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Civil litigation against China's listed firms: Much ado about nothing?

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Summary¹

Since January 2001, the Supreme People's Court has made considerable progress in terms of setting up a framework for private securities litigation to allow investors to sue listed companies for losses caused by their false financial disclosures. The SPC has developed procedural and substantive rules for the filing and adjudication of such suits, and over 1,000 suits have been filed nation-wide against some 14 companies. The paper supplies detailed information about the current status of these suits.

Although a number of these actions have been settled out of court, most remain in legal limbo with courts refusing to make judgement, and none have been settled by a court judgement in favour of the investors. This paper argues that there are two main problems. First, the framework creates some serious obstacles for investors wanting to pursue actions. The physical location of where the suit can be filed, the too narrowly-defined causal link between false statements made by the company and losses made by investors, and the requirement that the CSRC or other relevant administrative organs previously find against the firm (or criminal verdict against the board directors) do not help. Moreover, the lack of a class action (*jituan susong*) framework, and the mechanics of the group suit (*gongtong susong*) that it allows creates considerable difficulties as hundreds of investors have to co-ordinate their actions across considerable distance.

Second, local courts simply appear unwilling to allow cases to be heard because of administrative protection of firms by local governments. The few actions that have reached conclusion in favour of the investors have been settled out of court. Though frustrated by the slow progress in PSL cases, lawyers remain cautiously hopeful that the courts will gradually recognise their role in protecting the rights of individual investors. However, it is unlikely that many of these cases will result in compensation being paid and the most important aspect of developments so far is the creation of a potential personal liability for directors which will discourage them from making false disclosures in the future.

Introduction

After a series of scandals involving popular listed companies such as Yi'an Keji, Yinguangxia, Lantian Gufen and MaiKeTe being discovered to have falsified in their financial accounts, the pressure on the government to protect small investors grew. Since 1998 the CSRC has moved to toughen punishments for illegal actions, including making false disclosures. Some companies have been heavily fined and some directors have been sentenced to jail on the basis of CSRC evidence. Much malpractice, including false disclosures, accounting fraud and market manipulation, have long been regulated through administrative measures (and sometimes the instigation of criminal charges).² Since the promulgation of *The Provisional Rules on Stock Issuance and Trading*³ in 1993 and especially *The Securities Law* in 1998, significant numbers of listed companies have been sanctioned for fabricating financial statements. 220 listed companies were investigated between 1999 and 2001, among which 92 were fined a total of Rmb1.42bn (\$17m).⁴ *The Criminal Law* (1997) (revised version) criminalised market manipulation and allowed those found guilty of it to be sent to jail.⁵ By year end 2001, 46 securities criminal cases had been tried.⁶

However, notwithstanding the increase in administrative sanctions, fines and criminal charges, investors themselves were left with no means of recovering their losses. Although investors attempted to file civil lawsuits against listed companies as early as 1998, it was not until 2002 that the first civil lawsuit (or private securities litigation (PSL)) against a listed company was accepted by the courts. Civil compensation had a slow start for at least three reasons. First, although *The Securities Law* provided that injured investors were entitled to civil compensation and the *Civil Procedure Law* contained basic procedural provisions enabling PSL in the form of individual or joint actions, there were no detailed rules for how such actions should be judged.⁷ Second, members of the central government feared (and continue to fear) that allowing such cases could invite indefinite numbers of claims and unlimited liabilities for China's listed companies, endangering the viability of the stock market itself. Third, most companies listed in China's stock market are state-controlled. Granting damages to the potentially large numbers of defrauded investors would lead to the loss of state assets and would worsen the already poor financial situation of these firms.⁸

1. December 1998 to September 2001: No rules, some action

The first civil compensation attempt on account of false statements occurred on December 4th 1998, when a case against the directors of *Hongguang Industries* was filed at Shanghai Pudong Xinqu People's Court by an investor, following a fine and administrative sanction given to the company by the CSRC.⁹ *Hongguang* was found to have overstated its 1996 and 1997 earnings by Rmb157m (\$19m) and Rmb31.52m (\$3.8m) respectively.¹⁰ The claimant alleged that she had suffered losses by investing in *Hongguang's* shares on the basis of these false statements.

The case was dismissed by the court because of the lack, it claimed, of a direct causal link between the false disclosures and the loss. However, the actual reason for this decision appears to be that the court believed that the case should be referred to the CSRC to determine.¹¹ The judges involved, apparently taking guidance from their superiors in the Supreme People's Court (SPC), did not want to interfere in an issue which until then was handled on an administrative basis by the government regulator.

By the end of 2001, despite the failure of the *Hongguang* suit, the large number of frauds perpetrated by listed companies had caused investors to file civil actions against a number of other companies, including *Zhengzhou Baiwen*, *ST Houwang*, *Yi'an Keji* and *Yinguangxia*. In the case of *Yinguangxia*, Gao Xiqing, then a deputy chairman of the CSRC, was cited in the China Securities Journal by saying that the CSRC would encourage small investors to sue companies for compensation.¹²

On September 20th 2001, for instance, PSL actions against *Yi'an Keji* were filed at the Intermediate People's Court in Beijing and Guangzhou by 363 defrauded investors. They demanded a total of Rmb24.6m (\$2.9m) in compensation.¹³ The next day, the Supreme People's Court (SPC) issued circular No. 406, instructing courts nation-wide not to accept PSL on the grounds that the judicial and legislative conditions were not yet ripe.¹⁴ Hu Baohai, a member of the law department at the CSRC, offers two reasons for the decision.¹⁵ One was that specific rules as to the implementation of PSL were not yet decided, meaning that there was no framework in place to hear such suits, despite the general provisions set out in The Securities Law. The second was that, if courts nation-wide were allowed to hear such cases and interpret the law, the likely result, given the huge disparity in the quality of judges, would be many inconsistent judgements on the basis of similar facts.

Accordingly, PSL on account of false statements, market manipulation and insider trading was suspended. The move attracted criticism. Donald Clarke notes that Circular No. 406 deprived investors of their rights to civil compensation apparently granted by Articles 63 of The Securities Law. In constitutional terms, Chinese courts are limited to clarifying legislation, they may not alter the original meaning of or add content to legislation, and certainly have no power to suspend rights laid down in legislation. In practice, however, the SPC does wander beyond these boundaries and even at times, according to Peerenboom, 'create legal rules that contradict the original legislation'.¹⁶

However, in this case there is a strong argument that without clear and detailed rules on how to proceed, and with the inability of local courts to set precedents, the SPC was right temporarily to suspend implementation of this right. Xuan Weihua, a lawyer with Grandall Legal Group in Shanghai, argues that while the legal justification for the suspension was weak, it was extremely difficult for courts to adjudicate on PSL cases based on only the few general rules that were laid down in the legislation.¹⁷ Furthermore, SPC officials did have a point when they argued that the notice actually represented progress, since the notice only suspended the admissibility of such cases pending a decision on implementation.¹⁸

2. January 15th 2002 to January 9th 2003: New rules, not much action

Four months after the suspension of PSL, on January 15th 2002, the SPC issued the *Notice Regarding Civil Lawsuits Against Listed Companies on the Grounds of False Statements (which quickly became known as the 1.15. Tongzhi)*.¹⁹ The notice allowed PSL to be accepted by local courts on the condition that an administrative sanction had already been issued to the company by the CSRC or one of its designated agencies (art. 2). However, the *1.15. Tongzhi*, containing only six articles in total, only briefly dealt with the procedural and jurisdictional issues of PSL. It did not contain any rules, for instance, regarding when investors were entitled for compensation or how to calculate such compensation if a liability was found.

Most importantly, Article 4 explicitly stated that *dandu susong* (individual litigation) or *gongtong susong* (joint litigation) were admissible, but that *jituan susong* (class action) was not. An equivalent term in Chinese to *jituan susong* is the term *daibiaoren susong* (representative litigation) which is found in Art. 55 of the *Civil Procedure Law* (CPL, 1991). Since 1991, academic literature in China has generally used the term *jituan susong* to replace *daibiaoren susong*, or has used the terms interchangeably. The concept of the 'class action' is borrowed from the legal tradition of the United States. In U.S. law, class actions are representative lawsuits where a group of persons with a common interest is defined as a class. One or more members of a class may be representative parties, and they take action in protection of the right that belongs to a group of people. The result of this class action is binding on all members of the class (unless they express to opt out), no matter whether they took part in the court action or not.²⁰ In England and Wales it is now possible to bring class action in restricted circumstances.²¹ It is generally accepted that the class action framework is an effective method of litigation in PSL cases in other jurisdictions.

Article 55 of the CPL 1991 allows indefinite numbers of claimants to register and participate in a similar claim, and the registered claimants can nominate representatives (*daibiaoren*) to go through the litigation process. However, according to SPC, the difference in legal traditions between the U.S and China justifies the rejection of the class action framework.²² The *gongtong susong* framework, as stipulated in article 53, is the SPC's preferred framework for PSL and it is substantially different since it involves combining parties with similar claims into a group, with the size and composition of the group lying at the discretion of the court.

Consequently, immediately after the promulgation of the 1.15. *Tongzhi*, claimants against *Daqing Lianyi* attempted, unsuccessfully, to file a *gongtong susong* case composed of 679 individuals with the Harbin Intermediate People's Court. The Harbin Intermediate People's Court rejected the filing of the group suit, and insisted on individual actions.²³ As a result, the court spent two months between August and October 2002 to accept and hear only 94 out of the 770 individual cases.²⁴ Xuan Weihua, the lawyer representing the investors in this case, estimated that the litigation documents weighed some three tons.²⁵

Despite these problems, the promulgation of the 1.15. *Tongzhi* was welcomed by lawyers and securities investors as it allowed the courts to accept PSL in limited circumstances, and was followed by increased numbers of PSL filings around China. By year end 2002, nearly 900 PSL against 10 companies had been filed, some of which were accepted by the courts.²⁶ The ten listed companies sued in these actions were *Daqing Lianyi*, *Shengfang Keji*, *Bohai Jituan*, *Jiabao Shiye*, *ST Tongda*, *Hongguang Industries*, *Yinguangxia*, *ST Jiuzhou*, *Sanjiu Yiyao* and *ST Tianyi*.²⁷ However, due to the lack of detailed rules as to establishment of a causal link between shareholder losses and falsified accounts, and the lack of details regarding the calculation of losses, the cases were stalled as judges waited for further guidelines from the SPC.²⁸

While most cases remained in legal limbo, two cases came to an unsatisfactory end, and one had a reasonably positive outcome. After four years of persistent efforts by lawyers, 11 claimants against *Hongguang Industries* received a total of some Rmb 224,096 (\$26,999) in compensation, 90% of the total amount claimed, as an out-of-court settlement. Second, one litigant, a Ms. Peng who had *sued ST Jiabao*, received Rmb800 (\$96) in compensation as a result of an out-of-court settlement. However, the money was paid out of the pocket of a company director, and the settlement agreement did not admit any responsibility for illegal actions on the part of the director or the company.²⁹

Other claimants were not so fortunate. In the case of *ST Jiuzhou*, three suits alleging false disclosures were accepted by the Xiamen Intermediate People's Court in March 2002. However, only a few months later, the court rejected the suits on the ground that the board members stated that they had not received any official sanction by the CSRC, a requirement before a PSL action can take place according to the 1.15. *Tongzhi*. However, one of the company's statements soon after the event actually noted the administrative penalty given by the CSRC, which seems to contradict the directors' protestations.³⁰ The Xiamen court appears to have been a little too quick to credit the company directors' claims.

3. January 9th 2003 to the present: Better rules, still no action

On January 9th 2003, the SPC promulgated detailed rules on PSL, 'Several Rules on Adjudicating Civil Lawsuits against Listed Companies on the Ground of False Statements' (known as the 1.9. *Guiding*).³¹ The 1.9. *Guiding* contained 37 articles, and provided rules on the jurisdiction of the courts, the mode of PSL litigation, definitions of what constituted false statements, details regarding public companies' liabilities and exemptions to PSL, provisions for joint and several responsibilities, and detailed guidance on the calculation of losses.

Article 6 enlarged the preconditions required to sue listed companies to include criminal verdicts against company directors and administrative sanctions given by relevant state organs like the Ministry of Finance (in addition to the CSRC sanction required by the 1.15. *Tongzhi*). Article 7 listed potential defendants of PSL actions. These included the (a) founders of the company, controlling shareholders; (b) the issuer or listed companies; (c) securities underwriters; (d) promoters and sponsors (e) accountant firms, law firms, assets evaluating firms etc. (f) the responsible directors, senior managers in the above-listed institutions. Article 17 specified situations where false disclosure (*xujia chenshu*) can be said to have occurred. This includes falsely recording major events (*xujia jizhai*), making misleading statements (*wudaoxing chenshu*), material omission in disclosing information (*zhongda yilou*), and disclosing information in an inappropriate manner (*bu zhengdang pilu*).

Article 18 and 19 specified situations when a causal link between false statements and investors' losses can be established. These were criticised by lawyers to be too narrowly defined.³² For example, investors' losses would not be recovered if they sold the shares of the company before the disclosure of false statements, even though the losses were caused by the similar facts as those who sold shares after the disclosure. In particular, article 19 was viewed as unreasonable to give blanket exemption to the listed companies from civil compensation before individuals' cases can be examined. There are situations when companies falsified information to make the price drop for the purpose of buying at low price in case of merger and acquisition. Consequently, investors sustained losses by selling their shares before the disclosure of the misconduct. Similarly, in the situation when companies falsified accounts in an attempt to prop up the price and failed, the investors who sold their shares before the disclosure were equally injured as those who sold after the disclosure.³³ The five investors in *Tongda* case and eight investors in *Jiobao* case failed because of the lack of causal link as required by the 1.9 *Guiding*. Song Yixin predicted that 10% to 30% of the 900 claims filed before the issuance of 1.9 *Guiding* would lose their cases because they fell foul of the causal link requirement.³⁴

In terms of the method of litigation, the 1.9. *Guiding* did not make any mention of *jitian susong* (class action), but permitted *dandu susong* and *gongtong susong* through representatives (art. 12). It is clear that class actions as provided for by Article 55 of the CPL are not permitted. Guan Xiaofeng, a professor at the Financial Law Research Centre of China University of Politics and Law, argued that there are two reasons for excluding class actions in the 1.9. *Guiding*. First, there are no specific rules in the Civil Procedure Law as to the practical implementation of such an action. Second, class actions could easily lead to the bankruptcy of numerous listed companies.³⁵ The exclusion of class actions was further supported by Li Guoguang, the vice president of SPC, who argued that class action not only prolongs litigation but is contradictory to the litigation principle which prohibits courts from seeking claims.³⁶ Class action as stipulated in article 55 of CPL imposes duty on courts to issue notice requesting potential claimants of similar facts to register with the courts. However, if Li's argument is justified, it seems strange that the legislators of CPL apparently ignored the general principle.

However, the 1.9. *Tongzhi* also failed to address several operational issues to do with the *gongtong susong*. It failed to introduce rules with regards to the qualification of representative litigant(s) (*gongtong susong daibiaoren*) or how they are nominated. This is a problem since without new regulations, courts have to rely on the CPL rules, and these have been criticised as unworkable.³⁷ They require, for instance, that all claimants registered with the courts need to come to a consensus as to the nomination of the representative litigant(s). This is extremely difficult for claimants, who could number in the thousands, and who are spread nation-wide.³⁸

Table 1. The state of civil suits in China, year end 2003

<i>Company name</i>	<i>Stock code</i>	<i>Reason for civil suit</i>	<i>Number of civil suits filed</i>	<i>Progress of civil suit(s)</i>
ST Bohai	600858	Faked accounts 1994-1998.	1	Case submitted to Jinan Middle People's Court on February 25 th 2002. Case began hearing on April 19 th 2002. No news since.
ST Tongda	600647	Reported fake restructuring plan (1/7/98) to conduct asset exchange with Shenzhen City Yuehai Qiye Group. This led to faked profits in 1998 mid-year and annual reports.	5	On Jan 21 st 03, cases withdrew from Shanghai No. 1 Intermediate People's Court because the claimants sold all Tongda shares before the scam was exposed, thus causal link between false statements and losses as required by 1.9 <i>Guiding</i> can not be established.
ST Dongfang Dianzi	000682	Faked accounts: Rmb1.70bn	1,500 – 1,600	8 cases were heard in Sep. and Nov. 2003, neither verdict nor settlement has been determined yet. ⁵⁰
Daqing Lianyi	600065	1. Faked Rmb161.76m profits in 1994, 1995 and 1996 to gain listing. 2. Fiddled document issued by Daqing City National Tax Office allowing deferred tax payment of Rmb400m, to allowing Rmb4,400m. 3. Faked another Rmb28.49m profits in 1997 annual report. 4. Also did not invest raised capital in the manner promised.	500 plus	The Harbin Intermediate People's Court heard nearly 500 cases so far, but did not give any judgment yet. In Aug. 2003, Daqing Lianyi reached out-of-court settlement with a claimant, paying Rmb6,000 (one quarter of total amount requested). ⁵¹
ST Jiabao Shiye	600622	1. Inflated 1998 total profits by Rmb28.04m to reach Rmb74.64m 2. 1996-1998 opened 300+ fake individual accounts to subscribe to the company IPOs and trade their shares, gaining Rmb840,000 fake profits.	25	a) 8 cases withdrew for lack of causal link as required by 1.9. Tongzhi. b) On Nov 11 th 02, Ms Peng was the first person to receive compensation in PSL.. She received Rmb800 as compensation from Jiabao's CEO and case was withdrawn. c) Jan 27 th 03, Jiabao reached out of court settlements with another 16 claimants. Jiabao paid Rmb61,973 to the claimants, one third of the total amount demanded. Individual claimant received compensation ranging from Rmb19,000 to Rmb30.
ST Yinguangxia	000557	1. Faked Rmb128m profits 1999-2000 2. Faked Rmb418m profits 2000-2001 3. Faked tax receipts 2001 involving Rmb37m+	1000+ cases attempted, but the court only accepted 6 cases in early 2002, and refused to accept any more since then. ⁵²	No court hearing has been arranged for the six accepted cases so far. Yinchuang Intermediate People's Court refused to take any PSL after mid-2002 without stating reasons. At year end 2003, lawyers have called for SPC and Supreme Procuratorate's intervention and involvement to compel the Yinchuang court to take PSL on the merits.

Sanjiu Yaoye	000999	1. Did not disclose Rmb16.9m capital transfer to related Sanjiu Yaoye; by year end 2000 Sanjiu Yaoye still owed Rmb695m, which Sanjiu Yiyao counted as profits (making 26.92% profits 'fake') 2. Did not disclose Rmb1.14bn loan to related company	6	The cases were dismissed by the Shenzhen Intermediate People's Court on 21 April 2003. The reason given is that the six claimants must get consent from all the shareholders before they were able to sue Zhao Xinqian, the president of Sanjiu Group. ⁵³
ST Hongguang	600083		11	November 25 th 2002 ,the cases were settled out of court, with the company paying Rmb224,096 to the 11 investors, 90% of the amount claimed.
ST Jiuzhou	000653	1. Smuggled Rmb2.77bn worth of goods 1994-1998, illegally gaining Rmb13.65m profits 2. Evaded Rmb1.8bn of taxes for above goods	3	The cases were initially accepted by Xiamen Intermediate People's Court in March 2002, but was adjudicated as inadmissible in June 2002 for lack of administrative sanction issued by CSRC. The real reason is that even though the CSRC sanctions have been delivered to the company directors, they were not signed by some of the receivers. Thus the administrative sanction could not take effect.
Jinzhougang/ Jinzhou B share	600190 900952	Faked Rmb487m profit 1996-2000	10+	Case against 1)Jinzhou Port co. 2)KPMG China branch In July 2003, one case was heard, but no verdict yet.
ST Shengfangke	000620	1. Registered Rmb45m more capital for Shanghai Xianshiju Co., which it acquired 98% of shares in 11/1999, than existed 2. Acquired Shanghai Xianshiju's 28% shares for sum of Rmb210m which it did not have	20+	Some of these cases have been tried. Most claimants agreed to accept mediation by the court, and awaited final sum of compensation to be decided by the court. ⁵⁴
Hubei Tianyi	600703	Faked accounts 1996-1998	1	Wuhan City Middle People's Court accepted a case on December 10 th 2002, but no news since.
PT Zhengbaiwen	600898	Criminal verdict against board directors for forging the company's profits in annual reports.	10+	No case was heard yet. ⁵⁵
Shenxinkai	600167	Sanction issued by ministry of finance for falsifying accounts.	2	In April 2003, both cases reached mediation agreement coordinated by Shenyang Intermediate People's Court. The compensation paid for was Rmb19,000, 70% of the total amount demanded. ⁵⁶

Source: News reports

In practice, the courts still appear uncertain about how to apply the rules. Table 1 shows the status of 14 companies as of year end 2003, none of which has been found by a court to be liable to pay compensation. Take the cases of *Daqing Lianyi* and *Yinguangxia*. Before the 1.9. *Guiding*, the Harbin Court refused to accept the *gongtong susong* filed by 676 investors against *Daqing Lianyi*. However, the lawyers' efforts and the promulgation of the 1.9. *Guiding* led to the acceptance of a group action composed of more than 100 claimants. Unfortunately, the positive attitude of the court did not last long. A recent trial of the case in August 2003 was based on the group format, but it was only comprised of 20 investors, after the court had decided to reject the suit with 107 claimants.³⁹ However, it should be noted that in this the Harbin court has already broken new ground. By comparison, some courts still insist on only accepting individual actions. Another issue which may well have a bearing on the willingness of local courts to accept *gongtong susong* is the internal judicial evaluation system. One factor in the assessment of the performance of individual judges is the annual numbers of cases they have heard and resolved. The more cases they hear, the more credit they will get for their political performance.⁴⁰

In the case of *Yinguangxia*, the Yinchuan Intermediate People's Court disregarded the SPC's 1.9. *Guiding*, refusing to accept any PSL at all in 2003. Despite the initial acceptance of six PSL suits in the *dandu susong* form in early 2002, neither a *dandu susong* nor a *gongtong susong* action filed in this court against *Yinguangxia* had been accepted up to end of 2003.⁴¹ As for the six accepted cases, no court hearing has been arranged so far. The reason given by the Yinchuan Court for 'delaying' acceptance of a group suit was that there were not enough judges to take care of the action. According to lawyers associated with the case, however, the real reason was 'local protectionism'.⁴² The Yinchuan government had spent considerable sums of money to restructure *Yinguangxia*, writing off a large bank loan to the company, and had no interest in the firm being pushed back to the verge of bankruptcy because of civil compensation claims.

The fact that the Yinchuan court neither accepted the PSL nor gave a written reply as to why it was 'delaying' their acceptance is a breach of civil procedure rules.⁴³ In November 2003, lawyers representing the investors submitted documents to the SPC and Supreme People's Procuratorate calling for them to take a look at the procedural and substantive matters of this case.⁴⁴ There appears to be some cause for hope that the case will receive central government attention.⁴⁵

One further problem with the 1.9. *Guiding* is that the claimants can now only sue in a court where the headquarter of the listed company is located. This removes the right previously enjoyed to file suit either in the investor's own domicile or at the location of the company's operations, a right apparently endowed by CPL. The concern is that this restriction may facilitate local protectionism since local courts are effectively subsidiaries of the same local government that is often the majority shareholder of the company in the dock.

Despite the weaknesses of the 1.9. *Guiding*, it does lay out some useful rules that should enable courts better to handle PSL cases. Since early 2003, a few additional cases have been heard and a small number of settlements have been reached. However, not a single case has been resolved through adjudication by the courts.⁴⁶ This seems to be consistent with the SPC's hope, set out in Article 4 of the 1.9. *Guiding*, that the courts would encourage litigants to settle disputes between themselves.⁴⁷

Up to year end 2003, nearly 500 cases in *Daqing Lianyi* had been heard, but no judgement had yet been rendered. According to the *Zhongguo Zhengquanbao (China Securities)*, one investor settled with the company in August 2003, receiving Rmb 6,000 (\$723), one quarter of the compensation he demanded.⁴⁸ However, it is unclear how this settlement will affect the remaining cases. Furthermore, investors in *Shenxinkai* and *Shengfang Keji* are now reaching the final stage of settlement.⁴⁹

Concluding remarks

There has been considerable progress in terms of setting up a framework for PSL. The two SPC interpretations have to some extent turned the principals set out in The Securities Law into workable provisions for PSL claimants and their lawyers. The media coverage of listed companies involved in falsifying disclosures, the support of the senior leadership of the CSRC for civil suits, and the entrepreneurial activity of a number of the lawyers involved, have all helped create an atmosphere which has facilitated this development.

However, two main problems remain. First, the framework creates some serious obstacles for investors wanting to pursue actions. The physical location of the suit, the narrow definition of causal link between false statements and losses, and the requirement for a CSRC finding against the firm (or successful criminal prosecution) do not help. Moreover, the mechanics of the group framework also create difficulties as investors have to co-ordinate their actions across considerable distance. Second, the local courts simply appear unwilling to allow cases to be heard, despite the SPC's framework, because of administrative protection of firms. The few actions that have reached conclusion in favour of the investors have been settled out of court. Though frustrated by the slow progress in PSL cases, lawyers remain cautiously hopeful that the courts will gradually recognise their role in protecting the rights of individual investors. However, perhaps the most important aspect of these developments may be probably the creation of a potential personal liability for directors (in addition to a boosted criminal liability), which will discourage them from faking accounts in the future.

¹ I am grateful to Stephen Green, Donald Clarke and Knut Pissler for their valuable comments. One of the most comprehensive treatments of these suits is provided by Walter Hutchens, 'Private securities legislation in China: Material disclosure about China's legal system?', *University of Pennsylvania Journal of International Economic Law*, Vol. 24, No. 3, 2003, pp. 599-689.

² China's legal tradition has traditionally placed emphasis on administrative and criminal sanctions. The development of a framework for civil liability has lagged behind. *The Securities Law* reflects this tendency: administrative and criminal punishment are clearly defined but the articles regarding civil sanction are ambiguous. See Liu Junhai, 'Lun zhengquan shichang falu zeren de lifa he sifa xietiao', *Xiandai Faxue (Modern Law Science)*, Vol. 25, No.1, Feb. 2003, p. 3.

³ *Gupiao Faxing yu Jiaoyi Guanli Zanzheng Tiaoli*, issued by Securities Commission of the State Council, April 1993, Art. 17.

⁴ See *Supra* note 2, p. 4.

⁵ Criminal Law 1997, Art. 182.

⁶ See *Supra* note 2, p. 5.

⁷ On substantive law of civil compensation against listed companies, see Art. 63 and art. 207 of *The Securities Law* which state that companies and their directors should be held liable for making false statements in prospectuses and annual reports. On procedural rules, see art. 53,54 and 55 of Civil Procedural Law 1991.

⁸ Hu Baohai, 'On Civil Compensation in Securities Law Violations – in the perspective of the company law and the security law' (sic.), p. 5. Sourced from <http://www.iwep.org.cn/cccg/pdf/On%20Civil%20Compensation%20in%20Securities%20Law%20Violations%20%20Hu%20Ba%20A1%AD.pdf>, November 2003.

⁹ *Zhongguo Gongsì Zhili Baogao [A Report on Chinese Corporate Governance]*, Fudan University Publishing House: Shanghai, 2003, p. 122.

¹⁰ Chen Zhiwu, 'Capital Markets and Legal Development: the China Case', Yale School of Management, September 2003, p. 15, sourced from <http://icf.som.yale.edu/research/china/files/Capital%20Markets%20and%20Legal%20Development.pdf>. Sourced November 2003.

¹¹ *Zhongguo Gongsì Zhili Baogao*, 2003, *supra* note 9, p 123.

¹² Knut Benjamin Pissler, 'First Wave of [Civil] Claims for Damages of Chinese Investors' (Erste Welle von Schadenersatzklagen Chinesischer Anleger), *Newsletter of the German-Chinese Lawyers' Association*, volume 8, December 2001, p. 191

¹³ 'Zhengquan minshi peichang zha bu shouli', *Caijing Zazhi*, Vol. 13/46, 2001. Sourced from www.caijing.com.cn/mag/preview.aspx?artID=1238, November 2003.

¹⁴ *Ibid.*

¹⁵ The two reasons given are derived from an anonymous interview with a SPC judge. See Hu Baohai, *supra* note 8, p.2.

¹⁶ Randall Peerenboom, *China's Long March to Rule of Law*, Cambridge University Press: Cambridge: 2002, p. 317.

¹⁷ Xuan Weihua, *Xujia Chenshu Minshi Peichang yu Touzizhe Quanyi Baohu (Civil Litigation against Listed Companies on account of False Statements and Protection of Investors' Interest)*, Beijing: Law Publishing House, 2003, p. 87.

¹⁸ 'Zhengquan minshi peichang zha bu shouli', *Caijing*, Vol. 13/46, 2001. Sourced from www.caijing.com.cn/mag/preview.aspx?artID=1238, November 2003.

¹⁹ In Chinese, 'Guanyu Shouli Zhengquanshichang Yin Xujiachenshu Yinfade Minshi Qinquan Jiufen Anjian Youguan Wenti De Tongzhi', issued on January 15th, 2002 by the SPC.

²⁰ Xuan Weihua and Song Yixin, 'Zhengquan Minshi Peichang Zhidu Jiqi Xingshi Chutan', in *Zhengquan Falu Pinglun [Securities Law Review]*, Law Publishing House, Vol 2, October 2002, pp. 247-268. See also Antonio Gidi, 'Class Actions in Brazil – A Model for Civil Law Countries', *American Journal of Comparative Law*, No. 2, Spring 2003, pp. 311-408. See also Rule 23, Federal Rules of Civil Procedure (U.S.A).

²¹ E.g. see Civil Procedure 2003 (the White Book Service), Sweet & Maxwell, volume 1, (May ed.), pp. 401,402. The rulings given by the House of Lords in *Connelly v. Rio Tinto Zinc Corp. Plc* [1998] and *Lubbe and others v. Cape Plc* [2000] 1 W.L.R. 1545 show that group actions (class actions) can be instigated in England and Wales against U.K.-based parent companies of multinational corporations, if litigation against their subsidiaries is not possible in their own jurisdictions.

²² See Xuan Weihua, 2003, p. 65.

²³ The 1.15. *Tongzhi* allows each court to decide whether to accept *dandu susong* (individual litigation) or *gongtong susong* (joint litigation), on the basis of the case's specific circumstances. See also Li Qinghua, 'Daqin Lianyì An Jinri Kaiting, Lushi Sishuo Yibosanzhe', *Zhongguo Jinji Shibao*, August 25th 2003. Sourced from <http://202.84.17.28/csnews/20030825/405683.asp>, December 2003.

²⁴ Chen Zhiwu, 'Capital Markets and Legal Development: the China Case', Yale School of Management, September 2003, p. 22, sourced from

<http://icf.som.yale.edu/research/china/files/Capital%20Markets%20and%20Legal%20Development.pdf>.

November 2003.

²⁵ Xuan Weihua, 2003, p. 70.

²⁶ Shen Lutaο & Tian Yu, 'Zuigao Renmin Fayuan Fuyuanzhang Li Guoguang Jiexi Zhengquan Minshi Qinquan Wuda Redian', *Xinhuashe*, January 3rd, 2003. Sourced from www.Chinacourt.org/public/detail.php?id=30619&k_title, November 2003.

²⁷ Song Yixin, 'Zhengquan Minshi Peichang Shi Da An Qishi Lu', *Zhongguo Zhengquan Bao*, February 18th 2003. Sourced from www.law.com.cn/pg/newsShow.php?Id=8680, November 2003.

²⁸ Yue Yihua, sanda pingjing you dai tupo, zhengquan minshi jiannan qibu, November 17th, 2002. Sourced from www.business.sohu.com/66/26/article204402666.shtml, November 2003.

²⁹ Ibid.

³⁰ See Song Yixin, www.syxlawyer.com.cn/116.htm, November 18th 2003. The Decision was not delivered effectively, partially because several board members refused to sign for it. Song thinks that the CSRC should take more effective measures to ensure the effective delivery of its administrative decisions and that it is not reasonable to reject cases on the grounds that some board directors have not been formally notified.

³¹ *Guanyu Shenli Zhengquan Shichang Xujia Chenshu Minshi Peichang Anjian de Ruogan Guiding*, January 9th 2003, issued by the SPC.

³² Xuan Weihua, 2003, p. 16.

³³ Ibid. p. 19.

³⁴ Ma Shisong, Bu fuhe 1.9 Guiding, Sanjiu Yiyao minshi peichang an chesu', *renmin wan*, www.people.com.cn, February 18th 2003, sourced from www.law.com.cn, November 2003.

³⁵ Kan Weiping, 'Zhengquan Minshi Susongxing Bailize Banjushi', *Caijing Zazhi*, January 15th 2003. Sourced from www.caijing.com.cn/mag/preview.aspx?ArtID=3854, November 2003.

³⁶ Ibid.

³⁷ Xuan Weihua, 2003, p. 67.

³⁸ Xuan Weihua, 'Zhuanjia Tuiqiao Zhengquan Peichang Fa'an, Sida Xuanyi Badian Wenti', *Renmin Wang*, February 18th 2003. Sourced from www.law.com.cn/pg/newsShow.php?ID=8676, November 2003.

³⁹ Wang Lu, 'Daqin Lianyi Zhengquan Minshi Peichang Gongtong Susong An Tingshen Jishi', *Shanghai Zhengquan Bao*, August 26th 2003. Sourced from <http://202.84.17.28/csnews/20030826/405683.asp>, December 2003.

⁴⁰ Interviews with PSL lawyers, February 09 2004

⁴¹ Up to November 2003, the Yinchuan Intermediate People's Court still found excuses to delay accepting cases submitted by the defrauded investors, even though Yinguangxia has received both administrative sanction and criminal verdicts against a few board members, satisfying the preconditions for PSL. The lawyers called for the intervention of the Supreme People's Court and Supreme People's Procuratorate. See 'Yinguangxia gumin suopei anjian wuguo erzong', *Zhongguo zhengxuan bao*, sourced from <http://202.84.17.28/csnews/20031102/429746.asp>, December 02 2003

⁴² Telephone interview with lawyers involved on condition of anonymity, February 09 2004

⁴³ Telephone interviews with lawyers, February 4th 2004 and February 9th 2004.

⁴⁴ The SPC has authority to supervise the work of local courts (see The Constitution of the People's Republic of China, Art 127 (2); and the Court Organisation Law of the People's Republic of China (*Renmin Fayuan Zuzhifa*), Art 30 (2)). It does this through issuing internal regulations and interpreting questions concerning the specific application of legislation in the proceedings of lower-level courts. The Procuratorate can also supervise courts through challenging (*kangshu*) final decisions made by the courts (see The Civil Procedural Law 1991, Art 177 (1), (3)). However, in some cases, lower courts are found to defy the orders of higher courts, including that of SPC. See Randall Peerenboom, *China's Long March to Rule of Law*, Cambridge University Press: Cambridge: 2002, p. 315.

⁴⁵ Rumour has it that a standing committee member of the Central Committee of the Communist Party became involved and was pushing for the Yinchuan Court to reconsider its decision. Interview with a lawyer representing *Yinguangxia* investors, February 4th 2004.

⁴⁶ Hao Min, '2004 Nian Fazhigua Jiang Jiashu Qianxing – Fang Zhongguo Shehui Kexueyuan Faxuesuo Yanjiuyuan Liu Junhai Boshi', *Zhongguo Zhengquan Bao*, December 30th 2003. Sourced from <http://202.84.17.28/csnews/20031230/452246.asp>, January 2004.

⁴⁷ Generally speaking, Chinese courts emphasise mediation over adjudication. Until its 1991 revision, the Law on Civil Procedure instructed courts to 'stress mediation' in cases that came before them. See Donald C. Clarke, 'Power and Politics in the Chinese Court System: The Execution of Civil Judgments', *Columbia Journal of Asian Law*, Vol. 10, 1996, pp. 6-15.

⁴⁸ 'Zhuyao Zhengquan Minshi Peichang Anjian Jinzhan', *Zhongguo Zhengquan Bao*, December 30th 2003. Sourced from <http://202.84.17.28/csnews/20031230/452251.asp>, January 21st 2004.

⁴⁹ On Shenxinkai, see 'Zhuyao Zhengquan Minshi Peichang Anjian Jinzhan', *Zhongguo Zhengquan Bao*, December 30th 2003. Sourced from <http://202.84.17.28/csnews/20031230/452251.asp>, January 21st 2004. On Shengfang Keji, telephone interview with Song Yixin, lawyer representing most investors in this case, February 09, 2004.

⁵⁰ 'Zhuyao Zhengquan Minshi Peichang Anjian Jinzhang', *Zhongguo Zhengquan Bao*, December 30th 2003. Sourced from <http://202.84.17.28/csnews/20031230/452250.asp>, January 2004.

⁵¹ Ibid.

⁵² Interview with Song Yixin (February 9th 2004), a lawyer representing two investors whose cases have been accepted but have been tried yet.

⁵³ *Zhongguo Gongsu Zhili Baogao*, 2003, p.125.

⁵⁴ Song Yixin, Lawyer representing investors in this case, Phone Interview, February 09, 2004.

⁵⁵ Song Yixin, Lawyer representing investors in this case, Phone Interview, February 09, 2004.

⁵⁶ 'Zhuyao Zhengquan Minshi Peichang Anjian Jinzhang', *Zhongguo Zhengquan Bao*, December 30th 2003. Sourced from <http://202.84.17.28/csnews/20031230/452250.asp>, January 2004.