

Article

Saying is One Thing; Doing is Another? Analyzing the Chinese Nonprofit Organization Model in Investor Protection through the Taiwanese Experience

Guan-Wei Chao *

ABSTRACT

As securities fraud enforcement can be divided into two major categories: (1) public enforcement conducted by administrative agencies, and (2) private enforcement in the form of litigations initiated by defrauded investors, however, this division cannot be viewed as black and white, but rather always within the areas of gray. For example, Taiwan allows a government-sanctioned nonprofit organization serving as a pro bono law firm to initiate securities class actions on behalf of aggrieved shareholders (the Taiwanese NPO model). By virtue of this NPO model, the government not only fills the gap of inactive private securities enforcement, but also retains substantial control over mass tort disputes. Perhaps due to its hybridity that encourages shareholder actions against securities fraud without risking China into a litigious society as the United States do, in April 2015, China's National People Congress drafted the amendment to China's Securities Law by reference to the Taiwanese NPO model (the Chinese NPO model), in which China promises to grant the civil society more enforcement power to protect shareholder interests. As a

DOI : 10.3966/181263242018031301002

* Prosecutor, Changhua District Prosecutors Office; S.J.D., Georgetown University Law Center; LL.M., University of Pennsylvania Law School; LL.B & LL.M., National Taiwan University. I am grateful to Professor James Feinerman of Georgetown Law Center for his excellent supervision on an earlier draft of this article. I also thank for Professor Alexa Freeman and other SJD candidates, including Ido Kiovaty, Edit Frenyo, Ada Siqueria, Liron Shilo, Akiko Ogwawa, and Xiangyu Zhang, for their valuable comments at the SJD Seminar. All remaining errors are my own. Email: gc626@georgetown.edu.

result, this Article examines whether the 2015 draft amendment could lead China into a hybrid securities enforcement mechanism as its stated purpose. However, by virtue of analyzing relevant provisions of the Chinese NPO model, this Article illustrates that the convergence of NPO models between Taiwan and China may not happen due to path-dependent factors, including political, economic, and cultural circumstance, specific to the Chinese NPO ecology. More importantly, the Chinese NPO model may also reveal China's intention to use this NPO model as an excuse to eliminate the early emergence of the grassroots NPO's participation in investor protection, and a guise to grant the government more control over private securities enforcement.

Keywords: *Securities Fraud, Investor Protection, Securities Enforcement, Representative Litigation, Securities Class Actions, Advance Settlement, Nonprofit Organizations, China's Securities Law, The Chinese NPO/NGO Ecology*



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I. INTRODUCTION

In the context of securities law enforcement, the anti-fraud provision can be enforced by both public agencies through administrative punishment or criminal prosecution (public enforcement) and injured shareholders in the form of civil lawsuits (private enforcement).¹ Most countries in the world utilize a default hybrid public-private enforcement scheme, in which some primarily rely on public agencies to lead securities enforcement; some prefer to grant more enforcement power to the private sector.² More importantly, the degree of government involvement in securities enforcement--or conversely, the level of autonomy of litigants in conducting their litigations--may appear as a spectrum, where one end is primarily controlled by public agencies, while the other end is essentially dominated by private plaintiffs and their attorneys. In other words, while no one illustrates the purest ideals of either ends of the spectrum, many nations fall within the range of models, some adopting more hybrid-public centric focus, while others remain more hybrid-private focused models.

While many nations are moving along the spectrum towards the common ground of increasing investor protections and enhancing corporate governance, many East Asian countries, for example, balk at the thought of adopting the U.S. private-focused regime, which many in Asia deem far too aggressive to the point of being frivolous and threaten their national environments.³ For example, due to the prevalence of state control over the Chinese securities market, the government by default tends to retain securities enforcement actions within its own purview in order to influence and implement industrial and regulatory policies. Thus, Professors Wen-yeu Wang and Jian-lin Chen suggest that instead of the U.S.-style class actions, the Taiwanese nonprofit organization (NPO) model may be a more optimal remedy for the Chinese securities enforcement reform.⁴ In addition to

1. See, e.g., Michelle Welsh & Vince Morabito, *Public v Private Enforcement of Securities Law: An Australian Empirical Study*, 14 J. CORP. L. STUD. 39, 39-40 (2014).

2. See John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229, 256 (2007) (separating securities enforcement into three models, including the "Government-Led Model" under which the central government retains dominant authority over securities market regulation; the "Flexibility Model," which grants greater authority to the market participants to decide basic policies but subject to some level of government oversight; and the "Cooperation Model," which authorizes a broad range of powers to market participants with respect to policymaking).

3. See Curtis J. Milhaupt, *Nonprofit Organizations as Investor Protection: Economic Theory and Evidence from East Asia*, 29 YALE J. INT'L L. 169, 171 (2004); see also Richard A. Nagareda, *Aggregate Litigation across the Atlantic and the Future of American Exceptionalism*, 62 VAND. L. REV. 1, 29 (2009) (arguing that the Europe hesitates to converge toward the U.S.-style class actions and shows no willingness to do so).

4. See generally Wallace Wen-Yeu Wang & Jian-Lin Chen, *Reforming China's Securities Civil Actions: Lessons from PSLRA Reform in the U.S. and Government-Sanctioned Non-Profit Enforcement in Taiwan*, 21 COLUM. J. ASIAN L. 115 (2008) (suggesting that the Taiwanese approach is

Taiwan, other East Asian countries, such as Japan and South Korea also adopted this intermediate solution that has received little theoretical or empirical attention--the NPO model to supplement the state and the private sector in creating, maintaining, and supporting the institutional structures necessary for an workable legal regime.⁵ However, while each country had adopted the East Asian NPO model, there are significant variations in form and function due to path dependent variables within each nation.⁶

China has never completely transplanted the formal business-related laws from Western jurisdictions to improve investor protection,⁷ however the judiciary has provided increasingly credible commitments with respect to corporate governance as well, although the institutions do not closely resemble those of Western courts.⁸ In addition, since 2003 the Chinese Supreme People's Court (SPC) lifted the ban for aggrieved shareholders to pursue compensation arising from misrepresentation cases, and also broadened their jurisprudence relating to their interpretations to cause of actions such as insider trading or market manipulation.⁹ However, one of the most salient endeavors to reform securities enforcement could be found from the attitudes of political leaders, which is particularly notable in view of China's top-down securities market.¹⁰

Such a change in attitude can be illustrated by Mr. Xiao Gang, former chairman of China Securities Regulatory Commission (CSRC), who in a 2013 speech, specifically recommended the adoption of the Taiwanese NPO model found in the Securities and Futures Investors Protection Center (SFIPC), which allowed for this government-sanctioned NPO to initiate "public interest litigation" on behalf of aggrieved shareholders who suffered

a hybrid model, where a government-sanctioned NPO fills the gap between public and private enforcement). See also Ching-Ping Shao, *Representative Litigations in Corporate and Securities Laws by Government-Sanctioned Nonprofit Organizations: Lessons from Taiwan*, 15 ASIAN-PAC. L. & POL'Y J. 58, 73 (2014) ("in view of the public/private approach, Taiwan's NPO approach is certainly a hybrid one").

5. See Milhaupt, *supra* note 3, at 172 (suggesting that government-NPO partnerships have the potential to supplement weak state enforcement of corporate and securities laws).

6. See *Id.* at 173 (arguing that the NPO experience in several countries, including South Korea, Taiwan and Japan, has developed with striking diversity due to localized situations).

7. See Tianshu Zhou, *Legal Regulation of China's Securities Markets: Recent Improvements and Competing Advantages*, in *ECONOMICS AND REGULATION IN CHINA* 63, 67-69 (Michael Faure & Guangdong Xu eds., 2014) (summarizing a complete table to show that China has adopted nearly all international standards of minority shareholder protection).

8. See Nicholas C. Howson, *The Doctrine that Dared Not Speak Its Name: Anglo-American Fiduciary Duties in China's 2005 Company Law and Case Law Intimations of Prior Convergence*, in *TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA* 193, 213 (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008) (observing that the Western fiduciary duty principle has been applied by the Chinese judges long before its formal adoption by the 2005 Chinese Company Law).

9. See e.g., Robin Hui Huang, *Private Enforcement of Securities Law in China: A Ten-Year Retrospective and Empirical Assessment*, 61 AM. J. COMP. L. 757, 761 (2013).

10. See generally William T. Allen & Han Shen, *Assessing China's Top-Down Securities Market*, in *CAPITALIZING CHINA* 149 (Joseph P. H. Fan & Randall Morck eds., 2012).

from securities fraud.¹¹ The commitment to such reform went beyond lip-service when in April, 2015, Arts. 167 to 176 aimed to amend the Chinese Securities Law,¹² which authorized the NPO to be sanctioned by the CSRC for initiating securities fraud suits on behalf of shareholders or derivative suits for stockholders against corporate fiduciaries (hereafter the Chinese NPO model).¹³

Furthermore, in 2012, prior to Xiao's speech and the latest Securities Law amendments, China paved the way for NPO model by revising the Civil Procedure Law (CPL) to provide a legal basis for public interest litigation primarily in the areas related to "pollution to the environment" and "damage to the legitimate rights and interests of consumers".¹⁴ Therefore, this series of legal proposals for reconstructing China's securities litigation landscape not only shed light on the future legal transplantation of China's public/private hybrid enforcement of securities fraud, but also reflects China's concerns related to her unique sociopolitical and socioeconomic legal culture, which makes it very unlikely for the U.S. enforcement model to infuse. In other words, it avoids the enforcement model that is driven by private interests, such as securities class action, to become one of the possible options for securities enforcement approaches.

As many commentators state, the transplanting of foreign legal systems often fails to function as expected owing to unexpected local conditions.¹⁵ Although China shares a Confucian heritage with Taiwan and other East Asia countries, the cultural, social, political, and economic changes resulting from the 1949 separation between Taiwan and China allowed spaces for

11. Xiao Gang (肖钢), *Zhengquan Fa de Fali yu Luoji—Xiao Gang Zhuxi zai Disijie "Shang Zheng Fazhi Luntan" Shang de Yanjiang* (《证券法的法理与逻辑—肖钢主席在第四届“上证法治论坛”上的演讲》) [The CSRC Chairman, Xiao Gang Delivered a Speech—The Legal Principles and Logics of Securities Law at the "4th Legal Forum of the Shanghai Stock Exchange", ZHONGGUO ZHENGQUAN JIANDU GUANLI WEIYUANHUI [中国证券监督管理委员会] (CHINA SECURITIES REGULATORY COMMISSION) (Nov. 28, 2013), http://www.csrc.gov.cn/pub/newsite/tzzbhj/tbgzdt/tbgzyw/201312/t20131218_240026.html.

12. *Zhengquan Fa* (《证券法》) [Securities Law] (promulgated Dec. 29, 1998, effective July 1, 1999, as amended Aug. 31, 2014) (China).

13. See *infra* Part V. B.

14. *Minshi Susong Fa* (《民事诉讼法》) [Civil Procedure Law] § 55 (promulgated and effective Apr. 9, 1991, as amended Aug. 31, 2012) (China); see also Richard W. Wigley, *Trends in Class Action-Type Public Interest Litigation in China*, KING & WOOD MALLESONS (May 29, 2015), <http://www.chinalawinsight.com/2015/05/articles/intellectual-property/trends-in-class-action-type-public-interest-litigation-in-china/>.

15. See, e.g., Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *The Transplant Effect*, 51 AM. J. COMP. L. 163, 188 (2003) (arguing that an effective legal transplantation should adopt measures to adapt the transplanted laws to local conditions, thereby increasing the familiarity of the laws prior to its formal introduction); John Gillespie, *Transplanted Company Law: An Ideological and Cultural Analysis of Market-Entry in Vietnam*, 51 INT'L & COMP. L.Q. 641, 645-46 (2002) (suggesting that host countries should take several elements, including legal ideology, institutional variance, and special interest groups, into their consideration in transplanting foreign laws).

distinct environments that remain disparate today. Moreover, while Taiwan developed along a much more Western-style rule of law regime, Chinese financial development has been described as an engaging enigma, with a patchwork of her own path-dependent trajectories from socialism to subordination of rule of law to Confucian principles,¹⁶ which all combine to refute the generally-accepted norms that are preconditioned for economic growth or a legal system that provides secure property and contract rights.¹⁷

With reference to the Taiwanese NPO legal transplant model, many commentators speak to its leniency in not disrupting or causing dramatic changes to the current Chinese legal framework, thereby supplementing and filling the gap between public and private enforcement in China, as well as coordinating public and private resources to detect and deter securities wrongdoings altogether.¹⁸ Nonetheless, due to the varying path dependencies within China, in addition to the unsatisfactory performance of the NPO experience in Taiwan, this Article argues that the Taiwanese NPO model is far from an interim approach for China, but rather just a wolf in sheep's clothing. While the implementation aims to appear as an optimal intermediary solution to police rampant securities fraud in China's market with more private participation, the opposite is more likely to occur, where public entities gain more access and control from behind this intermediary facade.

The advent of transplanting the Taiwanese NOP model leads to a series of questions: What exactly is the Taiwanese NPO model? Why did Taiwan adopt the NPO model to protect shareholders? What is the efficacy of Taiwanese's NPO model, which has been in practice for almost twenty years? Whether this NPO model could be transplanted successfully to China

16. See Gil Lan, *Insights from China for the United States: Shadow Banking, Economic Development, and Financial Systems*, 12 BERKELEY BUS. L.J. [i], 144, 183 (2015); see also Lawrence S. Liu, *Law and Political Economy of Capital Market Regulation in the Republic of China on Taiwan*, 28 LAW & POL'Y INT'L BUS. 813, 856 (1997) (claiming that Confucian tradition may be an impediment to financial development).

17. See, e.g., ROBERT COOTER & HANS-BERND SCHÄFER, SOLOMON'S KNOT: HOW LAW CAN END THE POVERTY OF NATIONS 37 (2012) (arguing that China protects most property rights contracts by administrative sanctions, however, China's bureaucracy performs these tasks much worse than courts in its neighboring countries like Japan or Singapore); KENNETH W. DAM, THE LAW-GROWTH NEXUS: THE RULE OF LAW AND ECONOMIC DEVELOPMENT 232 (2006) (stating that the Chinese rapid economic growth challenges the norm that whether the rule of law must precede economic development); Gil Lan, *American Legal Realism Goes to China: The China Puzzle and Law Reform*, 51 AM. BUS. L.J. 365 (2014) (viewing the property rights in China as an interaction between societal relationships and politically constructed norms rather than formal rights held by private individuals); Michael Trebilcock & Jing Leng, *The Role of Formal Contract Law and Enforcement in Economic Development*, 92 VA. L. REV. 1517, 1554-59 (2006) (providing alternative arguments to explain how the Chinese business society honors property rights and contracts in the absence of a consistently enforced legal framework).

18. See Yu-Hsin Lin, *Modeling Securities Class Actions Outside the United States: The Role of Nonprofits in the Case of Taiwan*, 4 N.Y.U. J.L. & BUS. 143, 148 (2007); Milhaupt, *supra* note 3, at 204; Wang & Chen, *supra* note 4, at 158.

under the state-centered securities market, could the authoritarian environment appear to be unfavorable for NPO development? In order to answer these questions, this Article is organized as following: Part II discusses the development of the Taiwanese NPO model and provides a detailed analysis of how the NPO model is empowered to bring representative litigation according to Taiwan's corporate and securities laws. Part III critically evaluates the performance of the Taiwanese NPO model including its advantages and limitations on its securities enforcement, this part also criticizes the current framework, as not bringing about more innovative and meritorious actions due to its mismatched relationship between public and private enforcement. Part IV discusses the evolution of NPOs under China's interventionist, paternalistic regime and portends the demise of the proposed Taiwanese NPO model based upon China's disingenuous mask towards the grassroots NPO structure. Part V introduces and analyzes the proposed framework for the Chinese NPO model in the latest amendments to China's Securities Law. Although at first blush the Chinese NPO model appears similar to that in Taiwan, the Chinese NPO model however adopts certain distinct mechanisms that make it anathema to not only the Chinese legal system, thereby leading the Chinese securities enforcement into a more public zone beyond its status quo. Finally, a brief conclusion is provided.

II. THE BACKGROUND OF THE TAIWANESE NPO MODEL FOR INVESTOR PROTECTION

A. *The Development of the Taiwanese NPO Model*

The historical background of the Taiwanese NPO model for investor protection can be traced back to the early 1980s.¹⁹ The Securities and Futures Institute (SFI) was established with an endorsement by the then Taiwan's securities authority, the Securities and Exchange Commission under the Ministry of Finance in 1984.²⁰ The original funding of the SFI was financed by a special assessment on the securities trading commission

19. See Lawrence S. Liu, *The Merits of Shareholders Collective Actions (Class Action Suits) in Chinese Taipei*, in ENFORCEMENT OF CORPORATE GOVERNANCE IN ASIA: THE UNFINISHED AGENDA 25 (OECD publishing, 2007), <https://www.oecd.org/corporate/ca/corporategovernanceprinciples/42365100.pdf>.

20. The Securities and Exchange Commission was renamed as the Securities and Futures Commission (SFC) in 1997. In order to integrate multiple regulators in different financial sectors, including banking, securities, and insurance, into the "single-regulator" model, the Financial Supervisory Commission (FSC) was established in 2004, serving as the unified authority responsible for development, supervision, regulation, and examination of financial markets and financial service enterprises in Taiwan. Subsequently, the SFC was reorganized into the Securities and Futures Bureau (SFB) and designated as the agency governing securities and futures business under the FSC.

with charges collected from the Taiwan Stock Exchange, 14 securities brokerage firms and 14 banks offering brokerage services.²¹ However, at first, the SFI's establishing objectives aimed to educate the public by promoting the sound development of securities and futures markets through research, advancing corporate governance and training of financial professionals. None of which pertained to initiating civil lawsuits on behalf of investors.²² The moniker of the SFI would appear to represent an NPO. However, in actuality it serves as a government-sanctioned institute, which represents an ingenious partnership between the public and private sectors, rather than a government and nonprofit partnership.²³ At present, the SFI still receives SFB's grants and directives to carry out financial market studies, personal training and investor education.²⁴

The development of the Taiwanese NPO model for investor protection follows the history of financial crises, which mark the stages of its transformation. In the wake of financial crisis during the late 1990s, the Taiwanese NPO model moved from purely educating the public to the next stage--serving as the plaintiff shareholder, who bore the cost of litigation. Although Taiwan's economy had undergone a successful recovery from the shock of the Asian financial distress in 1998, a number of (approximately 44) public companies in Taiwan experienced mismanagement scandals. This period of distress initiated the demand for stronger protection by dispersed and unsophisticated shareholders, who were incapable of initiating lawsuits against companies involved in securities fraud.²⁵

As a result, in 1998, the Investor Services Center (ISC) was established under the SFI to coordinate claims against public companies on behalf of individual shareholders.²⁶ By purchasing one trading unit of shares (1,000 shares) of each publicly listed company, the SFI acquired the standing to bring civil lawsuits, thereby functioning similar to a public-interest law

21. See CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN (財團法人證券投資人及期貨交易人保護中心), CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN ZHONGHUA MINGUO 94 NIAN NIANBAO (財團法人證券投資人及期貨交易人保護中心中華民國94年年報) [SECURITIES & FUTURES INVESTORS PROTECTION CENTER, 2005 ANNUAL REPORT] 9 (2005) (Taiwan).

22. See CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN (財團法人證券投資人及期貨交易人保護中心), CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN ZHONGHUA MINGUO 102 NIAN NIANBAO (財團法人證券投資人及期貨交易人保護中心中華民國102年年報) [SECURITIES & FUTURES INVESTORS PROTECTION CENTER, 2013 ANNUAL REPORT] 39-40 (2013) (Taiwan).

23. See Milhaupt, *supra* note 3, at 195; Shao, *supra* note 4, at 78.

24. See Liu, *supra* note 19.

25. See Lin, *supra* note 18, at 165-66.

26. See *id.* at 167-68; see also Andrew Jen-Guang Lin, *The Challenges and Contemporary Issues of Taiwan's Investor Protection System: A Model to Learn or to Avoid*, 11 NTU L. REV. 129, 141-42 (2016).

firm.²⁷ As a shareholder, the SFI could do more than its original non-enforcement mission, where the SFI not only participated in shareholders meeting, but also provided investors with professional services including consultation and meditation.²⁸ In addition, by retaining a shareholder's interest, the SFI could also actively engaged in enforcement activities with the SFB's permission, including executing disgorgement rights for short-swing profits pursuant to Taiwan's Company Act and acting as an agent in de facto class actions.²⁹ In all cases, the court cost and lawyer's fees are financed by the SFI's. In other words, the SFI's contributors, including both the public agency and private sectors, are willing to cosponsor the cost of private enforcement.³⁰

Yet, the protection mechanisms continue its transformation and march from the former SFI to the recently created Securities and Futures Investors Protection Center (SFIPC), enacted by the Securities Investors and Futures Traders Protection Act (SIFTPA) that came into effect on January 1, 2003.³¹ This metamorphosis occurred against the backdrop of a series of global corporate scandals, such as Enron and WorldCom in the U.S., together with the corporate shenanigans that occurred in Taiwan during the early 2000s.³² The latest development of the Taiwanese NPO in the investor protection context occurred in the wake of the Lehman structured notes fiasco in 2008, while it was assumed that the SFIPC would bring class actions on behalf of shareholders who purchased the structured notes, however, the SFIPC decided not to take actions in the end recognizing that the notes were not "securities," pursuant to the Taiwan's Securities and Exchange Act.³³ As a result, the Financial Consumer Protection Act (FCPA) was passed in 2011 as a response to fill the gap between the definition of qualifying and non-qualifying financial instruments.³⁴ Although the FCPA provides financial consumers with a variety of protection mechanisms among others to establish the Financial Ombudsman Institution (FOI) as a unified forum to resolve dispute between investors and financial institutions via mediation,³⁵

27. See Liu, *supra* note 19; Shao, *supra* note 4, at 90.

28. See Lin, *supra* note 26, at 141.

29. See *id.*

30. See Liu, *supra* note 19; Milhaupt, *supra* note 3, at 178.

31. Zhengquan Touziren ji Qihuo Jiaoyiren Baohu Fa (證券投資人及期貨交易人保護法) [Securities Investors and Futures Traders Protection Act] § 5 (promulgated July 17, 2002, effective Jan. 1, 2003, as amended Feb. 4, 2015) (Taiwan).

32. See Shao, *supra* note 4, at 70.

33. To understand how the Taiwanese court system differentiates "structured notes" from "securities", see Christopher Chen Chao-Hung, *Judicial Inactivitism in Protecting Financial Consumer against Predatory Sale of Retail Structured Products: A Reflection from Retail Structured Notes Lawsuits in Taiwan*, 27 COLUM. J. ASIAN L. 165, 217-18 (2014).

34. Jinrong Xiaofeizhe Baohu Fa (金融消費者保護法) [Financial Consumer Protection Act] (promulgated June 29, 2011, effective Dec. 30, 2011, as amended Dec. 28, 2016) (Taiwan).

35. Financial Consumer Protection Act § 13 (Taiwan).

the FOI acts as a financial alternative dispute resolution (ADR) system instead of an investor protection organization. In short, in comparison to the SFIPC, FOI thus lacks legal authority to bring litigations on behalf of investors.³⁶

Pursuant to the SIFTPA, the newly government-sanctioned SFIPC was to provide consultations on the trading of securities and futures; mediation of disputes arising from the trading of securities and futures; and litigation services on behalf of shareholders.³⁷ In addition, the SFIPC manages an investor protection fund to compensate shareholders if a securities and futures firm is unable to do so due to financial difficulties and to defray the expenses that accrue from the litigation or arbitration brought by the SFIPC.³⁸ With respect to private actions instituted by the SFIPC, there are two forms of potential litigation, class actions or derivative lawsuits. In terms of class action lawsuits, all of the shareholders who want to opt into the class must delegate their right to sue to the SFIPC and then become nominal plaintiffs who have no control over the suit.³⁹ With reference to a derivative lawsuit, the SFIPC can bring representative litigation on behalf of the victimized corporation.⁴⁰ In all of the cases, the SFIPC acts as a public law firm, where all cases are tried by its staff attorneys. As a result, the SFIPC plays dual roles as both a lead plaintiff and the class counsel. According to the SFIPC 2015 annual report, its administrative department is staffed with thirty-two full-time employees, and its legal service department is staffed with twenty-three full-time employees, and most SFIPC's employees are college educated or with further graduate degrees.⁴¹ However in view of the complexities of securities cases, in juxtaposition against the vast resources of the defendant companies, the understaffing faced by many government agencies is even more apparent in the SFIPC.

Similar to its predecessor, the SFIPC is financed by public and private sectors including the Taiwan Stock Exchange, Taiwan Futures Exchange, then GreTai Securities Market (currently Taipei Exchange), Taiwan Securities Central Depository, the Taiwanese Securities Association,

36. For more discussion of financial ombudsman system, *see generally* Shuji Yanase, *The Standards of Judgement for Dispute Resolution in Financial ADR of Japan*, 26 COLUM. J. ASIAN L. 29 (2013).

37. Securities Investors and Futures Traders Protection Act § 17 (Taiwan).

38. Securities Investors and Futures Traders Protection Act §§ 20-21 (Taiwan).

39. To understand the different forms of class actions adopted by the SFIPC and the SFI, *see* Lin, *supra* note 26, 142-43.

40. Securities Investors and Futures Traders Protection Act § 10-1 (Taiwan).

41. *See* CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN (財團法人證券投資人及期貨交易人保護中心), CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN ZHONGHUA MINGUO 104 NIAN NIANBAO (財團法人證券投資人及期貨交易人保護中心中華民國104年年報) [SECURITIES & FUTURES INVESTORS PROTECTION CENTER, 2015 ANNUAL REPORT] 11 (2015) (Taiwan).

Securities Investment Trust and Consulting Association of ROC, Taipei Futures Association, Fuhwa Securities, Global Securities Finance, Fubon Securities, and Entie Securities.⁴² Moreover, the SIFTPA requires ongoing contributions to the investor protection fund from securities firms, futures firms, Taiwan Stock Exchange, Taiwan Futures Exchange, and GreTai Securities Market on a monthly basis.⁴³ Since its inception, the SFIPC has dramatically changed the ecology of shareholder action by a de facto monopoly over securities class actions due to its advantageous position granted by the state.⁴⁴

B. *The Rationale for Adopting a Government-Sanctioned NPO*

Taiwan's continuing efforts to apply the NPO model to protect investors has sparked discussion among academia, where many scholars have proposed a number of theories to address this puzzle. One of the most intuitive reasons is that the NPO model relieves individual shareholders of collective action/free rider problems commonly occurred in sophisticated and costly securities-related lawsuits,⁴⁵ especially in a securities market filled with dispersed individual shareholders each owing a small percentage of a company's stocks. The cost to pursue a securities fraud claim will likely exceed the value of the typical individual stake in a public company; therefore, the cost benefit analysis does not justify an individual shareholder to pay for litigating a claim.⁴⁶ However, the NPO model is just one of the possible solutions to collective action problems, a variety of other devices such as the U.S.-style class action aims to address this issue as well.⁴⁷

42. See the SFIPC official website, <http://www.sfipc.org.tw>; see also Securities Investors and Futures Traders Protection Act § 7 (Taiwan).

43. Securities Investors and Futures Traders Protection Act § 18 (Taiwan).

44. See Lin, *supra* note 18, at 169.

45. See CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN (財團法人證券投資人及期貨交易人保護中心), CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN ZHONGHUA MINGUO 103 NIAN NIANBAO (財團法人證券投資人及期貨交易人保護中心中華民國103年年報) [SECURITIES & FUTURES INVESTORS PROTECTION CENTER, 2014 ANNUAL REPORT] 4 (2014) (Taiwan); see also Paul Michael Jindra, *Securities Fraud in Singapore: China and the Challenge of Deterrence*, 51 COLUM. J. TRANSNAT'L L. 120, 169 (2012).

46. See Christopher R. Leslie, *The Significance of Silence: Collective Action Problems and Class Action Settlements*, 59 FLA. L. REV. 71, 74 (2007).

47. See, e.g., Janet Cooper Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 535 (1991) (noting the class action device makes private enforcement economically feasible by allowing a large number of small shareholders to aggregate their claims); *id.* at 74-77 (suggesting that class actions both aggregate individual claims and help coordinate litigation efforts that otherwise would be unmanageable); Jonathan R. Macey & Geoffrey P. Miller, *The Plaintiffs' Attorney's Role in Class Action and Derivative Litigation: Economic Analysis and Recommendations for Reform*, 58 U. CHI. L. REV. 1, 8 (1991) (arguing that the class action is a tool for overcoming free-rider and other collective action problems that impair any attempt to organize a large number of dispersed individuals in any common project).

The collective action theory only partially explains the rationale behind the Taiwanese NPO model, however it still helps to shed light on the government/market or contract mechanisms failure to respond to the supply of public goods.⁴⁸ While many scholars have proposed other NPO theories to explain the rise of the Taiwanese NPO model for protecting investor, none can fully resolve this puzzle and garner universal support.⁴⁹ In this section, I chose to discuss the two earliest and most dominant NPO theories--the government and market failure theory and the contract failure theory--both of which highlight that nonprofit action is a product of certain failures on the part of either the market, government or contract to meet demand.⁵⁰ However, by virtue of the historical transition of the Taiwanese NPO model discussed above, I conclude this section by introducing another theory--the path dependence theory--that has received little to no attention in the academic world.

First, the government and market failure theory posits that significant market failures by voluntary sectors to manage public goods are the only mechanism that beckons government intervention.⁵¹ However, the government's role to find the greatest and least common denominator naturally leads to classes of unmet needs.⁵² Thus, the NPO model is only able to meet the needs of a narrow margin, rather than a greater majority.⁵³

48. In light of the language of economics, public goods have two distinct aspects. First, the cost to provide the good to many persons is the same as that of to one person because one person's enjoyment of the good cannot exclude others from enjoying it at the same time the good (indivisibility). Second, once the good has been provided to one person there is no way to prevent others from consuming it as well (non-excludability). See Henry B. Hansmann, *The Role of Nonprofit Enterprise*, 89 YALE L.J. 835, 848 (1980). Moreover, it is generally accepted that corporate and securities law enforcement is a public good because it fits into the attributes of public good: indivisibility and non-excludability. See Lin, *supra* note 18, at 186; Milhaupt, *supra* note 3, at 181-84.

49. See Lin, *supra* note 18, at 187-89 (adopting Lester Salmon's "voluntary failure theory" in which the government subsidizes the nonprofit sector, when the nonprofit sector fails to provide adequate levels of public goods or services, however, the Taiwanese government does not subsidize the SFIPC directly but rather mandates market participants to contribute the funding of the SFIPC); Milhaupt, *supra* note 3, at 172-73 (outlining several theories to explain the emergence of the NPOs for investor protection in East Asia, but arguing that all these theories fall short of a fully account of NPOs in securities law enforcement globally); Shao, *supra* note 4, at 78-79 (analyzing the emergence of the Taiwanese NPO through public choice theory where the Taiwanese SFIPC is an unsatisfying but acceptable political compromise among different interest groups).

50. See PETER FRUMKIN, ON BEING NONPROFIT: A CONCEPTUAL AND POLICY PRIMER 70 (2002).

51. See BURTON A. WEISBROD, THE NONPROFIT ECONOMY 20 (1988) (noting that the government can attempt to fix market failures through a number of regulatory policies); see also Stephen J. Choi, *A Framework for the Regulation of Securities Market Intermediaries*, 1 BERKELEY BUS. L.J. 45, 48 (2004) (stating that different forms of market failure require different levels of government intervention, but lawmakers tend to regulate the failure without seeking a possibility to intervene the market in a less stringent way).

52. See WEISBROD, *supra* note 51, at 25 (arguing that the diversity is a major problem for the government due to difficulty to meet diverse public needs).

53. See Lin, *supra* note 18, at 184.

In other words, while the government responds to the demands of the majority, the NPO sector is responsible to fill the gap between the general public and the under satisfied.⁵⁴ Owing to its non-distribution constraint, NPOs may have better access to localized information to fill the void of public goods that the market and government fail to provide.⁵⁵ However, this theory falls short of explaining the SFI or SFIPC as a product of market and government failures. In actuality, either the SFI or the SFIPC was supported and considerably controlled by the government to serve as a tool to provide public goods of securities law enforcement. Simply put, government failure is not present here.⁵⁶ Instead, the emergence of the Taiwanese NPO model is a form of governmental intervention to avoid or ameliorate catastrophes when the market fails to provide privatized services.

Alternatively, a particular type of market failure, the contract failure theory, specifically focuses on the inability to monitor for-profit producers to supply goods and services according to their contractual commitment because consumers may be incapable of accurately evaluating the quality and price of goods or services provided or delivered.⁵⁷ In the context of public goods and services, however, due to their indivisibility and non-excludability, consumers only know what quality of goods or services is being provided, yet remain unaware of their exact contribution to its costs.⁵⁸ Furthermore, public goods require the separation of purchasers and recipients of public goods and services, thus blinding the purchaser from the condition or utility of the goods or services performed.⁵⁹ As a result, the NPO model is barred from distributing its net earnings, bridging the information asymmetry and trust problems, thus marking it a more reliable model due to eradicated incentives to exploit the consumer.

Based upon the contract failure theory, Professor Milhaupt suggests the Taiwanese NPO model presents a “layer of insulation” from the government and its enforcement problems by use of its novel position to deal with information asymmetry and mitigate trust problems remaining in the supply of investor protection services provided by the private sector. Thereby granting the government more leverage to expand its enforcement efforts by cooperation with the government-supported NPO and obtaining funding from private sectors.⁶⁰ However, as noted earlier, the driving force behind

54. See WEISBROD, *supra* note 51, at 27.

55. See *id.* at 23-27; see also Milhaupt, *supra* note 3, at 172.

56. See Lin, *supra* note 18, at 184; Shao, *supra* note 4, at 75.

57. See Hansmann, *supra* note 48, at 843-45.

58. See *id.* at 851.

59. See *id.* at 846-47 (making donative nonprofit organizations for example, there is no connection between donors and donees, if the program were organized for profit, it would have a strong incentive to skimp on the services, or even to ignore to perform the duties entirely).

60. See Milhaupt, *supra* note 3, at 196.

the SFIPC is the government instead of the purchasers of public goods, such as the stock exchange and brokerage firms, thus they are mandated to provide public goods to investors by the SIFTPA, rather than by mechanisms of contract or market.⁶¹ Hence, some scholars commented that it is difficult to measure the difference between market participants who trust in the “NPO form” and those who trust in the “government”. Thus, the Taiwanese NPO model cannot be wholly reconciled with the contract failure theory.⁶²

It is obvious that none of the aforementioned NPO theories conform to the Taiwanese NPO model, thus necessitating a further review of Taiwan’s unique history to find its own path dependent model. Instead of focusing on the “volunteerism” attribute without legal recognition,⁶³ this Article argues that the Taiwanese NPOs for investor protection historically has never been truly voluntary sectors organized by private donors or interest groups, but rather authorized as state actors. As a result, it is through this path dependence perspective that the Taiwanese NPO model is able to act as both sword and shield and shed light on the government’s choice to build a quasi-enforcement mechanism to address. Not only in impractical or inappropriate disputes, but also in attempt to handle a larger legal framework that include mass tort claims, such as investor and consumer protection,⁶⁴ and cross-strait relationship between Taiwan and China.⁶⁵

The path dependence theory is built around the idea that at crucial choice points certain directions of development were established that excluded other areas of development over long periods of time.⁶⁶ While traditions have developed throughout history, the reliance on path dependency as a bulwark to justify reliance on the present status-quo is not justified. In other words, it illustrates that once a country or region has started down a track, it becomes difficult to reverse its initial course due to potential lost transaction costs, which then leads to the formation of

61. See Lin, *supra* note 18, at 186.

62. See Shao, *supra* note 4, at 77.

63. See FRUMKIN, *supra* note 50, at 14.

64. Prior to the emergence of the SFIPC which has engaged in investor protection since 2003, the state-sponsored NPO model has been applied in the consumer protection area. The Consumer Foundation Chinese Taipei was established under the authorization of the Taiwanese Congress in 1980, which has assisted the state in enforcing consumer protection laws, including filing class actions for damage or losses incurred by the general public who had consumed harmful products. See generally Carol T. Juang, *The Taiwan Consumer Protection Law: Attempt to Protect Consumers Proves Ineffective*, 6 PAC. RIM L. & POL’Y J. 219 (1997).

65. In order to handle cross-strait technical or business affairs and avoid “official” contact, Taiwan and China both adopted a quasi-official organization. Against this backdrop, the Taiwanese Straits Exchange Foundation (SEF) was established in 1991 funded by the state and several private sectors. See the SEF official website, <http://www.sef.org.tw>.

66. See JAMES MAHONEY, *THE LEGACIES OF LIBERALISM: PATH DEPENDENCE AND POLITICAL REGIMES IN CENTRAL AMERICA* 264 (2003).

institutions or structures that tend to entrench the status-quo.⁶⁷ In the context of mass torts litigation involving securities fraud, cultural and historical factors of the Taiwanese NPO model reflects this path dependence, where Taiwan's history of paternalistic regimes lead to a hierarchical society, and develop its own particular norms to address grievances. This path dependence, however, impedes and undermines the transplantation of new rules from another jurisdictions or through the convergence of legal frameworks.⁶⁸

As illustrated earlier, a series of financial crises from 1998 to 2008 has lead Taiwanese retail investors to historically prefer help from organizations sanctioned by the government due to the high legal hurdles in contrast to the low costs of appealing to sense of authority.⁶⁹ This cultural deference to a higher authority plays right into the state's ambition to preserve its prosecutorial discretion in initiating class actions via the NPO to control mass tort disputes or serious social unrest or damages to the country's economy.⁷⁰ The ability of the government to directly intervene, in essence, reveals the state's desire to protect its own interest in the disguise of a falsely altruistic NPO model, by manipulating funds and controlling the number of securities class actions. The government appears as the benefactor, taking credit for protecting investors, while also avoiding congressional oversight of the organizational structure and personnel management. As a result, the overwhelming cost of "rule of law" reform to eliminate litigation barriers is highly unlikely. Attempt at Taiwan securities litigation reform will fail, as the government has no incentive to change and will resist the transformation--thus maintaining its status-quo. Clearly, Taiwan's history of path dependence sheds light as to why China is eager to follow Taiwan's NPO model.

67. See *id.* at 9; see also Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter*, 74 WASH. U.L.Q. 327, 329-30 (1996) (stating that certain initial conditions determined by fortuitous events makes it extremely difficult for any system to deviate from its original path, nevertheless these path-dependent factors traditionally are viewed as non-economic or inefficient).

68. See generally Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999) (stating that the form of corporate ownership in a country depends on the pattern it had developed earlier and persists in that path even the economy has become similar to other countries); Stephen J. Choi, *Law, Finance, and Path Dependence: Developing Strong Securities Markets*, 80 TEX. L. REV. 1657, 1726 (2002) (claiming that it is futile when transplanting the U.S.-style laws into another country without taking its cultural background and legal structure into account); Amir N. Licht, *The Mother of All Path Dependencies toward a Cross-Cultural Theory of Corporate Governance Systems*, 26 DEL. J. CORP. L. 147 (2001) (arguing that a nation's culture might be the aggregation of all path dependences and casually shapes its development of corporate governance).

69. See Jing-Huey Shao, *State Power in Disguise—Addressing Catastrophic Mass Torts in the United States, China, and Taiwan*, 24 TUL. J. INT'L & COMP. L. 175, 198 (2015).

70. See *id.* at 198-99.

III. THE CHARACTERISTICS AND PERFORMANCE OF THE TAIWANESE NPO MODEL

A. *The Structure and Functions of the SFIPC*

Pursuant to the SIFTPA, Taiwan's regulator of financial activities, the FSC has the right to monitor the business and operations of the SFIPC and appoint the board of directors and supervisors.⁷¹ The FSC can also order the SFIPC to amend articles of corporation, operating rules, or resolutions, and to conduct inspections of the SFIPC when it sees fit to protect securities and futures investors.⁷² The contribution to and utilization of the protection fund are also within the purview of the FSC.⁷³ Furthermore, in the case of rules violations or refusing to obey FSC orders, the FSC has the right to discharge directors, supervisors, managers, employees or mediation committee members.⁷⁴ As a result, Taiwan apparently follows the government-led model under which the central government maintains significant control over securities market regulation and leaves limited leeway to private institutions.⁷⁵ According to resolutions made by the government-controlled board of directors, the SFIPC can decide whether or not to initiate the following actions.⁷⁶

1. *Securities Class Action*

The principal duty of the SFIPC is to bring securities class actions on behalf of aggrieved shareholders. But it is worth noting that the structure and procedure of class action filed by the SFIPC are different from the class action provisions in Taiwan's Code of Civil Procedure (CCP),⁷⁷ but rather very similar to those in the Consumer Protection Law (CPL) of 1994.⁷⁸ This

71. Securities Investors and Futures Traders Protection Act §§ 11, 15 (Taiwan). In practice, the SFIPC's board of directors and supervisors have been heavily dominated by retired or former government officials, *see* Wang & Chen, *supra* note 4, at 144.

72. Securities Investors and Futures Traders Protection Act § 16 (Taiwan).

73. Securities Investors and Futures Traders Protection Act §§ 18-20 (Taiwan).

74. Securities Investors and Futures Traders Protection Act § 39 (Taiwan).

75. *See* Coffee, *supra* note 2.

76. In addition to bringing representative litigations, the SFIPC provides a variety of services, including accepting complaints, offering consultation, mediating disputes concerning securities and futures trading. *See* Securities Investors and Futures Traders Protection Act § 17 (Taiwan).

77. Minshi Susong Fa (民事訴訟法) [Code of Civil Procedure] § 44-2 (promulgated and effective Dec. 26, 1930, as amended July 1, 2015) (Taiwan), which reads that when multiple parties whose common interests have arisen from the same public nuisance, traffic accident, product defect, or the same transaction or occurrence to empower their representatives to initiate a civil lawsuit and the court may publish a notice to inform other persons with the same common interests to join the action by filing a pleading in a timely manner.

78. Xiaofeizhe Baohu Fa (消費者保護法) [Consumer Protection Law] § 50 (promulgated and effective Jan. 11, 1994, as amended June 17, 2015) (Taiwan), which stipulates that when numerous

is because as explained earlier, the path-dependence reflects Taiwan's "paternalistic" regulatory policy, which used to authorize the government-sanctioned NPOs to handle large-scale social conflicts. Prior to the emergence of the SFIPC in 2003 and 2013 amendment to CCP regarding modern class action mechanism the CPL already authorized eligible consumer protection groups to initiate class actions and award NPOs associated with consumer protection with much generous treatments and less procedural barriers than those of CCP. Not surprisingly, the SIFTPA followed this pattern to maintain the government's dominant influence in the area of mass tort litigations.

Under Article 28 of the SIFTPA, for protection of the public interest, within the scope of SIFTPA and SFIPC's articles of incorporation, the SFIPC may submit a matter to arbitration or bring an action in its own name with respect to a securities or futures matter arising from a single cause, injurious to multiple investors as long as more than twenty investors have empowered the litigation.⁷⁹ In contrast to the U.S.-style class action, civil actions initiated by the SFIPC adopted an opt-in mechanism that investors may choose to delegate their rights to the SFIPC prior to the conclusion of oral arguments or examination of witnesses, after which they shall notify the tribunal or court. Thus, the SFIPC may expand both the number of claims or claimants; however, in the same vein, participating investors can also withdraw from the class after the proceeding have begun, but prior to the conclusion of oral arguments or examination of witnesses in the court of first instance.⁸⁰ As noted earlier, the payment of court cost and lawyer's fees are financed by the SFI's own funding, where the SFIPC, just like its predecessor, is responsible for court cost and attorneys' fees and not entitled to seek remuneration for itself. The SFIPC shall disburse compensation it receives in an action or arbitration to the investors after deducting the expenses occurred in the proceeding.⁸¹

In addition to the attorney fees financing, the SIFTPA stipulates a number of preferential treatments, including a cap of court fees in terms of litigation and enforcement and exemption of deposits for injunctions or attachment applications. In Taiwan, the courts fees are charged proportionately, in accordance to the amount of claims and marginally

consumers are injured as a result of the same incident, a consumer protection group may take assignment of claims from twenty or more consumers and bring litigation in its own name.

79. Under this circumstance, the SFIPC will post a one-month e-notice on its website to solicit investors' claims, thus any investor who wishes to empower the SFIPC has to file her/his claim by filling out the claim form downloaded from the SFIPC website and mailing it to the SFIPC.

80. Securities Investors and Futures Traders Protection Act § 28, para. 1 (Taiwan).

81. Securities Investors and Futures Traders Protection Act §§ 20, 33 (Taiwan). In actuality, the SFIPC staff lawyers represent all the cases initiated by itself, the SFIPC will advance all litigation expenses and deduct the expenses from recovered amount. If the SFIPC receives no claims, it will bear the litigation cost. See Lin, *supra* note 18, at 172-73.

decrease as the amount increases. The plaintiff generally has to advance court fees of 1% of the claim at the court of first instance and 1.5% in matters of appeal to a court of second or third instance.⁸² However, pursuant to the SIFTPA, the SFIPC is not only exempted to pay court fees for the portion of the litigation amount in excess of NT\$ 30 million,⁸³ but also to grant relief from security deposits in terms of either a provisional injunction or attachment in the pre-judgment stage, or a provisional execution before the final judgment.⁸⁴ Furthermore, in order to facilitate securities class actions, a court may establish a special tribunal or designate a specialist to handle the suit.⁸⁵ As a result, such preferential treatment greatly alleviates the cost the SFIPC could have born as an ordinary plaintiff, but it also raises concerns of violations of the equality doctrine under civil procedure rules.⁸⁶

2. *Shareholder Activism*

Generally speaking, shareholder activism is a self-help measure that shareholders undertake in order to protect their investment along a spectrum of actions, from taking corporate control to instituting shareholder litigation to other forms of influence such as changing corporate directions without changing the stake of ownership via proxy solicitation, making proposals, etc.⁸⁷ At the nexus of Taiwan's Company Act, Securities and Exchange Act and the SIFTPA, it outlines four major types of representative action that the SFIPC can institute as a shareholder: (a) derivative suits brought by shareholders on behalf of the corporation against the directors and/or supervisors;⁸⁸ (b) removal suits brought by the shareholders against directors and/or supervisors;⁸⁹ (c) nullification suits brought by shareholders

82. Code of Civil Procedure §§ 77-13, 77-16 (Taiwan). By contrast, according to Taiwan's Code of Criminal Procedure, court fees are waived if the civil case follows the corresponding criminal charge, Xingshi Susong Fa (刑事訴訟法) [The Code of Criminal Procedure] §§ 504, 505 (promulgated July 28, 1928, effective Sept. 1, 1928, as amended Nov. 16, 2017) (Taiwan).

83. Securities Investors and Futures Traders Protection Act § 35 (Taiwan).

84. Securities Investors and Futures Traders Protection Act §§ 34, 36 (Taiwan).

85. Securities Investors and Futures Traders Protection Act § 28-1 (Taiwan).

86. See Lin, *supra* note 18, at 174.

87. See Iris H-Y Chiu, *The Meaning of Share Ownership and the Governance Role of Shareholder Activism in the United Kingdom*, 8 RICH. J. GLOBAL L. & BUS. 117, 138 (2008).

88. Gongsì Fa (公司法) [Company Act] § 214 (promulgated Dec. 26, 1929, effective July 1, 1930, as amended July 1, 2015) (Taiwan), which states that shareholders who meet the standing requirements, including continuously holding 3% or more of the corporation's outstanding shares over one year; making a demand in writing to request the board of directors or supervisors to sue but they fail to do; and providing security deposit at the request of the defendants, to bring a suit on behalf of the corporation against a director and/or supervisor in order to force such responsible persons to comply with their fiduciary duties.

89. Company Act § 200 (Taiwan) allows shareholders who hold 3% or more of the company's outstanding shares to seek for the court to remove the directors whose conduct resulting in material damages to the company or in serious violation of applicable laws but not discharged by a resolution

to invalidate the resolution of a shareholders' meeting;⁹⁰ and (d) short-swing profit disgorgement suits brought by shareholders on behalf of the corporation, which fails to sue for disgorgement of short-swing profits.⁹¹

As noted earlier, in order to acquire standing to bring civil lawsuits as a shareholder, the SFI must purchase one trading unit of shares (1,000 shares) of each publicly listed company, thus allowing its successor, the SFIPC to assume shareholder status. However, this minimum trading unit is also the maximum amount the SFIPC can purchase according to the rule of the Taiwan Stock Exchange.⁹² According to Taiwan's Company Act, it requires a shareholder to own 3% or more of the total number of the outstanding shares of the company in order to bring a derivative suit or a removal suit. Thus, the SFIPC cannot launch derivative or removal suits because of its ineligible shareholding requirement. As a result, in 2009, the SIFTPA further exempted the SFIPC from the minimum shareholding rule, thereby facilitating the SFIPC to bring derivative suits or removal suits if it finds that the conduct of any director or supervisor has materially injured the company or violated laws and provisions of the company's charter.⁹³

B. *The Performance of the SFIPC*

According to the SFIPC Annual Report, from its establishment to the end of 2015, the SFIPC has brought 201 class actions (including cases transferred from the SFI) arising from securities fraud on behalf of approximately 115,000 investors, seeking civil damages in an amount exceeding NT\$44.6 billion (about USD 1.49 billion). Among these lawsuits, sixty cases have been rendered total or partial victory for the plaintiffs by the courts, requiring defendants, including issuers, corporate directors and accountants, as well as their firms, to assume civil liabilities, which totaled about NT\$19.7 billion (about USD 657 million). Of these sixty cases, twenty-eight cases are final and non-appealable.⁹⁴ In addition to securities class actions, the SFIPC has been empowered to bring derivative suits and removal suits since the 2009 amendment to the SIFTPA. By the end of 2015,

of a shareholders' meeting.

90. Company Act §§ 189, 191 (Taiwan). Nullification suits allow shareholders to bring an action to nullify a resolution when the procedure or substance of a resolution made by a shareholders' meeting is contrary to law or charter of the corporation.

91. Zhengquan Jiaoyi Fa (證券交易法) [Securities and Exchange Act] § 157-1 (promulgated and effective Apr. 30, 1968, as amended Dec. 7, 2016) (Taiwan), which stipulates that shareholders can enforce disgorgement against short-swing transactions by insiders and controlling shareholders on behalf of the corporation.

92. See Shao, *supra* note 4, 72.

93. Securities Investors and Futures Traders Protection Act § 10-1 (Taiwan).

94. See CAITUAN FAREN ZHENGQUAN TOUZIREN JI QIHUO JIAOYIREN BAOHU ZHONGXIN (財團法人證券投資人及期貨交易人保護中心), *supra* note 41, at 4.

the SFIPC has brought thirty-three derivative suits and twenty-nine removal suits. With respect to derivative suits, the wrongdoers have compensated companies NT\$1.524 billion (about USD 50.8 million); and with reference to removal suits, a certain number of directors/supervisors have resigned voluntarily or withdrawn their bids for reelection. Among these derivative suits and removal suits, the SFIPC has won three cases to date.⁹⁵

When taking a closer look at the data, one finds that the performance of the SFIPC is far from satisfactory. While the SFIPC Annual Report lists an impressive 105 cases of a total of 201 cases as concluded, which represents around 18,000 investors seeking an approximate amount of NT\$6.6 billion (about USD 220 million), in reality there remain 96 class actions empowered by approximately 96,000 investors for a total amount of NT\$38 billion (about USD 1.27 billion) pending in the courts or are in the process of compulsory enforcement.⁹⁶ Despite giving the appearance that half of case load is closed, only 15 percent of aggrieved shareholders have had rendered the judgments, with more than 85 percent of claims still pending. As a quasi-public regulator, the SFIPC has the tendency to cherry-pick the easier, but smaller claims in order to enlarge the number of appeared enforcement actions.⁹⁷

In addition to the skewed data, there also remains an extremely high rate of overlap between public enforcement actions by the proper state bodies and SFIPC's securities class actions. It is hardly surprising that the SFIPC tends to free-ride on the gains of investigations undertaken by public prosecutorial agencies,⁹⁸ however, compared with counterparts in other jurisdictions,⁹⁹ the SFIPC has extraordinarily relied on administrative or criminal proceedings to pursue civil actions since its establishment.¹⁰⁰ For

95. *See id.* at 6-7.

96. *See id.* at 20.

97. *See, e.g.,* James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Law*, 100 CAL. L. REV. 115, 147-48 (2012) (arguing that the SEC tends to produce a certain amount of enforcement output due to its risk-averse character).

98. *See, e.g.,* John H. Beisner, Matthew Shors & Jessica Davidson Miller, *Class Action Cops: Public Servants or Private Entrepreneurs*, 57 STAN. L. REV. 1441, 1453 (2005); John C. Coffee, Jr., *Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter Is Not Working*, 42 MD. L. REV. 215, 222 (1983); Bryant Garth, Ilene H. Nagel & S. Jay Plager, *The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation*, 61 S. CAL. L. REV. 353, 376 (1988).

99. *See* James D. Cox, Randall S. Thomas & Dana Kiku, *Public and Private Enforcement of the Securities Laws: Have Things Changed since Enron*, 80 NOTRE DAME L. REV. 893, 897 (2005) (finding that 15% of the 248 securities class actions filed from 1990 to 2001 overlapped public actions); Mark D. West, *Why Shareholders Sue: The Evidence from Japan*, 30 J. LEGAL STUD. 351, 382 (2001) (stating that fifty-three cases of 140 derivative suits filed between 1993 and 1999 in Japan followed criminal proceedings).

100. *See* Lin, *supra* note 18, at 180-83 (arguing that this overreliance on public enforcement results from information asymmetry by which the SFIPC's investigation power is relatively weak compared to the public agency or judicial system). But *see* Shao, *supra* note 4, at 83 (the SFIPC's quasi-investigation power is strong but its bureaucratic slack surrenders this power to other

example, among the eighty-three pending lawsuits initiated by the SFIPC so far, thirty-five cases were piggyback suits¹⁰¹ and all remaining forty-eight cases brought directly by the SFIPC to the civil court retain paralleled criminal actions.¹⁰² Thus, private lawsuits initiated by the SFIPC are unable to proactively detect violations of securities laws, nor supplement the work of official securities agencies. As a result of the SFIPC's non-discretion in case selection, this practice poses a danger of simultaneous over-enforcement and under-enforcement.¹⁰³ On one hand, the threat of coattail actions not only yields wasteful duplication of efforts and social costs, but also may discourage wrongdoers from cooperating with public agencies.¹⁰⁴ But on the other hand, the risk of redundancy without differentiation does not allow the SFIPC to detect new errors, nor increase resources or aggregate information, and improve monitoring through their potential supplementary litigation.¹⁰⁵

IV. THE CHINESE STATE-CONTROLLED NPO ECOLOGY

The Securities Investor Protection Fund Limited Liability Company (SIPFLLC) is proposed to fill the Chinese NPO shoes by the CSRC, which stands as a wholly state-owned company to administer the investor protection fund.¹⁰⁶ The decision, however, is not final. More importantly, it is worth mentioning, however, that some grassroots NPOs have already engaged in the investor protection movement in China for many years. Nevertheless, they are not registered as lawful NPOs. As noted in the introduction, this Article suggests that the proposed Chinese NPO model will

authorities).

101. According to Taiwan's The Code of Criminal Procedure, piggyback civil suits allow those who are injured by a criminal offense to bring a follow-on civil lawsuit after the criminal charge proceeds to trial and the court fees can be waived. *See* The Code of Criminal Procedure §§ 504, 505 (Taiwan).

102. *See* Lin, *supra* note 18, at 182; Shao, *supra* note 4, at 82.

103. Some commentators discuss the issue of over-enforcement v. under-enforcement from different perspectives, *see* Shao, *supra* note 4, at 81-86 (stating that the SFIPC tends to under-enforce securities law violations but over-enforce corporate law litigations).

104. *See, e.g.*, David Freeman Engstrom, *Agencies as Litigation Gatekeepers*, 123 YALE L.J. 616, 630-41 (2013) (providing comprehensive critiques of private enforcement); Amanda M. Rose, *Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2221 (2010) (arguing that the threat of a follow-on securities class action may discourage individuals from cooperating with the public enforcer, thereby affecting the manner in which the public agency resolves the investigation).

105. *Cf.* Zachary D. Clopton, *Redundant Public-Private Enforcement*, 69 VAND. L. REV. 285 (2016) (suggesting that redundant litigation may cure under-enforcement by allowing private enforcers to fill the remedial gap left by public agencies depending on relevant advantages between public and private enforcers).

106. *See* Xin Tang, *Protecting Minority Shareholders in China: A Task for Both Legislation and Enforcement*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 141, 154 (Hideki Kanda, Kon-Sik Kim & Curtis J. Milhaupt eds., 2008).

cause further tension between the government and grassroots NPOs in the state-controlled NPO ecology. Thus, prior to introducing the Chinese NPO model, it is critical to have an overview of the current regulations governing NPO development in China. By virtue of analyzing China's legal framework, we can not only conclude that establishing a lawful NPO in China is a not an equal right for everyone, but a privilege reserved only for certain specified groups. Thus, as the gatekeeper to grant or deny access to the NPO, the Chinese government can affect and control NPO activities in a variety of ways in order to cater to its own needs.¹⁰⁷

A. *The Overview of NPOs in China*

In China, the term NPO has only surfaced in legal theories recently, and the emergency of “civil society” seems to be far from thriving in China, due to the state's tight control over NPO activities.¹⁰⁸ The definition and scope of NPOs are still somewhat opaque, because there are no uniform laws governing NPOs yet, notwithstanding the array of regulations concerning different types of civil groups. As the terms NPO and non-governmental organizations (NGOs) are used interchangeably among legal literature in China,¹⁰⁹ the Chinese government grants favor to the term NPO over NGO, as the literal translation of “non-governmental organization” is “*fei zhengfu zuzhi*”, which can also be translated into “anti-government organization.” “*Fei*” means both “non” and “anti”, so the term NGOs could insinuate to the public that they are engaging in anti-government activities. As a result, this linguistic nuance fully demonstrates the perceived tension between the acceptance of civil organizations and the preservation of China's state-centered NPO regulatory policy.¹¹⁰

Under the current legal framework in China, a number of resembling terms are used by commentators to divide NPOs into several types of

107. See Milhaupt, *supra* note 3, at 183 (suggesting that legal regimes can affect NPO activity in a variety of oblique ways, such as speech and assembly laws, which may disturb the development of civil society).

108. See Anna Jane High, *Grassroots NGO Regulation and China's Local Legal Culture*, 9 SOCIO-LEGAL REV. 1, 11 (2013). The norm of civil society in Western countries emphasizes its functions to limit the state power and shifts the power to voluntary organizations to enhance liberal democracy, see generally Mark Tushnet, *The Constitution of Civil Society*, 75 CHI.-KENT L. REV. 379 (2000) (suggesting that the institutions of civil society allow us to generate and maintain social values independent of the state's influence). For a summary of different views on the relationship between the state and civil society in China, see Shu-Yun Ma, *The Chinese Discourse on Civil Society*, 1994 CHINA Q. 180 (1994).

109. See L. Susan Kaur, *The Third Sector: The Law in China and Non-Profit Organization*, 4 INT'L J. CIV. SOC'Y L. 47, 49 (2006). This Part uniformly adopts NPOs instead of NGOs to prevent confusion arising from different terms.

110. See High, *supra* note 108, at 11; see also *id.* at 47 n.2.

organizations according to applicable regulations.¹¹¹ In general, NPOs are divided into three categories: social organizations or social groups (SOs; *shehui tuanti*),¹¹² foundations (*jijin* or *jijinhui*),¹¹³ and private non-enterprise units or civil non-enterprise institutions (PNEUs; *minban feiqiye danwei*).¹¹⁴ Similar to securities offering application, NPO registration in China is also subject to a state-administered system. Prior to 2000, in order to control the supply of securities and in turn the price of stocks, as in the case of initial public offerings (IPO), the quota of shares are first distributed to the issuing company by the local government where the company is located, and then the issuer must submit its application for approval by the CSRC (the so-called “double approval system”).¹¹⁵ The “double approval system” is replicated here, where the goal to oversee NPO activities and the laws concerning NPO establishment, including the SO Regulation, Foundation Regulation, and PNEU Regulation, all must adopt a “dual registration and supervision system.” To be more specific, prior to the registration with the Ministry of Civil Affairs, the NPO promoter has to also obtain approval from an organizational sponsor, or the business supervisory unit.¹¹⁶ Hence, by virtue of the “dual management system,” the government plays the gatekeeper over NPO formation, thereby transforming certain government-backed organizations into one part of the regulatory system that

111. See Jillian S. Ashley & Pengyu He, *Opening One Eye and Closing the Other: The Legal and Regulatory Environment for Grassroots NGOs in China Today*, 26 B.U. INT'L L.J. 29, 42 (2008) (breaking down NPOs into “social organizations”, “private non-enterprise units”, and “foundations”); Kaur, *supra* note 109, at 49 (dividing NPOs into “social organizations”, “foundations”, and “civil non-enterprises institutions”); Deyong Yin, *China's Attitude toward Foreign NGOs*, 8 WASH. U. GLOBAL STUD. L. REV. 521, 523 (2009) (NPOs include “social groups”, “foundations”, and “private non-enterprise entities”); Ge Yunsong, *Nonprofit Organizations & the Reform of China's Public Institutions*, 2 INT'L J. CIV. SOC'Y L. 27, 38 (2004) (categorizing “foundation” as a type of social organizations).

112. “Social organizations” refer to NPOs organized by citizens voluntarily in order to realize a shared objective and engage in the activities according to their charters; all groups other than state organs may join social organizations as institutional members, see *Shehui Tuanti Dengji Guanli Tiaoli* (社会团体登记管理条例) [Regulations on Registration and Management of Social Organizations] § 2 (promulgated and effective Sept. 25, 1998, as amended Jan. 13, 2016) (China).

113. “Foundations” refer to NPOs donated by natural persons, legal persons, or other organizations with the purpose of pursuing welfare undertakings, see *Jijinhui Guanli Tiaoli* (基金会管理条例) [Regulations on Management of Foundations] § 2 (promulgated Feb. 11, 2004, effective June 1, 2004) (China).

114. “Private non-enterprise units” refer to NPOs established by enterprises, social organizations or other civic entities as well as individual citizens by means of non-state assets and engage in not-for-profit social services, see *Minban Feiqiye Danwei Dengji Guanli Zanxing Taioli* (民办非企业单位登记管理暂行条例) [Provisional Regulations on Registration and Management of Private Non-Enterprise Units] § 2 (promulgated Sept. 25, 1998, effective Oct. 25, 1998) (China).

115. See, e.g., ROBIN HUI HUANG, *SECURITIES AND CAPITAL MARKETS LAW IN CHINA* 54-55 (2014).

116. See *Regulations on Registration and Management of Social Organizations* § 9 (China), *Regulations on Management of Foundations* § 7 (China), *Provisional Regulations on Registration and Management of Private Non-Enterprise Units* § 3 (China).

collaborates with the government and supplements resources to the government in the name of “civil society.”

As a result of overregulation due to the dual management system, most domestic NPOs in China are not willing to register as lawful NPOs, but rather operated as either illegal grassroots NPOs or register as commercial enterprises to avoid the state’s intervention or the high-bar registration requirements.¹¹⁷ Not surprisingly, compared with recognized government-organized NPOs (GONPOs)¹¹⁸ and lawful NPOs closely connected to the government or the GONPOs,¹¹⁹ grassroots NPOs face a variety of hurdles in their operations.¹²⁰ While some NPOs disingenuously disguise themselves in the form of a commercial enterprise, thus granting certain incorporation benefits, such as bank accounts, all unregistered NPOs are precluded from partaking of tax benefits, receiving donations and applying for grants available to registered NPOs. More importantly, because such organizations are illegally incorporated, once they are targeted by the government, the government can take actions to shut down their operation, confiscate the assets, and punish their managers with administrative sanctions or even criminal liability.¹²¹

NPOs face further scrutiny from not only their structural incorporation, but also upon their preferred stated mission. The Chinese government

117. See Ashley & He, *supra* note 111, at 42-43 (arguing that the actual number of NPOs in China is difficult to measure because of the difficulty in registration); Adam S. Chodorow, *Charity with Chinese Characteristics*, 30 UCLA PAC. BASIN L.J. 1, 12-13 (2012) (indicating that NPOs without political connections in China were formed either as for-profit businesses or unregistered organizations, however, the government usually turns a blind eye to illegal NPOs’ existence as long as they do not harm national security or social stability).

118. One of the major categories of GONPOs derives from traditional Leninist mass organizations (人民團體) [*renmin tuanti*]. There are “top eight” of them such as the All China Youth League, All China Women’s Federation, and the All China Federation of Trade Unions. See Chen Jie, *The NGO Community in China Expanding Linkages with Transnational Civil Society and Their Democratic Implications*, 68 CHINA PERSPECTIVES, 29 (2006), <https://chinaperspectives.revues.org/3083>; see also High, *supra* note 108, at 12 (arguing that most registered NPOs are state’s subsidiaries); C. David Lee, *Legal Reform in China: A Role for Nongovernmental Organizations*, 25 YALE J. INT’L L. 363, 376 (2000) (illustrating that some of the “top eight” originate from the concept of mass organizations; and some of them are GONPOs. The former group has quasi-official status and enjoys a highest status than other organizations; the latter group is officially recognized by the government and subject to varying degrees of state control).

119. In order to secure the legal status, the promoter of a NPO must cultivate personal relationships with the government officials to develop trust and connections. The government could also certify a GONPO as a sponsor of other NPOs in registration application, thereby granting the GONPO to raise more external funds through collection of sponsorship fees, see Ashley & He, *supra* note 111, at 43, 46.

120. See Yin, *supra* note 111, at 541 (suggesting that unregistered NPOs in China face troubles in operation, including developing members, receiving donations, recruiting employees, and entry-exit procedures).

121. Regulations on Registration and Management of Social Organizations § 35 (China), Regulations on Management of Foundations § 40 (China), Provisional Regulations on Registration and Management of Private Non-Enterprise Units § 27 (China).

consistently applies a “differentiated standard” in its NPO regulatory scheme. In other words, the state seeks to foster certain types of NPOs with preferential treatment, while suppressing other NPOs engaged in politically and socially sensitive agendas. For example, NPOs that focus on disaster and poverty relief, the environment, health, education, and services for the disabled are very welcomed and supported by the Chinese government. To the contrary, NPOs working in taboo areas, such as human rights or democracy advocacy, are subject to restrictive surveillance.¹²²

In a nutshell, all NPOs in China are under varying degrees of supervision by a state-controlled NPO ecology. That is to say that the level of their self-autonomy spans across a spectrum where, on one end are NPOs organized by the government such as GONPOs (top-down NPOs), and on the other end are unlawful NPOs (grassroots or bottom-up NPOs) working in areas of civil rights and liberties.¹²³ As a result, in the same vein for a NPO to engage in legal services, whether the government would tolerate its activities or not depends not only by its political connection with the government, but also on what legal services it provides to the public.

B. *The Legal Aid NPOs in China*

In general, the major legal services carried out by legal aid NPOs include initiating public interest litigation in their own name or seeking out appropriate representative plaintiffs, and public interest lobbying such as petitions and participation in the legislative process.¹²⁴ However, when taking a closer look at the legal aid culture in China, there appear to have more types of legal aid NPOs than originally imagined. Some commentators have divided the roles performed by legal aid NPOs under the Chinese legal framework into four types: (a) a legal service provider, especially targeting disadvantaged segments of the population; (b) an education provider, primarily responsible for transmitting legal knowledge and inculcating of legal values to the public; (c) a regulatory assistant, whereby the legal aid NPO assists the government in regulating certain market activities or in enforcing the nation’s laws; and (d) an advisor or a potential activist, by

122. See Yin, *supra* note 111, at 536-37; see also Mei Qi, *Developing a Working Model for Legal NGOs in China*, 10 WASH. U. GLOBAL STUD. L. REV. 617, 622 (2011) (arguing that existing NPOs in China usually engage in non-political activities, such as environmental protection, education, women and children’s rights, and health and medical rights, which non-governmental works have been more tolerated by the government. However, amidst these permitted NPOs, very few operate in the legal field).

123. See High, *supra* note 108, at 11; see also Lee, *supra* note 118, at 376 (stating that the Chinese scholars divide NPOs into four categories according to political affiliation).

124. See Haiding Xie, *Public Interest Legal Organizations in China: Current Situation and Prospect for Future Development*, in *NGOS IN CHINA AND EUROPE: COMPARISONS AND CONTRASTS* 117, 129-33 (Yuwen Li ed., 2011).

virtue of its ability and skills to influence the government on initiating policies.¹²⁵

Moreover, some scholars have adopted other approaches and methodologies to categorize legal aid NPOs into different groups. For example, these NPOs can be organized by substantive form with either brick and mortar fixed structures versus Internet and cloud based forums; or either by sponsorship by public (such as public universities and academic institutes) or private sectors (law firms or individuals); or divided based upon the target group (specific groups, people suffered in particular illness, people with economic difficulties and so forth) they serve.¹²⁶ However, no matter what parameter was used to draw the distinction, successful NPOs with legal aid must share a number of common features to engage in public interests and thrive in China, as all scholars pointed out. First, in order to enjoy support from the state or local governments, the legal aid NPOs' founders or managers must maintain close ties with officials to facilitate NPOs' interactions with the public sector.¹²⁷ Without political connections, the NPOs face difficulties in obtaining their legal status and legitimacy for their activities.¹²⁸ Second, compared with other grassroots NPOs, where self-financing always remains an issue, NPOs associated with the government are relatively well-funded due to their ability to acquire limited subsidies from the government or sponsorship from foreign or international NPOs by virtue of their political affiliation.¹²⁹ Finally, a well-funded NPO can draw the government and mass media's attention, thereby building its reputation to attract and retain talented personnel and competent attorneys.¹³⁰

As a result of the degree of governmental involvement, the NPOs that provide legal services could range from the most public government legal-aid centers to the most private law firms that voluntarily provide pro bono services.¹³¹ However, not every legal aid NPO is welcomed by the

125. See Lee, *supra* note 118, at 382.

126. See Xie, *supra* note 124, at 124-29.

127. See Lee, *supra* note 118, at 386.

128. See Xie, *supra* note 124, at 134-36; see also Chodorow, *supra* note 117, at 12 (arguing that NPOs lacking political connections tend to forego registration and remain illegal); High, *supra* note 108, at 42 (suggesting that the success of NGOs rests on the ability to negotiate with the state to maximize political legitimacy rather than to comply with formal laws).

129. See Xie, *supra* note 124, at 138-39; see also Lee, *supra* note 118, at 386 (noting that many NPOs such as Wuhan University Center are funded by the Ford Foundation); The Harvard Law Review Association, Note, *Adopting and Adapting: Clinical Legal Education and Access to Justice in China*, 120 HARV. L. REV. 2134, 2147 (2007) (indicating that the Ford Foundation may be the only available foreign funding resource for most legal clinics in China).

130. See Xie, *supra* note 124, at 138-39; Lee, *supra* note 118, at 386.

131. See Benjamin L. Liebman, *Legal Aid and Public Interest Law in China*, 34 TEX. INT'L L. J. 211, 225 (1999) (dividing legal aid in China into five loose categories depending on public-private characteristics, including government legal aid centers composed of full-time lawyers; government legal aid centers that delegate legal aid work to law firms; legal aid programs run by government actors other than the Ministry of Justice or local justice bureaus; non-government and university-based

Chinese government, only the less litigious groups are able to belong under the NPO moniker. In other words, whether a legal aid NPO will be supported or oppressed by the government depends on what kind of legal services and litigation it provides to the public. Generally speaking, litigation itself has been historically discouraged under Chinese Confucian society, as it, not only taps much social resources, but also destroys personal relationship, regardless of who wins or loses.¹³² More importantly, in order to maintain political and social stability, the Chinese judicial system tends to be more cautious with regard to certain types of lawsuits—including securities lawsuits,¹³³ administrative cases,¹³⁴ environmental actions,¹³⁵ and employment disputes.¹³⁶

In actuality, a securities group action represents a combination of several undesirable lawsuits, merging both general litigation and administrative cases. Due to its involvement of a large group of defrauded shareholders, and the procedural requisite in which any private securities lawsuit must “piggyback” on public enforcement—mainly the CSRC’s sanctions,¹³⁷ thus the facts and issues behind any previous administrative decision must then be reviewed and debated intensively by both parties again in any subsequent private action. This shed light not only on the defendant’s behavior, but also the authority and legitimacy of the courtroom and administrative procedure itself. Finally, while the Chinese securities market appears as a mixed nexus of public-private ownership, in actuality, the state owns dominant influence over every business.¹³⁸ As a result, private securities litigation filed by NPOs seem to fall in the middle of the Chinese

legal aid centers; and law firms which voluntarily provide pro bono work).

132. See William P. Alford, *Tasselled Loafers for Barefoot Lawyers: Transformation and Tension in the World of Chinese Legal Workers*, 1995 CHINA Q. 22, 26 (1995) (arguing that the Chinese society traditionally despises the lawyer industry).

133. See, e.g., Benjamin L. Liebman, *China’s Courts: Restricted Reform*, 21 COLUM. J. ASIAN L. 1, 27 (2007).

134. See generally John Wagner Givens, *Sleeping with Dragons? Politically Embedded Lawyers Suing the Chinese State*, 31 WIS. INT’L L. J. 734 (2013-2014).

135. See Jin Wang, *Environmental Public Interest Litigation: When Will It Flourish in China?*, 7 J. KOREAN L. 217, 228 (2007).

136. See generally Jiefeng Lu, *Regulating Employment Discrimination in China: A Discussion from the Socio-Legal Perspective*, 23 MICH. ST. INT’L L. REV. 437 (2015).

137. In order to grant public agencies gatekeeping power over private securities litigation, China’s SPC created a procedural prerequisite that in order to bring a securities suit, there must be a prior criminal judgment or administrative sanction by relevant government bodies. See Zuigao Renmin Fayuan Guanyu Shenli Zhengquan Shichang yin Xujia Chenshu Yinfa de Minshi Peichang Anjian de Ruoguan Guiding (最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定) [Provisions of the Supreme People’s Court Concerning the Acceptance and Trial of Civil Compensation Securities Litigations Involving Misrepresentation] § 6 (promulgated and effective Feb. 1, 2003) (China).

138. See, e.g., Donald C. Clarke, *Law without Order in Chinese Corporate Governance Institutions*, 30 NW. J. INT’L L. & BUS. 131, 145 (2010) (arguing that the government typically owns about two-thirds of total outstanding shares).

government's love-hate spectrum, due to the Chinese government ambiguous support of certain badges of private ownership, yet highly sensitive to other parts of China's socialist market economy.

C. *The Chinese Investor Protection NPO at the Embryonic Stage*

It is quite apparent that the Chinese state and government bureaucracy are not yet ready for the upcoming sea of change. Their attitude towards grassroots NPOs remain one of deep ambivalence, alternating between fear that these groups will be a source of social instability and political opposition, and acknowledgement that without these NPOs' help the state will be unable to meet the growing social need--a situation that will itself foment instability and political unrest. The current legal and regulatory environment for grassroots NPOs is a clear reflection of this ambivalence. Despite the unfavorable Chinese legal environment for civil society development, a loosely organized group of securities lawyers, however, has recently opened securities joint actions on behalf of aggrieved shareholders in the wake of a series of corporate scandals since 2001. For example, in July 2006, the CSRC published its administrative penalties against Kelon (a listed company manufacturing home-appliances) for manipulating financial statements and its auditor, Deloitte, for failing to detect internal fraud from 2002 to 2004. As a result, Kelon was fined 600,000 yuan (about USD 90,000) and the company's top management received fines ranging from 50,000 to 300,000 yuan (about USD 7,500 to 45,000).¹³⁹

Due to the difficulty of individual shareholders, who are widespread in China and insufficient resources to initiate any meaningful legal actions, a group of lawyers voluntarily released a movement statement to accept any qualified Kelon shareholders' claims through a high-profile media solicitation.¹⁴⁰ This prompted sixty lawyers from forty-five law firms across China to form the "Justice Claiming Team" to bring joint actions on behalf of the 200 individual shareholders seeking approximately 28 million yuan (about USD 4.2 million) in civil compensation from Kelon and its management.¹⁴¹ The senior judge of a representative court, who accepts such cases of securities litigations, confirmed that the Kelon case stands on the marginal edge in China's legal landscape. Due to the professional complexity and political sensitivity of these types of cases, the court heavily

139. See Zhang Ran, *Deloitte Faces Double Trouble in China*, CHINA DAILY (Mar. 31, 2006), http://www.chinadaily.com.cn/bizchina/2006-03/31/content_556998.htm.

140. See Tang, *supra* note 106; Huang, *supra* note 9, at 768.

141. *Id.*; see also Xin Tang, *Commentary on "New Hope for Corporate Governance in China?"*, in CHINA'S LEGAL SYSTEM: NEW DEVELOPMENTS, NEW CHALLENGES 36, 64 (Donald C. Clarke ed., 2008).

persuaded and advocated for a quick settlement over litigation, thus settling most cases for a total of 15 million yuan (about USD 2.25 million).¹⁴²

The Justice Claiming Team created a number of precedents with reference to investor protection in China. As the first and largest group, formed by legal experts known as “rights defense lawyers” (*weiquan lushi*), they originally focused on only the “Kelon,” which has been recognized as one of the five most influential securities litigations in the area of investor right protection in China. Kelon represents a shift in mentality, where, for the first time, shareholders sued one of the Big Four accounting firms under the newly created (2005) civil liabilities amendment for securities professionals.¹⁴³ More importantly, through the right defense movement, this group of lawyers established and outlined a future action agenda for potential securities fraud cases. Prepared with a defensive strategy before another potentially devastating crisis, the team has automatically organized to provide legal services to aggrieved shareholders, thereby creating an educational mechanism and perceived potential threat to help enforce laws against potential breaches.¹⁴⁴

Similar to Korean and Japanese NPO models,¹⁴⁵ the Justice Claiming Team was formed by a group of securities lawyers who have experience in securities-related lawsuits in China.¹⁴⁶ However, in contrast to these models, the Justice Claiming Team is a loose organization, serving as a network for securities lawyers to exchange information gathered from previous lawsuits, who then select and divide claims upon a case-by-case basis.¹⁴⁷ Given the Chinese authoritarian NPO regime and state-controlled legal profession ecology,¹⁴⁸ it is hardly surprising that the Justice Claiming Team is

142. See Wang Suikun (王遂昆) & Hao Xiaosong (郝小松), *Wanshan Woguo Xujia Chenshu Minshi Peichang Zhidu zhi Sikao—Kelon Gongsi Xujia ChenShu An de Qishi* (完善我国虚假陈述民事赔偿制度之思考—科龙公司虚假陈述案的启示) [*Reforming China's Civil Compensation System against Securities Misrepresentation: Lessons from Kelon*], 29 CAIKUAI YUEKAN (财会月刊) [FIN. ACCT. MONTHLY] 74 (2010).

143. See Dan Harris, *China's New Securities Law Being Put to Legal Test*, CHINA LAW BLOG (Apr. 5, 2006), http://www.chinalawblog.com/2006/04/chinas_new_securities_law_bein.html. See also Huang, *supra* note 9, at 761 (asserting that the 2005 revisions of the Chinese Securities Law provide legal basis of civil liability in misrepresentation).

144. See Tang, *supra* note 106.

145. In Korea, the People's Solidarity for Participatory Democracy (PSPD) is a registered NPO primarily funded by membership fees and its activities rely heavily on the voluntary participation by staff lawyers, who provide their services without compensation. The Japanese Shareholder Ombudsman is a unregistered NPO founded by a group of lawyers, accountants, and academics, although it is not legally established as a NPO under Japan's Civil Code due to the onerous formation requirements at the time of its founding, it still complies with the non-distribution constraint. See Milhaupt, *supra* note 3, at 175-81.

146. See Tang, *supra* note 106.

147. See *id.*

148. In contrast to most countries where lawyers are regulated by the bar association, China's lawyers and the bar association are controlled by the Ministry of Justice. See Leland Benton, *From*

unwilling and unable to register as a lawful NPO.¹⁴⁹ Most of China's rights defense lawyers face varying degrees of risk in their right to liberty and security of persons.¹⁵⁰ While the potential risk is less severe than for such sensitive issues of human rights advocacy, the lawyers dedicated to investor right protection still face significant hurdles from being granted with a little more leeway.¹⁵¹ However, with the advent of the 2015 Securities Law amendments, their fragile space is heavily threatened and may exclude or marginalize the entire investor rights defense movement.

V. THE PROPOSED CHINESE NPO MODEL AND ITS REGULATORY IMPLICATIONS

A. Overview of the 2015 Amendments to China's Securities Law

In April, 2015, the draft amendment (hereafter the Bill) to the Securities Law was read by the Standing Committee of the National People's Congress (NPC) for the first time.¹⁵² The newly created Securities Law Bill, which contains 338 provisions, added 122 new provisions, revised 185 different amendments and deleted twenty-two old provisions.¹⁵³ Clearly, this Bill overhauled China's previous 2005 Securities Law. Generally, the Bill offers firms more access to the IPO market, calls for stricter supervision and law

Socialist Ethics to Legal Ethics: Legal Ethics, Professional Conduct, and the Chinese Legal Profession, 28 UCLA PAC. BASIN L.J. 210, 215 (2010-2011); Jun Zhao & Ming Hu, *A Comparative Study of the Legal Education System in the United States and China and the Reform of Legal Education in China*, 35 SUFFOLK TRANSNAT'L L. REV. 329, 342 (2012).

149. See Tang, *supra* note 106, n.62 (quoting one of the right defense lawyer in the Justice Claiming Team, Yixin Song, who states that they have no plan to register the team as an official organization).

150. There are numerous news concerning the risk and threat encountered by right defense lawyers in China, *see, e.g.*, Chris Buckley, *Charges against Chinese Rights Lawyers Draw Foreign Criticism*, N.Y. TIMES (Jan. 18, 2016), http://www.nytimes.com/2016/01/19/world/asia/china-lawyers-arrest-reaction.html?_r=0.

151. See Walter Hutchens, *Private Securities Litigation in China: Material Disclosure about China's Legal System*, 24 U. PA. J. INT'L ECON. L. 599, 655 (2003) (asserting that some Chinese lawyers are active in promoting private securities litigation). *But cf.* Guo Rui, *Blowing Whistle without Protection: Can Chinese Regulator Afford Sending Sheep among Wolves*, 10 FRONTIERS L. CHINA 123, 131-32 (2015) (providing a case where an investor rights defense lawyer, Yiming Yan was retaliated by Guizhou Changzheng Electric Co., the company which he filed complaint to the CSRC concerning alleged accounting fraud); *see also* RACHEL E. STERN, ENVIRONMENTAL LITIGATION IN CHINA: A STUDY IN POLITICAL AMBIVALENCE 52 n.18 (2013) (describing a fact that Attorney Yiming Yang was beaten up in his Shanghai office by unknown thugs in April 2009).

152. *China Mulls Draft Law to Ease Regulations on Securities*, XINHUANET NEWS (Apr. 20, 2015), http://news.xinhuanet.com/english/2015-04/20/c_134166615.htm.

153. See Zhao Xiaohui (赵晓辉), Liu Kai-Xiong (刘开雄) & Xu Sheng (许晟), *Zhengquanfa Yishen Touzizhe Zuigai Guanzhu de Shijianshi er* (《证券法》一审投资者最该关注的十件事儿) [*The Top Ten Issues Investors Should Know about the First Deliberation on China's Securities Law*], XINLANG CAIJING (新浪财经) [SINA FINANCE] (Apr. 20, 2015), <http://finance.sina.com.cn/stock/y/20150420/212522001177.shtml>.

enforcement, stipulates information disclosure obligations, and most importantly, adopts the Chinese NPO model by authorizing the investor protection NPO sanctioned by the government to bring securities class actions and derivative suits on behalf of aggrieved shareholders or defrauded companies.¹⁵⁴

Under normal legislative practices within the NPC, prior to voting, a bill shall be deliberated three times.¹⁵⁵ Currently, the NPC Standing Committee has not deliberated the Bill for the second time, nor solicited public opinion. In contrast to previous amendments to the Securities Law, the Standing Committee appears to be intentionally delaying the legislative process, perhaps due to the large-scale modification and far-reaching impact of the Bill on China's securities market.¹⁵⁶ Thus, the next section will discuss the most significant attributes of the proposed Chinese NPO model, as well as its regulatory implications for investor protection.

B. *The Functions and Responsibilities of the Chinese NPO*

1. *Representative Litigations and Shareholder Activism*

Similar to the Taiwanese NPO model, the primary function of the Chinese NPO is to bring representative claims, including securities fraud joint actions on behalf of shareholders and derivative suits on behalf of companies. With reference to securities fraud actions, Article 176 of the Bill states that a large group of shareholders can file civil suits arising from misrepresentation, market manipulation and insider trading by electing representatives, including the Chinese NPO to represent the aggrieved shareholders. In addition to Article 176, in 2012, Article 55 of the amendments to China's CPL also provided some additional legal basis for the Chinese NPO to file representative litigation on behalf of the public interest. In contrast, Western style litigation almost always assumes that representative litigations concerning the public interest should be filed by private actors, rather than by a governmental agency.¹⁵⁷ Article 55 of CPL

154. *Id.*

155. Under the Legislation Law of the PRC, a bill which has been put on the agenda of the Standing Committee session is generally deliberated three times in the current session of the Standing Committee before coming to vote, then requiring a simple majority of the members of the Standing Committee for its adoption as national law. After its adoption by the NPC Standing Committee, it will be signed and promulgated by the President of the State. *See* Lifa Fa (立法法) [Law on Legislation] §§ 40-41 (promulgated Mar. 15, 2000, effective July 1, 2000) (China).

156. *See* Wang Su (王姝) & Jin Yu (金玳), *Zhengquanfa Xiuding Caoan Jiangyu Jinniandi Ershen* (证券法修订草案将于今年底二审) [*The Amendment to China's Securities Law may be Second Deliberated by the End of 2016*], XINHUA WANG (新华网) [XINHUANET NEWS] (Apr. 23, 2016), http://news.xinhuanet.com/politics/2016-04/23/c_128923087.htm.

157. *See, e.g.*, John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 110

expanded the standing requirement by authorizing relevant government entities and organizations to bring litigation against actions that pollute the environment, infringe upon consumers' rights and interests, or otherwise harm the public interest.

Although Article 55 of CPL does not specify nor characterize securities causes of actions as belonging within the rubric of public interest litigation, from the literature, there exist several reasons for allowing such actions to fall within the domain of public interest. First, early indications show that this provision may have originally been intended to include a wide expanse of violations, including securities laws, when they also included the "destruction of cultural relics" as falling within the domain of "public interest".¹⁵⁸ Second, the draft of Article 55 originally adopted a much narrower definition of "relevant SOs," but rather than adopting the current definition, it represented a broader definition of "relevant organizations".¹⁵⁹ As noted earlier, the organization "social group" in China is a type of NPO that is restricted to groups that meet particular procedures regarding their registration and management, and typically have a political affiliation with the government. Thus, this shift suggests that China desires to include and broaden the types of NPOs within its definition of "protecting the public interest," including quasi-government NPOs. Finally, China initially established its securities market in order to buttress the teetering state-owned enterprises (SOEs) and enable a more efficient and competitive environment, all with the aim to maintain political and social stability.¹⁶⁰ Thus, securities fraud litigation was implemented to increase investor confidence and strengthen market integrity, by enabling the statutory category to fall within the rubric of "otherwise harm the public interest." However, currently, public interest litigation primarily focuses solely in environmental area, where most cases are handled by prosecutors. Only a few cases are brought by government-controlled GONPOs, and not surprisingly, none were representative of grassroots NPOs.¹⁶¹

For derivative suits, Article 175 of the Bill authorizes government-sanctioned NPOs to bring derivative suits as a shareholder on

COLUM. L. REV. 288, 302-04 (2010) (arguing that representative actions and public interest litigations are usually brought by NPOs seeking only injunctive or equitable relief); Peter Nussbaum, *Attorney's Fees in Public Interest Litigation*, 48 N.Y.U. L. REV. 301, 305 (1973) (stating that public interest litigation is filed by the private sector, including an individual or an organization, rather than by a governmental agency).

158. See Dana M. Muir, Junhai Liu & Haiyan Xu, *The Future of Securities Class Actions against Foreign Companies: China and Comity Concerns*, 46 U. MICH. J.L. REFORM 1315, 1333 (2013).

159. See *id.* at 1334.

160. See, e.g., Jiangyu Wang, *Dancing with Wolves: Regulation and Deregulation of Foreign Investment in China's Stock Market*, 5 APLPJ 1, 14 (2004).

161. See Jenna Scott, *Cleaning up the Dragon's Fountain: Lessons from the First Public Interest Lawsuit Brought by a Grassroots NGO in China*, 45 GEO. WASH. INT'L L. REV. 727, 744 (2013).

behalf of the defrauded company to sue directors, supervisors or senior managers who violate the laws, regulations or articles of incorporation while carrying out their duties, and thereby cause damages to the company. By virtue of the Taiwanese SIFTPA example, Article 175 exempts the Chinese NPOs from meeting the 1% threshold shareholding requirement imposed by Article 152 of China's Company Law. However, except for this preferential treatment, Article 175 does not exempt other requirements for plaintiffs to satisfy in order to bring securities joint litigation or derivative suits. In other words, while the Chinese NPO retains only the threshold shareholding benefit, it must comply with all other relevant laws and regulations. For example, in order to file a securities joint action, the Chinese NPO must piggyback on to a corresponding public enforcement action and fix the number of represented plaintiffs prior to the proceeding.¹⁶² With reference to derivative suits, the Chinese NPO must first request the board of supervisors to sue the director or request the board of directors to sue the supervisor, then wait thirty days. If the board of directors or supervisors do not take action, only then can the Chinese NPO or any other entity bring a derivative suit on behalf of the company.¹⁶³ In sum, as a quasi-public enforcer, the Chinese NPO rarely has the incentive to establish an independent enforcement agenda within the entrepreneurial litigation environment.

Aside from derivative suits, the last, but perhaps not the least, mechanism for shareholder activism falls within the ability of the Chinese NPO to participate and manage shareholder proposals and proxy solicitations. Article 170 of the Bill stipulates that the Chinese NPO may be appointed as a proxy to attend shareholder meetings to exercise the voting rights or submit shareholder proposals for approval on behalf of the shareholders who cannot attend shareholder meetings.

2. *The Advance Settlement Provision*

Article 173 of the Bill reads that in the cases of securities fraud, including material fraudulent issuance of stocks, misrepresentation, and other serious violations that result in material damages to shareholders, the alleged company's controlling shareholders, securities service institutions, such as underwriters and sponsors, in addition to the Chinese NPOs, may settle with potential plaintiff shareholders and pay compensation in advance (so-called "Advance Settlement", *xianqi peifu*). After compensating shareholders, these settling entities may seek contribution from the issuing

162. See Provisions of the Supreme People's Court Concerning the Acceptance and Trial of Civil Compensation Securities Litigations Involving Misrepresentation §§ 6, 14 (China).

163. Gongsi Fa (公司法) [Company Law] § 152 (promulgated and effective Dec. 29, 1993, as amended Dec. 28, 2013) (China).

company and other joint-tortfeasors.

According to tort liability of joint infringement in China,¹⁶⁴ the “Advance Settlement” provision allows for any of the multiple parties that are jointly and severally liable for the same tort and damages to compensate the aggrieved shareholders first, regardless of liability, then seek a proportional contribution from other tortfeasors after the advanced settlement has been made. Ultimately, joint wrongdoers should be required to pay their share of a common burden. In other words, no one should unjustly benefit at the expense of others, and thus multiple liable parties are a prerequisite for the rule of Advance Settlement to apply.¹⁶⁵ Obviously, the Chinese NPO committed no wrongdoing within the securities fraud in question. However, the Bill includes Chinese NPOs as a potentially liable party in the same provision. Why should an innocent party be lumped within the same basket of fraudulent securities deplorable? The inclusion of the Chinese NPO not only violates tort law theory, but also produce the inequitable result, where one innocent quasi-public agency bears the burden of the other violators’ wrongs.

The Advance Settlement approach, in fact, has already been in practice prior to the Bill’s enactment for several years. In 2013, the first case involved the Wanfu Biotechnology Agriculture Development Co. (Wanfu), which was found liable by the CSRC for fraudulently inflating its revenues by a total of 740 million yuan (about USD 111 million) and net profits by 160 million yuan (about USD 24 million) during its IPO process, in addition to inflating its revenues in continuing disclosure obligations. Wanfu and its management were barred from the securities market for life; however, the fine imposed separately on Wanfu and its chairman were merely 300,000 yuan (about USD 45,000). In contrast, on May 10, 2013, the CSRC imposed a penalty of 76.65 million (about USD 11.50 million) on Wanfu’s sponsor, Ping An Securities Co., Ltd. (Ping An), in fines of 51.10 million yuan (about USD 7.67 million) and confiscated revenue of 25.55 million yuan (about USD 3.83 million) for failing to accurately conduct due diligence in Wanfu’s IPO case. The CSRC suspended Ping An’s sponsorship agency qualification for three months as well. Most importantly, on the same day, Ping An made an unprecedented announcement to launch a special 300 million yuan fund (about USD 45 million) to compensate defrauded shareholders who suffered

164. Qinquan Zeren Fa (侵权责任法) [Tort Law] § 8 (promulgated Dec. 26, 2009, effective July 1, 2010) (China), which reads that two or more parties whose joint infringement causes damage to another party shall be jointly and severally liable.

165. See Chen Jie (陈洁), *Zhengquan Shichang XianQi Peifu Zhidu de Yinru ji Shiyong* (证券市场先期赔付制度的引入及适用) [The Adoption and Application of Advance Settlement in the Securities Market] 8 *FALU SHIYONG* (法律适用) [J. L. APPLICATION] 25 (2015).

losses because of Wanfu's fraudulent statements.¹⁶⁶ However, the compensation fund only accepted claims submitted within the first sixty days, where the SIPFLLC was authorized by Ping An to manage the compensation fund and finished distribution to participating shareholders within two months by July 2013.¹⁶⁷ As of now, Ping An has not taken any civil actions against Wanfu, and Ping An is still Wanfu's sponsor.

At the first glance, the Advance Settlement program provides shareholders a more efficient method to recover their losses partially from the compensation fund, and may have a deterrent effect on the securities industry by increasing operation costs due to the need to compensate shareholders first out of their own pocket once their client has become involved in fraudulent activities.¹⁶⁸ But in actuality, this approach benefits only the regulator and perpetrator, at the expense of shareholder welfare. It is believed that Ping An's civil settlement with shareholders was rather a negotiation agreement with the government, due to Ping An's much lighter than expected punishment, especially in light of its history of previous violations.¹⁶⁹ Thus, the Advance Settlement provision should be recognized for its true function, as another form of administrative sanction, which shifts the focus away from litigation and preventative enforcement, and more as a means to prevent shareholders from initiating large-scale private actions.¹⁷⁰ Through the Advance Settlement approach, a synergy exists for the benefit of the CSRC and the alleged wrongdoer, where the alleged wrongdoers agree to rectify irregularities detected by the CSRC and settle with shareholders in advance of formal enforcement, thereby preventing the CSRC's further investigation and receiving less severe punishments. In addition, the CSRC receives credit for "protecting investors in a timely manner," and thus save

166. See Chen Jia, *Pin An Securities Hit with Fire*, CHINA DAILY (May 11, 2015), http://europe.chinadaily.com.cn/business/2013-05/11/content_16492075.htm.

167. See *Wanfu Shengke An: Shishui Xianqi Peifu Touzizhe Zhudong Weiquan* (万福生科案：试水先行赔付 投资者主动维权) [*Lessons from the Wanfu Case: The Trial of Advance Settlement Program and Investor Rights Protection*], ZHONGGUO ZHENGQUAN JIANDU GUANLI WEIYUANHUI [中国证券监督管理委员会] (CHINA SECURITIES REGULATORY COMMISSION) (Aug. 3, 2015), http://www.csrc.gov.cn/pub/newsite/tzbbh1/tbtzzjy/tbfxff/201508/t20150803_282336.html.

168. See Elzio Barreto & Yikun Wang, *New China Rules for Botched IPOs Spooking Underwriters*, REUTERS (Jan. 14, 2016), <http://www.reuters.com/article/china-ipo-regulations-idUSL3N14W25S20160114>.

169. Ping An has had a lengthy violation record prior to Wanfu's IPO case, but it only was punished by a fine of 2 times its illegal gains and three-month suspension, see Zhang Juaner (张娟儿), *Pin An Zhengquan de "Zui yu Fa"* (平安证券的“罪与罚”) [*The Sin and Punishment of Pin An*], MEI JING WANG (每经网) [NAT'L BUS. DAILY] (May 19, 2013), <http://www.nbd.com.cn/articles/2013-05-19/742437.html>.

170. See Jin Sheng, *Private Securities Litigation in China: Passive People's Courts and Weak Investor Protection*, 26 BOND L. REV. 94, 118 (2014) (arguing that about 80% of securities civil actions were concluded by conciliation under the judge's instruction because the courts are mandated to encourage settlement between parties in hearing misrepresentation cases).

enforcement resources from having to investigate further into, perhaps, more alleged fraud that could create further scandals and social unrest. Perhaps due to these practical considerations, Article 173 of the Bill includes the quasi-public NPO, with its deeper pocket, in the same basket of fraudulent securities deplorable. Notwithstanding that this addition not only contradicts theories of tort law, but also increases government involvement in the private compensation context.

C. *Regulatory Implications of the Chinese NPO Model*

Although the Chinese NPO model was allegedly transplanted from the Taiwanese experience, there are several critical differences between these two models. Due to path differences between Taiwan and China in each NPO environment as well as rule of law development, this section suggests that the quasi-public Chinese NPO model would increase investors' reliance on the public agency more than ever, and subsequently restrain private sectors' energy and opportunities to engage in the investor protection movement. To be more precise, this Chinese NPO model goes against its declaration of decreased government's control over private enforcement, but rather leads China to move to a more unequal public-private partnership enforcement model.

1. *Representative Securities Litigations: The Opt-Out Rule and the Preclusive Effect*

One of the most salient distinctions between the U.S.-style securities class action and the Chinese securities joint action is the manner of how litigants can join the litigation. Similar to the Taiwanese NPO model, the current Chinese joint litigation regime stipulates that plaintiffs must voluntarily "opt in" to the class before initiating a suit, thereby fixing the number of claims at the time of filing.¹⁷¹ Compared to the opt-in rule that requires shareholders to voluntarily participate in the action, the U.S. class action regime requires a class of plaintiffs to remain within the suit, unless an affirmative step to "opt-out" is taken. In other words, covered shareholders will be bound by the final judgment (the so-called *res judicata* effect), unless they choose to opt out the class, regardless of whether they are aware of being exposed to the alleged wrongdoings.¹⁷²

However, in the U.S. securities class actions regime, one of the greatest pitfalls of the opt-out rule remains to be the substantial agency cost between

171. See Provisions of the Supreme People's Court Concerning the Acceptance and Trial of Civil Compensation Securities Litigations Involving Misrepresentation § 14 (China).

172. See, e.g., Coffee, *supra* note 157, at 291.

representative plaintiffs and class members. This has led to lawyer-driven litigation that primarily benefits representative plaintiffs and their attorneys, rather than for the benefit of all shareholders. In general, retail shareholders prefer to free ride with the class due to the substantial costs for them to opt out and pursue their own, individual small claims.¹⁷³ To the contrary, large institutional investors have the resources and a sufficient stake to exercise their opt-out rights.¹⁷⁴ As a result, plaintiffs who remain in the class are individual shareholders without incentive or ability to monitor their representatives, thus the representative plaintiffs and their attorneys retain far more leverage in the settlement negotiations, thus may bargain away represented members' interests in exchange for their own benefits.¹⁷⁵ To be more precise, representative plaintiffs and their attorneys retain an incentive to file frivolous and meritless suits, so long as the amount of the settlement outweighs their litigation cost, notwithstanding that the settlement award may be trivial in relation to entire class of shareholder losses.¹⁷⁶

Perhaps due to these concerns, we see a general resistance from other countries to the U.S.-style litigious environment. Aside from the U.S., only four other countries in the world, including Canada, Australia, South Korea, and the Netherlands, have adopted the opt-out provision in the securities class action system.¹⁷⁷ Surprisingly, China may change its current opt-in mechanism and become the sixth country to adopt the opt-out rule in the representative securities litigation context. According to Article 176 of the Bill, the court judgment of representative securities litigation would bind all shareholders suffered in the same cause, except for those who exercise their opt-out right. However, from my perspective, this unprecedented provision could cause several new problematic issues within the Chinese legal framework.

First, agency cost still occurs when the public agency or a quasi-public organization asserts a claim on behalf of injured victims. Nevertheless, the

173. See Macey & Miller, *supra* note 47, at 28; Hal S. Scott & Leslie N. Silverman, *Stockholder Adoption of Mandatory Individual Arbitration for Stockholder Disputes*, 36 HARV. J.L. & PUB. POL'Y 1187, 1208 (2013) (suggesting that retail investors typically do not opt out the class because they have smaller stake in the action).

174. See, e.g., John C. Coffee, Jr., *Accountability and Competition in Securities Class Actions: Why Exit Works Better Than Voice*, 30 CARDOZO L. REV. 407, 409-10 (2008) (arguing that large shareholders can acquire much higher returns if they opt out and pursue their individual actions).

175. See, e.g., Jill E. Fisch, *Class Action Reform: Lessons from Securities Litigation*, 39 ARIZ. L. REV. 533, 552 (1997) (illustrating that individual shareholders have little incentive to monitor litigation decisions or opt out from the class, thereby leading to lawyer-driven litigations).

176. For a detailed account of the incentives why the plaintiffs' counsel intends to settle claims for much less than provable losses, see Coffee, *supra* note 98, at 230-35.

177. Letter from David Hirschmann & Lisa Rickard, *President and Chief Executive Officer, Center for Capital Markets Competitiveness, U.S. Chamber Commerce & Lisa Rickard, President, U.S. Chamber Institute for Legal Reform, to Elizabeth Murphy, Secretary, U.S. SEC. EXCHANGE COMMISSION* (Feb. 18, 2011), at 13, <https://www.sec.gov/comments/4-617/4617-37.pdf>.

assumptions remains that the Chinese NPO is presumed to not be driven by monetary incentives as compared to private attorneys in the entrepreneurial litigation environment.¹⁷⁸ Under the Chinese government-led enforcement regime, both the CSRC and the court system are more inclined toward selective enforcement to avoid huge cost of effective enforcement. For example, when all things are equal, the CSRC tends to take more lenient action and impose lighter punishments on significant SOEs, rather than on private companies.¹⁷⁹ By the same token, in a de facto enforcement action initiated by the securities regulator, the NPO-driven litigation may primarily benefit the government and its affiliated enterprises, instead of aggrieved shareholders. If the SIPFLLC, a 100% SOE by the CSRC, is licensed by the CSRC to bring representative litigation, it is hardly surprising that this NPO would adopt similar discriminatory strategies against defendants depending upon their affiliation, political connections and their significance within the economy. Due to inconsistency of goals between the nominal plaintiff (i.e., the government-controlled NPO) and the substantial beneficiaries (i.e., the shareholders and the public interest), there appears to be a separate, parallel agency cost between the NPO-led litigation and its representative class that exists between the government and the public, rather than between representative plaintiffs and class members, as in a traditional class action suit.

Second, the opt-out provision directly contradicts, not only the opt-in rule adopted by securities joint action, but also the non-preclusion regulation related to public interest litigation. With reference to the former rule, China's SPC has specifically regulated that plaintiffs must register with the court to participate in securities joint actions.¹⁸⁰ By virtue of the opt-in rule, the court can confirm the number of plaintiffs and their claims prior to trial, and thus control the impact of litigation within the state's tolerable limit. With respect to the latter regulation, in order to balance the interests between public interest litigations represented by an NPO and subsequent private suits initiated by victims in environmental pollution cases, the SPC issued a judicial interpretation stating that when an NPO files a public interest litigation according to Article 55 of CPL, it cannot preclude injured parties

178. See, e.g., Margaret H. Lemos, *Aggregate Litigation Goes Public: Representative Suits by State Attorneys General*, 126 HARV. L. REV. 486, 511-18 (2012) (arguing that the conflicts of interest remain between the state attorney general and state residents she represents in public aggregate litigations, notwithstanding the attorney general is not driven by financial award as private attorneys).

179. See Tianshu Zhou, *Is the CSRC Protecting a "Level Playing Field" In China's Capital Markets? Public Enforcement, Fragmented Authoritarianism and Corporatism*, 15 J. CORP. L. STUD. 377, 387-94 (2015); see also Weixia Gu, *Securities Arbitration in China: A Better Alternative to Retail Shareholder Protection*, 33 NW. J. INT'L L. & BUS. 283, 290-91 (2013) (demonstrating that the CSRC is subject to enormous political pressure not to actively pursue SOEs for securities fraud).

180. See the Provisions of the Supreme People's Court Concerning the Acceptance and Trial of Civil Compensation Securities Litigations Involving Misrepresentation § 14 (China).

from pursuing any further suits against tortfeasors arising from the same cause.¹⁸¹ Hence, the subsequent question arises: Why would China design an incompatible opt-out provision within the current opt-in securities litigation scheme?

In performing a opt-in versus opt-out cost benefit analysis, we find that the opt-in mechanism allows for aggrieved shareholders to decide whether to join the class, bring their own suits or even abandon their rights, however claims are piecemeal and the shareholder ultimately retains the right to bring further action. In contrast, the opt-out rule potentially can resolve all cases against the defendant of the same claim once and for all. However, China wants to retain and limit the power of private sector ambition in potentially unruly U.S. style class actions claims. As a result of the advent of quasi-public NPO-led litigation, China seems to slightly alter, again, its original plan and has initiated a more efficient solution to solve mass tort disputes. As long as China replaces unbridled private class action attorneys with controllable quasi-public NPOs, China could turn one of the most private features in the U.S. class action regime upside-down and build a strong form of public intervention over private litigation, in disguise of the public interest.

Finally, the opt-out provision would increase further tension between the Chinese NPO and grassroots NPOs due to claim preclusion. Similar to Taiwan, many retail shareholders involved in the Chinese securities market,¹⁸² and thus most aggrieved plaintiffs, will not opt-out of lawsuits. In other words, there will be no competition in litigation, except for those first to file. Therefore, it is very important for the private sector, either grassroots NPOs or attorneys, to take the lead of alleged securities fraud and file the lawsuit first, otherwise they will lose the opportunity to pursue further claims. However, due to China's prerequisite of requiring private suits to piggyback on public sanction, the government or the Chinese NPO obviously retains first-hand information. This information asymmetry favors the Chinese NPO, thus allowing for it to file ahead of the headline. Hence, it will be very difficult for the private sector to compete in the first-to-file regime with the Chinese NPO in the future.

181. Zuigao Renmin Fayuan Guanyu Shenli Huanjing Minshi Gongyi Susong Anjian Shiyong Falu Ruogan Wenti de Jieshi (最高人民法院关于审理环境民事公益诉讼案件适用法律若干问题的解释) [Interpretation of the Supreme People's Court on Several Issues Concerning the Application of Law in Environmental Civil Public Interest Litigations] § 29 (promulgated June 1, 2015, effective July 1, 2015) (China).

182. See Gu, *supra* note 179, at 287.

2. *The Advance Settlement: Securities Fraud Insurance with a “Premium” Waiver*

The Advance Settlement provision is another unique device enacted in the Chinese NPO model that remains absent from the Taiwanese NPO model. As discussed earlier, the joint-tort theory could not fully provide a legal basis for the Chinese NPO to engage in advance settlement with shareholders. Thus, other approaches are needed to explore this compensation device. Although Article 173 of the Bill merely stipulates that any NPO sanctioned by the CSRC is entitled to engage in the Advance Settlement program, the SIPFLLC stands alone as the only NPO that has the ability and experience to carry out the task.¹⁸³ The SIPFLLC is the only quasi-public NPO 100 % owned by the CSRC and overseen by the State Council, which, since 2005, has administered an initial capital of 6.3 billion yuan of insurance fund (investor protection fund) for investors for protection against securities company failures.¹⁸⁴ Moreover, the SIPFLLC continues to review, manage and distribute the special compensation funds that were established by alleged liable sponsors, such as the Ping An case in 2013.¹⁸⁵

Prior to China's establishment of the insurance fund in 2005, many countries established similar systems to address the risk of broker-dealer insolvency. In general, the funding sources mostly derived from stock exchanges, securities companies and brokerage community; with certain entities, usually an NPO appointed as the fund administrator.¹⁸⁶ More importantly, the shareholders themselves are responsible for losses in their securities investment activities. These funds are not obliged to bail out investors or the securities industry when the value of stocks, bonds or other investment falls of any reason.¹⁸⁷ The SIPFLLC, however, aims to expand

183. In addition to the SIPFLLC, other quasi-public NPOs such as Zhongzheng Smaller Investors Service Center Co Ltd (中证中小投资者服务中心有限责任公司), a public financial institution established by the CSRC in 2014, might be another possible candidate.

184. Securities Law § 134 (China). The investor protection fund has grown annually, however, the SIPFLLC has not updated the annual reports since 2012. By the end of 2012, the present value of the investor protection fund was approximately 20.7 billion yuan (about USD 3.1 billions). See the SIPFLLC official website, <https://www.sipf.com.cn:7002/NewCH/bhjj/02/69860.shtml>.

185. The SIPFLLC website offers a special section for aggrieved investors to check the progress of the Advance Settlement programs, <http://www.sipf.com.cn/zxbc/index.shtml>.

186. See Lin, *supra* note 26, at 150-51 tb1 (outlining basic features such as size, coverage, source, and adjudication system of the securities investor protection funds in Taiwan, Canada, China, Singapore and the United States).

187. See, e.g., Michael E. Don & Josephine Wang, *Stockbroker Liquidations under the Securities Investor Protection Act and Their Impact on Securities Transfers*, 12 CARDOZO L. REV. 509, 512 (1990); Stephen P. Harbeck, *Stockbroker Bankruptcy: The Role of the District Court and the Bankruptcy Court under the Securities Investor Protection Act*, 56 AM. BANKR. L.J. 277, 279 (1982); see also the U.S. Securities Investor Protection Corporation (SIPC) official website, <http://www.sipc.org/about-sipc/sipc-mission> (holding that it only bails out investor losses arising from bankruptcy of brokerage firms).

coverage of the investor protection fund to cover these exact risks, including losses arising from securities fraud, which then allows the Chinese NPO to acquire a “cause of action” similar to the right of subrogation against tortfeasors. It is fair to say that the insurance account may harness greater explanatory and predictive power than the tort law theory.¹⁸⁸ Yet, even within the insurance rubric, the quasi-public SIPFLLC differs from traditional insurers in that insurance premiums are waived and cases are engulfed by this Chinese NPO, where insurers recoup funds through fees in accordance to the insured’s propensity for fraud.

As noted earlier, most commentators define the Advance Settlement program as a civil settlement rather than an insurance policy, and ignore the invisible hand played by the public agency in the private compensation system. But in actuality, this invisible hand has emerged officially in other jurisdictions. For example, the U.S. Securities and Exchange Commission (SEC) has provided compensation to defrauded shareholders by creating a special fund (the so-called Fair Fund provision), composed of civil penalties and disgorgements;¹⁸⁹ and the Taiwanese SIFTPA has extended the coverage of the investor protection fund to defray the costs and expenses accrued from representative litigations filed by the SFIPC.¹⁹⁰ Lastly, the CSRC is also trying to strengthen its compensatory role via the Advance Settlement provision. In contrast to the U.S. or the Taiwanese approach, by collecting illicit profits from wrongdoers prior to distributing funds to aggrieved shareholders, the Advance Settlement provision requests the Chinese NPO to “insure” securities fraud *ex ante*, without securing any “premiums” from the potentially injured parties. As a result, the insurance theory creates a compensation design that may result in several problems for the Chinese NPO.

First, the problem of moral hazard arises, when those whose value of a potential loss is fully insured by the insurance company without paying corresponding premiums according to the magnitude of risk. For example, in securities class action context, where there may be thousands of individual plaintiffs in a class, thus it would be procedurally impossible for each plaintiff to illustrate the individualized proof of “reliance” in certifying the class. To that end, the Supreme Court in *Basic Inc. v. Levinson* held that the

188. See, e.g., Thomas W. Joo, *Who Watches the Watchers—The Securities Investor Protection Act, Investor Confidence, and the Subsidization of Failure*, 72 S. CAL. L. REV. 1071, 1074 (1999) (analogizing the investor protection fund to the FDIC which provides the protection for the accounts of bank depositors); James J. White, *Work and Play in Revising Article 9*, 80 VA. L. REV. 2089, 2098 (1994) (suggesting that some government insurance programs such as the FDIC or the SIPC as a form of industry tax).

189. 15 U.S.C. § 7246 (2012).

190. Securities Investors and Futures Traders Protection Act § 20 (Taiwan); see also Lin, *supra* note 26, at 147 (suggesting that the SFIPC Fund shall be reconsidered and reviewed periodically in order to respond the growth of the securities market).

requirement of reliance in a securities fraud class action could be satisfied by adopting a rebuttable fraud-on-the-market (FOTM) assumption which only requires a showing of reliance on the integrity of the market price as sufficient to establish transaction causation.¹⁹¹ By virtue of the FOTM theory, plaintiffs are released from the burden of proving the transaction's causation, and in turn allowing for easier qualification of certification, thus encouraging shareholders to bring more frivolous suits. Thus, the FOTM assumption has led some to believe that class actions have become little more than an *ex post* scheme of shareholder's "insurance", as Justice White feared.¹⁹² Likewise, insuring securities fraud *ex ante* without charging premiums would cause shareholders' excessive reliance on the Advance Settlement program, and in turn increase the moral hazard, while decreasing any deterrence effect.

In a risk-oriented securities world, if investors were fully insured without any risk of loss, the cost of transactions fall from calculation in any investment decisions. Nor will any adoption of precautionary measures to avoid or lessen damages be included, but rather the system encourages far less prudent behavior by pursuing higher risk activity. When securities fraud occurs, instead of filing costly litigation, most aggrieved shareholders would rather settle, thus shifting litigation costs to the Chinese NPO. In other words, the Advance Settlement program could replace, rather than complement, private actions. This in turn releases the shareholders from ferreting out information related to securities fraud within the corporate fundamental structure (e.g., abnormal profit margins and other signs of fraudulent practice), creating the ultimate moral hazard of shifting incentives for investors to monitor fraud-prone companies. But for the Advance Settlement program, shareholders could have played a supplemental role in aiding the public agency to detect and deter fraud, as they are the most vested. As compensation is forthcoming, the effort and resources for the shareholder to privately litigate remain futile under the Advanced Settlement program.

Second, the Advance Settlement provision imposes a significant financial burden on the Chinese NPO, leading to questions of fairness and conflict of interest between the securities community and the public. As mentioned earlier, the Chinese government donated the initial capital of 6.3 billion yuan to establish the investor protection fund under the SIPFLLC in 2005. While the investor protection fund does collect fees from securities companies and stock exchanges based upon a risk rating,¹⁹³ under the

191. *Basic Inc. v. Levinson*, 485 U.S. 224, 248-50 (1988).

192. *Id.* at 252-53 (White J., joined by O'Connor, J., concurring in part and dissenting in part).

193. Zhengquan Touzizhe Baohu Jijin Guanli Banfa (证券投资者保护基金管理办法) [Regulation on the Administration of Securities Investor Protection Fund] § 12 (promulgated and

present system, the SIPFLLC only aims to maintain its operating costs.¹⁹⁴ The plan to incorporate securities fraud within its lists of coverable claims will unduly burden the Chinese NPO model, especially considering that the payout to aggrieved shareholders could come well before the establishment of the scale of securities litigation, thus leaving the Chinese NPO with the responsibility to assume any disproportionate risk by the securities market. Thus, the SIPFLLC's investor protection fund will potentially become insufficient as compared to the magnitude of total shareholder losses, particularly in large-scale fraud cases. Even though the SIPFLLC retains a private cause of action against the wrongdoer, the claim might be practically unavailable due to a variety of political considerations. Defendants, as in all cases, can be found either insolvent or unaccountable for their alleged violations. By granting the SIPFLLC default status as the perennial plaintiff and fund administrator, any potential losses and costs become the burden of the government,¹⁹⁵ therefore also on all taxpayers, rather than the culpable securities community.

Finally, through the Advance Settlement provision, the government not only decreases shareholder incentives to bring private lawsuits as mentioned above, but also gains further control over the securities market and civil society. For example, in the Ping An case mentioned earlier, the sponsor's role as gatekeeper to the securities community creates an unnecessary reliance by the potential company upon its sponsor in order to gain the recommendation required for listing. As a result, the CSRC could manipulate the supply of IPOs, and thus affect stock prices and market conditions by controlling the sponsorship system. With the advent of the Advance Settlement program, the CSRC will have legitimate grounds to require the securities industry or the Chinese NPO to comply with this new policy by promising to engage in the Advance Settlement program with entry applications, or use their lack of adherence as an excuse to withdraw their qualification. By raising the high financial bar for entry, only entities with strong political affiliations will retain any chance for admittance. In other words, by creating an additional barrier to entry, the government is able to screen unwelcomed organizations.

effective June 1, 2005) (China).

194. See JING BIAN, CHINA'S SECURITIES MARKET: TOWARDS EFFICIENT REGULATION 172 (2014).

195. See, e.g., Barbara Black, *Should the SEC Be a Collection Agency for Defrauded Investors*, 63 BUS. LAW. 317, 345 (2008) (suggesting that the SEC wastes too much resource in obtaining and distributing Fair Funds to aggrieved shareholders); Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1136 (2008) (arguing that the Fair Fund programs divert the SEC's resources to distribute compensation to aggrieved investors). Cf. Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STAN. L. REV. 331, 388 (2015) (illustrating that the SEC does not invest much resources on Fair Fund distribution proceedings).

VI. CONCLUSION

Based upon path-dependence reasons, Taiwan has developed a unique NPO model to deal with mass tort disputes. Although the Taiwanese NPO model is far from a perfect solution to securities enforcement, and is still affected by potential political intervention and business influence, it is generally recognized as an interim measure to fill the gap between public and private enforcement. The SFIPC still enjoys some degree of autonomy in enforcement decisions and reputation on litigation results. More importantly, compared to China, the Taiwanese court system and regulatory agencies are relatively independent and impartial in enforcing securities law violations.

At the first glance, the Chinese NPO model resembles that of Taiwan, but due to its own political situation, China has altered several important attributes, or even adopted additional measures beyond the scope of the Taiwanese NPO model. As illustrated, while the Chinese government released some regulatory authority to the private sector in 2003 which allows aggrieved shareholders to file coattail suits following public enforcement action, in essence, the proposed 2015 Amendment is actually a disguise masked behind the powers of the quasi-state controlled NPO to recapture or regain authority over the market. Ultimately, the Chinese securities enforcement regime may shy away from its original goal of the more optimal public-private partnerships, but rather remain in a government-centered position or even move further toward the public controlled sphere of hybrid securities fraud enforcement.

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心口不一？從臺灣投保中心論中國大陸證券投資者維權組織之立法

趙冠璋

摘 要

證券法反詐欺條款之執法，正如同其他違法行為之執法模式，可分為公權力執法（public enforcement），即由主管機關以行政處罰或是轉介檢察機關訴追的手段予以制裁；或是私人訴訟（private enforcement），即在造成私權受損之情況下，被害人可提起訴訟請求損害賠償。本文指出依據路徑依循（path dependence）理論，每個國家依照自身的政經情勢演變出「公私」不同混合程度之證券欺詐執法模式，如美國，私人訴訟尤其是集團訴訟十分活躍，甚至與公權力執法彼此扞格衝突；相反地，在中國大陸，證券欺詐主要依賴公權力執法，私人訴訟被政府部門相當地抑制。而臺灣，證券投資人及期貨交易人保護中心（投保中心）早已「壟斷」了證券欺詐的私人訴訟市場，而投保中心此一由政府與證券期貨業者共同支持所成立之投資人保護機構，無疑地處於美國與中國大陸兩個極端執法模式的中間地帶。本文認為當美國努力地抑制已然失控之證券欺詐集團訴訟，並嘗試授與政府部門更多執法權力的同時，相反地，在2015年4月，中國大陸證券法草案採取類似臺灣投保中心之模式，即授權經政府許可之投資人保護機構代表受害股東提出「公益訴訟」以請求損害賠償。此舉乍看似乎係給予在公權力控制下的私人證券訴訟更多的空間。惟本文指出囿於中國大陸特殊之政經情勢，中國大陸之證券法草案採取了若干與臺灣投保中心不同的作法，其影響之重要性將使得公權力部門更加

主導操縱私人證券欺詐訴訟權利之行使，甚至危及尚在萌芽的證券維權組織之發展。

關鍵詞：證券欺詐、投資人保護、證券維權、代表訴訟、團體訴訟、先行賠付、非營利組織、中國大陸證券法、中國大陸特有非營利組織／非政府組織生態



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