China's 2023 Company Law Reform: Shifting the Accountability System for IPO Misrepresentation from Regulatory to Contractual Paradigms?

Jiujing Ye and Lerong Lu[*]

Abstract

In cases of misrepresentation, the mandatory disclosure of information by publicly listed companies is a legal obligation designed to enable informed investment decisions, uphold market integrity, and support broader societal goals. Currently, misrepresentation is governed by arts 89 and 163 of the Securities Law of the People's Republic of China 2019 (PRC Securities Law 2019), which applies a tort law approach. Aggrieved investors may pursue private legal action, exemplifying a contractual accountability paradigm where market participants are expected to fulfil their roles. However, investors often face challenges, such as burdensome proof requirements, which limit the effectiveness of private actions even after the removal of administrative preconditions. In this context, intervention by the China Securities Regulatory Commission (CSRC) and institutions like the China Securities Investor Services Center Co Ltd (CSISC) is critical to ease the burden on investors. Administrative measures like "buybacks" and "advanced compensation" reinforce the system's administrative tone. The 2023 revision of the Company Law of the People's Republic of China (PRC Company Law 2023), which aims to strengthen individual liabilities, retains the tort-based logic of the PRC Securities Law 2019, failing to shift fully to a contractual paradigm. This paper recommends future revisions focus on clarifying the distinct roles of the PRC Securities Law 2019 and PRC Company Law 2023 in creating a "regulatory-contracting mixed paradigm" for accountability. Greater involvement of market professionals in misrepresentation cases would streamline compensation for primary market investors and mitigate future risks.

Keywords: Accountability System, Misrepresentation, IPO, Investor Protection, PRC Company Law 2023

[*] Jiujing Ye, PhD Candidate, The Dickson Poon School of Law, King's College London, UK. Email: jiujing.ye@kcl.ac.uk. Dr Lerong Lu, Reader in Law, The Dickson Poon School of Law, King's College London, UK. Email: lerong.lu@kcl.ac.uk.

Introduction

An Initial Public Offering (IPO) allows a private company to raise capital by accessing stock markets and issuing new shares to public investors. China, which now hosts the world's second-largest securities market for IPOs, has seen this sector expand threefold over the past decade, with 414 IPOs worth US $57.1 billion in 2023.[1] This substantial growth is largely attributed to continuous reforms in China's IPO system, which have been tailored to meet the evolving needs of companies and protect the interests of investors. The successful launch of the Beijing Stock Exchange (BSE) in September 2021, as China's first stock market applied a registration-based regime, signal a significant shift towards a more liberalised IPO system.[2] Unlike the previous approval-based regime, in which the China Securities Regulatory Commission (CSRC) conducted thorough examinations of disclosures to ensure high-quality market entrants, the registration-based system let the market make decision.

After a period of two years, the registration-based regime has been fully implemented in China's major stock markets including BSE, Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) in 2023. In this case, the information disclosure mechanism has become paramount within the IPO regulatory framework. During this process, the prospectus is a mandatory information disclosure document required under art.13(4) of PRC Securities Law of China 2019.[3] It provides investors, including qualified institutional and retail ones, with details about the investment offering. Ensuring the truth, accuracy, and completeness of disclosed information is crucial, as it allows investors to make well-informed decisions. Under such circumstances, it is reasonable for investors to bear the outcomes of their investment decisions. However, achieving this fairness necessitates a robust system of accountability.

China's current accountability system for misrepresentation in information disclosure documents is grounded in the principles of tort law. In recognition of disadvantaged market position of investors, especially the retails, arts 85 and 163 of the PRC Securities Law 2019 impose strict liability and a reverse onus on those responsible for disclosing information, reducing the burden of proof for investors and allowing them to seek compensation more efficiently. From an enforcement perspective, China's style special securities representative action (SSRA) mechanism, combined with the investor protection institution, has been introduced under art.95 of the PRC Securities Law 2019. However, even with the removal of the administrative precondition, the role of the CSRC remains central, making the pursuit of civil rights and interests heavily dependent on a regulatory-driven legal

[1] Zhou Chun, Zhang Wei and Professor Dan Puchniak, "The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations" ECGI Blog (23 September 2024), *https://www.ecgi.global/publications/blog/the-overlooked-reality-of-shareholder-activism-in-china-defying-western*. Statista, "China: Domestic IPOs by Chinese Companies 2023" (2024) *https://www.statista.com/statistics/279675/number-of-ipos-by-chinese-companies-in-china/*.

[2] Lerong Lu and Jiujing Ye, "Beijing Stock Exchange and Multi-Tier Capital Markets: How China Alters Share Listing and Trading Rules to Promote SME Finance?" (2022) 43 Comp. Law. 233.

[3] To undertake a public offering of new shares, a company shall submit an application for the public offering and the following documents: (4) The prospectus or other public offering documents.

system,[4] such as through mechanisms like "buybacks" and "advanced compensation." While these frameworks provide with investors an efficient means of making compensation, in the long term, they may diminish investors' investment capacity.

Recently, a robust revision of the PRC Company Law 2023 that came into effect in July 2024, has further reinforced its role as a key regulatory framework for corporate governance. This is the second significant amendment since the enactment of the first China's Company Law in 1993. Under these revisions, liabilities have been assigned to directors, audit committees, controlling shareholders, and actual controllers in cases of misstated disclosure documents (as per arts 121, 137, 180, 191, and 192 of the PRC Company Law 2023). These changes are in alignment with art.85 of the PRC Securities Law 2019, providing investors either as the third parties or as shareholders a cause of action to protect their legal interests in instances where misconducts of corporate insiders incur to financial losses. This means, investors or shareholders could make compensations from the direct obligators without the need to pierce the corporate veil or initiate a derivative action within the realm of company law. These changes reflect regulators' intent to shift the accountability system from a "regulatory paradigm" to a "contracting paradigm"—a model widely adopted by dynamic public stock markets in countries like the US, the Netherlands, and the UK (during its transitional phase).[5] This contracting approach is seen as more adaptable to the needs of modern stock markets. However, the newly introduced rules in the PRC Company Law 2023 still adhere to the principles of tort law, which fails to fully address issues such as the burden of proof that persist under the PRC Securities Law 2019.

This paper seeks to explore whether the changes regarding liabilities of corporate insiders in the PRC Company Law 2023 will impact the effectiveness of the current SSRA mechanism introduced by the PRC Securities Law 2019 and examine whether they will promote China's financial regulatory transition toward a "primacy of rights" system. It first examines the current accountability system by highlighting the limitations of arts 85 and 163 of the PRC Securities Law 2019, which are based on the principles of tort law. Building upon this, it discusses the revisions related to the liabilities of obligors in the PRC Company Law 2023 and how these revisions grant investors a direct right to sue for compensation. Finally, it summarises how the PRC Securities Law 2019 and the PRC Company Law 2023 each play a role in constructing a "regulatory and contracting mixed paradigm" legal system, emphasising that the regulators' role is to ensure the efficiency of investor protection, while involving all market participants helps create deterrence against further misrepresentation. However, attention should be given that the liability of audit committees remains ambiguous in both the PRC Company Law 2023 and the PRC Securities Law 2019. A key question arises as to whether these committee members would be considered obligators, particularly concerning their simple majority vote as a prerequisite for the board's decision, in cases of misrepresentation.

[4] This paradigm uses stringent regulatory measures and involves regulators ceding their active role in IPO review to safeguard investors by reducing market failures.

[5] Bobby V. Reddy, "Going Dutch? Comparing Regulatory and Contracting Policy Paradigms Via Amsterdam and London SPAC Experiences" University of Cambridge Faculty of Law Research Paper No.1/2024 (2023), *https://ssrn.com/abstract=4656655*.

Substantial rules: how do investors lodge a tort suit for damages caused by misrepresentations?

Resolving misrepresentation cases primarily relies on tort law, as outlined in arts 85 and 163 of the PRC Securities Law 2019 and arts 191 and 192 of the PRC Company Law 2023. These provisions empower investors to bring private suits against not only the issuers but also corporate insiders who are responsible for the misrepresentation directly. These rules contribute to establish a balanced and fair accountability system with the implementation of listing registration regime, seeking to reduce the challenges posed by an increasingly complex and frequent occurrence of misrepresentation cases in China's financial market.

The interpretation of arts 85 and 163 of the PRC Securities Law 2019

The most direct rules concerning accountability of information disclosure obligors in IPO process are found in arts 85 and 163 of the PRC Securities Law 2019. The misrepresentation incorporating any faults or misleading statements or material omissions in the announced share offering documents. Though, this research does not dive into the disparities among these three types of misrepresentation.

The misconduct under art.85 of the PRC Securities Law 2019 is constituted by three respective behaviours: (1) making misrepresentations (positive and passive),[6] (2) lacking due diligence (passive), and (3) making disclosed decisions (positive). It is evident that the PRC Securities Law 2019 interpretates this issue from a view of tort law. The obligors under the PRC Securities Law 2019 include not only the but also controlling shareholders, actual controllers, directors, supervisors, officers, and other individuals directly liable in connection with the issuer, as well as sponsors, underwriting securities companies, and their directly liable persons. Moreover, securities service institutions like accounting firms and law firms, along with their directly liable personnel, are typically held accountable for misrepresentation in practice,[7] as regulated by art.163 of the PRC Securities Law 2019.[8] Besides, the listing rules implemented in each stock market and the Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market (2022) (as its name manifests, a tort) set out a non-exhaustive list of individuals responsible for a prospectus and thus potentially liable to compensating investors. For obligors not explicitly listed, legislators have left it to the courts to exercise discretion in determining liability on a case-by-case basis. However, the common point among

[6] As per art.4 of the Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market 2022 (Provisions 2022), misrepresentation includes three types: "false record," "misleading statement," and "material omission." The former two are positive act while the omission could be made in positive and passive manner. This research will limit to delve into the disparities among them.

[7] This could be seen in *China Securities Investor Services Centre v Kangmei Pharmaceutical Co* (the *Kangmei* case) which will be discussed in detail in the next section.

[8] Article 163 of PRC Securities Law 2019. A securities service institution that prepares and issues documents such as audit reports and other assurance reports, asset appraisal reports, financial advisory reports, credit rating reports, or legal opinions for securities offering, listing, or trading and other securities business activities shall act with due diligence, and check and verify the veracity, accuracy and completeness of the contents of documents and materials as the basis. If the documents prepared and issued by it contain any false or misleading statements or material omissions, causing any loss to any other person, it shall be jointly and severally liable in damages with the client, unless it is able to prove that it has no fault.

these rules is that the loss of the investors is the premise for them to invoke a suit against the obligers, which aligns with the general principles in a tortious case as outlined in the art.120 of the Civil Code 2021.

According to art.120 of the Civil Code 2021, the infringed parties have the right to request that the tortfeasor assume tort liability in cases of infringement upon civil rights and interests. In terms of rights of the investors, there is no rule explicitly stating that investors have a "right to know" during the IPO process before they become shareholders by purchasing shares. Moreover, especially for retail investors, it is difficult to assert that their investment decisions are based on the fulfilment of the "right to know." It would be more reasonable to consider the damage to investors as the result of purchasing newly issued stocks at an inflated price. While at the same time, the loss of the aggrieved investors corresponds to the illegal gains of the issuer. Thus, it is a rational form of damage compensation to require the issuer to compensate investors with the illegal gains.

However, the burden of proof under tort law is generally heavy on plaintiffs. A claim might be actionable only if the claimant can prove: (1) the existence of the infringement; (2) a loss of civil rights and interests; (3) fault; and (4) the causation between the infringement and the loss. For instance, if the language in the prospectus is ambiguous, investors might only succeed in raising a claim if they can demonstrate that they misinterpreted the words, were thereby induced to purchase shares, and suffered a loss—a subjective and challenging task to convince the courts.

In order to alleviate potential burdens in a misrepresentation case, art.85 of the PRC Securities Law 2019 introduces the "principle of presumed fault" and a "reverse onus" on issuers, who hold relatively advanced information and power within the market. This approach eases the burden of proof on investors, particularly when it comes to establishing the subjective state of those responsible for information disclosure, such as intent or gross negligence.[9] Additionally, this arrangement reduces the pressure to prove causation between the misrepresentation and the resulting loss. For example, if a misrepresentation is found in a publicly disclosed prospectus, the issuer is directly liable for damages, and the relevant parties specified in art.85 are jointly and severally liable. In this scenario, it is irrelevant whether investors read the prospectus and circular—they are presumed to have relied on the misrepresentation. Plaintiffs only need to prove that their investment actions, whether buying or selling,[10] were made after the misrepresentation and before the "Exposure Date of Misrepresentation"[11] or the "Correction Date of Misrepresentation" to establish a causation.[12] For obligors, they can only escape liabilities if they can prove they were not at fault.

However, challenges remain in identifying the existence of misrepresentation, not to mention determining the scope of proper defendants (the relevant obligors). As outsider investors, they generally lack the ability to examine disclosed information and access non-public documents, or to prove what directors said or

[9] Article 13 of Provisions 2022.

[10] The plaintiff buys the relevant securities as a result of misrepresentation inducing purchases. Or the plaintiff sells the relevant securities as a result of misrepresentation inducing sales. During the IPO period, only the former performance needs to be considered.

[11] Article 8 of the PRC Securities Law 2019.

[12] Article 9 of the PRC Securities Law 2019.

did at the time until after the information is disclosed. This places investors at a significant disadvantage in gathering evidence to initiate a claim. Although courts are empowered to notify parties who must participate in joint actions but fail to do so,[13] judges typically play a passive role in this process in practice.[14]

The revision of the PRC Company Law 2023: liabilities imposing on the information obligers

The PRC Company Law 2023, promulgated by the Standing Committee of the National People's Congress (NPC), introduces significant enhancements aimed at enforcing individual accountability, particularly in cases of corporate misrepresentation. A key feature of the revision is the provision granting aggrieved investors the right to file private lawsuits, enabling them to name specific individuals, referred to as information obligors, as defendants in misrepresentation claims.

Of particular relevance in this context are art.180[15], art.191[16] and art.192[17] of the PRC Company Law 2023, which collectively address key aspects of liability in misrepresentation cases. Article 180 defines the scope of fiduciary and managerial duties, clarifying the nature of the obligations that may give rise to liability. Article 191 delineates whose liabilities may be engaged, identifying the specific individuals—directors, supervisors, senior executives, and controlling shareholders—who may be held accountable. Article 192 establishes to whom these liabilities are owed, thereby clarifying the scope of responsibility and the rights of aggrieved parties. Together, these provisions form a comprehensive framework for addressing corporate misrepresentation and enforcing legal remedies for affected investors.

Article 180 of the PRC Company Law 2023 clarified and expand to the fiduciary duty. In particular, it reaffirmed the duty of loyalty, duty of diligence (fiduciary duty) and duty of care imposed on directors, supervisors, and senior executives. Notably, Article 180 of the PRC Company Law 2023 extends these duties to controlling shareholders or actual controllers who, while not holding directors' positions within the company, exercise de facto control over its affairs. With respect to the duty of loyalty, art.180 mandates that individuals subject to its provisions must proactively avoid conflicts of interest with the company. In situations where such conflicts arise, they are required to act in good faith, prioritising the company's

[13] Article 135 of the Civil Procedure Law of the People's Republic of China (2023 Amendment).

[14] Jin Sheng, "Private Securities Litigation in China: Passive People's Courts and Weak Investor Protection" (2015) 26 *Bond Law Review*, *https://blr.scholasticahq.com/article/5623-private-securities-litigation-in-china-passive-people-s-courts-and-weak-investor-protection*.

[15] Article 180 of the PRC Company Law 2023. (1) Directors, supervisors, and senior executives shall have a duty of loyalty to the company and take measures to avoid conflicts between their own interests and the interests of the company and shall not use their powers to seek improper interests. (2) Directors, supervisors, and senior executives shall have an obligation of diligence to the company, and exercise reasonable care that managers shall ordinarily exercise, in the best interests of the company in performing their duties. (3) If a controlling shareholder or actual controller of the company does not serve as its director, but attends to the company's affairs, the provisions of the first two paragraphs shall apply.

[16] Article 191 of the PRC Company Law 2023. Where directors and senior executives cause damage to others by performing their duties, the company shall be liable for compensation; if directors and senior executives are intent or grossly negligent, they shall also be liable for compensation.

[17] Article 192 of the PRC Company Law 2023. Where the controlling shareholder or actual controller of a company instructs a director or officer to engage in an act against the interests of the company or shareholders, the controlling shareholder or actual controller shall be jointly and severally liable with the director or officer.

interests and refraining from any abuse of managerial power for personal gain. The duty of diligence, as prescribed, requires individuals to exercise a standard of behaviour consistent with that of a reasonably diligent person, equipped with the general knowledge, skill, and experience that could reasonably be expected in their position. Finally, the duty of care obliges these individuals to faithfully discharge their responsibilities and act in a manner that protects and advances the company's interests. Notably, the duties outlined in art.180 of the PRC Company Law 2023 are not only specific to the company with which these individuals are employed but also extend to shareholders and, pursuant to art.191, even third parties. This expansion signifies that these duties are not merely contractual obligations arising from agreements between directors, supervisors, senior executives, and the company but are, in fact, statutory obligations embedded in the law. While these individuals may concurrently assume contractual duties, the duties under art.180 are grounded in legal mandates, reinforcing their binding nature beyond any individual contract. However, with respect to controlling shareholders and actual controllers who are not formally appointed as directors, supervisors, or senior executives, the question remains open as to whether their duties should be coextensive with those of corporate officers. The law remains silent on whether these controlling parties are subject to the same benchmarks as those in official management positions. Breaches of these duties, however, may give rise to civil, administrative, or even criminal liabilities, depending on the nature and severity of the violation.

Article 191 of the PRC Company Law 2023 imposes direct liability on directors and senior executives who, through intentional misconduct or gross negligence in the execution of their duties, cause harm to third-party interests. This provision underscores the heightened accountability of corporate officers for actions that extend beyond the internal governance of the company. In addition, art.192 stipulates that when a director or senior executive acts upon instructions from a controlling shareholder or actual controller, resulting in harm to the company or its shareholders, the controlling shareholder or actual controller is held jointly and severally liable alongside the director or senior executive. This provision reinforces the principle that de facto controllers cannot evade responsibility for corporate misconduct by acting indirectly through management.

For investors deceived by information obligors before the buy-sell contract is finalised, they are considered third parties—external to the company and its existing shareholders—covered by the "others" mentioned in art.191 of the PRC Company Law 2023. In this context, art.191 provides investors an additional avenue to sue information obligors, specifically directors and senior executives. Although art.191 does not specify the obligations imposed on directors and senior executives, these obligations vary depending on the type of infringement against third parties, such as direct or indirect damages. Specifically, in cases of misrepresentation, directors or senior executives are jointly and severally liable for the losses suffered by investors, alongside the issuer. This is because the disclosure of misrepresentation in the prospectus is a joint misconduct by the information obligors, directly leading to investor losses through the completion of the disclosure. However, art.191 requires the intent or gross negligence of directors or senior executives to establish liability, whereas art.85 of the PRC Securities Law 2019 applies presumed liability and a reverse onus, allowing directors and senior executives to avoid liability by

proving the damage was not intentional or did not result from gross negligence or a serious breach of the duty of care.[18]

Article 192 outlines the liabilities of the controlling shareholder or actual controller. It should be noted that art.192 does not extend the liabilities of the controlling shareholder or actual controller to third parties, despite controlling shareholders or actual controllers are typically held accountable as obligors in cases of misappropriation.[19] Only the damaged company and its shareholders are the suitable claimant to take action against the controlling shareholder or actual controller. In misrepresentation cases due to the long-lasting impact of misconduct, which can extend beyond the position change of the investor—from a third party to a shareholder of the company. After the misrepresentation is disclosed by the issuer and investors have made their investment decisions, shareholders (investors) could invoke this rule, along with art.191, to hold the information disclosure obligors—including the issuer, directors, executives, controlling shareholders, or actual controllers—accountable, provided substantial damages occur. For example, if a corrective disclosure reveals an earlier misrepresentation, and the share price significantly drops, the controlling shareholder or actual controller, together with the directors or senior executives to be instructed by them, would bear joint and several liabilities.

However, this revision introduces some uncertainties in cases involving misrepresentation, particularly concerning the introduction of the audit committee (as per arts 121 and 137 of the PRC Company Law 2023).[20] The committee has been suggested to establish by the Code of Corporate Governance for Listed Companies in 2002.[21] While in this revision, its role in the corporate governance sphere has been weighted considerably, which is intended to replace the role of the board of supervisors or individual supervisors in a company limited by shares.

The committee's primary responsibilities include facilitating communication, supervision, and verification of internal and external audits, with accountability to and direct reporting to the Board of Directors. As mandated by art.137, the committee has the authority to veto proposals by a simple majority, thereby preventing them from being presented to the board of directors, including those related to the disclosure of financial and accounting reports. However, concerns arise from the fact that the audit committee is a sub-committee of the board, unlike the board of supervisors or individual supervisors, who are on equal footing with the directors. This structure could potentially compromise the independence and objectivity of the committee's decisions. To mitigate this concern, art.121 requires that the majority of audit committee members must neither hold any other position within the company nor have any relationship with it. The introduce of the audit committee reflects China's corporate governance system opens to both "two-tier

[18] Article 14 of the Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market 2022 (Provisions 2022).

[19] Sheng, "Private Securities Litigation in China: Passive People's Courts and Weak Investor Protection" (2015) 26 *Bond Law Review*.

[20] Article 121 of the PRC Company Law 2023 is about arrangements audit committee in a company with limited shares and art.137 of the PRC Company Law 2023 is about special arrangements in a listed company.

[21] ECGI, "Corporate Governance in China", *https://www.ecgi.global/publications/codes/countries/corporate-governance-in-china*.

board structure"[22] and "single-tier board structure".[23] Though, the single-tier board structure is prevalent internationally, as seen in the United States, the United Kingdom and countries with developed commerce,[24] due to its provision of easy access to company and management information for all board members.[25] This is because all members of the committee are simultaneously seated on the board of directors. It is difficult to assert the clear superiority of one model over the other, as both have emerged for historical reasons.[26] There are still specific requirements for the audit committee outlined in guidelines issued by stock exchanges. However, this revision and the accompanying measures do not address certain key issues. Specifically, if the committee's approval process is based on a simple majority, with a minimum membership of three, is it fair to hold audit committee members liable for resolutions made by the Board of Directors due to defaults or misconduct in their supervisory roles? If so, what kind of liability would they bear?

While the introduction of the audit committee may introduce some uncertainties, it provides an opportunity for companies to make further detailed arrangements, and for regulators to draw insights from practical experience and company feedback for future adjustments about the audit committee. The implementation of art.85 of the PRC Securities Law 2019 and arts 191 and 192 of the PRC Company Law 2023 contributes to establishing a balanced and fair accountability system, where the responsibilities of company members (e.g. shareholders, actual controllers, senior managers, etc.) are strengthened from substantial rules perspective. Besides, procedure rules are designed to help investors, which are examined as follows.

Procedural arrangements: how to help investors lodge a tort suit for damages caused by misrepresentations easily

The removal of the administrative precondition in 2022 and the introduction of class actions in 2019 are considered significant advancements in providing investors with more effective mechanisms to seek compensation through private litigation, rather than relying solely on intervention from administrative bodies like the CSRC. These reforms aim to empower investors by streamlining access to legal remedies. However, despite these developments, state intervention remains present during the enforcement process, not as a dominant force, but as a facilitator.

The waive of the administrative precondition

The waive of the administrative preconditions seeking to incentivise investors' initiative has been finalised in art.2 of the Provisions of the Supreme People's

[22] Company Law 2018 separates the board into a management board and a supervisory board. Both directors and supervisors (except for supervisors representing shareholders) are elected by the shareholders' meeting. The board of directors is accountable to the shareholders' meeting, while the supervisory board separate the board of directors and is responsible for overseeing the conduct of directors and senior management in performing their duties.

[23] In a company, there is only one board that incorporates both the management and the supervisors.

[24] Klaus Hopt and Patrick Leyens, "The Structure of the Board of Directors: Boards and Governance Strategies in the US, the UK and Germany" (12 April 2021), *The Harvard Law School Forum on Corporate Governance*, *https://corpgov.law.harvard.edu/2021/04/12/the-structure-of-the-board-of-directors-boards-and-governance-strategies-in-the-us-the-uk-and-germany/*.

[25] Klaus H. Hopt, "The German Supervisory Board" *Oxford Business Law Blog* (2 December 2022), *https://blogs.law.ox.ac.uk/oblb/blog-post/2022/12/german-supervisory-board*.

[26] Hopt, "The German Supervisory Board" *Oxford Law Blogs* (2 December 2022).

Court (2022).[27] This means that investors no longer need to base their claims on the existence of a specific administrative penalty. In other words, courts shall not enter a ruling to dismiss the complaint based on the lack of the administrative preconditions from the view of the procedure requirements or dismiss the compliant based on the lack of the significant as it had not incurred an administrative precondition from the view of the substantial requirement.

The administrative precondition has long been criticised as a significant barrier for investors seeking to claim their losses.[28] This is not only due to the time-consuming nature of administrative procedures but also because of the inherent difficulties in initiating an administrative review by the CSRC itself. It is unsurprising that the CSRC lacks the incentive to conduct such reviews, as doing so could harm its reputation by acknowledging mistakes after the fact. The public enforcement by the CSRC used to encompass the entire IPO process under the approval system,[29] and despite the shift to a registration-based mechanism,[30] the CSRC's influence remains significant due to its ongoing supervisory role across the market[31] and its retained veto power during the registration process.[32] Specifically, if the CSRC has concerns about disclosed information, it can instruct the stock exchange to resume the exchange-issuer regulatory conversation or even mandate a supplementary review. Moreover, the CSRC can conduct on-site examinations itself or require sponsors or other involved gatekeepers to do so, ensuring the quality of information disclosure. This is to say, while significant power has been transferred to the stock exchanges, the CSRC also retains the power to conduct substantial examinations, which is to ensure that stock exchanges' administrative performances align with authorised objectives and do not exceed the scope of their authorised powers.[33]

Another factor is that the enforcement power of stock exchanges has largely been delegated by the CSRC. Critics argue that (1) the authority of stock exchanges to review share issuances stems from an administrative license granted by the CSRC, rather than from the PRC Securities Law 2019; and (2) the internal governance of stock exchanges, such as the councils (decision-making bodies) and general managers of the Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE), are appointed by the CSRC. Even though the BSE is registered as a company, its board of directors and management are influenced by the CSRC.[34] For instance, Guihua Zhou, the current chairman of the BSE, was previously a CSRC official. In a nutshell, initiating administrative rectification is challenging,

[27] No.2 [2022] of the Supreme People's Court. Article 2 of Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market: The people's court shall not rule against acceptance only on the grounds that the regulatory authorities have not imposed an administrative, or on the grounds of a determination in an effective criminal judgment of the people's court.

[28] Fa Chen, "The Chinese-Style Securities Class Action Mechanism for Investor Protection: Context, Content, Comparison and Consequence" (2022) 30 *Asia Pacific Law Review* 287.

[29] For instance, the China Securities Regulatory Commission (CSRC) as the government financial securities regulator was responsible to substantially examine and makes a value judgement on prospectus from the truthfulness, accuracy and completeness perspectives respectively, which is one of the ex-ante mechanisms to mitigate the possibilities of the misrepresentation happening.

[30] Article 9 of the PRC Securities Law 2019.

[31] Article 7 of the PRC Securities Law 2019.

[32] Article 24 of Measures for Registration-Based IPOs 2023.

[33] CSRC, "Overview", *http://www.csrc.gov.cn/csrc_en/c102023/common_zcnr.shtml*.

[34] BSE's board of directors are also performed as senior managers and run its daily business. This shows the highly centred management model of BSE. "Inner governance of BSE" (nnnn - nnnnnnn), *https://www.bse.cn/company/organization.html*.

which creates hurdles for aggrieved investors seeking compensation through the courts, as they are unable to proof the existence of a misrepresentation or whether the misrepresentation is significant.

Without the administrative preconditions and with the full implementation of the registration regime, administrative intervention appears to have been reduced. However, this shift places greater discretion in the hands of the courts, necessitating improvements in the professional handling of financial cases and the overall financial trial system. For instance, courts must determine whether the misrepresentation in the prospectus meets the "significance" threshold. After accepting the case, the court should scrutinise all elements within the issues incorporating the existence of misrepresentation, materiality of misrepresentation, the existence of fault, and causality. In response to these practical demands, the Shanghai Financial Court (established in 2018) and the Beijing Financial Court (established in 2020) have been specifically launched. Both courts play a vital role in fostering a favourable financial environment and promoting a robust national economy.

However, challenges may arise considering the current state of Chinese investors. The primary investor base in China's stock market consists of retail investors,[35] many of whom are unsophisticated and lack a professional knowledge in finance.[36] As alluded, without an administrative penalty highlighting the existence of a misrepresentation or demonstrating its significance, investors bear the burden of proving that (1) the disclosure obligor committed misrepresentation (i.e. the existence of misrepresentation), and (2) the defendant's misconduct caused the loss for which they seek to recover damages—establishing the causality between the act and the result. Confronted with these challenges, investor protection organisations and the newly introduced legal action mechanism are being applied to facilitate the individuals' remedies.

Article 95(3) of the PRC Securities Law 2019: the Chinese-style securities class action mechanism

The Chinese-style securities class action mechanism, known as the Special Securities Representative Action (SSRA), is stipulated in art.95(3) of the PRC Securities Law 2019.[37] It is said to provide a convenient and low-cost claim channel for small and medium investors to get remedy available to civil cases (either contractual or tort)[38] and deter directors and officers (D&O) from abusing their power and escaping liabilities by the misuse of corporate charter provisions and

[35] As of the end of 2022, there were 212.13 million investors in the Chinese securities market, of which individual investors accounted for 211.05 million, making up approximately 99.5%. See China Securities Registration and Settlement Statistical Yearbook 2022, available on the China Securities Depository and Clearing Corporation's official website at: *http://m.chinaclear.cn/zdjs/tjnb/center_scsj_tlist.shtml*.

[36] Charles M. Jones et al, "Retail Trading and Return Predictability in China" (2024) *Journal of Financial and Quantitative Analysis* 1. Sheridan Titman, Chishen Wei and Bin Zhao, "Corporate Actions and the Manipulation of Retail Investors in China: An Analysis of Stock Splits" (September 2021), National Bureau of Economic Research, *https://www.nber.org/papers/w29212*.

[37] SSRA is regarded as a China-style class action, comparable to the US class action, due to the significant similarities between them.

[38] Deminor, "China Introduces a Class Action Regime Aimed at Financial Investors" (20 August 2020), *https://www.deminor.com/en/news-insights/china-introduces-a-class-action-regime-aimed-at-financial-investors*.

D&O insurance coverage.[39] There are four conditions that must be met to initiate a case under this mechanism: (1) the subject matter of the litigation must be the same or of the same type; (2) the investor protection institution must be authorised by the plaintiffs; (3) the number of plaintiffs must be at least 50 or more; and (4) the plaintiffs must be the registered rights holders confirmed by the securities depository and clearing institution.[40]

SSRA is an enhanced action type that incorporates elements from the Ordinary Representative Action (OSRA) outlined in art.56 of the Civil Procedure Law of China 2023 (CPLC 2023) and the opt-out regime.[41] Unlike the representative plaintiffs who may have dual roles in OSRA, the investor protection institution in SSRA serves merely as an authorised agent of the claimants, not as the claimant itself. While the key difference between OSRA and SSRA is the adoption of the opt-out regime, meaning only registered aggrieved investors can receive compensation under OSRA. In other words, registered rights holders will receive compensation unless they choose to opt out. In this scenario, the investor protection institution acts as the representative in the case, and its litigation conduct binds all the parties represented. Specifically, once the litigation is initiated and succeeds, all rights holders benefit, unless they expressly indicate their reluctance to participate by opting out through a formal announcement to the court. Afterward, investors who do not wish to join the class action must take specific actions to preserve their legal right to file an individual suit. However, the court is likely to make the same decision concerning about the similarity between cases.

The introduction of SSRA is also seen as providing a new option for investors who do not wish to hold shares for long periods, compared to the derivative action.[42] This is because it circumvents the requirements for initiating a derivative action, such as the minimum shareholding prerequisite and the internal inspection mechanism based on the two-tier board governance structure.[43] After its application in *China Securities Investor Services Centre v Kangmei Pharmaceutical Co* (*Kangmei* case), SSRA has been regarded as a sufficient deterrent to potential opportunistic behaviours, for the following three reasons: (1) unprecedentedly strict liabilities are imposed on specific individuals, not just the issuer; (2) the scope of liable parties is expanded to include the involved accounting firm and negligent accountant; and (3) punitive damages imposed on the liable parties are more severe. Overall, considering the characteristics of misrepresentation in the IPO process, such as joint tortious liability and the joint maintenance and fostering relations among the obligers, SSRA is deemed suitable for adoption by the courts.

However, there are still implicit conditions or hurdles to adopting SSRA. Specifically, initiating SSRA requires that more than 50 investors register with

[39] W. Bailey, H. Ma, R. Yuan and H. Zou, "Does the Threat of Securities Class Actions Add Value for Shareholders? Evidence from China" CLS Blue Sky Blog (18 May 2022), *https://clsbluesky.law.columbia.edu/2022/05/18/does-the-threat-of-securities-class-actions-add-value-for-shareholders-evidence-from-china/*.

[40] Article 95(3) of the PRC Securities Law.

[41] Deminor, "China Introduces a Class Action Regime Aimed at Financial Investors" (20 August 2020).

[42] Chen, "The Chinese-Style Securities Class Action Mechanism for Investor Protection: Context, Content, Comparison and Consequence" (2022) 30 *Asia Pacific Law Review* 287. The shareholders of an LLC or the shareholders of a joint-stock company who individually or collectively hold more than 1% of the company's shares for more than 180 consecutive days may request the supervisory board or board of directors of a wholly owned subsidiary to submit a written request to the People's Court. Alternatively, they may file a lawsuit directly with the People's Court in their name.

[43] The two-tier board government structure is known as the supervisory board and the management board.

the court to opt into the case.[44] During the registration process, the court has the discretionary power to deny unqualified applicants after reviewing within ten days. There is with no clear benchmark for the reasons for denial, which increase the difficulties for investors in raising such actions. Besides, the role of the court during the notification procedure is somewhat passive, as they are only required to issue an announcement stating the facts of the case and notifying investors. The court is not obligated to ensure that the notification reaches all parties, which could make it challenging to initiate an SSRA given the dispersed nature of the investors in China. Furthermore, difficulties in initiating a claim via SSRA might also arise during the proceedings, given the varying interests among the claimants, due to their large numbers and dispersion. The negotiation process may be time-consuming and demanding, requiring sustained participation from investors. According to available data, 2020 to 2024 have witnessed a mere 43 securities class action,[45] which is bit abnormal given China's board and prosperous share markets.

There are still some other relevant arrangements that might influence the effectuation of the SSRA. For instance, according to art.12 of the Measures for the Administration of Lawyer Service Fees, the contingent fee system[46] is not permitted to fund representative actions in China. This is said to prevent lawyers from moral hazard.[47] However, at the same time, it might discourage lawyer participation, leading to actions dominated by the securities depository and clearing institution, while lawyers, who play a more professional role in such cases, may be sidelined.

Any other approaches for investors' remedy?

State intervention is evident in the "buyback" and "advance compensation" mechanisms introduced under the PRC Securities Law 2019, both of which are contingent upon the requirements or direct intervention of the China CSRC. These measures are designed to offer investors a more immediate and effective means of recouping their investments in the short term. However, in the long term, excessive investor protection may inadvertently undermine the development of investors' risk tolerance and hinder the maturation of their decision-making capabilities, as it reduces the necessity for rigorous risk assessment. In this regard, what can investors do in protecting their lawful rights and interests in a private action would be discussed accordingly.

Under PRC Securities Law 2019: buyback and advance compensation

In an effort to enhance the efficiency of compensating aggrieved investors, art.24(2) of the PRC Securities Law 2019 introduces the "buyback" provision.[48] At first

[44] Article 23 of the Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes 2020.

[45] Legal 500, "Country Comparative Guides | China: Class Actions", *https://www.legal500.com/guides/chapter/china-class-actions/*.

[46] It refers to the amount of fees a lawyer is paid, which is usually contingent on the outcome of a specified event.

[47] Legal 500, "Country Comparative Guides | China: Class Actions".

[48] Article 24 of the PRC Securities Law 2019, where a stock issuer conceals any material fact or falsifies any major content in the prospectus and other securities offering documents, if the stock has been offered and listed, the securities

glance, this provision appears to function as a mechanism aimed at restoring the parties to their pre-contractual positions, with potential obligations imposed on issuers, controlling shareholders, and actual controllers. The underlying rationale for this rule is rooted in the doctrine of unjust enrichment,[49] or the law of restitution, which seeks to return to investors the funds they expended based on material misrepresentations. In such cases, the issuer, controlling shareholders, and actual controllers are presumed to have been unjustly enriched as a result of the misrepresentation. Unlike "share buyback rights" stipulated in art.89 of the PRC Company Law 2023 providing a legal basis for shareholders to seek remedies through the courts, the "buyback" under the PRC Securities Law 2019 provision requires the involvement and recognition of the CSRC, which is entitled to exercise its administrative powers to determine from whom investors may seek compensation—specifically, listed companies, controlling shareholders, and actual controllers.

In line with the spirit of the revision of the PRC Company Law 2023 regarding the strengthening of the accountability system for corporate insiders, future legislative amendments could explore the possibility of making the "buyback" provision a legal obligation for issuers, controlling shareholders, and actual controllers. This obligation would enable plaintiffs to directly claim compensation in private lawsuits once the existence of a misrepresentation has been established. However, such a development may pose challenges for investors seeking to invoke claims based on unjust enrichment. The burden of proof would likely shift to investors, requiring them to demonstrate that they were misled by the information provided by the obligors and that their resulting actions contradicted their genuine will.[50] The complexity of the case increases if the issuer argues that investors' decisions were primarily based on the advice of an expert consultant.[51] In such a scenario, it would first need to be demonstrated that the expert was, in fact, misled by the issuer's misrepresentation. Only then can it be established that the investors, relying on the expert's advice, were consequently influenced in their decision-making. This additional layer of proof introduces significant complications in attributing liability, as it raises questions about the degree of reliance on intermediary expertise and the causal link between the misrepresentation and investor actions. To effectively bring the role of the "buyback" provision into play in private lawsuits, regulators must focus on establishing the causal link between the investors' decision and the alleged misrepresentation. This can be facilitated by adopting a presumption of reliance, where causation is presumed to exist, thus shifting the burden of proof to the defendant. The defending company would then have the opportunity to rebut this presumption in order to avoid liability, demonstrating that the investors' decisions were not influenced by the misrepresentation.

regulatory agency of the State Council may order the issuer to repurchase the securities or order the liable controlling shareholder and actual controller to buy back the securities.

[49] Article 147 of Civil Code 2021. The actor shall be entitled to request a people's court or an arbitral institution to revoke a juridical act performed based on a material mistake.

[50] Article 184 of Civil Code 2021. Where a juridical act is performed by a party against his or her true will as a result of fraud by the other party, the defrauded party shall have the right to request a people's court or an arbitral institution to revoke the act.

[51] A. Pijls, "Prospectus Liability and Causation" Oxford Business Law Blog (29 September 2023), *https://blogs.law.ox.ac.uk/oblb/blog-post/2023/09/prospectus-liability-and-causation*.

Article 93 of the PRC Securities Law 2019 establishes the framework for advance compensation in cases of market misrepresentation.[52] The advance means such compensation happens before any administrative penalties from CSRC or the listed stock market or judicial rulings are made against the issuer. The compensation is based on the agreement between the investors and the obligators under art.89 of the PRC Securities Law 2019. In practice, sponsors—typically securities companies—frequently play a pivotal role in facilitating this process. According to the principle of full compensation, sponsors may be required to assume responsibility for the entire amount when the apportionment of liability among the relevant parties remains unclear. A notable example is the case of Dandong Xintai Electric Co (2015),[53] where the sponsor shouldered the entire upfront compensation, paying over 200 million yuan (around £22 million) from its special compensation fund,[54] significantly more than its proportionate share of liability. This approach not only takes into account the sponsor's financial capacity but also strengthens its gatekeeping function within the securities market under the registration-based regime. From the perspective of sponsors, this arrangement is not viewed negatively, as it contributes to enhancing their reputation and reinforces their role as key actors in ensuring market integrity.

Simultaneously, art.93 grants these obligated parties the right to seek reimbursement from the issuer and other jointly and severally liable persons (as stipulated, though not limited to, art.85 of the PRC Securities Law 2019) after they have provided advance compensation. This arrangement effectively balances fairness—ensuring parties are accountable for their conducts—and the efficiency of compensating investors promptly.

The advance compensation can be seen as a mechanism designed to transform the tortious liabilities into a form of contractual liability. This allows investors to seek compensation for their losses based on contracts made with entities like the sponsor. However, initiating such compensation requires proof of existence of significant misrepresentation, typically established through administrative decisions made by the CSRC or its agent—the stock exchange. In this case, the difficulty in the class action has remained. In this case, the advance compensation agreement approved by CSRC is regarded to be granted administrative validity, which enhance its practical feasibility, certainty and enforceability.

Provided the number and geographic dispersion of investors in China stock market, achieving unanimous consent between investors and obligors presents significant practical challenges. In instances where certain investors dissent on specific terms of an agreement, a question arises: can these dissenting investors justifiably be subject to the terms to which they implied or explicitly disagree with? Furthermore, the practice of advance compensation may incur moral hazards, as it could be employed by sponsors and issuers to mitigate penalties that would

[52] Article 93 of PRC Securities Law 2019 Where an issuer's fraudulent offering, misrepresentation, or any other major violation of the law causes any loss to investors, the issuer's controlling shareholder and actual controller and the relevant securities company may authorize an investor protection institution to enter into an agreement with the aggrieved investors on compensation matters and make compensation in advance. After making compensation in advance, they may legally recover such compensation from the issuer and other jointly and severally liable persons.

[53] Li Xiang (China Daily), "Dandong Xintai Delisting Starts over IPO Fraud" (9 September 2016), Chinadaily.Com.Cn, *https://www.chinadaily.com.cn/business/2016-07/09/content_26025410.htm*.

[54] Investor Protection Fund Company serves as the fund manager and is responsible for reconciling accounts with eligible investors.

otherwise be imposed by the CSRC or the courts. From the perspective of investors, such mechanisms might incentivise complacency in risk assessment, weakening their diligence in scrutinizing the risks associated with listed companies. This erosion of vigilance could, in turn, impair the quality of investment decision-making. Additionally, as sponsors are profit-driven entities, any financial burdens or liabilities they face are likely to be shifted to investors. This could manifest through higher sponsorship fees, which sponsors may justify as risk hedging measures. These increased costs would eventually be reflected in the share price, with the ultimate financial burden falling upon the investors themselves.

Both "buyback" mechanisms and "advance compensation" schemes are designed to provide investors with compensation in a more efficient and cost-effective manner, reducing the expenses associated with potential litigation. While the buyback option is rarely employed in practice, the advance compensation model demonstrates a more proactive regulatory intervention aimed at effectively safeguarding investors' interests. The latter reflects the evolving role of regulatory bodies in ensuring timely and equitable redress, thus highlighting the shift towards regulatory facilitation of investor protection.

From a view of the contractual relationship

Rather than viewing the misconduct as a joint tort[55] committed by several individuals against investors, the misrepresentation found in IPO could also be regarded as a breach of contract made by the issuer. However, it should be noted that the tortious and contractual perspectives do not conflict with each other but have the concurrence of legal relations in a misrepresentation case.

Theoretically, investors could seek remedy based on the buy-and-sell contract made with the issuer. During the IPO process, investors purchase newly issued shares from the company rather than from its existing shareholders. If a misrepresentation is found in the prospectus, investors can claim compensation from the issuer based on the contract, given the privity of contract. The cause of action from a contractual perspective could be based on (1) "culpa in contrahendo" (fault in concluding a contract)[56] and (2) a breach of contract.

The prospectus is an invitation to offer proposed by the issuer, as outlined in art.473 of the Civil Code 2021.[57] In the first case, aggrieved investors could argue that their trust was betrayed. In this case, the misrepresentation is separate from, and made before, the performance of the buy-and-sell contract, constituting a fault in concluding the contract, which incurs reliance damages for investors. Alternatively, in the second case, the primary duties for the information disclosure obligors in the contract incorporate not only buy-and-sell but also providing true, accurate, and complete information (per se art.19 of the PRC Securities Law

[55] According to art.1168 of Civil Code of the People's Republic of China 2020, the jointly tort is where two or more persons jointly commit a tort, causing harm to another person, they shall be liable jointly and severally.

[56] It means contracting parties are under a contractual duty to deal in good faith with each other during the communicating stage, or else face liability, customarily to the extent of the wronged party's reliance. Friedrich Kessler and Edith Fine, "Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study" (1964) *Faculty Scholarship Series*, *https://openyls.law.yale.edu/handle/20.500.13051/2066*.

[57] An invitation for offer is a declaration to invite other parties to make offers to the inviter. Stock prospectuses are invitations for offer. The "a fault in conclusion of a contract" stipulated in art.500(2) of the Civil Code of the People's Republic of China 2021 (Civil Code 2021) can be applied once the misrepresentation has been proofed exist in the disclosed document.

2019).[58] While disclosing a misrepresentation constitutes a breach of the main duty of the contract, or in short, a breach of contract (per art.577 of the Civil Code 2021).[59] It should be noted that misrepresentation in the prospectus is a violation of legal obligations rather than terms agreed upon by both parties. In both cases, there is no need for investors to prove that the misrepresentation was significant enough to influence their investment decisions, such as whether to buy or sell shares, buy at a higher price, or sell at a lower price. In other words, once investors prove that a misrepresentation exists in the mandatory disclosed document during the IPO process, the issuer is liable for "breach of contract" or "fault in the conclusion of a contract," concerning damages to the performance or executory interests (future interests).

From a contract law perspective, it is relatively straightforward for investors to lodge a suit against issuers. However, for other liable parties who are not signatories to the buy and sell contract—such as controlling shareholders, actual controllers, and members of the issuer (including directors, supervisors, and officers)—their liability cannot be based solely on the contract between the issuer and the investors. Unless they contract with the company or perform as guarantors of the buy-and-sell agreement. However, rational individuals may have little incentive to expose themselves to such duties.

For investors seeking to hold these insiders accountable, two approaches are available: (1) piercing the corporate veil and (2) initiating a derivative action. However, both methods have been questioned. Regarding veil-piercing, some scholars argue that when decisions about disclosure are made through board resolutions in accordance with the company's Memorandum and Articles of Association, the actions of these liable persons are, in essence, the actions of the company itself. Consequently, it may be unfair to hold them personally liable, as their actions are effectively absorbed by the company.

Alternatively, the liability may be considered direct to the company and indirect to the investors. Liability may arise on the grounds that directors, supervisors or senior executives have breached their duty of care or duty of loyalty to the company. This is because misrepresentation in the prospectus could expose the company to significant legal risks, which would harm the company's interests—whether under a shareholder or stakeholder primacy theory. Share prices might decline if a misrepresentation is suspected, and administrative penalties from their listed stock exchange or the CSRC could further exacerbate the situation. Nevertheless, aggrieved investors often face challenges in pursuing litigation due to: (1) strict requirements for qualified plaintiffs,[60] and (2) refusal from the board of directors

[58] Article 19 of the PRC Securities Law 2019 The application documents for an offering of securities submitted by an issuer shall fully disclose the requisite information for investors to make value judgments and investment decisions, with the contents being true, accurate, and complete.

[59] Article 577 of the Civil Code 2021, Where a party fails to perform its obligations under a contract, or its performance fails to satisfy the terms of the contract, it shall pay damages or be otherwise held liable for breach of contract.

[60] Article 189(1) of the PRC Company Law 2019, the requirements for qualified plaintiff are shareholder(s) separately or aggregately holding 1% or more of the total shares of the company for 180 consecutive days. In China, the institution investors are less common to bring derivative actions. See Jingchen Zhao and Chuyi Wei, "Shareholder Remedies in China—Developments towards a More Effective, More Accessible and Fairer Derivative Action Mechanism" (2021) 16 *Capital Markets Law Journal* 445.

or supervisors to proceed with claims.[61] Moreover, these qualified plaintiffs may lack the incentive to initiate claims, given the potential costs and limited perceived benefits.[62] Imposing liabilities on other company members who are not directors, supervisors and senior executives of the issuer but might be potential information obligors is much more difficult. They (mainly referring to the mangers) generally do not owe a duty of care or fiduciary duty to the company unless they have specific contractual obligations. Even if they do assume such duties towards the company, in the case of making positive misrepresentations in the prospectus or for failing to conduct due diligence, only the company, rather than the investors, cause to initiate action against the obligors.

Regarding the obligations of third parties such as sponsors, underwriting securities companies, and their directly liable persons, their liabilities to investors are indirect from the view of contract law. It is originating from the service contracts made between the issuers and these third parties. The intent or grossly negligence happened during they play their due diligence role might lead the breach of the service contract. Accordingly, damages happened on the investors. This approach also applies to information obligors like legal and accounting firms and their directly liable persons who are not covered by art.85 of the PRC Securities Law 2019. From the perspective of contractual relationships, obligations can be determined in advance by market participants. Obligors and their corresponding obligations should be clarified in company law, which can be seen as a "standard contract" providing rights holders with general guidance. This approach facilitates the empowerment of each market participant, creating a strong deterrent to issuers, as supervision is omnipresent. Building on this, securities law, which incorporates various forms of administrative intervention, is key to resolving issues in a simple and effective manner.

Conclusion

Under the registration-based IPO system, the effectiveness and integrity of the stock market hinges on the presence of a strong accountability framework. In cases of misrepresentation, arts 85 and 163 of the PRC Securities Law 2019 provide the primary legal basis for determining the responsibilities of involved parties. Beyond these provisions, the participation of the CSRC or its market agents, via mechanisms such as stock "buybacks" (art.24 of the PRC Securities Law 2019) and "advanced compensation" (art.93 of the PRC Securities Law 2019), significantly enhances the efficiency of investor compensation processes. It is inevitable that the distinct features of the Chinese state's involvement in the stock market remain salient and are expected to persist, particularly in light of the relative immaturity of retail investors, politically connected firms and the administrative, paternalistic style of leadership.[63] However, it would be an oversimplification to ignore the significant

[61] Article 189(2) of PRC Company Law 2019, on the premise that board of supervisors or board of directors refuses to lodge a lawsuit after receiving a written request, hey fail to initiate a lawsuit within 30 days after receiving the request, or if, in an emergency.

[62] The plaintiff shareholder will have to bear the legal costs of the action in advance, while receiving only a small portion of the total recoveries accruing to the company. Hui Huang, "The Statutory Derivative Action in China: Critical Analysis and Recommendations for Reform" (2007) 4(2) *Berkeley Business Law Journal* 227.

[63] Shunyu Chi, "The Kite on a String: State Power and the Chinese IPO Mechanism on the Path to Liberalization" (2023) 31(2) *Asia Pacific Law Review* 308, *https://www.tandfonline.com/doi/epdf/10.1080/10192557.2023.2181774?needAccess=true.*

strides made by Chinese authorities in liberalizing the public stock market through a more market-oriented regulatory approach.

The revision of the PRC Company Law 2023 represents a robust effort to enhance the accountability mechanisms for corporate insiders. Articles 180 and 191 of the PRC Company Law 2023, when applied to misrepresentation cases, explicitly grants investors the right to bring legal actions against directors and senior managers, thereby aligning with the principles enshrined in art.85 of PRC Securities Law 2019. However, art.192 of the PRC Company Law 2023 does not extend liability to controlling shareholders or actual controllers for the actions of third parties. Nevertheless, investors who purchase shares retain the right to file suit in their capacity as shareholders.

Evidently, the allocation of risk is instrumental in ensuring that direct obligors are held accountable for their actions, promoting a more equitable market environment. At the same time, it mitigates the imposition of excessively burdensome liabilities on specific parties, such as issuers, thereby facilitating more efficient compensation mechanisms. From a deterrence perspective, more effective measures could involve expanding investor rights and streamlining legal procedures. For example, simplifying the processes for initiating class actions and increasing the involvement of legal professionals in such lawsuits, rather than relying predominantly on investor protection institutions, may more effectively mitigate the risks of future misrepresentation. These changes would not only enhance enforcement mechanisms but also promote a more active and empowered investor community in addressing corporate misconduct.