THE JUDICIAL APPLICATION OF THE CAUSATION TEST OF THE FALSE STATEMENT DOCTRINE IN SECURITIES LITIGATION IN CHINA

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Abstract: As part of the reform of China’s centrally planned economy, one of the primary purposes in establishing a stock market was to help state-owned enterprises raise sufficient capital from the public. The protection of investors’ interests was not essential in the initial contemplation of securities laws, though the listed companies have a duty of disclosure under the 1998 Securities Law. After the Supreme People’s Court promulgated its judicial interpretation of the false statement doctrine in civil securities cases in 2002, the lower courts started to interpret and apply the elements of the false statement doctrine in securities cases brought by public investors to seek civil compensation against the listed companies that misrepresented or omitted major information. The causation test of the false statement doctrine is the determinative issue in many false statement cases. This Comment explores the confusion in the causation test under the Supreme People’s Court’s judicial interpretation of the false statement doctrine, evaluates the application of the causation test in two civil securities cases, and argues that a trial court should interpret the causation test in favor of public investors in a close case in light of the legislative intent to protect public investors and the practical need to reconstruct investors’ confidence in the stock market in China.

I. INTRODUCTION

In 2001, more than eighty listed companies in China’s stock market were investigated and penalized by the China’s Securities Regulatory Commission (“CSRC”) for fraud, misrepresentation, or non-disclosure of material corporate information.1 The stock market in China underwent an unprecedented trust crisis,2 and numerous investors who had suffered losses started to question the existing model of the stock market.3 In August 2004, the Jinan Intermediate People’s Court (the trial court) of Shandong Province issued its decision in Zhang He v. Bohai Group.4 This case brought about

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3 Re dian tou shi, supra note 1.
4 Zhang He su Yinzuo Bohai Yituan [Zhang He v. Bohai Group] (Jinan Interm. People’s Ct., Aug. 4, 2004) (hereinafter Bohai Group). Different from U.S. courts, Chinese courts publicize a very small number of cases. This case has not been publicized by the court. All the discussions of the case in this comment are based on the information collected from websites, Bohai Group’s official corporate documents, and the CSRC documents. See Ba yue fa zhi jiao dian hai gu [August Legal Focuses], Renmin Wang [People’s
the first open trial in China involving a public investor seeking damages against a listed company under the false statement doctrine.\(^5\) In the same month, the Ha’erbin Intermediate People’s Court made a judgment in *Chen Lihua v. Daqing Lianyi Corporation* on the same grounds.\(^6\) These two cases are representative of earlier judicial application of the false statement doctrine in civil securities litigation in China.

Despite its short history, the stock market in China has experienced considerable ups and downs since its establishment in the early 1990s. By the end of 2005, the number of listed companies in the securities market had increased from fewer than twenty to 1,381.\(^7\) The total value of the stocks trading in the open market reached RMB 3.24 trillion (US$405 billion) in 2005.\(^8\) However, in spite of its early rapid development, there has been a downturn in the stock market since 2000. For example, the Composite Index of Shanghai Stock Exchange has declined from over 2,073 at the end of 2000 to 1,161 in 2005.\(^9\) The majority of public investors have suffered serious loss in recent years, including most institutional investors.\(^10\)

The large scale misconduct of listed companies played a significant role in the downturn of the stock market. The listed companies’ constant false disclosures or major omissions of material information garnered broad attention, both within the stock market and among society generally. For example, cases of listed companies making false statements occurred every month in 2001.\(^11\) Pervasive misconduct as well as the poor performance of many listed companies exhausted investors’ trust and confidence in the market.\(^12\) Many scholars have pointed out that the securities market cannot

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5. Ba yue fa zhi jiao dian hui gu, supra note 4.
8. Id. (Major Index).
10. See Shi Guohua, supra note 2.
be revitalized without an effective mechanism to monitor and prevent such misconduct.  

A system of civil compensation through judicial processes is often regarded as the most popular candidate for such a mechanism. Under current law, although a listed company that conducted fraud or made false statements might be fined by administrative agencies, or the directors of the company may be punished by criminal statutes, public investors who have suffered serious financial losses due to the companies’ fraud or other misconduct do not have legal remedies. Public investors need greater protection, and the current legal system is woefully insufficient. To address the inadequacies of the system, in 2003, the Supreme People’s Court of China (“SPC”) issued its judicial interpretation under the title of “Some Provisions of the Supreme People’s Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market” (“SPC Provisions”). For the first time, a SPC judicial interpretation provided substance and procedures for aggrieved public investors seeking civil damages against a listed company that made false statements.

The causation test in the SPC Provisions soon became the dispositive issue of the false statement doctrine after the SPC’s promulgation of the SPC Provisions. The relationship between cause and effect can be very complicated in civil securities litigation. One cause might result in multiple effects while one effect may result from multiple causes. In a stock transaction, it is often very hard for a plaintiff investor to prove that

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13 See, e.g., Chen Sheng, Min shi ze ren zhi du yu zheng quan fa zong zhi de shi xian [The Realization of Civil Liability System and Goals of Securities Laws], RENMIN FAYUAN BAO [NEWSPAPER OF PEOPLE’S COURT], Dec. 12, 2001.


15 See Shi Xiaobo, supra note 14, Yu Guangua, supra note 14.

16 The highest court in China [hereinafter SPC].


19 Id.
the alleged false statement is the sole or significant cause of the investor’s loss. Many plaintiffs have lost their cases merely because they failed to sufficiently demonstrate that the company’s false statement was in fact the sole cause of their losses in the stock transaction. A trial court’s interpretation and application of the causation test under the SPC Provisions has become determinative in deciding the false disclosure dispute between a public investor and a listed company.

This Comment argues that a trial court should broadly interpret the causation test of the false statement doctrine to protect the interests of public investors in cases where public investors seek monetary damages against the listed company for its false statements. Part II describes the establishment of the false statement doctrine and the causation test through market practice and the development of the legal system. Part III analyzes the confusion of the causation test in the SPC Provisions and tries to demonstrate the possible readings a trial court may have when applying it to cases. Part IV analyzes the application of the causation test in *Zhang He v. Bohai Group* and *Chen Lihua v. Daqing Lianyi Corporation*. Finally, Part V explains why the trial court should adopt a broad approach in applying the causation test in civil securities cases.

II. THE CAUSATION TEST OF THE FALSE STATEMENT DOCTRINE WAS FORMALLY ESTABLISHED THROUGH THE PROMULGATION OF THE SPC PROVISIONS

The false statement doctrine in China’s securities laws has its roots in general civil liability cases in tort and contract. Under the General Principles of the Civil Law, a party that acquired property as a result of fraud should compensate the other party for losses that are caused by the fraud. However, the concept of this doctrine of fraud was not fully developed in private securities litigation when the Securities Law was first promulgated in

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1994. Instead, the doctrine developed to fulfill the needs of the stock market and legal practice.

The false statement doctrine in securities laws is a special category of the doctrine of fraud applied in general civil compensation cases. In the context of securities laws, the false statement doctrine under the SPC Provisions allows a public investor to seek civil damage against a listed company, where (1) the listed company has made a false statement consisting of either untruthful information or omission of material information, (2) the public investor has suffered loss in his stock transactions, and (3) the listed company’s false statement has caused the public investor’s loss. Thus, the false statement doctrine can be summarized by three elements: the false statement, actual losses, and the causation test. A public investor who brings a lawsuit against a listed company under the false statement doctrine will receive monetary compensation based on his actual financial loss if he can prove all three elements at trial.

In most cases, the falsehood in the company’s public documents and the investor’s loss can be easily found because of the broad definition of false statement under the SPC Provision. A false statement can be any untruthful disclosure or major omission of material information. The investor’s loss can be found through the records of transaction prices. However, the causal relationship between the false statement and the investor’s loss remains difficult to discern even after SPC issued its judicial interpretation of the doctrine and the test.

A. The Protection of Public Investors from Listed Companies’ False Statements Was Not Contemplated During the Establishment of the Stock Market

The modern stock market in China is still very new, but it has developed rapidly. The Chinese government established the Shanghai Stock Exchange in 1990 and the Shenzhen Stock Exchange in 1991, which

24 This Comment only discusses listed companies who have made false statements. Under the SPC Provisions, defendants can include intermediate agencies in the stock market such as law firms, accounting firms and brokerage firms.
25 Li Minghui & Xie Jun, supra note 21, at 60.
26 See SPC Provisions, supra note 17, art. 17.
27 Id.
28 Shao Zongwei, supra note 20; Li Minghui & Xie Jun, supra note 21, at 60.
30 Id. at 148.
became the national stock exchanges in China.\(^{31}\) Individual investors compose the majority of trading accounts in China’s stock market.\(^{32}\) There are over 72 million securities trading accounts in China today.\(^{33}\) A little more than half of the individual investors have an annual income below RMB 20,000 (US$2,418).\(^{34}\) Many individual investors do not have the necessary financial or investment knowledge of securities to conduct trading in the stock market.\(^{35}\)

One of the primary motives of the Chinese government in establishing a stock market was to further the reform of state-owned enterprises.\(^{36}\) Since the mid-1980s, the Chinese government started to delegate some power to state-owned enterprises through contracting between the government and the enterprises.\(^{37}\) However, the management of the contracting enterprises lacked long-term objectives under the contracting system because all of the appointed managers were “officials affiliated with government agencies and had no incentive to improve the enterprises’ performance.”\(^{38}\) The shareholding system in enterprises was proposed and established to “provide a means of raising capital, management means, and motivation mechanisms.”\(^{39}\) Since the establishment of the stock market, the government has emphasized the interests of state-owned enterprises and their revenue-producing capability.\(^{40}\) Though the government tried to realize the role of the enterprises in light of their independent management, the government did not contemplate the potential liability that such an independent enterprise might have to assume with regard to its public investors.\(^{41}\)

\(^{31}\) Jian Fu, supra note 11, at 4.
\(^{33}\) Id at 347-48.
\(^{34}\) Id.
\(^{35}\) Id.
\(^{36}\) Hong Jun, Zheng quan shi chang xu jia chen shua ji qi min shi pei chang ze ren [False Statements in Securities Market and Civil Liability], LIAONING JINGJI [LIAONING ECONOMY], Sept. 2003, at 76, 76-77.
\(^{38}\) Id. at 74-75.
\(^{39}\) Id. at 76.
\(^{40}\) Hong Jun, supra note 36, at 76.
\(^{41}\) See id.
B. The Initial Development of Securities Laws Nurtured the False Statement Doctrine but Failed to Provide a Sufficient Private Cause of Action

The uniform national regulations of the stock market in China started with the Interim Regulation on the Issue and Trading of Shares (“IRITS”) on April 22, 1993.42 Before the promulgation of national regulations, both Shanghai and Shenzhen municipal governments enacted administrative measures to regulate the stock transactions in their regions.43 In 1992, the State Council Securities Committee (“SCSC”) and the CSRC were created to form “a nationwide regulatory policy” as a response to the existence of national stock markets in Shanghai and Shenzhen.44 Together, the SCSC and the CSRC promulgated the IRITS.45

The IRITS narrowly defines the liability of the corporations, promoters, and intermediaries for violating the duty of disclosure. The IRITS requires that the listed companies correctly reveal material corporate information.46 However, its explicit regulation on falsification is limited to only the information disclosed in the initial public offering of stocks (“IPO”).47 Moreover, violators for misinformation are only subject to administrative penalties.48 The IRITS does not hold the violators liable to public investors.

The first Securities Law49 in China defined the company’s liability but failed to provide a sufficient legal mechanism under which a public investor could seek private remedies. Although the Statute provided that a company should be liable to its investors for their losses in the course of securities trading that resulted from the company’s misinformation, it did not provide an explicit cause of action to public investors.50 Moreover, fines remitted by

44 Id. at 420.
45 Id.
46 IRITS, supra note 42, ch. 6.
47 Id. art. 17, 21, 73.
48 Id. art. 74.
49 Zheng quan fa (P.R.C.) [Securities Law of P.R.C], Chairman’s Order 1998 No. 12, CHINALAWINFO (last visited Apr. 14, 2006) (hereinafter Securities Law). The latest Securities Law of People’s Republic of China was issued in 2005. Because the false statement doctrine in the SPC Provisions was established in accordance with the securities laws before 2003, any discussion of securities laws in this Comment is limited to those before 2003.
50 Id. art. 63; see also id. art. 24, 59, 63, 72, 177, 181, 188, 189, 202 (governing information disclosure of listed companies and other violators).
the company would go to the government instead of to the injured private party. Before the issuance of the SPC Provisions in 2003, when a public investor brought a lawsuit against a listed company under then-existing securities laws, most courts simply declared that they did not have jurisdiction over these cases because the Securities Law was silent about whether a public investor may file a lawsuit against the listed company for its false statement.

C. The SPC Issued Its Circular to Complement the Legal Insufficiency of the Securities Law on Civil Liabilities for Falsehood of Information

The stock market in China experienced a downturn since 2000 despite its rapid development in earlier years. The Composite index of the Shanghai and Shenzhen Stock Exchanges continuously declined until 2005. The majority of public investors suffered serious loss as a result. Numerous cases of fraudulent information disclosed by listed companies diminished the public investors’ incentive to invest and significantly contributed to the downturn of the stock market. Misconduct of the listed companies, particularly in the form of false disclosure, has plagued the stock market in China since the early 1990s due to insufficient legal remedies. Shenzhen Yuanye Industry Corporation became the first company de-listed from the stock market in 1992 for its illegal conduct, which included false statements regarding the source and amount of its investment capital.

On September 21, 2001, the SPC decided that the courts, for the time being, would not hear any cases seeking civil damages for insider trading, fraud, market manipulation, and other misconduct of listed companies and intermediate stock agencies. This decision was a result of the absence of civil liability provisions in the Securities Law. Courts were unable to protect individual investors due to the absence of statutes governing false statements

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51 Id. art. 177.
52 Liu Junhai, supra note 18, at 4.
53 See Shanghai Stock Exchange, supra note 9.
54 Id.
55 See Shi Guohua, supra note 2.
57 Jian Fu, supra note 11, at 9.
58 Id. at 10-11. Listed companies who have falsified material information include the Qingminyuan Company in 1998, Sichuan Hongguang Company in 1998, Lantian Shareholding Compay and Yiguangxia Company in 2001, and Daqing Lianyi Company in 2002. Id.
59 Sun Min & Li Jing, Corporate Fraud before the Courts, CHINA DAILY, Feb. 12, 2003, at 2.
in securities cases and providing for civil compensation. Individual public investors lost not only their money but also their trust in the stock market because of the listed companies’ fraudulent conduct on such a large scale. The revitalization of the stock market must include a civil compensation system to deter listed companies from making false statements, provide remedies for investors’ losses resulting from companies’ violations of law, and reconstruct investors’ trust and confidence in the stock market.

To address the legal insufficiency of the Securities Law in civil litigation, the SPC issued a Circular in January 2002 establishing the jurisdiction of courts over a dispute between public investors and listed companies on false statements. This Circular explicitly provides that a court must hear a civil securities case on the issue of a false statement when a plaintiff files the lawsuit based on the CSRC’s confirmation of a defendant’s violation. However, the Circular does not provide any substantive or procedural rules to the application of false statement cases. It does not define what constitutes a false statement, nor does it specify the allocation of burden of proof. In practice after the Circular was issued, though courts had jurisdiction over the cases to address the interests of public investors, they had trouble determining the rules governing civil securities cases.

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60 See Chen Sheng, supra note 13; Xin Zhiming, Bring Companies That Lie to Court, CHINA DAILY, Jan. 21, 2002, at 4.
61 Xu Binglan, supra note 12.
63 Circular, supra note 62, art. 2.
64 Li Guoguang, Wo guo zheng quan shi chang si fa su song de shi jian wen ti yu qian jing [The Practice, Challenges and Prospect of Securities Litigation in China], RENMIN FAYUAN BAO [NEWSPAPER OF PEOPLE’S COURT], June 21, 2002. Li Guoguang is the Vice Chairman of the Supreme People’s Court in China.
65 See Jia Wei, Shen li zheng quan shi chang xu jia chen shu min shi pei chang an jian de ji ge yi nan wen ti [Several Difficult Questions Regarding Judicial Hearing of Civil Compensation Cases for False Statements in Securities Market], RENMIN CIFA [PEOPLE’S JUDICARY] 9 (May, 2002).
D. The SPC Provisions Have Fully Established the False Statement Doctrine in Civil Securities Litigation

The SPC Provisions help establish the legal foundation for the courts to protect individual investors through civil compensation.\textsuperscript{66} They contain eight chapters including general, substantive, and procedural provisions.\textsuperscript{67} The substantive provisions include Ascertainment on False Statement, Causes for Liability Fixation and Exemption, and Ascertainment for Losses.\textsuperscript{68} Procedural provisions include Entertainment of Cases and Jurisdiction, Litigation Methods, and Liability for Joint Torts.\textsuperscript{69}

The causation test of the false statement doctrine is described in Articles 18, 19, and 20 of Chapter IV Ascertainment on False Statement.\textsuperscript{70} Article 18 defines the circumstances in which the causal relationship can be established in false statement cases:\textsuperscript{71}

(a) The investor’s transactions of the securities are directly related to the false statement;

(b) The investor buys the securities on or after the date of false statement, and before the exposure date or correction date;

(c) The investor suffers loss from selling the securities after the exposure date or correction date or from continuously holding the securities.

Under Article 18, the plaintiff investor has the initial burden of proving that the company made false statements causing plaintiff’s losses.\textsuperscript{72} For a causal relationship to exist, a public investor in lawsuits against the listed company must show that a false statement made by the defendant company will directly affect the transaction of securities.\textsuperscript{73} For example, a listed company may report an increase in revenue, which in turn causes the stock price to increase. Moreover, the causal relationship is structured in terms of timing.\textsuperscript{74} Thus, the plaintiff must prove that he either bought or sold the

\textsuperscript{66} The SPC Provisions were approved in December 2002 and publicized on January 15, 2003.
\textsuperscript{67} See SPC Provisions, supra note 17.
\textsuperscript{68} Id.
\textsuperscript{69} Id.
\textsuperscript{70} See id. arts. 18, 19, 20.
\textsuperscript{71} Id. art. 18.
\textsuperscript{72} See id.
\textsuperscript{73} Id. art. 18(a)
\textsuperscript{74} Id. art. 18(b), (c).
securities during a certain period of time to establish the causal relationship.\footnote{Id.}

By contrast, Article 19 lists circumstances that exclude the existence of the causal relationship:\footnote{Id. art. 19.}

(a) The investor has sold the securities before the revelation date or correction date;

(b) The investor conducts a transaction of the securities after the revelation or correction date;

(c) The investor conducts a transaction despite his/her knowing the existence of the false statement;

(d) The investor’s loss or part of the investor’s loss results from the systematic risks of the securities market or due to reasons other than the false statement;

(e) The investor invests maliciously.

Under Article 19, the defendant company bears the burden of proof.\footnote{Article 19 provides that “the defendant produces evidence” with respect to the listed circumstances under this Provision.} As long as the defendant can prove one of the illustrated circumstances under Article 19, the court will find no causal relationship between the plaintiff investor’s loss and the defendant’s false statement. Article 19 generally assumes that the effect of the false statement on the securities prices and investors’ behavior no longer exists once the false statement is disclosed or the investor has actual knowledge of the false statement.\footnote{Jia Wei, Zheng quan shi chang xu jia chen shu min shi an jian de pe ichang fan wei [The Scope of Compensation in Civil False Statement Cases in Securities Market], RENMIN CIFA [PEOPLE’S JUDICARY], Nov. 2002, at 9, 10.}

Article 20 provides definitions of three important dates in finding a defendant’s liability:\footnote{SPC Provisions, supra note 17, art. 20.}

(a) The date of the false statement is the date when the false statement is made or occurs;

(b) The revelation date is the date when the false statement is initially exposed in national media including newspapers, radio stations, and TV stations;

\footnote{Id.}
(c) The correction date is the date when the person who made the false statement announces and corrects the false statement on the media that are designated by the CSRC to disclose securities market information and also suspends the trading of the securities in accordance with provided procedures.

The definition provision is particularly important in finding the specific time of disclosures, which ultimately determines causation. It is directly related to Article 18’s provisions.

Through the SPC Provisions, the causation test of the false statement doctrine is formally established in securities litigation where individual investors may seek civil damages against listed companies that have violated the disclosure requirement in the Securities Law. Articles 18 and 19 not only provide circumstances for finding or excluding the causal relationship but also allocate the proper burden of proof between the plaintiff investors and the defendant companies.

The plaintiff investor does not need to prove the defendant’s actual knowledge of the false statement so long as the evidence suffices to satisfy Article 18 requirements. On the other hand, the defendant can rebut the claim by proving any circumstances provided under Article 19 to deny the existence of causal relationship between the plaintiff’s loss and the defendant’s false statement.

The formal establishment of the false statement doctrine is, to a large extent, a response to the legal inadequacy of securities laws and trust crisis in the stock market. Despite its origin in the general civil laws promulgated in the 1980s, the application of the false statement doctrine in securities litigation was not fully conceptualized in the initial development of securities laws. The SPC formally established the doctrine through its judicial interpretation in assuming the courts’ jurisdiction over securities litigation brought by public investors seeking monetary damages. The causation test contained in Articles 18, 19 and 20 of the SPC Provisions has become the key issue in false statement cases.

III. THE CAUSATION TEST IN THE SPC PROVISIONS IS CONFUSING AND OPEN TO SEVERAL POSSIBLE INTERPRETATIONS

Despite the SPC’s efforts to provide an unambiguous and thorough interpretation of the false statement doctrine, confusion exists not only in the plain meaning of the provisions but also from the application of the causation test in legal practice. The provisions related to the causation test

\(^{80}\) See id. arts. 18, 19.
contain three major problems: the arguable relationship between Article 18(b) and 18(c), the loose definitions of the revelation date and correction date under Article 20, and the uncertain scope and effect of systemic risks under Article 19.

A. Whether a Plaintiff Should Prove Both Article 18(b) and 18(c) or Only One of Them to Meet the Causation Test Is Arguable

Article 18 is the key to understanding the causation test of the false statement doctrine. Article 18 states that a court shall find that a listed company’s false statement is the cause of a public investor’s loss if the public investor can prove that he is under the illustrated circumstances of Article 18(a), 18(b), and 18(c). Article 18(a) requires that the plaintiff investor have traded the stock that is directly related to the defendant company’s false statement. In most cases, the plaintiff has suffered losses from buying and selling the stock issued by the defendant company. The proof of a “direct relationship” under Article 18(a) rarely arises as an issue before a court.

Article 18(b) and 18(c) lay down the other two possible circumstances: (1) an investor buys the stock after the false statement date and before the disclosure date and (2) an investor sells or holds the stock after the revelation/correction date. In the original text of the SPC Provisions, no connector exists between Article 18(b) and 18(c). If the connector between Article 18(b) and 18(c) is “and,” only plaintiffs who buy the stock before the disclosure date and sell or hold after the disclosure date can sustain the burden to prove the causal relationship under the false statement doctrine and therefore receive appropriate compensation for their losses. If the connector is “or,” both plaintiffs who buy before the disclosure date, and those who sell or hold afterwards, may receive their compensation. The choice between “and” as opposed to “or” becomes important because it determines how many investors may survive the causation test under the false statement doctrine and eventually win their cases.

The plain meaning of the causation test provisions does not answer the question of whether Article 18(b) and 18(c) are connected by “and” or

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81 See id. art. 18.
82 Id. art. 18(a).
83 Id. art. 18(b). The disclosure date is the earlier of the revelation date or the correction date, referring to the first time when the falsehood of a company’s prior statement is disclosed to the public under Article 18.
84 Id. art. 18(c).
85 See id. art. 18.
“or.” On the one hand, the connector between Article 18(b) and 18(c) seems to be “and” by reading Articles 18 and 19 together. Article 19(a) explicitly excludes a causal relationship when an investor sells the stock before the disclosure date.\(^{86}\) If the connector between Article 18(b) and 18(c) is “or,” an investor may prove the causation test when he buys the stock after the false statement date and sells before the disclosure date under Article 18. This is certainly inconsistent with Article 19.

On the other hand, a connector “or” is also possible if one examines the structure and the coherent use of wording of the two articles. Article 18 imposes the burden of proof on the plaintiff to establish a causal relationship.\(^{87}\) By contrast, Article 19 imposes the burden on the defendant to provide evidence to rebut the plaintiff’s allegation.\(^{88}\) These two articles are parallel to each other in the statutory structure. In addition, both Article 18 and Article 19 employ the exact same wording before their respective illustration of circumstances that a people’s court shall (Article 19 here includes “not”) find a causal relationship “under any of the following circumstances”.\(^{89}\) The text seems clear enough that no causal relationship exists under Article 19 whenever one of the Article 19 circumstances is proven.\(^{90}\) This strongly indicates that a causal relationship can be shown by any of “the following circumstances” of Article 18(b) and 18(c).\(^{91}\)

However, an investor’s reasonable reactions to different false statements support the use of the connector “or” between Article 18(b) and 18(c). In an article explaining the false statement doctrine, one of the SPC Judges points out that the causation test in the SPC Provisions is drafted according to the different effects of two types of false statements on investors’ transactional behavior.\(^{92}\) A false statement can be either falsely optimistic or falsely pessimistic information about a listed company.\(^{93}\) For example, suppose a listed company falsely announces a revenue increase. The company’s stock price increases accordingly and investors purchase the

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\(^{86}\) Id. art. 19(a).

\(^{87}\) See id. art. 18; Jia Wei, supra note 78, at 10.


\(^{89}\) SPC Provision, supra note 17, arts. 18, 19.

\(^{90}\) See id. art. 19.

\(^{91}\) Id. art. 18(b), (c).


\(^{93}\) See id.
listed company’s stock relying on the false revenue increase news. The stock price decreases and the investors suffer losses on or after the date when the company’s false statement is disclosed, and the company has not performed well enough to increase its revenues. Presumably, the stock price will not be negatively affected by the false statement before its disclosure. Thus, the causal relationship can only be found when an investor sells or holds the stock after the revelation or correction date.94

Similarly, a false statement that reports untruthfully pessimistic information about the company can also cause the investors’ loss.95 Even though most companies are inclined to make falsely optimistic statements, the opposite scenario also exists.96 Many scholars have criticized the causation test in the SPC Provisions as insufficiently conceptualizing the pessimistic false statement scenario.97 Investors who suffer losses from the false bad information should be equally protected.98 Sitting in equity, a court should find the causal relationship in cases where investors sell the stock before the disclosure date as well as those who hold the stock all along or sell afterwards, so long as the investors can prove actual losses.99

The absence of a connector between Article 18(b) and 18(c) results in different readings as to what kind of investors might bring sufficient evidence to prove the existence of a causal relationship. Once a court determines the revelation date or the correction date, it can find a causal relationship if the investor buys the stock before the disclosure of a

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94 Jia Wei, supra note 78, at 10.
95 For example, a company that has received favorable tax treatment does not disclose the good news to the public in a timely manner. In this scenario, the stock price will be lower than it should be if not for the false statement. The investor sells the stock before the disclosure of the false statement. The stock price increases when the false bad information is disclosed and corrected. The investor has given up the opportunity of profits by selling the stock earlier, in reliance on the false bad information. See Jia Wei, supra note 92.
98 Chen Jianjun, supra note 96; Li Minghui, supra note 21; Guo Feng, supra note 97; Chen Jie, supra note 18; Han Jin & Zhao Yongping, supra note 97; Wei Shufa & Jiang Qinhui, supra note 97.
99 See Chen Jianjun, supra note 96; Li Minghui, supra note 21; Guo Feng, supra note 97; Chen Jie, supra note 18; Han Jin & Zhao Yongping, supra note 97; Wei Shufa & Jiang Qinhui, supra note 97.
company’s falsification of information and sells or holds afterwards. By contrast, if an investor buys and sells after the disclosure date, the company’s false statement cannot cause the investor’s loss. However, pursuant to the principles of equity, a court may interpret the causation test provisions broadly to provide remedies to investors who sell the stock before the disclosure date.

B. The Revelation Date and Correction Date Are Ambiguous and Offer Courts Wide Discretion in Interpretation

The revelation date and the correction date are not clearly defined in the SPC Provisions. Under Article 20, the revelation date is the day when the false statement is disclosed for the first time in the nationwide media. However, the Article does not designate the authority of disclosure to any specific media entities. Few people will question the authority of a CSRC announcement, or one from Securities Daily, the single largest securities newspaper in China. However, it is up to the courts to decide whether many other disclosing entities are qualified authorities under Article 20 to reveal false statements to the public.

Article 20 also fails to specify the degree to which existing misinformation should be revealed to the public so as to constitute sufficient disclosure. After a listed company has made any false statement, many kinds of suspicions of its misconducts are likely to arise in the market before the full authoritative disclosure of the misinformation. Mere suspicion of misinformation probably does not suffice as public disclosure under Article 20. However, most investors will hastily sell the stock upon any suspicious news of the company’s misconducts.

The definition of correction date in Article 20 is also ambiguous. The correction date occurs when the listed company announces and corrects the false statement on CSRC-designated media and suspends trading in its shares in accordance with provided procedures. The definition does not specify what kind of correction by the listed company qualifies as “announcement and correction” under the SPC Provisions. It is unclear

100 See SPC Provisions, supra note 17, art. 18.
101 Id.
102 Id. art. 20.
103 See id.
104 Wei Shufa & Jiang Qinhui, supra note 97, at 126.
105 Chen Jie, supra note 18, at 39.
106 Id.
107 SPC Provisions, supra note 17, art. 20.
108 See id.
whether a company’s mere mentioning of prior misrepresentation or omission in one or two short sentences is sufficient. The SPC Provisions are also unclear as to the required “procedures” that a company should go through to suspend trading.109

A court’s determination of the revelation date and the correction date is essential to the causation test. The general rule of the causation test under Article 18 reflects a timing structure.110 The finding of causation entirely depends on when the purchase and sale transactions of purchase and sale take place with respect to the revelation date or the correction date.111 When the statutory definitions are uncertain, a court understandably has more discretion to reach its legal conclusion.112

C. The Scope and Effect of Systemic Risks Under Article 19 Are Subject to Each Court’s Interpretation

The concept of so-called systemic risks in the SPC Provisions is not only ambiguous but also highly adverse to individual investors. Article 19(d) excludes the existence of a causal relationship if a defendant company proves that the investor’s loss or part of the investor’s loss results from the systemic risks of the securities market.113 The SPC Provisions do not define the concept of systemic risks. The idea of systemic risks with respect to the stock market seems to presume that stock transactions are intrinsically risky and investors have to absorb all the consequences resulting from such systemic risks.114 This implicitly invites questions, such as what kind of evidence a defendant may introduce to prove the systemic risks, the extent of the burden of proof, and how a plaintiff may rebut the defendant’s allegation of “systemic risks.” All of these questions are left unanswered in the SPC Provisions.115

To deny causation with proof of systemic risks is potentially disadvantageous to investors because a defendant may exaggerate the effect of systemic risks to dodge its liability. A defendant will certainly raise the argument of systemic risks to deny the existence of causation, since systemic

109 Id.
110 See Han Jin & Zhao Yongping, supra note 97, at 104.
111 Id. at 103-04.
113 SPC Provisions, supra note 17, art. 19(d).
114 See Jia Wei, supra note 78, at 11. Jia Wei, a judge of the SPC, exemplifies the systemic risks through the change in the composite index as a result of issuing new stocks.
115 See SPC Provisions, supra note 17, art. 19(d).
risks always exist in the stock market. Due to ambiguity in the scope and effect of systemic risks, a false statement case becomes highly unpredictable. A plaintiff may never survive the causation test because the systemic risks are presumably an intrinsic part of any stock transaction and always related to investment losses to some degree. The uncertainty of the systemic-risk argument will deter investors from bringing cases against companies who have breached their duty of disclosure. A court should be particularly cautious in evaluating systemic-risk arguments to prevent companies’ abuse of this argument as allowed for under Article 19.

As a result, a court may exercise its judicial discretion in its application of the causation test due to the confusion of the SPC Provisions. Articles 18, 19 and 20 of the causation test contain unresolved issues that are open to the court’s interpretation. The interpretation of the causation test, narrowly or broadly, will directly affect the conflicting interests of public investors and listed companies. Filling in the gaps of the SPC Provisions, a court must take an explicit and firm position in carrying out its judicial role in the causation test.

IV. TWO SECURITIES CASES DEMONSTRATE JUDICIAL UNCERTAINTY IN THE APPLICATION OF THE CAUSATION TEST

After the SPC’s promulgation of its judicial interpretation of the false statement doctrine in civil securities cases, the courts have started to apply the SPC Provisions to pending or new securities cases brought by public investors seeking compensation for their investment losses resulting from the listed companies’ false statements. Whether a listed company’s false statement is the cause of an investor’s loss becomes the key issue in many cases. Among these cases, the Jinan Intermediate People’s Court decided that a plaintiff investor failed to prove causation in Zhang He v. Bohai Group, while the Ha’erbin Intermediate People’s Court found the existence of causation between the false statement and investors’ losses in

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117 See id.


119 Bohai Group, supra note 4.
Chen Lihua v. Daqing Lianyi Corporation. Both courts focused on the definition of the disclosure date and the effect of systemic risks in the causation test of the false statement doctrine. Nevertheless, the two courts reached different conclusions in the causation test, which ultimately determined the result between the investors and the companies.

A. The Court in Zhang He v. Bohai Group Found No Causal Relationship

The facts of this case indicate a relatively straightforward incidence of a false statement. In 1993, Bohai Group acquired Jinan Matches Factory. In its acquisition and merger report as part of its “Public Announcement,” Bohai Group announced that a bank offered it favorable interest rate loans for the acquisition. However, Bohai Group did not disclose the fact that it would not be able to enjoy the low interest benefit until the banks reported to their supervisory bank and received final approval. Instead, Bohai Group became a defendant in a lawsuit filed by one bank for the interest payment. From 1994 to 1998, Bohai Group never counted its interest expenses for acquisition loans in its annual financial statements. In 1999, Bohai Group added its interest expenses from 1994 to 1998 in its 1999 interim financial statements.

From March 2000 to November 2001, the CSRC conducted a series of investigations into potential false statements by listed companies. The CSRC found that Bohai Group, among sixteen other listed companies, made false statements in violation of the Securities Law. The CSRC further publicized Bohai Group’s false statement in its Letter of Administrative Penalty.

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120 Daqing Lianyi, supra note 6. The case report publicized by the Higher People’s Court of Heilongjiang also includes the text of the case report issued by the Ha’erbin Intermediate People’s Court (the trial court). The discussions of both the trial court decision and appellate court’s opinion are based on this case report.
121 See infra Part IV.A-B.
123 Id. According to the announced favorable interest loan, Bohai Group would be waived the interest payments for 1994 and 1995 and its interest payment from 1996 to 1998 would be based on half of the normal interest rate in the financial market.
124 Id. Bohai Group Board Announcement, supra note 122.
125 Id.
126 Id.
127 Id.
129 Id.
Penalty on November 5, 2001. Every listed company whose false statement had been investigated and discovered by the CSRC received such a penalty letter, which constituted a confirmation of the listed company’s wrongdoing and the administrative prerequisite to file a civil lawsuit by a public investor against the listed company.

Plaintiff Zhang He was a clerk working at a bank’s branch office in Zaozhuang, Shandong. On August 16 and 17, 2001, he purchased a total of 1500 shares of the defendant company’s stocks at the price of RMB 18,435 (US$2,304). The stock price decreased continuously after his purchase. On January 29, 2002, after the publication of the Letter of Administrative Penalty to the defendant in November 2001, Zhang sold the stock at the loss of RMB 9,434 (US$1,179). Zhang filed the lawsuit in February 2002 asking for RMB 9,930 (US$1,241) in damages, which included the loss from the stock transaction and other related costs.

The Jinan Intermediate People’s Court decided for the defendant on the ground that a causal relationship did not exist between the defendant company’s false statement and Zhang’s loss in his stock trading. The Court found no causal relationship established in the case for two reasons. First, Bohai Group corrected its prior false financial information in 1999 while Zhang purchased the stock in 2001. Thus the trial court concluded that Zhang could not have relied on the defendant’s false statement when he traded the stock and that his stock transaction was not causally related to the defendant’s false statement. Second, Bohai Group successfully proved that Zhang’s loss resulted from the systemic risks in the stock market rather than from his reliance on the company’s false statement. The Court reasoned that stock transactions were full of risk and that public investors had to consider and bear the risk resulting from fluctuations in the market.

130 Id.
131 SPC Provisions, supra note 17, art. 6.
133 Id.
134 Id.
135 Id.
136 Id.
138 Id.
139 Id.
140 Id.
141 Id.
The Court found that the defendant sustained its burden of proof by demonstrating the decreasing Composite Index of the whole stock market during the period of time when Zhang was conducting his transaction.  

The Jinan Intermediate People’s Court’s reasoning in support of its decision raises serious concerns about the likelihood that a plaintiff will survive the causation test in a false statement case. The court’s finding of the disclosure of the false statement in 1999 is questionable. According to the court, Bohai made false statements in 1994 and corrected the misinformation in its financial statements in 1999. Zhang purchased the stock in August 2001. In November 2001, the CSRC announced its Letter of Administrative Penalty to Bohai Group. Zhang sold his stock at a loss in January 2002. If Bohai Group had corrected its false statement in 1999, Zhang’s trading after the disclosure of Bohai Group’s misconduct could not have caused his loss. If Bohai Group’s false statement was not disclosed until the CSRC’s issuance of the penalty report in November 2001, Zhang’s purchase in August 2001 and sale in January 2002 would meet the most rigorous causation test under Article 18. In that scenario, Zhang obviously bought before the disclosure date and sold afterwards.

While the CSRC’s penalty letter would undoubtedly be considered authoritative national disclosure of the defendant’s misconduct under Article 20, it is arguable whether Bohai Group’s 1999 financial statements qualify as a “correction” under the SPC Provisions. In its 1999 Interim Report, Bohai Group merely mentioned that it had settled with the bank with regard to the interest payment and would pay all the interests from 1994 to 1999 that it owed to the bank. Bohai Group did not explicitly and affirmatively confess the fact that it did not disclose the interest expenses in its financial statements from 1994 to 1998. It was very unlikely that a reasonable investor would consider this a sufficient disclosure of Bohai’s prior misinformation. The facts on record do not sufficiently support the court’s finding that Bohai Group had corrected its false statement in 1999.

In addition, the court overemphasized the effect of systemic risks in this case. At trial, Bohai presented the Composite Index of Shanghai Stock
During the period of time when Zhang traded the stock, the Composite Index of the stock market went down continuously. In reliance on the gloominess of the market as a whole, the court concluded that systemic risks, rather than Bohai’s false statement, was the real cause of Zhang’s loss. This conclusion entirely ignored the individual performance of a company’s stock in the stock market. The stock market is not only risky but also dynamic. The performance of the stock market as a whole will certainly exert some influence on the price of one stock. Nevertheless the gloominess of the stock market never precludes the possibility of price increases of individual stocks. The decrease of a stock’s price can be attributable to multiple causes. The court’s attribution of the cause solely to systemic risks is neither persuasive nor equitable to public investors.

The Jinan Intermediate People’s Court’s denial of the causal relationship in Zhang’s case reflects not only the confusion in the causation test of SPC Provisions but also the insurmountable obstacle that an investor will encounter in a false statement case. The court’s finding of a correction date lacks sufficient factual support. Its overemphasis of systemic risks opens the door to potential abuse in counter-proving the causation between the defendant’s misconduct and the plaintiff’s loss in false statement cases. Based on the court’s reasoning, a defendant can easily rebut a plaintiff’s allegation on the ground of systemic risks and shake off the liability. Many lawyers and public investors have expressed their dissatisfaction with the trial court’s reasoning, because the trial court did not perform its judicial role properly and failed to protect the interests of the individual investor in this false statement case.

B. Public Investors Won a Compromised Victory in Chen Lihua v. Daqing Lianyi, Inc. Due to the Court’s Finding of Disclosure Dates

The facts of the Daqing Lianyi case are more complicated than that of Bohai Group. The plaintiffs were twenty-three individual investors who had...

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149 Zheng Zhong, supra note 137.
150 Id.
151 Id.
152 Shao Zongwei, supra note 20.
153 Sun Fuhai, supra note 132.
154 Liu Junhai, supra note 18; Chen Jie, supra note 18.
155 Sun Fuhai, supra note 132.
156 See id.
been involved in Defendant Daqing Lianyi Corporation ("Daqing Lianyi") stock transactions.\footnote{The alleged defendants also included Shenying Wanguo Securities Corporation, a brokerage firm. However, this Comment will only discuss the plaintiff’s claim against the defendant Daqing.}

Daqing was incorporated in Heilongjiang Province. Lianyi Shihua Factory ("Lianyi") was Daqing’s predecessor.\footnote{Daqing Lianyi, supra note 6.} On April 26, 1997, Lianyi published a Prospectus on behalf of Daqing Lianyi.\footnote{Id.} The Prospectus had included untruthful revenue information so as to attract public capital.\footnote{Id.} Daqing Lianyi issued its IPO on the Shanghai Stock Exchange in May 1997.\footnote{Daqing Lianyi, supra note 6.} On March 23, 1998, Daqing Lianyi again untruthfully reported a revenue increase in the "1997 Annual Report."\footnote{Id.} The misconduct of Daqing Lianyi, and of its predecessor Lianyi, caused the attention of some governmental supervisory agencies.\footnote{Daqing Lianyi, supra note 6.} At the request of a supervisory agency, the Board of Daqing Lianyi published a “Board Announcement” in Securities Daily on April 21, 1999, admitting that Daqing Lianyi was under investigation for falsifying revenue increases in its 1997 Annual Report.\footnote{Id.} On April 27, 2000, the CSRC issued its Letter of Administrative Penalty to Daqing Lianyi and determined that Daqing Lianyi committed fraud in its IPO and its 1997 Annual Report.\footnote{Id.}

The twenty-three plaintiffs brought suit against Daqing Lianyi at Ha’erbin Intermediate People’s Court after the issuance of the CSRC Letter of Administrative Penalty to Daqing Lianyi.\footnote{Id.} The plaintiffs had started trading Daqing Lianyi stock in May 1997 and sold or held the stock around April 27, 2000.\footnote{Id.} The plaintiffs sought RMB 960,063 (US$120,007) in damages under the false statement doctrine.\footnote{Id.}

Daqing Lianyi, as a defense, argued that no causal relationship existed between the plaintiffs’ loss and any false statement made by Daqing Lianyi.\footnote{Daqing Lianyi, supra note 6.}
or its predecessor Lianyi.\footnote{Id.} Daqing Lianyi did not deny its misconduct in making false statements, nor did it question whether the plaintiffs actually suffered loss. Rather, Daqing Lianyi tried to deny the existence of a causal relationship under the false statement doctrine.\footnote{Id.} At trial, Daqing Lianyi argued that the revelation date was not April 21, 1999, but rather April 27, 2000 when the CSRC issued its Letter of Administrative Penalty.\footnote{Id.} Daqing Lianyi believed that its Board Announcement on April 21, 1999 about the investigation of its alleged false statement was merely a warning to the public of potential transaction risks.\footnote{Id.} In addition, Daqing Lianyi claimed that the systemic risks in the stock market were the real cause of the plaintiffs’ loss.\footnote{Id.}

The trial court decided for the plaintiffs on the issue of causation and the appellate court affirmed. The appellate court found that April 21, 1999 was the correction date of the false statement in Daqing Lianyi’s 1997 Annual Report when its board announced the ongoing investigation. The court found that April 27, 2000 was the revelation date of Daqing Lianyi’s false statement in its 1997 Prospectus when the CSRC issued its Letter of Administrative Penalty.\footnote{Id.} In addition, the appellate court found that Daqing Lianyi failed to prove that systemic risks were the cause of the plaintiffs’ loss.\footnote{Id.} The court awarded the plaintiffs their actual loss of RMB 425,388 (US$53,173).\footnote{Id.} The award was about half of the plaintiffs’ claimed damages because the court’s loss calculation was based on its finding of the revelation date and the correction date.\footnote{Id.}

The trial court made a substantial effort to support its finding of causation. However, the court’s finding concerning disclosure dates is still problematic. Daqing Lianyi fabricated its revenue information in its Prospectus in April 1997 and made similar false statements in its Annual Report in 1998.\footnote{Id.; see also CSRC’s Letter of Administrative Penalty to Daqing Lianyi, supra note 160.} In 1999, the Board of Daqing Lianyi announced that it was under investigation for allegedly making false statements.\footnote{See Daqing Lianyi, supra note 6.} In April 2000, the CSRC issued its Letter of Administrative Penalty, confirming Daqing Lianyi’s fraud in its IPO and misrepresentation in its Annual Report.
in 1998.\textsuperscript{180} All the plaintiffs started trading Daqing Lianyi stock in May 1997 and continued until April 2000, when the CSRC official announced Daqing Lianyi’s misconduct.\textsuperscript{181} Daqing Lianyi attempted to persuade the court that its false statement was not disclosed until 2000 when the CSRC confirmed Daqing Lianyi’s fraud and misrepresentation.\textsuperscript{182}

The most rigorous causation test requires, under Article 18, that the investor sell after the disclosure date.\textsuperscript{183} Many plaintiffs sold the stock before April 2000.\textsuperscript{184} If the court adopted Daqing Lianyi’s argument, the plaintiffs’ sale of the stock before April 2000 would negate the causation between Daqing Lianyi’s misinformation and most plaintiffs’ losses. By contrast, the plaintiffs tried to prove that the Board’s announcement of the investigation determined the disclosure date in 1999.\textsuperscript{185} If the court adopted the plaintiffs’ argument, all the stock sales after 1999 and before 2000 would satisfy the causation test. Because the Board Announcement date occurred one year earlier than the Letter of Administrative Penalty date, the court’s adoption of either party’s argument would result in significant differences in loss calculation.

Instead of choosing between the two arguments, the court reached its own conclusion regarding the disclosure dates. Affirming the trial court’s decision, the appellate court found that the Board Announcement in 1999 disclosed Daqing Lianyi’s misrepresentation in its Annual Report while the Letter of Administrative Penalty in 2000 disclosed Daqing Lianyi’s fraud in its Prospectus.\textsuperscript{186} Although the CSRC’s report was an official announcement of both Daqing Lianyi’s IPO fraud and later misrepresentation, it was difficult to tell whether the announcement of investigation revealed all false statements or merely Daqing Lianyi’s misrepresentation in its Annual Report.\textsuperscript{187} The court’s decision concerning the disclosure dates was a compromise between the two parties’ contentions, with neither party winning completely. Based on this compromise, the court awarded the plaintiffs half of their claimed damages in its loss calculation.\textsuperscript{188}

Both the trial court and the appellate court found in favor of the plaintiffs regarding Daqing Lianyi’s systemic risks argument.\textsuperscript{189} The

\textsuperscript{180} Id.; see also CSRC’s Letter of Administrative Penalty to Daqing Lianyi, supra note 160.
\textsuperscript{181} Daqing Lianyi, supra note 6.
\textsuperscript{182} Id.
\textsuperscript{183} See SPC Provisions, supra note 17, art. 18; supra Part III.A.
\textsuperscript{184} Daqing Lianyi, supra note 6.
\textsuperscript{185} See id.
\textsuperscript{186} Id.
\textsuperscript{187} Id.
\textsuperscript{188} Id.
\textsuperscript{189} Id.
appellate court admitted that the causation test did not define the meaning of “systemic risks.” According to its own understanding, the appellate court concluded that systemic risks were “risks affecting the prices of all stocks in the market” and beyond the control of individual companies.

The court further identified two steps that a defendant company should take to sufficiently rebut the causation. First, the defendant must present the specific facts that constitute so-called systemic risks. Second, the defendant must prove that such specific facts have caused the price fluctuation in the whole stock market. The court made it clear that a decrease in the Composite Index of the stock market as a whole was not sufficient evidence to prove the effect of systemic risks.

This case represents a victory for investors in false statement cases in which the causation test is applied. The plaintiffs did not receive all the claimed damages because of the court’s compromise in the determination of disclosure dates. Nevertheless, through its own interpretation of systemic risks, the court successfully mitigated the overwhelming adverse effect that the systemic-risks argument could impose on investors’ cases. Though the plaintiffs did not win completely, they created an example of how investors may rebut the argument of systemic risks in the causation test in civil securities cases.

V. THE JUDICIARY SHOULD PLAY A PROTECTIVE ROLE TOWARD PUBLIC INVESTORS IN ITS APPLICATION OF THE CAUSATION TEST IN CIVIL SECURITIES LITIGATION

In the interests of bolstering investor confidence, courts should interpret the causation test in favor of public investors in close false statement cases where public investors seek civil compensation against listed companies for fraud, misrepresentation or major omission of material information. As discussed above, proof of causation is often crucial in contests between public investors and listed companies. Bound by the SPC Provisions, courts must apply the most rigorous causation test based on the rigid timing structure of Article 18. Many investors whose losses are attributable to defendant companies’ false statements might be excluded

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190 Id.
191 Id.
192 Id.
193 Id.
194 See id.
195 See supra Parts II, III, IV.
196 See SPC Provisions, supra note 17, art. 18; supra Part III.A.
from receiving compensation. However, with limited discretion, a court should protect public investors’ interests with the causation test. Both current government policy and the success of China’s economic reform require substantial judicial protection of the interests of public investors in civil securities litigation. In addition, due to the confusion surrounding the causation test in the SPC Provisions, an explicit position of a court in favor of public investors in close cases not only saves transaction costs but also enhances judicial certainty and consistency.

A. Courts Should Evaluate the Totality of the Circumstances in Determining the Revelation and Correction Dates

To find the right revelation or correction date, a simple review of facts relating to when the false statement was revealed or corrected is insufficient. Due to the timing structure of the causation test, the determination of the date will either prove the causation or completely deprive a plaintiff of compensation. Each party tries to persuade the court to pick the date in its favor. When investors file a lawsuit employing the false statement doctrine, they usually have already stopped trading the alleged stock. The timing of their trading is decisive at trial. By contrast, the defendant company is likely to have a choice between the CSRC’s announcement and its own corporate activities which may indicate the defendant’s prior false statement. For example, in Bohai Group, the defendant company managed to persuade the court that the defendant’s own adjustment in financial statements amounted to a “correction” or “revelation” under Article 20. In Daqing Lianyi, the defendant company argued that the Board announcement was merely a warning and did not constitute a “revelation.” The company contended that the CSRC’s announcement was the official “revelation” of the company’s false statement to the public.

Instead of a factual review to decide the timing of the revelation or correction, a court should examine the unveiling effect of the alleged “revelation” or “correction.” The timing structure of the causation test presumes the causal effect the disclosure of a false statement will exert on investors’ transactions and losses. According to this presumption, the false statement will not affect the stock price before or long after its

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197 See supra Part II.D.
198 Supra Part IV.A.
199 Supra Part IV.B.
200 Id.
201 See Jia Wei, supra note 78, at 10.
Disclosure, but will cause a price change upon its disclosure.\textsuperscript{202} Therefore, a court should question whether the alleged “revelation” or “correction” has brought about such disclosure.

A court must evaluate all relevant factors in finding the revelation or correction date with respect to the disclosing party, the means of disclosure, and the extent of disclosure. The CSRC’s issuance of a Letter of Administrative Penalty for a listed company’s false statement is an unquestionable “revelation” under Article 20.\textsuperscript{203} In most cases, whether the alleged corporate activity amounts to sufficient disclosure is the issue before the court, but no single factor is dispositive. A court must examine the totality of the circumstances and consider the effect of the alleged corporate activity from the perspective of a reasonable investor.

\textbf{B. Courts Must Firmly Prevent the Abuse of the Systemic Risks Argument}

A court should be skeptical when presented with the systemic risks argument. Under Article 19, the proof of systemic risks constitutes a sufficient rebuttal to causation between the alleged false statement and the plaintiff’s loss.\textsuperscript{204} If a defendant succeeds in the systemic risks argument, the plaintiff loses both the contest over the causation test and the entire lawsuit. Despite the significance of the systemic risks argument,\textsuperscript{205} the SPC Provisions neither define the meaning of systemic risks nor specify the burden of proof. This presents certain unintended problems. Due to the uncertain yet destructive effect of the systemic risks argument with respect to causation, every defendant may invariably claim that the investment loss is a result of systemic risks. In both \textit{Bohai Group} and \textit{Daqing Lianyi}, the defendant companies spared no effort in persuading the courts to adopt this argument, though the outcomes differed.\textsuperscript{206} The potential abuse of the systemic risks argument imposes additional obstacles to the plaintiffs’ case beyond the rigorous timing structure of the causation test. A court must cautiously deal with the systemic risks argument and try to undermine its overreaching destructive consequence in a false statement case.

The judiciary should send a clear message to the community of its opinion about the systemic risks argument. The SPC Provisions leave the rule of systemic risks open to the courts. On the issue of systemic risks, a court should not reach a conclusion, especially in favor of a defendant.

\textsuperscript{202} Id.
\textsuperscript{203} See SPC Provisions, supra note 17, art. 20.
\textsuperscript{204} Id. arts. 11, 19(d).
\textsuperscript{205} See supra Part III.
\textsuperscript{206} See \textit{Bohai Group}, supra note 4; \textit{Daqing Lianyi}, supra note 6.
company, without a thorough interpretation of the rule. The court must solve two problems in its interpretation of systemic-risks: (1) identifying the systemic risks and (2) deciding what burden of proof a defendant should bear. In Daqing Lianyi, the appellate court adopted a two-step test.\(^{207}\) The court required that a defendant arguing systemic risks as the cause of the plaintiff’s loss demonstrate the specific facts of systemic risks.\(^{208}\) In addition, the defendant would be required to prove that those specific facts caused the price change in the stock market.\(^{209}\) A court of another province does not have to adopt the same two-step test. Yet every court in its own interpretation of the rule should ensure the requirement of specific arguments and a relatively high burden of proof. Otherwise, few plaintiffs who have in fact suffered losses from the listed company’s false statement may prevail in the causation test.

C. Current Government Policy, Revitalization of the Stock Market, and Judicial Consistency Justify Judicial Protection of Investors’ Interests

A considerable disparity in the power between public investors and listed companies calls for judicial protection of public investors’ interests. Most Chinese investors, referred to as “scattered households” (san hu),\(^{210}\) are individual investors. Each san hu is one of “thousands of passive actors” in the stock market and barely has any control over or impact on other participants like the listed companies.\(^{211}\) Public investors face many more disadvantages than listed companies. Most investors are middle class workers and the average share ownership of each investor is very limited.\(^{212}\) Few investors possess the necessary basic knowledge about stock investment and they are often subject to fraud at the hands of stock issuers.\(^{213}\) In addition, local governments tend to favor the interests of local companies listed in the stock market and often help cover up fraud.\(^{214}\) As a result, public investors are usually unable to fight against the oppressive behavior

\(^{207}\) Daqing Lianyi, supra note 6.
\(^{208}\) Id.
\(^{209}\) Id.
\(^{213}\) Id.
\(^{214}\) Id.; see also Chen Zhiwu, Capital Markets and Legal Development: The China Case, 14 CHINA ECON. REV. 451 (2003).
of the more powerful participants in the stock market, such as the listed companies’ fraud or misleading disclosure.\textsuperscript{215} To redress that imbalance for public investors, the judiciary should perform its role in terms of fairness and equity in private securities litigation.\textsuperscript{216}

Protection of public investors is one of the top agendas of current Chinese government policy. Many listed companies were transformed from state-owned enterprises.\textsuperscript{217} One of the primary purposes in establishing a stock market in China was to raise sufficient capital for state-owned enterprises from the public.\textsuperscript{218} Many listed companies manipulated the stock market “as a channel to pool investors’ money.”\textsuperscript{219} Overall, investors’ interests were not in contemplation of the initial design of the stock market and corresponding legal mechanism. The tone then changed in 2000, with investor protection becoming a major concern in recent years.\textsuperscript{220}

In 2004, the State Council issued the Opinions on Promoting the Reform, Opening and Steady Growth of Capital Markets.\textsuperscript{221} In its opinion, the State Council repeatedly called for the protection of public investors’ rights and interests.\textsuperscript{222} This policy declaration signified the central government’s determination to protect public investors.\textsuperscript{223} Furthermore, protection of public investors’ interests was one of the primary reasons for the revision of China’s Securities Law.\textsuperscript{224} Ensuring public investors’ rights and interests was the top priority of CSRC, for which it earnestly lobbied law-makers.\textsuperscript{225} In judicial practice, judges should interpret and apply the rules of law in private securities litigation in a way that echoes this policy.

The revitalization of the Chinese stock market requires forceful judicial protection of public investors’ interests. Due to the inadequacy of legal protection, listed companies are more interested in raising money but have less incentive to improve their performance.\textsuperscript{226} Before the

\textsuperscript{215} Howson, supra note 211, at 241.
\textsuperscript{216} Id.
\textsuperscript{217} Id. at 242.
\textsuperscript{218} Chen Zhiwu, supra note 214; see also Hong Jun, supra note 36, at 76.
\textsuperscript{219} Xin Bei, Investors Win for All in Market, CHINA DAILY, Nov. 29, 2002, at 4.
\textsuperscript{220} Chen Zhiwu, supra note 214.
\textsuperscript{222} Id.; see also Jiong Deng, supra note 32, at 349-50.
\textsuperscript{223} Jiong Deng, supra note 32, at 349-50.
\textsuperscript{224} The Securities Law of the People’s Republic of China (1998) was revised in 2005 and became effective on January 1, 2006.
\textsuperscript{226} Hong Jun, supra note 36, at 76.
promulgation of SPC Provisions, numerous investors who had suffered losses in reliance on fabricated information could not receive any remedy from wrongdoers. Consequently, investors’ confidence diminished and the stock market deteriorated.227 A protective judicial role toward public investors is necessary to redress the listed companies’ past wrongdoings and to deter them from violating the law in the future. A private securities case can involve a large number of plaintiffs.228 Companies are more likely to comply with their duty of disclosure under the threat of massive liability.229 In addition, the assurance of legal protection and remedy helps to revitalize investor confidence and attract more funds from the public.230 As scholars suggest, a realistic remedy for infringed investors, offered by a legal decision-maker such as a judge in a private securities case, is probably the only assurance of social stability and harmony in the development of China’s capital markets.231

A uniform judicial attitude to protect public investors enhances judicial certainty and consistency in private securities litigation. Most plaintiffs in private securities litigation are individual investors.232 Both their investment and potential for loss are very limited. The uncertainty in judicial practice raises their costs, considering the time and expense of a lawsuit. In contrast with general tort lawsuits, a private securities lawsuit may be filed by numerous plaintiffs against the same defendants for the same cause in different courts.233 It is very likely that different courts may conclude differently for cases arising from the same cause.234 For example, though the parties were different in Bohai Group and Daqing Lianyi, one court ruled against the defendant’s systemic-risks argument while the other court agreed with the defendant, yet the defendants in the two cases presented similar evidence and adopted the same reasoning in the same rebuttal against causation of the false statement doctrine.235 The inconsistency between the lower courts will “jeopardize the reputation and credibility of the legal system.”236 Where class action lawsuits are not yet permitted in private securities litigation in China, the best solution is for

227 Xu Binglan, supra note 12.
228 Hutchens, supra note 210, at 603.
229 Id.; see also Feng Qihua, Circular Safeguards Investors’ Interest, CHINA DAILY, Jan. 14, 2003.
230 Hutchens, supra note 210, at 603.
231 Howson, supra note 211, at 246.
232 Hutchens, supra note 210, at 612.
233 Chen Zhiwu, supra note 214.
234 Id.
235 See supra Part IV.
236 Chen Zhiwu, supra note 214.
lower courts to adopt a uniform and explicit judicial position in favor of public investors in a contested false statement case.

VI. CONCLUSION

Private securities litigation is a necessary legal mechanism to deter listed companies from misconduct and to protect the interests of public investors. However, the earlier securities laws in China failed to provide such a legal mechanism and public investors had no sufficient cause of action against violators for stock trading losses as a result of listed companies’ false statements. The SPC formally established the false statement doctrine in private securities litigation through its judicial interpretation. Nevertheless, public investors are still facing challenges to win their cases and gain monetary compensation due to the confusion contained in the causation test of the SPC Provisions. Two cases demonstrate that different interpretations of the causation test by the lower courts can eventually determine the outcome of a private securities dispute.

Lower courts hearing private securities cases should play a protective role toward public investors in their application of the causation test. Protection of public investors’ interests reflects current Chinese government policy. In addition, it is also vital to reconstruct the confidence of public investors in the stock market. The judiciary must perform its adjudicatory role to punish the wrongdoers and compensate the victims so as to assure the stability of the capital market in China.

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237 See Chen Sheng, supra note 13.