CHINA LAW UPDATE

THE DEVELOPMENT OF INVESTOR PROTECTION IN CHINA’S NEW SECURITIES LAW: MULTIPLE DISPUTE SETTLEMENT AND COMPENSATION SYSTEM

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THE DEVELOPMENT OF INVESTOR PROTECTION IN CHINA’S NEW SECURITIES LAW: MULTIPLE DISPUTE SETTLEMENT AND COMPENSATION SYSTEM

Wu Peiyao

I. INTRODUCTION

One of the persistent themes underlying modern securities market is the protection of ordinary investors. Compared with sophisticated investors, the retail investors generally stand in a weaker position due to information asymmetry. Hence, the securities legislations have always been expected to give a hand to ordinary investors. Recently in China, increasingly relevant to this concern is about improving the remedy system for ordinary investor, as China’s economic reform is approaching to expand direct financing and it requires institutional adaptation to a more liberalized and stable stock market.1

According to Doing Business 2020 published by the World Bank, China witnessed a remarkable rise in the index of minority investor protection (10%).2 To accomplish this improvement, the China Securities Regulatory Commission (hereinafter referred to as the “CSRC”) was in charge of revising related regulations. With the revision of Guidelines for Articles of Association of Listed Companies3 and Rules Governing the Listing of Stocks on Stock Exchange4 being fruitful5, the CSRC now aims at building a “General

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Investor Protection System. One of its critical missions is to propel the legislature to grant more diversified remedial approach so as to improve investors’ awareness and ability on seeking remedies.

The securities law’s preferential protection system for ordinary investors can be viewed from two branches: the substantive branch and the procedural branch. Substantive branch mainly entitles rights to investors and obligations to issuers, while procedural branch consists of special procedural arrangements on investor remedies, including investor protection organizations as well as multiple means of dispute settlement and compensation. The Securities Law (2019 Revision) encompasses an addition of two special chapters, Information Disclosure and Investor Protection, which correspond to the two branches of the investor protection system.

This Note focuses on the procedural protection under the new Securities Law and comments on the development of dispute resolution and damage compensation between investors and liable parties. To start with, in Section II, the Note goes through multiple forms of litigation available before and after the new Securities Law, and focuses on the most prominent creation, China’s “opt-out” group litigation. In Section III, alternative approaches of non-litigation dispute resolution and their improvement under the new Securities Law are introduced. Furthermore, Section IV intends to view the procedural investor protection as a whole and extract feature of related law revision.

II. MULTIPLE FORMS OF LITIGATION

A. Securities Litigation System before the New Securities Law

Before the new Securities Law, the injured investors could resort to both separate and joint litigation to seek protection and compensation, and the Investor Protection Institution would provide support for filing the lawsuits. However, as is demonstrated below, in judicial practice, joint lawsuits with uncertain number of plaintiffs (herein referring to injured investors) were barred by the Supreme People’s Court. Under such circumstances, investor lack incentives to seek remedy due to the high cost and low efficiency of separate litigations. In early 2019, not long before the new Securities Law came out, Beijing and Shanghai initiated experiments on a system of model judgments and parallel cases, in order to push aside obstacles of litigation remedies under the limitation of old regulations.


1. Forms of Litigation: Separate Lawsuits and Joint Lawsuits with Certain Number of Parties. In China, plaintiffs seeking civil compensation in securities cases may bring separate lawsuits or joint lawsuits.\(^8\) When one or both sides of a lawsuit consist of two or more persons who are involved in the same kind of claims and the court deems that the disputes may be tried concurrently, under the agreement of all parties, the lawsuit becomes a joint lawsuit.\(^9\) In a joint lawsuit, the side with several parties may elect a representative to participate in the action. Joint actions are categorized into two types, actions where the number of parties is certain and actions where the number of parties is uncertain.\(^10\) For the latter category, the number and identities of parties cannot be confirmed before the opening of the court, and the effectiveness of a judgment may be expanded to other potential parties afterwards. However, Article 14 of the Provisions on Trying Cases in Securities Market actually excludes joint actions with uncertain parties as a form of securities civil lawsuit, by requiring that “[t]he number of plaintiffs in a joint lawsuit shall be determined before the opening of the court.”\(^11\) In practice, there is no civil compensation case in securities market that involves uncertain parties and proceeds by raising a representative.

2. The Investor Protection Institution: Support and Participate in Litigations. Article 15 of the Civil Procedure Law provides the principle of supporting the instituting of lawsuits. According to the article, “[f]or conduct

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\(^8\) Guanyu Shenli Zhengquan Shichang Yin Xujia Chenshu Yinfa de Minshi Peichang Anjian de Ruogan Guiding (关于审理证券市场上虚假陈述引发的民事赔偿案件的若干规定) [Some Provisions of the Supreme People’s Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market] (promulgated by Sup. People’s Ct., Jan.9, 2003, effective Feb. 1, 2003) art. 12 (Chinalawinfo). “The plaintiffs in cases of civil compensation involving securities mentioned in the present provisions may bring separate lawsuits or joint lawsuits.” Provisions issued by the Supreme People’s Court are interpretations of law application, which are binding on all People’s Courts in China.

\(^9\) Minshi Susong Fa (2017 Xiuzheng) (民事诉讼法（2017修正）) [The Civil Procedure Law (2017 Amendment)] (promulgated by the Nat’l People’s Cong., Apr. 9, 1991, amended by the Standing Comm. Nat’l People’s Cong., Jun. 27, 2017) art. 52, para. 1 (Chinalawinfo). “A joint action means that one side or both sides of a civil action consist of two or more persons, the subject matter of action for each party is same or is of the same kind and the people’s court deems that the disputes of all the parties may be tried concurrently, to which all the parties agree.”

\(^10\) Minshi Susong Fa (2017 Xiuzheng) (民事诉讼法（2017修正）) [The Civil Procedure Law (2017 Amendment)] (promulgated by the Nat’l People’s Cong., Apr. 9, 1991, amended by the Standing Comm. Nat’l People’s Cong., Jun. 27, 2017) art. 54, para. 1 (Chinalawinfo). “Where the subject matter of action for each party is of the same kind, the parties on one side of an action are numerous, but the exact number of such parties is uncertain when the action is instituted [. . . ]” By setting special rules for joint lawsuits where the number of parties is uncertain at the time of institution, the Civil Procedure Law classifies joint lawsuits into two types.

\(^11\) Guanyu Shenli Zhengquan Shichang Yin Xujia Chenshu Yinfa de Minshi Peichang Anjian de Ruogan Guiding (关于审理证券市场上虚假陈述引发的民事赔偿案件的若干规定) [Some Provisions of the Supreme People’s Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market] (promulgated by Sup. People’s Ct., Jan.9, 2003, effective Feb. 1, 2003) art. 14 (Chinalawinfo). “The number of plaintiffs in a joint lawsuit shall be determined before the opening of the court. If the number of plaintiffs is large, two to five litigation representatives may be selected, and each litigation representative may entrust one or two agents ad litem.”
which infringes upon the civil rights and interests of the state, a collective or an individual, a state organ, a social group, an enterprise or a public institution may support the entity or individual which suffers infringement in instituting an action in a people’s court.”

For civil litigations involving securities, the China Securities Investor Service Center (hereinafter referred to as Investor Service Center) selects cases from investors’ applications and appoints agents to support relevant investors in filing lawsuits. The selected cases mostly involve a wide range of small and medium investors and attract much public attention. Up to the end of 2019, the Investor Service Center has supported the filing of 24 lawsuits and gained compensations for investors of over RMB55 million. Plus, the institution also assisted 9 courts in the ratification of injuries of over 3,000 investors.12

Another important principle, requiring the Investor Service Center to participate in securities litigations when necessary, is provided by the Scheme on Expanding Pilots for Exercising Shareholder’s Rights,13 proposed by Investor Service Center and approved by the CSRC. According to the document, by holding 100 shares of every A-share listed company, the Investor Service Center shall exercise its rights as an ordinary shareholder, including filing lawsuits with no requirements for the amount and time of shareholding, as well as soliciting shareholders’ rights to file litigations with such requirements, like derivative actions.

3. Recent Pilot Experiments: Model Judgments and Parallel Cases. In 2019, two Pilot cities, Beijing and Shanghai issued opinions on experimenting model judgments and parallel cases,14 a system referring to similar practices in other jurisdictions. Chapter 19 of the Civil Procedure Rules (1999) in the


14 Beijing Shi Gaoji Renmin Fayuan Guanyu Yifa Gongzheng Gaoxiao Chuli Quntixing Zhengquan Jiufen de Yijian (Shixing) (北京市高级人民法院关于依法公正高效处理群体性证券纠纷的意见（试行）)[Opinions of the Beijing Higher People’s Court on Fairly and Efficiently Resolving the Group Securities Disputes According to Law (trial)][promulgated by Beijing Higher People’s Ct., Apr. 29, 2019, effective Apr. 29, 2019] (Chinalawinfo). Shanghai Jinrong Fayuan Guanyu Zhengquan Jiufen Shijian Panju Jizhi de Guiding (Shixing) (上海金融法院关于证券纠纷示范判决机制的规定（试行）)[Provisions of the Shanghai Financial Court on the Model Judgment Mechanism for Securities Disputes (For Trial Implementation)] (promulgated by Shanghai Financial Ct., Jan. 6, 2019, effective Jan. 6, 2019) (Chinalawinfo). Opinions issued by local courts are localized application of legal rules, binding on lower courts in the same region.
United Kingdom and the Capital Markets Model Case Act (2005) in Germany both entitle courts to actively select model cases from a group of cases with common factual or legal issues, and apply judgments of the model cases to other cases of the group, while the Rules of the United States Court of International Trade grant such practices only upon the court’s approval of applications filed after all parties agree to be bound by the model judgment. According to the Beijing and Shanghai documents, when a firm’s misrepresentation injured numerous investors who file lawsuits separately, the court may make a judgment on a typical case (the model case) among these lawsuits and figure out the common issues of these cases, as well as controversies of facts and application of law. Afterwards, other cases, based on the same false statement, would be the parallel cases, to which the common issues shall apply and priority of hearing and deciding shall be given.

The effectiveness of model judgments applies to their parallel cases, due to the following rules. For common facts determined by the model judgment, no evidence is required from the parties of parallel cases. For common standards for the application of law, investors of parallel cases can apply for direct use of these standards. Plus, after a model judgment comes into force, authorized mediation shall be given priority for the parallel cases according to the common facts and standards for the application of law determined by the model judgment.

The documents also emphasize using professional support. The court may, based on the application of the parties concerned or ex officio, obtain such evidences as trading data and trading records from the relevant authorities, or authorize relevant professional institutions to conduct special analysis such as loss assessment. Persons with expertise may appear in court and offer opinions on relevant specialized or technical issues. The court shall also, based on the requirements of case trial, select the persons with expertise as expert assessors to participate in the case trial.

The design of the model judgments and the parallel cases system reduces the investors’ difficulty on proving and establishing their cases, and avoided the court’s repetitive consideration on cases with the same facts and legal issues. This encourages investors to seek remedies through securities civil litigations without exceeding the Supreme People’s Court’s limitations on joint lawsuits.

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15 See Xiaojianguo and Xiejun, Shifanxing Susong Jiqi Leixinghua Yanjiu --- Yi Meiguo, Yingguo, Deguo Wei Duixiang de Bijiaofa Kaocha (示范性诉讼及其类型化研究——以美国、英国、德国为对象的比较法考察) [Research on Typical Action and Its Extensive Application — In Comparison with Practices in the United States, the United Kingdom and Germany], 1 FAXUE ZAZHI (法学杂志) [LAW SCIENCE MAGAZINE] 34, 33–37 (2008).
B. Reform in the Form of Litigation and the Role of the Investor Protection Institution

The new Securities Law removes restrictions on joint lawsuits with uncertain plaintiffs, while establishing a new form of securities litigation, which is very similar to class actions in the United States but with more limitations on prevention of malicious litigations. Also, the Investor Protection Institution creates more opportunity to defend investors’ rights, since the new Securities Law exempts the institution from the minimum shareholding requirements for filing derivative lawsuits.

1. Removal of the Shareholding Thresholds for the Investor Protection Institution to File Derivative Lawsuits. According to paragraph 3 of Article 94 of the new Securities Law, when the investor protection institution which holds shares of a liable company file a lawsuit in its own name for the interests of the company, “the shareholding ratio and shareholding period shall not be subject to the restriction prescribed in the Company Law.” Under such a rule, derivative litigations filed by the investor protection institution no longer requires soliciting shareholders’ rights to meet the thresholds set by the Company Law, granting the institution to seek remedies for investors immediately once any illegal behavior is detected.

2. Acknowledgment of Joint Lawsuit with Uncertain Plaintiffs. Joint lawsuit with uncertain plaintiffs, which were barred from application by the Supreme People’s Court, is re-activated by Article 95 of the new Securities Law. According to paragraph 2, “if there may be many other investors who have the same claim, the people’s court may issue an announcement to state the case facts of the claim and notify investors to register with the people’s court within a certain period. The judgments or rulings rendered by the people’s court shall be valid for the registered investors.”

An interesting topic is the application of such rulings to investors who are entitled to recover but are not registered. According to paragraph 4 of article 54 of the Civil Procedure Law, “[s]uch a judgment or ruling shall also apply to actions instituted during the time limitation by rights holders which have not registered with the people’s court.” There are two possible interpretations to the silence of the new Securities Law on this issue. One explanation is that, in conflicts with general provisions, special provisions should prevail. Therefore, for lawsuits filed by non-registered investors, defendants can still reply to the specific circumstances of the case. The other interpretation,

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16 Lifa Fa (2015 Xiuding) (立法法 (2015 修订)) [The Legislation Law (2015 Amended)] (promulgated by the Nat’l People’s Cong., Mar. 15, 2000, amended Mar. 15, 2015) art. 92 (Chinalawinfo). “For laws, administrative regulations, local regulations, autonomous regulations, separate regulations, or rules developed by the same authority, if there is any discrepancy between special provisions and general provisions, special provisions shall prevail; if there is any discrepancy between new provisions and old provisions, new provisions shall prevail.”
however, is quite the opposite. Since the forms of litigation originate from the civil procedure, rules of paragraph 4 of article 54 of the Civil Procedure Law should fill the void. On March 13, 2020, the Intermediate People’s Court of Hangzhou notified investors who bought bonds issued by Wuyang Construction Group Co., Ltd. to register as proper plaintiffs in the joint lawsuit. As the first case of its kind, the announcement reflects same attitude as the second explanation, and clarified that the judgment shall apply to actions instituted during the time limitation by right holders which have not registered.

3. Establishment of Chinese “Opt-Out” Group Litigation. Theoretically, the number of circulating shares on the disclosure day of a false statement is the maximum number of shares claimable for compensation, and the securities depository and clearing institution can directly screen the eligible right holders based on investors’ transaction records. However, due to limited information on misrepresentations, high cost of litigations and low value of losses, few retail investors or ordinary investors are willing to file lawsuits against responsible parties. To solve this problem, paragraph 3 of Article 95 of the new Securities law stipulates a new form of group litigation, which, if properly enforced, will be even more efficient in remedy and deterring violations of issuers than the model and parallel judgment system previously mentioned.

The new litigation form can be called Chinese “opt-out” group litigation, for it encompasses the following features. First, compared to ordinary joint lawsuit with uncertain plaintiffs, injured investors confirmed by the securities depository and clearing institution become plaintiffs automatically rather than by registration, unless they explicitly refuse to participate in the action. In all jurisdictions, there are two modes of confirming plaintiffs in securities civil litigation. One mode is “opt-in,” which means injured investors become plaintiffs only when they clearly express such an intention. On the contrary, the “opt-out” rule means that injured investors are plaintiffs in actions against liable parties, unless they express an intention to quit the litigation. The new form of litigation stipulated by paragraph 3 applies the “opt-out” rule, which is able to automatically cover all injured investors in one litigation. Second,

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17 Xin Zhengquan Fa Sheli Zhongguo Tese Zhengquan Susong Xin Jizhi, Quanmin Suopei Shidai Lailin (新《证券法》设立中国特色证券诉讼新机制,全民索赔时代来临) [With The Establishment of Chinese Characteristic Securities Litigation under the New Securities Law, the Era of Thriving Claims for Compensations Has Come], ZHONGLUN SHIJIE (中伦视界) [ZHONGLUN LAW FIRM] (Feb. 22, 2020), https://mp.weixin.qq.com/s/H7DwGwttgZa7ZEzGQJg (last visited May 20, 2020).
18 Zhengquan Fa (2019 Xiuding) (证券法（2019修订）) [Securities Law (2019 Revision)] (promulgated by the Standing Comm. Nat’l People’s Cong., Dec. 28, 2019, effective Mar. 1, 2020), art. 95, para. 3 (Chinalawinfo). “An investor protection institution may, as entrusted by 50 or more investors, participate in legal proceedings as a representative, and shall register the obligee confirmed by the securities depository and clearing institution at the people’s court in accordance with the provisions of the preceding paragraph, unless the investors have clearly expressed their unwillingness to participate in legal proceedings.”
there is a strict threshold to initiate the litigation. Such lawsuits can only be initiated by the Investor Protection Institution when it is entrusted by 50 or more investors and agree to act as a representative. Under this requirement, attorneys and ordinary investors themselves cannot file the “opt-out” group litigation. It is predictable that, once the Chinese “opt-out” group litigation comes into real practice, civil lawsuits on false statements will be more normalized, with an increase of tens or even hundreds of times in its volume.

C. Comments on the Chinese “Opt-Out” Group Litigation


(a) Careful Innovation Under Current Litigation System. Article 54 of the Civil Procedure Law provides for the “opt-in” application of joint lawsuits with uncertain parties, which requires the parties to be registered before they participate in a joint litigation. Under the frame of such joint lawsuits, the new Securities Law introduces an “opt-out” rule for investors’ participation and limits the rule’s application to cases where the Investor Protection Institution agrees to represent the plaintiffs. The newly stipulated form of securities litigation makes full use of current legal frame and resources by highlighting the efficiency of joint lawsuits and introducing the mandatory participation of an existing public institution.

(b) Emphasis on the Role of the Investor Protection Institution to Avoid Abuse of Securities Litigation. Group litigations are accompanied with controversy, for attorney’s pursuit for profits may result in serious abuse of such litigations, especially under radical litigation designs like American class actions. Under the new Securities Law, the “opt-out” rule of determining plaintiffs only applies when the representative of plaintiffs is the Investor Protection Institution, which undertakes cases on the basis of selection with certain criteria. As a non-profit public institution, the Investor Protection Institution can enact “opt-out” lawsuits under more careful considerations and avoid bringing excessive and unnecessary burden to the judicial system.

(c) Introducing Public Institutions into Assisting Litigations to Improve Efficiency of the Judicial Procedures. In past securities civil litigations, courts manually verified relevant information, consuming a lot of judicial resources. In 2019, the National Courts’ Commercial Trial Work Conference pointed out the problem and urged introducing technology assistance from related institutions. Article 95 of the new Securities Law, which requires the
securities depository and clearing institution to confirm the obliged, has taken steps towards a more efficient litigation system with the support from other public institutions. In current practice, there are courts introducing the Investor Service Center as a third-party professional to assist in verifying losses. In the future, the Investor Protection Institution may also play an important role in the enforcement of judgments, by escrowing redistribute the enforced fund through the securities transaction and clearing system.20


(a) The Capability of a Public Institution to Fully Satisfy Investors’ Needs in Filing Lawsuits. Under Article 90 of the new Securities Law, the Investor Protection Institution is a non-profit institution of public nature. Given the institution’s limited resources, it is uncertain whether the investor protection institution have incentive and capability to accept every application from investors for representing in the case. If not, then, what is the fair and reasonable standard for selecting cases? If other litigation representatives are granted by law to participate at the same time, what is the relationship between the investor protection institution and other elected representatives?21 There are several important issues yet to be clarified.

(b) The Risk of Impracticability Without Promotion by the Judicial System. The Chinese “opt-out” group litigation is initiated only when the court decides to issue an announcement and notify investors to register through the procedure of joint lawsuits with uncertain plaintiffs, as stipulated by paragraph 2 of Article 95 of the new Securities Law. Therefore, without support from the Supreme People’s Court, paragraph 3 of Article 95, which stipulates the Chinese “opt-out” group litigation, is still at risk to be merely a dead letter.

(c) Several Practical Problems to Be Clarified by Judicial Interpretations. There are other practical uncertainties that need further judicial interpretation. For example, if the implementation date and disclosure date of the false statement cannot be determined in advance, the range of investors who are entitled to be compensated as well as to be registered by the court cannot be determined. However, investigating these dates in the case docketing stage may not be proper, as they are issues to be solved by related parties shall be vigorously coordinated, and the establishment of an information technology-enabled trial assistance platform and a normalized and sustainable working mechanism shall be promoted.”


21 Id.
Practical problems alike need to be stipulated by the judicial interpretation of the Supreme People’s Court.

(d) Potential Negative Effect on Impartiality of Judgments. Under the new Securities Law, the Investor Service center, which previously acted as a professional institution in litigations, is given a second role as the representative of plaintiff investors. The institution’s governmental nature and its possible close interaction with the court may put the defendant issuers at a much more adverse position than that of the plaintiff, as the listed companies may find it difficult “confronting with a governmental institution.” This may leave a negative impression on regulatory institutes like the CSRC.

D. Group Litigations in Other Jurisdictions

The creation of the Chinese “opt-out” litigation by the new Securities law is undoubtedly an important improvement towards a mature system of group litigation for securities disputes. Speaking of group litigation, the class action in the United states is one of the most prominent practices, for it provides tendentious investor protection, stimulates attorneys’ active participation in securities civil litigation, and imposes severe deterrence from violations of the securities law. Most other jurisdictions choose to establish less radical forms of litigation, by posing limitations on different elements of group litigations. Taiwan, as a region sharing the same legal system (the civil law system) and Chinese cultural heritage, sets a good example on how civil law jurisdiction localize the securities class action invented by common law jurisdictions. In comparison, the Chinese “opt-out” group litigation is stipulated with more restrictions than American class action, but less than Taiwan group litigation. The litigation designs in these three jurisdictions actually reflects the art of balancing the interest of eliminating restraint of illegal market activity and the need to restrain malicious litigation.

1. Class Action in the United States. According to Rule 23 of the Federal Rules of Civil Procedure, American class action adopts an “opt-out” mode for injured investors to be compensated, which means that once the court grants remedies for victim investors of a securities fraud, any victim investor is entitled to recover their loss unless the intention of waiving such right is shown by the individual investor. Based on the Fraud on the Market

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22 When docketing a case, a civil court shall only examine the existence of a proper plaintiff and a clear defendant, the existence of specific claims, facts and reasons, as well as whether the case is a civil action under its jurisdiction. Minshi Susong Fa (2017 Xiuzheng) (民事诉讼法（2017修正）) [The Civil Procedure Law (2017 Amendment)] (promulgated by the Nat’l People’s Cong., Apr. 9, 1991, amended by the Standing Comm. Nat’l People’s Cong., Jun. 27, 2017) art. 119 (Chinalawinfo).

23 See Wu Guangming (吴光明), Zhengquan Tuanti Susong Wenhua zhi Tantao — Meiguo yu Woguo Taiwan Diqu Duijuo Fa Jiaodu zhi Guancha (证券团体诉讼文化之探讨——美国与我国台湾地区比较法角度之观察) [Discussion on the Culture of Group Litigations — Comparison between the United States and Taiwan], 3 JIAODA FAXUE (交大法学) [SJTU LAW REVIEW] 99, 102-05 (2013).
Theory\textsuperscript{24}, courts tend to lower the threshold for the confirmation of causation. Plus, the incentive of contingency fees encouraged attorneys to strive for representing the plaintiffs in securities class actions. The above factors enhanced investors’ enthusiasm to guard their interests and forced the listed companies to follow the rules of the securities market. However, such a mechanism also resulted in the abuse of class action and waste of both economic and judicial resources. In 1995 and 1998, Private Securities Litigation Reform Act and The Securities Litigation Uniform Standards Act were passed in response to the problems. These acts heightened the threshold for filing a class action, restrained the application of the Fraud on the Market Theory and provide punishment for plaintiffs and attorneys who bring malicious class actions.

2. Group Litigation in Taiwan.\textsuperscript{25} Securities group litigation in Taiwan is stipulated by the Securities Investors and Futures Traders Protection Law. According to the provisions,\textsuperscript{26} a group action can only be brought by a non-profit public institution, the Securities Investors and Futures Traders Protection Center. Investors grant the institution their “enforcement right” of litigation or mediation, therefore, the participation in litigation follows an “opt-in” rule. The institution is authorized to require liable parties to provide relevant information and documents, which could partly eliminate the information asymmetry between plaintiffs and defendants. Though such a system design avoids the abuse problem, there are still other issues to be solved.

For one thing, the opt-in rule in Taiwan means that the effectiveness of a judgment does not extend to investors that have not granted their “enforcement right” to the institution. Not only will some investors lose the opportunity to be recovered if they have no knowledge about the lawsuit, but even if they file separate lawsuits afterwards, there is still possibility that judgments in these later cases will contradict previous ones arising from identical situations. In comparison, under the new Securities Law, the expansion of effectiveness of judgments eliminates such concerns.

\textsuperscript{24} Peil v. Speiser, 806 F.2d 1154, 1160–1161 (CA3 1986). “The fraud on the market theory is based on the hypothesis that, in an open and developed securities market, the price of a company’s stock is determined by the available material information regarding the company and its business . . . Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements . . . The causal connection between the defendants’ fraud and the plaintiffs’ purchase of stock in such a case is no less significant than in a case of direct reliance on misrepresentations.”


For another, issuing public announcements for notifying potential victims as a prepositive procedure for litigation brings difficulties for applying for property preservation, since relevant parties may transfer their assets once they know the incoming litigation. In comparison, the new Securities Law allows courts to confirm victim investors by transaction records, and in this way improves efficiency and secrecy.

Besides, non-profit institution with strong relations to the government has its own deficiencies as the representative of victim investors. Given the similar design of the new Securities Law to introduce the Investor Protection Institution, these problems shall be given much attention. First, a public institution lacks transparency compared to companies, for the service it provides is hard to assess and there is no strict requirement for disclosure. Second, the government may improperly intervene the prosecution and settlement of specific litigations. Third, the public institutions lack the supervision by owners. Admittedly, there have already been several proposals to tackle these problems. For instance, the legislature can authorize multiple public institutions to represent in group litigations so as to improve their service by competition. Also, heavier duty of disclosure should be imposed on these public institutions, and these institutions should provide references to better assist the investors to choose their ideal representatives. More importantly, more legislation is needed to assure that, in their decision-making, these public institutions have sufficient independence from administrative interference.

III. ALTERNATIVE DISPUTE RESOLUTION APPROACHES

Apart from litigations, other mild alternative dispute resolution approaches, such as mediation and reconciliation, also play a crucial role in providing remedies for ordinary investors. Before the new Securities Law, ordinary investors are easily discouraged by multiple difficulties in litigation, therefore, non-litigation resolution with higher efficiency, more privacy and lower cost becomes a feasible alternative. Under the new Securities Law, these approaches will be more extensively applied, as the liable parties are shouldered with heavier duty to cooperate.

A. Non-Litigation Compensation Before the New Securities Law

In practice, apart from ordinary civil mediations and reconciliations, some administrative procedures also ensure that investors can be compensated with efficiency. Plus, there is also a multiple-source fund to deal with the risk when a liable issuer is incapable of the payment. For civil reconciliation, advance compensation makes remedies readily available under the promise of issuers to pay for recovery before complex responsibility confirmation. For mediations, the Investor Protection Institution developed several special approaches to simplify the gaming process between both sides.
1. Administrative Reconciliation. Administrative Reconciliation is an administrative procedure established in 2015, which makes it more efficient for the injured investors to seek compensation. When the CSRC conducts investigation and law enforcement for any suspected violation of securities laws and regulations, potential reliable parties under investigation may reach a reconciliation agreement with the CSRC. Under the agreement, if the related alleged parties correct their violation, eliminate relevant adverse consequence and compensate the loss suffered by investors accordingly, then the CSRC will terminate the investigation procedures and law enforcement. In April 2019, the first case of administrative reconciliation is completed between CSRC and the applicants, Goldman Sachs (Asia) L.L.C., Goldman Sachs Gao Hua Securities Company Limited and their relevant employees. With the applicants meeting their obligations under the administrative reconciliation agreement and paying RMB150 million, CSRC terminated the investigation procedures.

2. Securities Investor Protection Fund. The Securities Investor Protection Fund is used to compensate investors when an issuer is unable to repay, under circumstances such as administrative dissolution, bankruptcy and takeover. The fund is raised from handling fees of stock change, operating income of issuers, certain types of interest incomes and donations, and is managed by the wholly state-owned China Securities Investor Protection Fund Corporation to ensure proper compensation.

3. Special Fund for Advance Compensation. For investors’ losses caused by false statements or fraudulent offering, there are already three successful cases of advance compensation. In these cases, after the

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27 Xingzheng Hejie Shidian Shishi Banfa ([行政和解试点实施办法](行政和解试点实施办法)) [Implementation Measures for the Pilot Program of Administrative Reconciliation] (promulgated by the CSRC, Feb. 17, 2015, effective Mar. 29, 2015) art. 2 (Chinalawinfo). “Administrative reconciliation’ means that the CSRC, in the course of conducting investigation and law enforcement for any suspected violation of law, administrative regulation or relevant regulatory provisions on securities and futures conducted by a citizen, legal person or any other organization (hereinafter referred to as the “administrative counterpart”), according to the application filed by the administrative counterpart, reaches an administrative reconciliation agreement with the administrative counterpart through consultation in respect of such matters as correcting the suspected violation of law, eliminating the adverse consequence of such suspected violation of law, and accordingly terminates the procedures for investigation and law enforcement.”

28 Zhengquan Touzizhe Baohu Jijin Guanli Banfa ([证券投资者保护基金管理办法]) [Measures for the Administration of Securities Investor Protection Fund (2016 Revision)] (promulgated by the CSRC, MOF, PBOC, Apr. 19, 2016, effective Jun. 1, 2016) art. 19 (Chinalawinfo). “The fund shall be used: (1) to repay creditors according to the relevant policies of the state when a securities company is administratively dissolved, closed or bankrupt, or is taken against any compulsory regulatory measure such as administrative takeover and trusteeship operation by the CSRC; or (2) for any other purpose approved by the State Council.”

29 Id., art. 7, art. 14.

30 The liable issuers are Wanfu Biotechnology Co., Ltd, Hirisun Technology Co., Ltd and Xintai Electric Co., Ltd.
establishment of the compensation fund by responsible parties, China Securities Investor Protection Fund Co., Ltd. (hereinafter referred to as Securities Investor Protection Fund), as a third-party institution, was entrusted as the manager of the fund. Compared with litigation, the advance compensation has the following advantages. For one thing, such funds compensate a wider range of investors with higher efficiency, thanks to the shelving of complex responsibility confirmation and the electronic operation from application to the final payment. For another, the Securities Investor Protection Fund, which only manage and operate the funds for advance compensation, is independent and impartial, ensuring fairness to both responsible parties and investors.

4. Mediation System Before the New Securities Law. The Investor Protection Institution and authorized mediation organizations have been promoting several highly efficient mediation procedures, among which the fast-track mediation for low-value claims and mediation for parallel cases based on model judgements are two prominent examples.

For cases where an investor’s loss is under RMB10,000, issuers are encouraged to reach an agreement with a mediation organization, promising to unconditionally accept the mediation proposal made by the mediation organization and thus improve the efficiency of dispute settlement.31

For parallel cases of a model judgment, mediation will be given priority as the common issues of facts and law application have been settled. Till the end of 2019, the Investor Service Center has established such a mechanism with 39 Intermediate and Higher People’s Court in 35 jurisdictions, wishing to save judicial resources, unify law application and lessen the cost for investors to be remedied.32

B. Increased Burden on Liable Parties in Alternative Dispute Settlement Under the New Securities Law

In general, the new Securities Law does not provide any new approaches of alternative dispute resolution. Instead, the new law emphasized issuers’ obligation to cooperate in dispute resolution to ensure investors’ right to be

31 Guanyu Quanmian Tujin Zhengquan Qihuo Jiajenu Duoyuan Huajie Jizhi Jianshe de Yijian (关于全面推动证券期货纠纷多元化解机制建设的意见) [Opinions on Comprehensively Advancing Establishment of Diversified Resolution Mechanism of Securities and Futures Disputes] (promulgated by Sup. People’s Ct. & China Securities Regulatory Commission, Nov. 13, 2018) art. 14 (Chinalawinfo). “In order to better resolve disputes on capital markets, securities and futures market operators shall be encouraged to enter into an agreement with a mediation organization by the principle of freedom, promising to unconditionally accept the mediation proposal made by the mediation organization to the extent of a certain amount.”

heard, by legalizing the advance compensation system and stipulating issuers’ mandatory participation in mediation with ordinary investors.

1. Incorporation of Advance Compensation into the New Securities Law. Based on former experimental experience, Article 93 of the new Securities Law stipulates that, “[w]here an issuer causes any loss to investors due to fraudulent offering, false statements or any other major violation of law, the issuer’s controlling shareholder, actual controller or the relevant securities company may entrust an investor protection institution to enter into an agreement with investors who suffer losses on compensation matters to make compensation in advance. It may legally claim compensation from the issuer and other parties jointly held liable after making compensation in advance.”

There are several issues that require further discussion. First, given the coexistence of two equivalent systems, advance compensation and Chinese “opt-out” group litigation, the relationship between them remains to be observed. In the past, advance compensation is deemed as an effective remedy in the lack of efficient group litigation. However, in the era of “opt-out” group litigation, such a relationship will accordingly change. Will the two system subsidize each other? Or, will advance compensation become a tool for issuers to avoid greater losses in litigations?

Second, the intention of adding such an advocacy provision is worth discovering. Advance compensation can be carried out smoothly without being written in law since it is, by nature, a civil reconciliation between injured investors and liable persons. Before the new Securities Law, three successful cases of advance compensation have already taken place. There are viewpoints that such a provision is an empowerment for the investor protection institution to participate in advance compensation procedures and may serve as the legal basis for CSRC to require sponsors’ promise of advance compensation in prospectuses.33

Third, in cases where multiple liable parties can voluntarily decide whether to pay in advance, it may be difficult to implement advance compensation without an appropriate incentive mechanism. Some scholars believe that the administrative reconciliation system provided for by Article 171 of the new Securities Law may become the key to full implementation of the advance compensation system.34 In previous advance compensation cases, the CSRC only reduced the penalty for the responsible parties. However, according to Article 171, if the parties have fulfilled their commitments to correct illegal acts, compensate investors’ losses, and

34 Id.
eliminate the damage or adverse effects, the CSRC may suspend the investigation, that is, no penalty at all.

2. Mandatory Mediation. Paragraph 1 of Article 94 of the new Securities Law gives ordinary investors the right to communicate and negotiate with the issuer, by stipulating that “[i]f an ordinary investor has any dispute over the securities business with a securities company and the ordinary investor files a request for mediation, the securities company shall not reject the request.” However, the legal consequence of securities company’s objection is unclear, without which the mandatory procedure cannot be effectively implemented. There is also a lack of rules for procedures after a failure in mediation. Plus, there are guesses on whether the investor protection institution is given the power of mandatory investigation and evidence collection under this paragraph, concerning the trend of alleviating difficulties in investigations of securities dispute resolution.35

IV. FEATURES OF CHINESE SECURITIES DISPUTE RESOLUTION SYSTEM

A. The Transition from Merits Regulation to Disclosure

The new Securities Law signifies the transition from approval to registration in securities offering. Without high threshold for securities offering, investors’ decision relies solely on the information disclosed by issuers. Under such circumstances, it is necessary to strengthen the procedural protection for ordinary investors, who are in a weak position to obtain information and pay for the cost of dispute settlement.

B. Improved Litigation System: Activated Forms of Group Litigation

With the innovation under current civil procedure, the new Securities Law has developed a more complete system of litigation, including separate litigation, model judgment, joint lawsuits with certain or uncertain plaintiffs and the Chinese “opt-out” group litigation. Compared with well-developed markets, there is still room for designing special procedures for low-value litigations.36 Currently, there is only a fast-track mediation mechanism of claims with low-value losses provided by the Investor Protection Institution.

35 For example, in the establishment of the Science and Technology Innovation Board Market, the Shanghai Financial Court intended to further enhance the coercive power of investigation orders issued in the resolution of securities disputes. Shanghai Jinrong Feyuan Guanyu Fuwu Baozhang Sheli Kechuangban Bing Shidian Zhucezhi Gaige de Shishi Yijian (上海金融法院关于服务保障设立科创板并试点注册制改革的实施意见) [Implementation Opinions of the Shanghai Financial Court on Serving and Guaranteeing the Establishment of the STAR Market and the Launch of the Pilot Program of Reform on the Registration System] (promulgated by Shanghai Financial Court, July 23, 2019) art. 9 (Chinalawinfo).

C. The Investor Protection Institution’s More Extensive Participation in Dispute Settlement

Based on the above analysis, there are several provisions granting more active participation of the Investor Protection Institution. In litigations, the Investor Protection Institution is the authorized representative for plaintiffs in the group litigations stipulated by Paragraph 3 of Article 95. Plus, the requirements of amount of time of shareholding for filing derivative litigation are eliminated for the Investor Protection Institution.

D. The Unclarified Relationships Between Different Approaches to Remedies

For example, the relationship between advance compensation and opt-out group litigation, both resulting in full recovery for all victim investors, is yet to be discussed. Another case in point, is the relationship between model judgments and joint lawsuits, a pilot mechanism and a newly activated system. Given the coexistence of several mechanisms which have the same remedial function, it is necessary to clarify their application, whether complementary or alternative.

V. CONCLUSION

To conclude, in terms of dispute resolution procedures, the new Securities Law has surely taken an important step towards building a well-rounded investor protection system. For the litigation system, the revision reactivates joint lawsuits with uncertain plaintiffs before the opening of the court and creates Chinese “opt-out” group litigation, which is less radical than American class action but more radical than the group litigation in Taiwan. However, to what extent can the reform encourage securities civil litigation is uncertain, as full implementation of the stipulated approaches require promotion by the judicial branch. For the alternative dispute resolution system, the new Securities Law mainly emphasizes the obligations for issuers to cooperate, leaving the space of creativity to the Investor Protection Institution and mediation organizations. Both litigation and non-litigation systems call for more extensive participation and support of the Investor Protection Institution, therefore, there is still room of improvement for the capability of the Investor Service Center. Last but not least, there is likely to be comparisons and confusions among some of the above dispute resolution procedures which share highly similar functions and features, and there will be inevitable demands for detailed administrative regulations and judicial interpretations to clarify the relationship between these remedial approaches.