuse, because those who make the false statements may use illegal means to manipulate the trading volumes.\textsuperscript{236} When this happens, the calculation of investors' losses would be affected.\textsuperscript{237}

On the basis of the cut-off date, two different formulas are available to calculate actual losses suffered by the investors depending on if or when they sold their securities prior to or after the cut-off date.\textsuperscript{238} For those investors who sold their securities on or prior to the cut-off date, actual losses are determined by multiplying the number of securities they held by the difference between the average purchase price and the actual price by which they sold their securities.\textsuperscript{239} For those investors who sold their securities after the cut-off date or continued to hold them, actual losses are calculated by multiplying the number of securities they hold by the difference between their average purchase price and the average closing prices of every trading day from the date when the false statement was exposed or corrected, until the cut-off date.\textsuperscript{240}

\begin{itemize}
\item \textsuperscript{235} Id. at 99.
\item \textsuperscript{236} See Song Yixing, supra note 62, at 10.
\item \textsuperscript{237} Id. at 10.
\item \textsuperscript{238} Rules of the SPC, supra note 3, arts. 31 and 32; see Wang Dan, Zhengquan Xujia Chenshu Peichang Jishuan Fangfa Lun [On the Method for the Calculation of Compensation from Securities-related False Statements], FAXUE [6 LEGAL SCIENCE] at 103-108 (2003) (discussing these formulae and other calculation method in general).
\item \textsuperscript{239} Rules of the SPC, supra note 3, art. 31.
\item \textsuperscript{240} Id. art. 32.
\end{itemize}
Table 5. Cut-off Date for the Calculation of Actual Losses of Investors

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<thead>
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</thead>
<tbody>
<tr>
<td>Trading volumes of defendant company's share at 50%</td>
<td>Trading volumes of defendant company's share has been aggregated to 100%</td>
<td></td>
<td></td>
<td>Court unable to determine by trading volumes</td>
<td>30th trading date after the date when the false statement was exposed or corrected</td>
</tr>
<tr>
<td>Where defendant company's share has been de-listed</td>
<td></td>
<td></td>
<td>Preceding de-listing day</td>
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<td></td>
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<tr>
<td>Where defendant company's share has been suspended</td>
<td></td>
<td></td>
<td>Preceding suspension day</td>
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<td></td>
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<tr>
<td>Where defendant company's share has been restored after suspension</td>
<td></td>
<td></td>
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<td></td>
<td>Trading volumes of defendant company's share has been accumulated to 100%</td>
</tr>
</tbody>
</table>
### Table 6. Formulas for the Calculation of Actual Losses

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td>Investor A:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>Average</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>purchase price</td>
<td>purchase price</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 yuan minors</td>
<td>15 yuan minors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>average selling price</td>
<td>average selling price</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 yuan = 11 yuan x 200</td>
<td>11 yuan x 200 = 2200 yuan</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sold 200 shares on July 2</td>
<td>Sold 100 shares on July 31 at 6 yuan per share</td>
<td>Sold 50 shares on Aug. 15 at 3 yuan per share</td>
<td>Sold 50 shares on Aug. 20 at 1 yuan per share</td>
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<tr>
<td>at 10 yuan per share, and</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>another 200 shares on 30</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>July at 20 yuan per share. Total: 6000 yuan for 400 shares</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investor A:</td>
<td>Same as above</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>Average</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>purchase price</td>
<td>purchase price</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15 yuan minors</td>
<td>15 yuan minors</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>average selling price</td>
<td>average selling price</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>of each trading day</td>
<td>of each trading day</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3 yuan = 11.7 yuan x 200</td>
<td>11.7 yuan x 200 = 2340 yuan</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Share price 7 yuan at close of trading</td>
<td>Share price 2 yuan at close of trading</td>
<td>Share price 1 yuan at close of trading</td>
<td>Sold 200 shares on Aug. 28 at 2.50 yuan per share</td>
<td></td>
</tr>
<tr>
<td>Investor B:</td>
<td>Purchased on 2 July 100 shares at 10 yuan per share, and on 30 July 100 shares at 20 yuan per share. Total: 3000 yuan for 200 shares</td>
<td>Price at 7 yuan per share at the close of trading</td>
<td>Price at 2 yuan per share at the close of trading</td>
<td>Still holding 200 shares</td>
</tr>
<tr>
<td>Average</td>
<td>Average</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>purchase price</td>
<td>purchase price</td>
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<tr>
<td>15 yuan minors</td>
<td>15 yuan minors</td>
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<tr>
<td>average selling price</td>
<td>average selling price</td>
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<td>of each trading day</td>
<td>of each trading day</td>
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<tr>
<td>3.3 yuan = 11.7 yuan x 200</td>
<td>11.7 yuan x 200 = 2340 yuan</td>
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</table>
Table 6 illustrates an application of these two different formulas to calculate the actual losses of Investors A and B of the defendant company. Suppose the court determined the cut-off date as August 20, 2003, in accordance with an aggregated trading volume of the defendant company’s share. The actual losses of Investor A who bought 400 shares with 6,000 yuan and sold them both before and after the cut-off date are 4,540 yuan in total. Investor B who bought 200 shares with 3,000 yuan and still holds them after the cut-off date has an actual loss of 2,340 yuan.

D. Compensation of Investors’ Losses

The combined effect of these rules can be determined by carefully following the causal link between actual losses, the cut-off date, and the calculation formulas. First, only those investors who purchase affected securities after a false statement is made, and before the false statement is exposed or corrected, and who then sell the affected securities or continue to hold them after the false statement is exposed or corrected, are entitled to claim compensation for the losses they suffered. Second, investor plaintiffs would not be able to claim compensation if defendants could prove: (1) that the plaintiffs purchased or sold the securities outside, the period prescribed by the Rules of the SPC; (2) their losses were caused by other risk elements of the market; (3) they had knowledge of the false statement but nevertheless made an investment; (4) or they made the investment in bad faith in order to manipulate the market. Third, those plaintiffs who have satisfied the causal link test and are entitled to compensation, including the following reimbursements: (1) the difference of their investments; (2) the commission charges and stamp duties connected with their lost investments; and (3) interests of their losses calculated against bank interest rates for deposit for the affected period.241 Finally, depending upon whether the plaintiffs

241 The Rules of the SPC do not provide further guidelines as to how the commissions, charges, and stamp duties are calculated. Rules of the SPC, supra note 3. Presumably, in accordance with the principle of “actual loss”, the calculation would be based on what investors have paid for commissions and stamp duties connected with their lost investment. Starting from January 24, 2005, the rate of stamp duty for securities trading is 0.1%. See Circular of the Ministry of Finance and the State Bureau of Taxation on Adjustment of Securities Trading Stamp Duties, issued on, and effective from, January 24, 2005. Starting from May 1, 2002, the commission that securities
sell the effected securities before or after the cut-off date, their lost investment is calculated by: multiplying the number of securities they hold by either the difference between the average purchase price and the actual price at which the securities were sold, or the difference between the average purchase price and the average closing prices of every trading day from the date when the false statement is exposed or corrected until the cut-off date.

Some authors believe that the scope of compensation prescribed by the Rules of the SPC is too narrow and should be enlarged to include indirect losses or expenses of investors. They argue that only by such an enlargement of the scope of compensation could victim investors be made whole, as if the false statement had not happened. These authors assert that this complies with the general fairness principle of civil law, and prevents the occurrence of false statements by increasing the cost of making false statements. For other authors, the compensation provisions of the Rules of the SPC already comply with the fairness principle of civil law since they define a scope of actual losses for investors while not imposing any extra burden on defendants. They argue that this is consistent with China’s current conditions on the securities market with respect to the protection of investors.

In contrast to the provisions of the Rules of the SPC regarding the calculation of investors’ losses on the securities trading market, the Rules of the SPC give little attention to the calculation of investors’ losses on the securities issuing market, a shortcoming...
that some regard as a significant failure.\textsuperscript{247} Article 29 of the Rules of the SPC simply states that where investors suffered losses as a result of false statements made on the securities issuing market, they are entitled to compensation from wrongdoers in accordance with Article 30 of the Rules of the SPC.\textsuperscript{248} Additionally, where the false statement leads to a cancellation of the issue of securities, investors are entitled to a refund of their money plus interest calculated according to bank deposit interest rates for the same period. The calculation formula for losses occurring on the securities trading market under Article 30 may, to certain extent, apply to the calculation of the losses occurring on the issuing market. However, as the circumstances on the issuing market are different from those on the trading market, it is necessary for the Rules of the SPC to provide a set of detailed guidelines separately governing the calculation of the losses occurring on the issuing market.\textsuperscript{249} As pointed out by one practicing lawyer, another omission in the Rules of the SPC that may cause serious problem in practice is a lack of more detailed guidelines on the practical determination of the false statement date, the exposure or correction date, and the cut-off date.\textsuperscript{250} Every single alternation of these crucial dates may lead to a large scale increase or decrease in compensation figures.\textsuperscript{251}

\textbf{V. Summary: Limitations of the Rules of the SPC}

The SPC took the unprecedented step of issuing three circulars within a short period of time—from September 2001 to January 2003—giving instructions to local people’s courts on how to handle civil compensation claims arising from securities fraud on China’s securities market.\textsuperscript{252} This demonstrated that the SPC was, on one hand, under unavoidable pressure from the public to issue

\begin{itemize}
\item \textsuperscript{247}See Tu Binhua, supra note 66, at 93.
\item \textsuperscript{248}Rules of the SPC, supra note 3, art. 29.
\item \textsuperscript{249}See Tu Binhua, supra note 66, at 93 (discussing the way different situations in the securities-issue market affect false statement makers’ liability and the compensation of damages).
\item \textsuperscript{250}See Song Yixing, supra note 62, at 9-10. Song Yixing is a practicing lawyer from Shanghai Wenda Law Firm.
\item \textsuperscript{251}Id. at 10.
\item \textsuperscript{252}See supra note 1.
\end{itemize}
guidelines for the people's court to deal with such cases; on the other hand, the SPC was reluctant to make the people's court fully open and available for such cases due to social, political, legal, and other reasons. Although the current Rules of the SPC are generally welcomed by lawyers, academics, and investors at large, they nevertheless fall short of expectations. Indeed, the SPC and the Rules of the SPC could not surpass the limit of the second circular on certain key issues. Under these circumstances, it is unrealistic to expect that the SPC may make any radical moves. The Rules of the SPC, as discussed above, must inevitably be limited in regards to the following key issues.

First, the Rules of the SPC limit the scope of cases that will be accepted and heard by the people's court. Compared with the second circular, the Rules of the SPC are a positive step towards allowing criminal court judgments and the penalty decisions of other administrative authorities—besides the CSRC—to be used to accept cases for the people's court. However, the prerequisite rule set out effectively limits the scope of cases to be accepted and heard by the people's court. In addition, the Rules of the SPC only apply to the cases arising from false statements, which now excludes from the people's court civil actions related to insider trading or market manipulation. Social, political, legal, and procedural criticisms of this prerequisite rule point to this defect and show that it is an unpopular provision of the Rules of the SPC.

Second, the Rules of the SPC limit the eligibility of shareholder investors to receive compensation of losses suffered as a result of false statements. The Rules of the SPC do not discriminate against any group of shareholder investors or any individual, legal person, or other organization who subscribes and trades securities on the securities market established by the government. They have the right to file a case in the people's court and seek compensation if they suffer losses as a result of a false statement. However, the actual provisions of the Rules of the SPC concerning causal links actually limit the eligibility of shareholder investors for the compensation of their losses. In effect, all the shareholder investors who purchase or sell affected securities at times other than those prescribed by the Rules of the SPC are excluded from the scope of compensation regardless of whether or not they suffered losses.

Third, the Rules of the SPC fail to provide shareholder
investors with a helpful and effective procedure by which they may access the court and judicial remedies. Lawyers will face unpredicted difficulties bringing their cases to the people’s court in a timely and efficient manner. Many factors contribute to this difficulty: (1) the Rules of the SPC’s cautiously chosen form of joint action for investors to bring their lawsuits; (2) a limited number of intermediate people’s courts designated by the Rules of the SPC in contrast to a large number of potential lawsuits; (3) a priority given to the intermediate people’s courts located at the places of issuer or listed company defendants; and (4) the Rules of the SPC lack provisions on the determination and calculation of losses suffered on the issuing market and on the practical determination of the false statement date and other crucial dates. These factors combine to hamper lawyers’ abilities to reliably obtain compensation for every shareholder investor who suffers a loss as a result of the false statement.

Fourth, the Rules of the SPC play only a limited role in assisting the prevention of market abuse and the regulation of China’s securities market. There is no doubt that the Rules of the SPC, by prescribing a specific and wide-ranging list of possible defendants and their corresponding liabilities—particularly targeting issuers, listed companies, and their promoters or controlling shareholders—will have a positive impact on the corporate governance and the regulation of China’s securities market as a whole. However, there are a limited number of cases tried by the people’s court and a limited number of investors who are eligible for compensation. The way in which actual losses are calculated, as well as the potential consequence of the prerequisite rule that defendants may interfere with administrative investigation process in order to escape civil penalties, means that the application of the Rules of the SPC would not bring about substantial costs for defendants. Therefore, this would not effectively deter them from making false statements on the securities market.

In conclusion, the Rules of the SPC are a first and important step towards the establishment of a civil litigation and compensation system to address securities fraud cases on China’s securities market by the people’s court. However, it fails to surpass its predecessors and transcend their limitations. Though the SPC may find it difficult, a balance must be struck between the
court, the government, social stability,\textsuperscript{253} the protection and development of state-owned listed companies, and the need to protect and compensate all investors who suffer losses as a result of securities frauds. In addition, the gaps and defects of the current primary legislations also contributes to the limitations of the Rules of the SPC. Nevertheless, the system established by the Rules of the SPC has brought securities civil litigation arising from false statements in China to a new stage of evolution. Further changes and improvements are still necessary in order for the system to operate effectively. It is hoped that the forthcoming amendments of the 1998 Securities Law\textsuperscript{254} will improve securities civil litigation as a whole in China, so that the law can play an important and necessary role in the protection of the rights and interests of investors and the promotion of the sound development of China's securities market.

\textsuperscript{253} See Yang Wei & Pan Jing, Li Guoguang: Zhua Shenpan Bao Wending Shi Fayuan Shouyao Renwu [Li Guoguang: To Work on Adjudication and to Protect Social Stability is the First and Important Task of the People's Court], Sept. 15, 2002, http://www.chinacourt.org (where Li Guoguang—deputy president of the Supreme People's Court, speaking at a meeting on the trial of civil compensation cases arising from false statements on the securities market on September 12-14, 2002, in Lanzhou city, Gansu province—emphasized that protecting social stability is the first and most important task of the people's court).

\textsuperscript{254} It was announced by the Financial and Economic Committee of the NPC on July 18, 2003, that a working team had been set up to start the work of amending the 1998 Securities Law. See Zhengquanfa Xiugai Zhengshi Qidong [The Work of Amending the Securities Law formally Start], ZHENGQUAN RIBAO [SECURITIES DAILY], July 19, 2003, http://www.zqrb.com.cn.