



高等院校双语示范教材·法学系列

Chinese Securities Law : Cases and Rules

Yuan Dasong

中国证券法 ——案例与规则（英文版）



袁达松 编著



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Preface

This book is drafted in a style of common law textbook, just like those using in the law schools of U.S.A., but with typical Chinese securities cases and laws. It covers the general introduction of Chinese securities laws on securities issuance, transactions, institutions, regulatory and legal liabilities for illegal practices. In each section, after the introductions of specific rules and rationale, a case is followed with summary of facts, ruling of the courts. So the readers may have an oversight to Chinese securities laws and the students can learn the relevant laws through cases method.

I want to send this book to my wife Xu Xiaoxia as a gift to celebrate our loving time of 20 years. And thank the international students studying the Master Program in Chinese Law of Beijing Normal University. Sincerely appreciate helps from the editors of University of International Business and Economics Press.

Yuan Dasong
December 2013

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Chapter One

General Introduction of Chinese Securities Law

Part A Rules and Rationale

China started the securities law legislation at the early 1990s with the establishment and development of its securities market. The legislation process lasted for a relatively long time, and until the outburst of the 1998 Asia financial crisis which made the legislators concerned about the financial risk and security in China, although China is not so much affected by the crisis, China officially promulgated its securities law in 1998, i.e., the *Chinese Securities Law* adopted by the Standing Committee of the National People's Congress.

The *Chinese Securities Law* is the first comprehensive law in China to stipulate the rules for the issuance, trading and regulation of securities. It expressly provides that, it shall be applied to the issuance of and transactions in stocks, corporate bonds and other securities lawfully recognized within the territory of the People's Republic of China by the State Council. In order to adapt to the rapid development of the Chinese securities market, the *Chinese Securities Law* has been revised twice and the latest revision occurred in 2005. Currently, the *Chinese Securities Law* covers a wide range of subject, from rules for issuance of securities, transactions in securities (including mainly listing of securities, ongoing disclosure of information and prohibited trading practices), acquisitions of listed companies, to provisions on stock exchanges, securities companies, securities registration and clearing institutions,

securities trading service institutions, securities industry association as well as the securities industry regulatory bodies. Further, legal liabilities for the relevant parties in the securities market are provided in the *Chinese Securities Law*.

In the strict sense, securities law in China refers to the *Chinese Securities Law* only; however, broadly speaking, securities law also includes the following: provisions in other Chinese laws (the Chinese Criminal Law, for example) involving the issuance, trading and regulation of securities, regulations promulgated by the State Council providing for the issuance, trading and regulation of securities, judicial interpretation issued by the Supreme People's Court concerning the application of relevant securities laws, regulations and rules, and rules, provisions, measures or other stipulations of the same nature issued by the securities regulatory bodies (especially the Chinese Securities Regulatory Commission) for the issuance, trading and regulation of securities. In addition, the constitutional documents, transaction rules and other self-regulated provisions as enacted by the relevant stock exchanges, securities industry associations or other self-regulated bodies have also binding force on the relevant parties although they are not "securities law" from a legal prospective, to the extent that such self-regulated provisions do not violate "securities law".

According to the *Chinese Securities Law*, its main legislative purpose is both market-oriented and investors' interests-oriented, that is, to regulate the issuance of and transactions in securities, protect the lawful rights and interests of investors, safeguard the economic order and social and public interests, and promote the growth of the socialist market economy. In furtherance of such purpose, the *Chinese Securities Law* has established three general principles for the issuance of and transactions in securities, i.e., openness, fairness and impartiality. In addition, the *Chinese Securities Law* also sets up general business rules for securities activities in China, that is, parties involved in the issuance of securities and transactions therein shall have equivalent legal status and shall uphold the principles of free will, due consideration, integrity and creditworthiness, with due regard to all applicable laws and administrative regulations. No fraud, insider trading or market manipulation shall be permitted.

Part B Cases and Materials

The Chinese Securities Law has provided a specific rule about issuing of warrants in Article 10. However, there is no rule about establishing of warrants in the Chinese Securities Law and only some business rules created by Shanghai Stock Exchange provide some

regulations, which results in some suspect to the legitimacy of some new warrants. This is a question in the substantive law. Besides, a case of Chinese Securities Law may have some problems in the procedural law, for example, the burden of proof. And we will have better comprehension by learning the following case.

Shanghai High People's Court

Hu Zhenzhu v. Shanghai Stock Exchange

([2011] Hu Gao Min Wu (Shang) Zhong Zi No.5, April 21, 2011)

SUMMARY OF FACTS

On June 28, 2007, Hu Zhenzhu (the “plaintiff” or “appellant”) signed the entrusted agency agreement of securities exchange and commission online agreement with the business department in Dongfang Road of Jinyuan Securities Company (the “defendants”). After the put warrants of China Southern Airlines establishing and appearing on the market, Hu Zhenzhu bought some put warrants of China Southern Airlines through her securities account in the business department in Dongfang Road of Jinyuan Securities Company on February, 22, 2008. Then, she lost RMB 119288.72 because of the put warrants of China Southern Airlines.

Hu Zhenzhu thought: 1. Shanghai Stock Exchange (the “appellee”) connived China Southern Airlines’ illegal establishing of put warrants; 2. the staff in Shanghai Stock Exchange, Li Gang, misled her to sell her put warrants at a low price from an expert’s angle; 3. Jinyuan Securities Company and the business department in Dongfang Road of Jinyuan Securities Company did business beyond its permissions. Therefore, Hu Zhenzhu sued Shanghai Stock Exchange, Jinyuan Securities Company and the business department in Dongfang Road of Jinyuan Securities Company and asked for RMB 141,682 as compensation.

RULING OF THE COURT OF FIRST INSTANCE

The Court of First Instance found that:

[1] At present, there are no special laws or administrative regulations about the establishing and trading of warrants. Only some business rules created by Shanghai Stock Exchange provide some regulations based on the Chinese Securities Law and authorization of Securities Regulatory Commission (CSRC). Moreover, since the above business rules have

been approved by the CSRC, they have legal validity. In allusion to this case, only the Article 29 of Authority Card Management Approach rules that Shanghai Stock Exchange can permit qualified institutions to establish same kind of warrants having been appeared on the market. Therefore, the establishing of China Southern Airlines' put warrants is legal and valid.

[2] First, ordinary investors should obey the trading rules created by the Stock Exchange. Second, the investors don't have direct contractual relationship with Stock Exchange and there are no rights and obligations relations between them. Third, Hu Zhenzhu couldn't provide adequate evidences to show that Li Gang had misled her. Under such circumstance, the Court of First Instance rejected the plaintiff's claim for compensation against the defendants.

[3] Jinyuan Securities Company and the business department in Dongfang Road of Jinyuan Securities Company acted on behalf of Hu Zhenzhu and did as her instructions. At the same time, Jinyuan Securities Company and the business department in Dongfang Road of Jinyuan Securities Company had explained the trading risk to Hu Zhenzhu. Therefore, they didn't have any fault.

To sum up, the claims of Hu Zhenzhu didn't have factual and legal basis, so that in accordance with the Article 106(2) of the Chinese Civil Law, the court dismissed the claims of the plaintiff.

POSITION OF THE PARTIES ON APPEAL

Appellant's position

The appellant refused to accept the judgment by the Court of First Instance, and appealed to this Court based on the following two reasons.

First, the Court of First Instance applied to the law falsely. The Authority Card Management Approach infringes the Chinese Securities Law and should be affirmed as invalid. Based on this, the establishing of China Southern Airlines' put warrants is illegal and Hu Zhenzhu should be compensated.

Second, the Court of First Instance did not make any investigation about Li Gang. She had applied for Li Gang appearing in court, but Li Gang didn't appear, which led to the indistinct facts.

Therefore, Hu Zhenzhu requested the court to repeal the first judgment and Shanghai Stock Exchange to compensate her RMB 141,682.

Appellees' position

In response, the appellees alleged that:

First, the Chinese Securities Law only has rules in issuing of warrants but not in establishing. So, the establishing of the China Southern Airlines' put warrants is valid.

Second, the Authority Card Management Approach was approved by the State Council as legitimate.

Third, the act of establishing put warrants is universal for securities trades and not aiming at Hu Zhenzhu. So, they don't have any direct connections with Hu Zhenzhu's losses.

Fourth, Hu Zhenzhu couldn't provide adequate evidence.

REASONING OF THE APPELLATE COURT

The appellate court had the following three opinions:

[1] The effectiveness of the Authority Card Management Approach

First, the function of Shanghai Stock Exchange is to provide places and facilities for securities trading with organization and supervision. Making business rules is one of its functions. So, anyone who chooses trading through Shanghai Stock Exchange should accept and obey the rules. Hu Zhenzhu was an investor and chose trading through Shanghai Stock Exchange, which showed she had accepted the rules and couldn't overturn the results for reason of her misunderstanding unless the rules were invalid.

Second, in July, 2005, the Shanghai Stock Exchange Authority Management Interim Measures came into effect, which was approved by the CSRC, infringing not the Chinese Securities Law. So, the setting of the Authority Card Management Approach is legitimate.

[2] The effectiveness of warrants' establishing

The Shanghai Stock Exchange's act of establishing warrants does not infringe the above business rules and moreover, the State Council and the CSRC have never affirmed the warrant is invalid. Therefore, the establishing of warrants is valid.

[3] The misleading act of Li Gang

Hu Zhenzhu thought the staff in Shanghai Stock Exchange, Li Gang, misled her to sell her put warrants at a low price from an expert's angle. To prove this, she provided the history list of account, short messages and testimony of Gu Zukang, etc. However, the court thought the evidences were not adequate.

At the same time, Hu Zhenzhu appealed to the court that Li Gang should appear on the court on October 13, 2010, but the time limit for adducing evidence had been exceeded. So, the fact that Li Gang didn't appear on the court is not illegal.

RULING OF THE APPELLATE COURT

To sum up, the appellant's claim on appeal requesting the appellee to compensate for her loss is not established and this Court rejects to support her claim. According to Article 153 and Article 158 of the Chinese Civil Procedure Law, this Court rules as follows:

Appeal dismissed and the trial court judgment affirmed.

This is the final judgment.

Chapter Two

Issuance of Securities

Issuance of securities in China is subject to strict regulation. The issuer shall apply for approval from relevant regulatory body for its issuance of securities and as such proper procedures must be followed. Where the issuer offers the securities to the public at large, such offer of securities is required to be underwritten by a securities company. The underwriting of securities is also regulated by the applicable laws and regulations.

Section I Issuance of Stock, Bond or Other Securities

Part A Rules and Rationale

In China, securities may be issued and offered publicly or non-publicly, with both ways of issuance subject to the government's regulation.

For the public issuance of securities, the *Chinese Securities Law* requires that it shall satisfy the requirements of the relevant laws and regulations and shall be reported to the securities regulatory authority (i.e., CSRC) for examination and approval. No entity or individual may issue securities to the public without first obtaining approval in accordance with the law. Public issuance of securities under the *Chinese Securities Law* is defined as issuance of securities in any of the following circumstances: (1) where securities are offered to

the public at large; (2) where securities are offered to a total of more than 200 persons; or (3) where, in accordance with any law or administrative regulation, the offer is deemed to have been made to the public.

Public issue of corporate bonds and initial public offering of stocks are the two most common ways of raising funds through issuance of securities in China. For the public issue of corporate bonds, the following requirements as provided for under the *Chinese Securities Law* shall be satisfied: (1) where the issuer is a joint stock limited company, its net assets shall be no less than RMB 30 million, and where the issuer is a limited liability company, its net assets shall be no less than RMB 60 million; (2) the total value of bonds to be issued shall be no more than 40% of the value of the company's net assets; (3) the company's average profits available for distribution over the previous 3 years shall be sufficient to cover the annual coupon payments on the bonds; (4) the purpose for which the funds raised are to be used shall comply with the industrial policies of the state and the funds raised through any public issue of corporate bonds shall be used for the purpose(s) specified and may not be used to cover any deficit or non-productive expenditure; (5) the bond yield shall not exceed the rate specified by the State Council; and (6) any other requirement prescribed by the State Council. If it is an initial public offering of stocks, then the issuer shall: (1) have a sound corporate governance structure and be well-operated; (2) have a profitable outlook and be of sound financial status; (3) have no record of having filed any misleading financial statement in the previous 3 years or any other major legal irregularity; and (4) meet any other requirement prescribed by the securities regulatory authority under the State Council. It can be seen from above that public issuance of securities in China is under heavy regulation.

Any prospective issuer shall submit its application of issuance of securities to the CSRC for its examination and approval and procedures for examination and approval shall be publicized and shall be subject to supervision in accordance with the law. The CSRC shall, within 3 months of accepting any application to issue securities, approve or decline the application in accordance with statutory requirements and procedures. Any period of time required for a prospective issuer to supplement or amend its application documents in accordance with the relevant requirements shall not be included within the aforesaid period of time for examination and approval. In the event that an application is declined, a written explanation of the reasons shall be provided. Where the CSRC finds that any decision having approved a particular issue of securities does not meet the relevant statutory requirements or procedures, (1) if the relevant securities have not been issued yet, the CSRC shall revoke the

approval and terminate the issue, and (2) if the relevant securities have already been issued but have not yet been listed, the approval to issue the securities shall be revoked and the relevant issuer shall return any funds raised to the relevant investors based on the issue price plus interest calculated in accordance with the bank deposit rate for the corresponding period of time, with the sponsor to bear, unless it is able to demonstrate an absence of fault, and any controlling shareholder or ultimate controller who is at fault to bear, joint and several liability together with the relevant issuer. However, if the non-conforming issuance of securities is found and identified after the relevant securities have already been listed, despite of wide controversy, the *Chinese Securities Law* merely imposed an administrative punishment providing that any issuer who has previously failed to meet the requisite issuance requirements subsequently obtains approval to proceed with an issue of securities using any fraudulent means shall be fined between 1 and 5% of the total amount of funds unlawfully raised in the event that the securities have been issued and the person in charge and any other person directly responsible shall be fined between RMB 30,000 and 300,000. It is a pity and defect in the legislation that issuance of securities based on CSRC's approval obtained by fraudulent means is not made a cause for delisting of the issuer and a cause of class action for compensation by the securities investors. The CSRC has noticed this issue and claimed to push for relevant legislation in future.

For the non-public offering of securities, it shall be conducted privately and is not subject to the examination and approval of the CSRC. For the purpose of keeping it a "non-public" nature, the *Chinese Securities Law* stipulates that non-public offering of securities may not be advertised, associated with any public inducement or offered in a way that a reasonable person would regard as being directed at the public. For the non-public offering of stocks, the State Council has issued a Circular Concerning Some Matter on Severely Cracking Down on Illegal Issuance of Stocks and Illegal Operation of Securities Business in 2006, providing that it belongs to non-public issuance of stocks that the accumulated number of the shareholders is not more than 200 after issuing stocks to specified objects. The stocks of non-public issuance and stock equity thereof may not be issued and transferred in such public ways either directly or disguised as advertisement, public announcement, broadcasting, telephone, fax, letter, recommendation fair, explanation meeting, network, short message, public inducement and so on to the public. It is strictly prohibited that any corporate shareholder transfers stocks to the social public in a public way, either by themselves or by entrusting other persons. With regard to transferring stocks to specified objects, the accumulated number of the shareholders after

the transfer may not exceed 200 if it is not reported to CSRC for examination and approval.

Part B Cases and Materials

In order to protect the lawful rights and interests of investors, safeguard the economic order and social and public interests, the Chinese Securities Law has corresponding provisions on public offering of securities. Also, the Chinese Corporate Law has provided the types and ways of transferring stock. Any action that does not meet the conditions prescribed in laws and administrative regulations is illegal. Although investors pay corresponding price and are in good faith, they cannot be legal shareholders and have the shareholders' rights. We will have better comprehension by learning the following case:

Shanghai High People's Court

Chen Mingang v. Shanghai Perfection Nanometre New Material Co., Ltd.

([2009] Hu Yi Zhong Min San (Shang) Zhong Zi No. 57, March 23, 2009)

Chen Mingang(the “plaintiff” or “appellant”) refused to accept the Civil Judgment by the People’s Court of Nanhui, Shanghai’s (2008) Hui Min Er (Shang) Chu Zi No. 695 on the stock rights affirmation case with Shanghai Perfection Nanometre New Material Co., Ltd. (Perfection Company, the “defendant” or “appellee”), and appealed to this Court. This Court accepted the case and formed a collegial bench according to the relevant law. A public court session was held. All parties and their respective representatives were present at the court session. This case is now closed.

SUMMARY OF FACTS

The Court of First Instance ascertained the following facts:

Perfection Company was set up on September 27, 1996 as a non-listed Co., Ltd., of which the registered capital was RMB 21 million yuan, including Shanghai Nanji Chemical (Group) Company’s (hereinafter referred to as Nanji Company) 5.25 million yuan.

On October 10, 2003, Nanji Company signed an equity transfer agreement with an outsider Zhang Hongyu. In the agreement, it was agreed that Nanji company transferred its 5.25 million shares of Perfection Company to Zhang Hongyu at 1 yuan per share, and that

Zhang Hongyu should remit all the equity-transferring money in cash to Perfection Company's account which Nanji Company designated within 6 months after signing this agreement (the specific date of payment was also arranged in the agreement). Moreover, it was agreed that if one party failed to perform the agreement, the other party would have the right to terminate the agreement.

In the same year, on November 13, Perfection Company and Zhang Hongyu signed a stock transfer agreement, agreeing on following these conventions. First, Perfection Company printed 2,100 copies of stocks (each containing 10,000 shares, par values 10,000 RMB); second, Perfection Company issued the corresponding stock to Zhang Hongyu in accordance with the equity money which Zhang Hongyu paid; third, only when Zhang Hongyu completed the payment for the 5.25 million shares and they finished the industrial and commercial registration of equity change, could Zhang Hongyu formally exercise shareholders' rights. Afterwards, Zhang Hongyu paid 0.88 million yuan, and obtained the corresponding value of the stocks (on December 18 in the same year, Zhang Hongyu signed receipt for the 30 pieces of stocks, number XII 000020—XII 000046).

On December 1 and 10, 2003, Shanghai Sai Ma Investment Consulting Co., Ltd. (hereinafter referred to as Sai Ma Company) sold 0.04 million shares of the above mentioned Zhang Hongyu's shares at the price of 3.85 yuan/share in twice (number XII000027, XII000037—XII000039). On those stocks, only the name of Chen Mingang, but not specified Nanji Company's enterprise name was recorded.

On February 1, 2004, Nanji Company sent a letter to Zhang Hongyu to notice termination of the agreement for not fulfilling his commitment on payment.

On December 18, 2006, Perfection Company reported to economic crime investigation team of Nanhui Public Security Bureau of Shanghai that Zhang Hongyu was suspected to be involved in fraud for having sold the stocks to third parties before completing the payment. But the Nanhui bureau made the notification that the case should not be filed since that there was no Zhang Hongyu's criminal facts. At present, Zhang Hongyu's whereabouts is unknown.

The court also found that Zhang Hongyu had not yet been recognized as Perfection Company's shareholder by the company's registration authority, and he had not paid the rest equity transfer money to Nanji Company except the settlement of 5 million shares. Sai ma Company was renamed Shanghai Guandai Investment Management Co., Ltd, of which business includes several fields, such as investment consulting, business consulting, property agency and household electrical appliances, clothing, building materials sales, but no securities