

***ENFORCEMENT WITHOUT FOUNDATION? – INSIDER TRADING AND CHINA’S
ADMINISTRATIVE LAW CRISIS***

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Abstract

China’s securities regulator presently enforces insider trading prohibitions pursuant to non-legal and non-regulatory internal “guidance”. Reported agency decisions indicate that such enforcement is often only possible pursuant to this guidance, as the trading behavior identified is far outside of the scope of insider trading liability provided for in the governing statute. This paper argues that the agency guidance is itself unlawful and unenforceable, and outlines legal challenges to the norms and enforcement of them. The radical infirmity underlying the basis for well-governed and investor-attracting capital markets has implications not only for China’s securities regulation regime and healthy market development, but also for the entirety of China’s legal and administrative law system in the reform era.

¹ Professor of Law, University of Michigan Law School. In composing this article, I have benefited from the insights of Professors Donald Clarke, Cui Wei, Keith Hand, Jamie Horsley, Victoria Langland, Ben Liebman, Neysun Mahboubi, Curtis Milhaupt, Shen Kui, and Alex Wang, and the good comments and questions received at a workshop convened by the Yale Law School Center for the Study of Corporate Law and the Yale Law School China Law Center in December 2011 and _____. For this article, I have modified the standard *pinyin* Romanization system for some Chinese terms to enhance reading for those who do not read or speak Chinese. Thus, the character sets properly rendered as “*guiding*” (the verb “to regulate” or the noun “legislative provisions”) and “*fading*” (meaning “stipulated in law”) are written “*gui’ding*” and “*fa’ding*” so as to avoid conjuring the English words in the phrases “the guiding light” or “the fading light.”

I. INTRODUCTION

The securities regulator of the People's Republic of China ("PRC" or "China") presently enforces statutory insider trading prohibitions pursuant to non-legal and non-public "guidance." Published Chinese agency decisions indicate that insider trading enforcement is often possible only pursuant to this internal guidance, because the trading behavior punished is far outside of the narrower statutory basis for insider trading liability. That enforcement reality is highly problematic because the agency guidance is itself illegal and should be unenforceable. At one level, this phenomenon presents a significant problem for China's securities regulator and its oversight of the nation's dynamic capital markets. At a broader level, however, the technical, securities law-related, issue described here is but a specific identity of the much larger dysfunction that can be seen in many other areas of the PRC's applied legal and administrative law system. Accordingly, this issue has wider implications for China's three decades-old "legal construction" project, and what some understand as pervasive and increasing *illegality* across the PRC's legal and governance system.

Securities fraud, including specifically insider trading, is an acknowledged fact of the Chinese domestic capital markets, and has been since the establishment of the Shanghai and Shenzhen stock exchanges in 1990-1.² Insider trading takes many forms in China. Certainly the classic situation – where corporate insiders use non-public material information from and regarding their company to trade in the stock of the same company prior to an announcement affecting the market price of that company's securities – is understood to occur very frequently.³

² With respect to insider trading specifically, see: Hui Huang, *The Regulation of Insider Trading in China: A Critical Review and Proposals for Reform*, 17 AUST. J. CORP. L. 1, 4, 5-6 (2005) (citing to WU HONG ET AL. ZHONGGUO ZHENGQUAN SHICHANG FAZHAN DE FALU TIAOKONG [LEGAL ADJUSTMENTS FOR THE DEVELOPMENT OF CHINA'S SECURITIES MARKET] 12 (2001); Ling Huawei, Qiao Xiaohui, Fu Tao, and Hu Runfeng, *neimu jiaoyi "wenyi"* [The Insider Trading "Plague"], 186 CAIJING MAGAZINE, May 28, 2007, at 66-9 (hereinafter, *Insider Trading Plague*); Han Shen, *A Comparative Study of Insider Trading Regulation Enforcement in the U.S. and China*, 9 J. BUS. & SEC. L. 41, 56-60 (2007).

³ A good example of this was revealed in the CSRC enforcement action against Zhejiang Hangxiao Steel Structure Co., Ltd. when its stock rose 150% in the five week period after the March 2007 announcement of a large infrastructure contract won by the firm in Angola. Insiders who purchased before the announcement, and sold afterwards but during the price run-up, were to said to have profited by over US\$ 5 million. The big Angola contract proved to be fictitious, causing a huge price slump, but only after the insiders had sold their pre-announcement purchases at the high end. See *Insider Trading Plague*, *supra* note __, at 67; Gady Epstein, "Market Maker," *Forbes*, January 28, 2008, available at: <http://www.forbes.com/global/2008/0128/050.html> (hereinafter, *Market Maker*). See also the examples described in: *zhongguo zhengquanhui xingzhengchufa juedingshu (Lin Shiquan)* [China Securities Regulatory Commission Administrative Punishment Decision (Lin Shiquan)] (2011) No. 26, issued June 29, 2011, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201108/t20110802_198433.htm, analyzed *infra* note __ and accompanying text; and *zhongguo zhengquanhui xingzhengchufa juedingshu (Liu Yang)* [China Securities Regulatory Commission Administrative Punishment Decision (Liu Yang)] (2011) No. 24, issued June 14, 2011, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201107/t20110718_197605.htm, analyzed *infra* note __ and accompanying text. At the same time, a good deal of the activity commonly understood or reported as "insider trading" in China is more closely akin to stock "manipulation" by what the Chinese idiom broadly labels "[casino] dealers" (*zhuangjia*). For instance, "front running" by "rat-cellars" (*laoshu cang*) – where non-insider mutual fund managers take advantage of non-corporate information to purchase the stock of an issuer just before the fund they control makes purchases of the same stock (triggering a price rise in the stock) – is also said infect the high volume domestic securities fund industry. See *Market Maker*, *supra* note __ (describing the experience of former private fund manager Lin Rongshi). A variant of this is the common breaching of the state-private gap in

At the same time, enforcement against insider trading – certainly given the amount of illegal activity commonly assumed and occasionally reported – has been anemic.⁴ The reasons for this are well-known, and include: regulatory resource constraints (investigatory and enforcement); low levels of investigatory sophistication and deficient technical means; difficulties in detecting insider trading contemporaneously and then obtaining evidence *ex post*;⁵ the securities regulator’s inability to act as a civil action plaintiff (and thus extract information and/or settlements from market participants); constraints on the private civil action applicable across China’s corporate law and securities law regimes; the uneven competence, autonomy and independence of China’s judiciary; and – of overwhelming importance in the Chinese context -- the political and economic power of some of the most flagrant violators, whether individuals or institutions. Some analysts even point to a conflict in the role of China’s securities regulator, the China Securities Regulatory Commission (“CSRC”): tasked on one side with the protection of investors and market transparency, and on the other side “... provid[ing] the [state-owned enterprises] with preferential access to the financial resources of the capital market for the best interests of the government; ...”.⁶ Whatever the constellation of reasons for it, lackluster enforcement will fuel a familiar vicious circle: obstacles to robust enforcement can ensure that the costs of insider trading are minimal or non-existent, especially when compared to the benefits on offer, which in turn only encourages further insider trading in the Chinese markets.

Generally unacknowledged, and perhaps less understood, is the fact that agency enforcement and public prosecution against insider trading in today’s China is often illegal. As I argue in this article, this statement is true for several reasons. First, the CSRC has *not* created a legal or regulatory norm which conforms to the statutory authorization to “regulate” (*gui’ding*) a critical, if narrow, part of insider trading liability. Second, the internal “guidance” offered in response to the statutory command “to regulate” is *ultra vires* on two counts: (i) with respect to the subject of regulation permitted in the governing statute, and (ii) with respect to the structure of the entire insider trading prohibition under the same statute. As demonstrated in some detail below, the liability for insider trading as set forth in the internal guidance departs radically and completely from the limited bases for insider trading under the statute: In U.S. jurisprudential terms, the non-public “guidance” provides for a *Texas Gulf Sulphur* theory of liability (targeting

China, where non-insider private fund managers are tipped by non-insider state-owned mutual funds that they about to purchase a given issuer’s stock, with an inevitable price rise upon the large state mutual funds purchase becoming known (and the state tipper and private tippee splitting the extraordinary profits).

⁴ One author reviewing the period between 2002 and the end of 2006, or the period prior to the issuance of what this article calls the “Insider Trading Guidance Provisions”, notes the application of administrative sanctions by the CSRC in 196 cases of securities fraud, only one of which (in 2004) relates to insider trading. See Han Shen, *supra* note __, at 57. See also Benjamin L. Liebman and Curtis J. Milhaupt, *Reputational Sanctions in China’s Securities Market*, 108 COLUM. L. REV. 929, 942 (for 2001-2006: “the number of [CSRC] sanctions seems rather modest given the ubiquity and severity of the problems with...insider trading... in China’s stock markets.”)

⁵ “With respect to the investigation of insider trading, [we] face two issues: difficulties in obtaining evidence and recognition...” (statement in May 2007 by a CSRC No. 1 Investigation Department official), *Insider Trading Plague*, *supra* note __, at 66.

⁶ Han Shen, *supra* note __, at 58 (pointing to the “quota” system discontinued more than a decade ago, and the continued presence of poorly-performing state-owned enterprises listed on China’s domestic capital markets). This author does not concur with Han Shen’s notion of a conflicted CSRC, a view informed by almost 20 years of interaction with the CSRC and its officers.

anyone simply in possession of inside information who trades), whereas the statute provides only for a narrow version of (again in U.S. parlance) *Cady, Roberts* liability (applicable only to specific insiders identified in, or pursuant to, the statute) plus what aspires to be *O'Hagen*-style misappropriation liability.⁷

The illegality of insider trading enforcement norms casts a significant shadow over the ability of the PRC securities regulator to govern China's capital markets, and thereby ensure the perceived transparency and information symmetry critical to sustaining investor confidence and participation. Any successful legal challenge to administrative or criminal enforcement of insider trading prohibitions by defendants would constitute a body blow to the regulator's hard-earned reputation for competence, regulatory power, and technical sophistication, and confirm what many small investors already understand as the unlevel playing field characterizing China's "casino" markets. Moreover, it would only contribute to the above-described vicious circle whereby the apparent costs of engaging in insider trading are virtually *nil*, encouraging in turn expanded illegal activity going forward.

At a broader level, the asserted illegality and unenforceability of China's insider trading norms (as conceived and implemented by what everyone recognizes as the PRC's first "modern" independent and least politicized regulatory agency) and the relative tolerance shown by defendants for such illegal enforcement, provides observers with significant insights into what the Chinese contemporary legal order actually is.

The problem described here is not limited to securities regulation, and is apparent in other key areas of regulation and enforcement. Indeed, the prevalence of these issues sparked articulated central government policy and legislative concern more than a decade ago, as embodied in the 1996 PRC Law on Administrative Punishments, the PRC State Council's 2004 Outline for Implementing the Full Promotion of Administration According to Law,⁸ the 2008 State Council Open Government Information Regulations,⁹ and the very recent 2010 State

⁷ See *infra* notes __ and accompanying text.

⁸ See *guowuyuan guanyu yinfa quanmian tuijin yifaxingzheng shishi ganyao de tongzhi* [State Council Notice Regarding Printing and Distribution of the Outline for Implementing the Full Promotion of Administration According to Law], *guofa* (2004) No. 10, available at: http://www.gov.cn/ztl/yfxz/content_374160.htm (hereinafter "Administration According to Law Outline"). See Paragraphs 1 (exhorting "administration according to law" (*yifa xingzheng*) and criticizing "illegal or inappropriate administrative action"); 5(i) (urging administrative agencies to act in accordance with law, administrative regulations or departmental rules, and forbidding administrative action not stipulated in law, administrative regulation or departmental rules); 5(iii) (calling for "due process" (*chengxu zhengdang*) and urging administrative agencies to "act publicly" (*yingdang gongkai*) in their administrative tasks); 5(v) (stipulating that administrative agencies may only undertake enforcement within the scope authorized in law or administrative regulations); 16 (calling for greater openness in rule-making, and publication of all enforceable norms in a government gazette); 20, 26, 28 & 30 (encouraging private recourse to administrative rehearing or administrative litigation); 23 (limiting enforcement powers to the scope stipulated in law); 29 ((central) "filing for the record" system for departmental rules and "normative documents"), etc.

⁹ *zhonghua renmin gongheguo zhengfu xinxi gongkai tiaoli* [Regulations of the PRC on Open Government Information], adopted by the PRC State Council on April 5, 2007 and effective May 1, 2008, unofficial English translation available at: http://www.law.yale.edu/documents/pdf/Intellectual_Life/Ch_OGI_Regualtions_Eng_Final_051607.pdf (hereinafter, "Open Government Regulations"), which create a presumption that government information, including

Council Opinion Regarding Strengthening the Construction of Rule of Law Government.¹⁰ As the State Council states very clearly in its 2010 pronouncement, ensuring that administrative rule-making and administrative law enforcement operate within the bounds described in “law” is at the very core of “rule of law government” (*fazhi zhengfu*) and “rule of law” (*yifa zhiguo*). As the problem persists in many areas of government administration, it has also drawn the long-overdue attention of PRC legal and administrative law scholars, and even the Chinese implementing agencies concerned.¹¹

This article describes one very specific example of that larger problem, but in a sector involving a much-admired and ostensibly “modern” regulator, and an area of critical import for China’s financial system, the efficient allocation of capital by domestic and foreign investors, continued economic growth, and interaction by common Chinese citizens and property rights-holders with their government. Part II of this article sets forth the formal statutory and regulatory bases for enforcement against insider trading in the PRC since the early 1990s and the establishment of China’s domestic equity capital markets. Part III reveals the conflicted approach to insider trading enforcement in China, both within the bounds of the governing statute, and between the statute and a 2007 norm issued internally by the agency charged with enforcement. In Part IV, I analyze the legality and thus enforceability of that regulatory norm, and find it to be seriously wanting, making enforcement pursuant to the same subject to legal challenge. Referring to administrative sanction decisions reported by the CSRC, Part V reveals that the regulatory norms which I argue are illegal and unenforceable are very often the sole basis upon which enforcement of China’s insider trading prohibition is implemented. Part VI concludes with a discussion of how the CSRC norms can be characterized as void or unenforceable, an outline of the Chinese law challenges to enforcement action (administrative and criminal) based upon such norms, and a broader meditation on what this problem means for China’s three decade-long “legal construction” project. Several CSRC insider trading enforcement decisions referred to in Part IV are summarized in an Appendix.

rules and regulations, should be disclosed and establishes a legal mechanism that citizens may use to compel disclosure, including administrative litigation (*see* Article 33(2)).

¹⁰ *guowuyuan guanyu jiaqiang fazhi zhengfu jianshe de yijian*, available at: http://www.gov.cn/zwggk/2010-11/08/content_1740765.htm (hereinafter, “Rule of Law Government Opinion”). *See* Paragraphs 1 (“administration according to law” (*yifa xingzheng*) a key component of “rule of law” (*yifa zhiguo*), and the construction of a “rule of law government” (*fazhi zhengfu*); describing mal-administration or chaotic application of administrative law and unfair application of administrative norms, or administrative agencies acting *ultra vires*); 6 (improve government rule-making); 7 (respect legally-stipulated constraints on power, and implement due process); 8 (review and rectify administrative regulations, departmental rules and normative documents); 9 (improve the formulation of normative documents, ensuring they are firmly based in law and do not increase civil obligations outside of those stipulated in law; normative documents not issued for comment or subject to hearings, etc. prior to enforcement not enforceable); 10 (improve “filing and review” (*beian shencha*) system for administrative regulations and departmental rules, publicly declare invalid regulations/rules that do not conform with law); Section VI (increase open government), etc.

¹¹ *See*, for example, Wei Cui, *What is the “Law” in Chinese Tax Administration?* 19:1 ASIA PACIFIC L. REV. 75 (2011) (noting the same phenomenon with respect to the issuance and application of *ultra vires* tax “circulars” by the Ministry of Finance and the State Taxation Administration, and the latter’s July 2010 regulation designed to rationalize and legalize tax rule-making).

II. LEGAL AND REGULATORY NORMS FOR INSIDER TRADING IN THE PRC

The legal and regulatory norms governing insider trading have developed quickly in the PRC, and concurrent with (or sometimes even before) the formal, legal, establishment of the PRC's domestic capital markets and stock exchanges.

With the formation of China's first post-1949 stock exchanges in Shanghai and Shenzhen, the governments of Shanghai (on November 27, 1990) and Shenzhen (on May 15, 1991) each promulgated municipal-level "measures" (*banfa*) that explicitly prohibited "insider trading" (*neimu jiaoyi*).¹² In April 1993, the State Council Securities Commission -- the State Council department governing the newly-established CSRC¹³ -- promulgated the first national-level regulation concerning securities issuance and trading, the Provisional Regulations on the Administration of Stock Issuance and Trading ("CSRC Issuance and Trading Regulations")¹⁴ which also explicitly prohibited "insider trading". That prohibition was echoed in the September 1993 Provisional Measures on Prohibiting Securities Fraud Behavior issued by the CSRC ("CSRC Securities Fraud Measures"),¹⁵ which set forth the first detailed treatment of insider trading in the history of China. In October of 1997, the PRC legislature amended the Criminal Law to include the crime of "insider trading" (at Article 180), but without any further elaboration on the elements of this new crime (other than heightened *mens rea*-type requirements which work across the Criminal Law).

Only in 1999, with passage of China's first post-1949 Securities Law ("1999 PRC Securities Law") was insider trading extensively described and prohibited in a non-criminal "law" (as contrasted with an administrative regulation or other normative document), a formulation largely carried over into the Securities Law passed in late 2005 and effective on January 1, 2006 ("2006 PRC Securities Law").

Finally, on March 3, 2007, the CSRC conceived its internal "guidance document" (*zhidaoxing wenjian*)¹⁶ on the 2006 PRC Securities Law statutory prohibition on "insider trading", the (Provisional) Guide for the Recognition and Confirmation of Insider Trading Behavior in the Securities Markets ("Insider Trading Guidance Provisions").¹⁷ The Insider

¹² See: Article 39 of Shanghai's *Shanghaishi zhengjuan jiaoyi guanli banfa* [Shanghai Municipal Measures on the Administration of Securities Trading], issued November 27, 1990, and Article 43 of Shenzhen's *Shenzhen shi gupiao faxing yu jiaoyi guanli zanxing banfa* [Shenzhen Municipal Interim Measures on the Administration of Stock Issuance and Trading], issued May 15, 1991. The term "insider trading" or "*neimu jiaoyi*" first entered China's legal and regulatory lexicon in the October 1990 Provisional Measures on the Administration of Securities Companies (*zhengquan gongsi guanli zanxing banfa*).

¹³ In April of 1998, the State Council Securities Commission was disbanded, and the CSRC elevated to a regulatory department at the rank of a state ministry.

¹⁴ *gupiao faxing yu jiaoyi guanli zanxing tiaoli*, available at: _____.

¹⁵ *jinzhi zhengquan qizha xingwei zanxing banfa*, available at: _____.

¹⁶ See Insider Trading Guidance Provisions, *infra* note __, Article 3.

¹⁷ See China Securities Regulatory Commission, *zhongguo zhengquan jiandu guanli weiyuanhui guanyu yinfa "zhengquan shichang caozong xingwei rending zhiyin (shixing)" ji "zhengquan shichang neimu jiaoyi xingwei rending zhiyin (shixing)" de tongzhi* [Notice of the China Securities Regulatory Commission Regarding the Printing and Distribution of the "(Provisional) Guide for the Recognition and Confirmation of Manipulative

Trading Guidance Provisions by their own terms do not constitute publicly-notified law or administrative regulations, departmental rules, or rules, or any norms of which market participants have any formal notice; instead, they are only internal guidance for staff of the CSRC, subordinate securities regulatory bodies, and the Shanghai and Shenzhen exchanges regarding the application of law and the implementation of administrative enforcement. (As this will become important for the legal analysis following, it is worth noting that the 2007 Insider Trading Guidance Provisions are not “public” as understood as a term of art; indeed, the Provisions appear to be “available”, for instance on a widely-used subscriber on-line collection of Chinese laws and regulations.¹⁸ They are not “public” in the sense that they are not issued by the CSRC to the public (but instead to CSRC staff, local securities regulatory bodies, and the two Chinese exchanges), are not posted on the CSRC website, and are not included in any form of legislative or regulatory gazette (*gongbao*).

III. INSIDER TRADING REGIME(S)

China’s insider trading regulatory regime is plagued by contradictions which arise in two contexts: (i) within the formal provisions of the governing statute itself, and (ii) as between the system articulated in formal law, on one hand, and as articulated (and increasingly enforced) *via* agency action of dubious legality, on the other. In formal, statutory, terms, the regime is conflicted because it seems at first blush intent on capturing securities trading – by anybody -- involving non-public material information (including misappropriated information). Conversely, there is much about the same formal regime which operates to limit liability to a much narrower class of specifically-enumerated insiders. Perhaps more pronounced is the radical difference between the formal regime (with all of its own internal contradictions) and an administrative enforcement structure – articulated in internal “guidance” and implemented in specific cases -- which cuts the insider trading breach out of a whole new cloth. This non-law based structure authorizes enforcement of insider trading liability against mere possessors of non-public, material, information who happen to trade securities during an *ex post* determined price sensitive period.

To make sense of these complexities, the following sections analyze the two kinds of contradictions in series -- first the conflicts inherent in the formal statutory regime, and then the more serious dysfunction between the statutory or “legal” regime, on one side, and the administrative enforcement structure, on another. While reviewing these expositional sections, it may be helpful to keep in mind two trading situations where insider trading liability might be at issue, depending upon how an insider trading regime is crafted: (i) “tippee” trading, and (ii) where an individual who acts as the financial advisor to an acquiring company trades in the stock of a listed target – defined here in short form as “tippees” and “M&A advisors” respectively. As will be shown below, in each case (and other than tippees or M&A advisors who are also “misappropriators”), there is *no* basis for the assertion of insider trading liability against such persons trading on non-public, material, information under the 2006 PRC Securities Law; the

Behavior in the Securities Markets” and the “(Provisional) Guide for the Recognition and Confirmation of Insider Trading Behavior in the Securities Markets”], March 27, 2007, *zhengjian jichazi* (2007) No. 1 (a CSRC notice which distributes guidance provisions for both insider trading and stock manipulation (the latter actionable under Article 77 of the 2006 PRC Securities Law)).

¹⁸ LawInfoChina, available at: <http://www.lawinfochina.com>.

only basis for enforcement or prosecution against such persons lies in what I argue are the legally defective 2007 Insider Trading Guidance Provisions.¹⁹

a. The Statutory Scheme

The 2006 PRC Securities Law addresses insider trading (*neimu jiaoyi*) at eight articles of the statute.²⁰ Perhaps most fundamentally, Article 73 prohibits (i) those “with knowledge of inside information” and (ii) those “who have illegally procured inside information,” from “using” (*liyong*) inside information to engage in securities trading activities. On a first view, the 2006 PRC Securities Law (like its 1999 predecessor) rejects the confines of a “classical” theory of insider liability by broadening the scope of defendants from those with the status of insiders (directors, officers, large shareholders, etc.) to those who simply have knowledge of inside information. For scholars familiar with U.S. insider trading jurisprudence, this regime looks like the *SEC v. Texas Gulf Sulphur*²¹ “equal access theory” expansion of *Cady, Roberts & Co.*,²² which extended insider trading liability from “corporate insiders” to anyone in possession of material, non-public information. (This expansive theory was subsequently cut back to the “classical” or fiduciary duty theory in *Chiarella v. United States*,²³ so that insider trading liability was narrowed to those in breach of some kind of fiduciary or special relationship of trust and confidence with the trading counterparty).²⁴ If this first reading was accurate, the 2006 PRC Securities Law would have represented a significant departure from the earliest iterations of insider trading law in China, which addressed only the actions of formal (status) insiders in the style of *Cady, Roberts*.²⁵

On closer inspection, however, the 2006 statute (like its 1999 predecessor) reveals no such ambition, for Article 74 explicitly narrows the scope of possible defendants to “include” (*baokuo*)²⁶ a roster of traditional or constructive insiders (including regulatory and exchange personnel) and “other persons stipulated (*gui'ding*) [in regulation] by the securities regulatory

¹⁹ See *infra* the *Jia Huazhang & Liu Rong* Decision (“tippee” liability) and the *Zhang Xiaojian* Decision (“M&A advisor liability”).

²⁰ See 2006 PRC Securities Law, Articles 5 (basic prohibition against insider trading), 47 (short-swing trading by insiders), 73-76 (elaborated provisions on insider trading, analyzed here), 180 (power of CSRC to stop trading in suspect securities), and 202 (administrative penalties and measures). Criminal prosecution for the established crime of insider trading (at Article 180 of the PRC Criminal Law) is explicitly authorized at Article 231, while civil damages (and, perhaps, a private claim in damages) are given a legal basis in the final clause of Article 76.

²¹ *SEC v. Texas Gulf Sulphur*, 401 F.2d 833 (2d Cir. 1968), *cert. denied* 394 U.S. 976 (1969).

²² *Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

²³ *Chiarella v. United States*, 445 U.S. 222 (1980).

²⁴ With the exception of the tender offer context, where the equal access theory lives on in the U.S. Securities Exchange Commission’s 1934 Securities and Exchange Act Rule 14e-3.

²⁵ See Article 81 of the CSRC Issuance and Trading Regulations, and Article 5 of the CSRC Securities Fraud Measures.

²⁶ It is difficult to divine whether the Chinese form means “including *only*” or “including *without limitation*.” Increasingly, Chinese statutes which seek to codify the latter understanding use the characters “*baokuo dan buxianyu*”, a form absent here. Accordingly, and given the contemporary tradition of Chinese statutory formulation, the present iteration would give defendants the strong basis to argue that if they are not included in the statutory list, or the persons specifically listed in CSRC regulation, they cannot be insider trading defendants for Article 74 purposes.

authority under the State Council [*i.e.*, the CSRC].”²⁷ The net effect of Article 74 is to limit the scope of insider trading defendants under the Article 74 cause of action to those persons or institutions listed in the article itself, or persons affirmatively described *ex ante* in CSRC regulation. In U.S. jurisprudential terms, the regime introduced in 2006 seemingly rejects the equal access theory (still employed in the U.K. and Europe) while adhering to the *Cady, Roberts/Chiarella* line, but with parties potentially liable identified *ex ante* in the Securities Law or a subsequent regulatory enactment.²⁸

In direct tension with Article 74’s apparent declaration of fealty to “classical” insider trading doctrine are (i) the second prong of Article 73 (read in conjunction with a phrase in Article 76) and (ii) the significant delegation of regulatory authority to the CSRC in Article 74(vii) noted immediately above. The second prong of Article 73 in tandem with one clause of Article 76 provides a separate “misappropriation” basis for insider trading in China. Misappropriators are identified separately from, and do not have to be in the class of, enumerated “persons with knowledge of inside information” set forth in Article 74. Again, in U.S. jurisprudential terms, these articles are meant to track the relatively recent (1997) innovation in *United States v. O’Hagen*,²⁹ which created an expanded basis of insider trading liability for traders who breach a fiduciary duty or other special relationship with the source of the inside information (recall that *per Chiarella* the special duty or relationship must be with the trading counterparty). These clauses thus invoke the culpability of anybody who has “illegally procured inside information” (*feifa huoqu neimu xinxi de ren*). For misappropriators, therefore, the government only needs to demonstrate: (i) “illegal procurement” of information, (ii) that such information is “inside information”, (iii) use of that inside information to trade, and (iv) trading of securities (of an issuer related in some way to the information), to effect a successful enforcement action. There is no requirement that the people actually trading be part of the enumerated class of people in Article 74.

The last clause of Article 74 allows the CSRC to identify – by the act of “regulation” (*gui ding*) -- “others” (*qitaren*) aside from the traditional insiders enumerated in Article 74(i) – (vi) as “persons with knowledge of inside information.”³⁰ Given the predominant and continuing Chinese focus on statutorily-enumerated insiders, the grant of regulatory authority to the CSRC

²⁷ Directors, supervisory board members, and senior managers of the issuer; 5% or more shareholders of the company and its/directors, supervisory board members and senior managers, and the actual controlling shareholders of the 5% shareholder(s) and its/directors, supervisory board members and senior managers; directors, supervisory board members and senior managers of companies controlled by the issuer, and such controlled companies [appropriately adjusted in the 2007 Insider Trading Guidance Provisions, Article 6(ii)(2), to mean: “the controlling shareholders of the issuer or listed company, other companies controlled by the actual control party, and their directors, supervisory board members and senior management”]; people whose executive or staff position in the company provides access to inside information; CSRC staff and others who administer or regulate securities issuance and trading; and securities sponsors, underwriters, securities exchange personnel, securities registration personnel, and securities service institution personnel (which presumably includes lawyers and accountants).

²⁸ Consistent with this limitation bias is the separate Article 76 focus on “tipper” liability only, and not “tippee” liability, described below.

²⁹ *United States v. O’Hagen*, 521 U.S. 642 (1997).

³⁰ There was no need to grant the CSRC authority to widen the scope of defendants independently guilty of misappropriation because there is no defined class of “persons who have illegally procured inside information” as there is for “persons with knowledge of inside information.”

in Article 74(vii) to widen the scope of persons “with knowledge of inside information” originally represented a very significant nod in the (future) direction of loosening the under-inclusive list of insider trading defendants.³¹

In defining what exactly the prohibited “use” (*liyong*) of inside information is, the 2006 PRC Securities Law at Article 76 elaborates on the legal duties of (i) those in possession of “inside information”, and (ii) misappropriators, duties which again seem to track, in part, the U.S.-style, disclose or abstain from trading rule: people in possession of inside information [relevant to specific] securities trading (*zhengquan jiaoyi neimu xinxi*) are prohibited from (i) purchasing or selling that company’s securities, (ii) disclosing such information, or (iii) suggesting that others purchase or sell such securities, in each case at any time before such inside information is publicly disclosed (*gongkai*). Article 76 is the basis in Chinese law for what other jurisdictions call “tipper” or “tipping” liability, or what the statutory Article describes as “suggesting that others purchase or sell such securities” even where the defendant has not actually engaged in securities trading (though assuredly “used” inside information). “Tippees” are not subject to insider trading liability, at least insofar as they are not persons enumerated in Article 74, identified in any CSRC regulation issued pursuant to Article 74(vii), or deemed to be guilty of misappropriation of the information.

In sum, the statutory forms of Articles 73 and 74 – if uninformed by the subsequent 2007 Insider Trading Guidance Provisions -- create a system whereby only specifically enumerated actors may have liability, a structure which can be both overbroad and under-inclusive: It is potentially overbroad given the clear liability for innocent traders who are part of the Article 74 enumerated class and who trade while in possession of statutorily-defined “inside information.” One aspect of the over-broadness problem, at least in the civil and administrative enforcement sphere, is the failure of Chinese law to require any *scienter* or breach of duty proxy on the part of those in possession of inside information who trade in the relevant securities before public disclosure of the information. (This critique of course does not apply to those who have misappropriated inside information, as their “illegal procurement of inside information” constitutes an element of fault or breach necessary to prove the case. Nor does this critique apply to the crime of “insider trading” under Article 180 of the PRC Criminal Law, which requires some showing of intentionality (interpreted as actual intent or recklessness).³²) This raises the very strong possibility of something like strict liability for certain individuals who trade innocently in the relevant securities while in the possession of inside information. One PRC scholar has attempted to imply something less draconian than strict liability, stating:

..., for insider trading liability to occur, a necessary element is the defendant’s knowledge of the nature of the information,... the knowledge that the possessed information is material and non-public. In China, there are two tests for proving the defendant’s knowledge that the information is inside information, namely, the subjective knowledge test to prove the insider “knew,” and the objective

³¹ And is consistent with larger patterns in PRC legislative practice, designed to allow a certain level of generality in law, while conferring significant discretion on administrative institutions.

³² PRC Criminal Law, Article 14. Merely negligent behavior is only subject to criminal prosecution when the Criminal Law explicitly says so. PRC Criminal Law, Article 15.

knowledge test to prove that the insider “ought to have reasonably known.”³³ ... China has set up an additional “personal connection” test to define insiders, requiring that there must be a causal link between the insider’s position and *the* acquisition of information. Those “persons with knowledge of inside information” would therefore be prohibited from trading only if they have access to the information by virtue of their connection with the company whose securities are affected, by virtue of their office or profession.³⁴

These readings seem to conjure important elements out of thin air: what the scholar understands as a kind of breach of duty/*scienter*-lite element, or what he later calls a “causal link” between trader status and “acquisition” (or even final possession) of information. This effort to read some kind of intentionality requirement into the statute ultimately fails,³⁵ and it seems crystal clear that – at least insofar as the statute is concerned -- there is strict liability for the Article 74 enumerated persons who happen to possess inside information at the time they trade in securities of the company (but who have not illegally procured such information).

The structure is under-inclusive for traders who are not part of the Article 74 enumerated class but who trade on statutorily-defined “inside information,” even apparently “tippers” alluded to in Article 76 (unless such “tippers” are also misappropriators). Likewise, neither “tippees” nor “M&A advisors” defined above who are not part of the Article 74 enumerated class of defendants would have exposure to insider trading liability (again, unless also guilty of misappropriation). “Tippees” are exculpated because Article 76 only prohibits “tipping” (although “tippees” would have liability if members of the Article 74-enumerated class, or their receiving the tip constitutes misappropriation of inside information). “M&A advisors” -- again, if not misappropriators of inside information – are also outside of the enumerated class of traders listed in Article 74, as they are not employed at the company which issues the traded stock.

b. Agency Designation of “Insiders” and a Parallel (and Conflicting) Enforcement Regime

As noted above, the CSRC evidently created the 2007 Insider Trading Guidance Provisions in response to the invitation at Article 74(vii) of the 2006 PRC Securities Law. However, the job was botched badly, with the CSRC issuing non-administrative regulatory norms of doubtful legality that nonetheless far exceed the statutory invitation. The Insider Trading Guidance Provisions do widen very significantly the defined scope of “people with knowledge of inside information” under Article 74, but then go many steps further to actually recast insider trading in China *in toto* and create new and additional bases for insider trading liability, far beyond that ever contemplated in China’s Securities Law. The result, in U.S. parlance, is the equivalent of an extremely robust *Texas Gulf Sulphur*-type doctrine.

³³ See Hui Huang, *supra* note __, at 10-11 (citing to the 1999 PRC Securities Law equivalent to the 2006 PRC Securities Law’s Article 74).

³⁴ *Ibid*, at 13-14.

³⁵ As the same scholar recognizes: “This issue [“possession versus use”] is largely ignored in China... the issue deserves careful attention, particularly given the stiff liability of insider trading.” *Ibid*, at 11.

How do the Guidance Provisions accomplish this? First, the Insider Trading Guidance Provisions create a new defined term, “insider” (*neimuren*), which term does not appear in the 2006 PRC Securities Law.³⁶ As noted above, the Securities Law does not ever mention, or address the liability of, “insiders”, but only “persons with knowledge of inside information,” misappropriators, and either of the foregoing who are also “tippers”. The Insider Trading Guidance Provisions, meant to elaborate the class of persons included in the category of “persons with knowledge of inside information,” do exactly the opposite – and reverse-merge the Article 74(i)-(vi) statutory list of “persons with knowledge of inside information” into the new Guidance Provisions category of “insiders.” Then, the Insider Trading Guidance Provisions state that such “insiders” are natural or legal persons who directly or indirectly gain possession of “inside information.” Most importantly, Article 12(i) of the Insider Trading Guidance Provisions then effectively constructs a new basis for insider trading culpability, holding that where the “actor is an insider [as newly defined in the same Guidance Provisions]” and the information used is “inside information,” then if the actor has purchased or sold the relevant securities, or suggested that another purchase or sell such securities, or communicated such “inside information” during a price sensitive period, then a case for insider trading is established. This is at substantial variance with, and goes far beyond, the insider trading regime as it is defined in Articles 73-76 of the 2006 PRC Securities Law described above.

Second, the statutorily-ungrounded definition of “insider” in the 2007 Insider Trading Guidance Provisions, coupled with the new definition of insider trading in Article 12 of the Guidance Provisions described immediately above, radically expands the narrower group of individuals liable for insider trading under the PRC 2006 Securities Law (recalled as simply “persons with knowledge of inside information” under Article 74(i)-(vi), misappropriators under Articles 73 and 76, and either of the foregoing who are also “tippers”) to include:

- The securities issuer, or listed company (as “persons with knowledge of inside information”)
- The controlling shareholder of the issuer or listed company, companies controlled by the actual control party of the issuer or listed company, and their respective directors, supervisory board members and senior management (as “persons with knowledge of inside information”)
- Any party involved in a listed company’s merger, acquisition or reorganization and their relevant personnel (as “persons with knowledge of inside information”)
- Persons who gain inside information in the performance of their work (as “persons with knowledge of inside information”)
- The partners and spouses of those natural persons included in Article 74(i)-(vi) of the PRC 2006 Securities Law (or statutorily-defined “persons with knowledge of inside information”)
- The parents or children or other relatives of any natural persons included in the above categories who come into possession of inside information
- Those who employ illegal methods such as trickery, coaxing, eavesdropping, monitoring, secret trading, etc. to gain inside information
- Those who gain inside information through other channels

³⁶ Insider Trading Guidance Provisions, Article 5.

In short, the 2007 Insider Trading Guidance Provisions – in particular the concept noted in the final bullet above, that an “insider” is simply someone “who gains inside information” -- explode the bounds of the 2006 PRC Securities Law. Whereas under the 2006 Law only a narrowly defined class of “persons with knowledge of inside information” or *ex post*-determined misappropriaters (acting directly or as tippers) could be liable for specifically-defined insider trading, under the CSRC Guidance Provisions any person simply in possession of information (and thus suddenly an “insider” under the Provisions) that is determined to be “inside information” who “purchases or sells relevant securities, or suggests that another purchase or sell such securities, or communicates such inside information” during a “price sensitive period” is liable for insider trading.

The result is a kind of strict liability under the Insider Trading Guidance Provisions for anyone trading in securities when deemed to be in possession of inside information and during a price sensitive period. To be fair, the liability is not absolutely strict as the same Guidance Provisions introduce a *scienter*-like requirement – “whether or not [the defendant] knew or was informed of (*zhicai*) inside information – but only for (i) “the parents or children or other relatives of any natural persons” included in the expanded scope of “persons with knowledge of inside information” in the 2007 Guidance Provisions³⁷ and (ii) “those who employ illegal methods such as trickery, coaxing, eavesdropping, monitoring, secret trading, etc. to gain inside information;” and “those who gain inside information through other channels.”³⁸ This must be cold comfort for the huge class of other potential defendants, for at the same time the 2007 Provisions make insider trading liability only stricter for (i) the “persons with knowledge of inside information” originally listed in the 2006 Securities Law at Article 74(i)-(vi) and (ii) the expanded scope of such persons, reversing the burden of proof for such defendants so that they will be liable for insider trading during the price sensitive period unless “they have sufficient evidence to demonstrate that they did not know or were not informed of inside information.”³⁹

Thus, for example, “tippees” (as defined above) who are not misappropriaters and who trade during the price sensitive period would be liable under the CSRC Insider Trading Guidance Provisions, although not under the PRC Securities Law. Likewise, M&A advisors (as defined above) consulting for an acquirer and trading in the shares of a target company during a price sensitive period would also be liable for insider trading under the CSRC Guidance Provisions, although not under the PRC Securities Law. As demonstrated below, the CSRC at least (and likely the People’s Procuratorate in the criminal sphere) is actually enforcing China’s insider trading prohibitions in this way, and without any basis in the nation’s Securities Law.

To be very clear here, the issue is not that the CSRC has broadened the scope of “persons with knowledge of inside information,” something that agency was perfectly entitled to do. Instead, the problem is that the CSRC has created a whole new class of defendants -- outside of

³⁷ Being the securities issuer, or listed company; the controlling shareholder of the issuer or listed company, companies controlled by the actual control party of the issuer or listed company, and their respective directors, supervisory board members and senior management; any party involved in a listed company’s merger, acquisition or reorganization and their relevant personnel; and persons who gain inside information in the performance of their work.

³⁸ Insider Trading Guidance Provisions, Article 14(ii).

³⁹ Insider Trading Guidance Provisions, Article 14(i).

“persons with knowledge of inside information,” and misappropriators (acting directly or as “tipsters”) – called “insiders” who can now be exposed to serious liability if they are foolish enough to trade during a price sensitive period with respect to any securities (*i.e.*, not the securities of the company relevant to their status), and with a new burden of proof which almost assures their guilt (unless they can prove a negative: that they did not know or were not informed of the inside information).

IV. REGULATORY INFIRMITY OF THE INSIDER TRADING GUIDANCE

The CSRC 2007 Insider Trading Guidance Provisions implicate a very serious problem for China’s insider trading regime. That is because the CSRC has not actually promulgated regulations, measures, provisions, departmental rules, rules, or indeed any species of public rule-making under the authority granted it in Article 74(vii) of the PRC 2006 Securities Law with the characters (as a verb) “*gui’ding*.” Instead, it has only distributed, internally and not publicly,⁴⁰ the Insider Trading Guidance Provisions which are mere “guidance” (*zhiyin*) or a “guidance document” (*zhidaoxing wenjian*) and which declare, by their own terms, that they function to “recognize and confirm” (*ren’ding*) – not “stipulate in regulation” (*gui’ding*) -- the enforcement of legal norms for insider trading.

Here, I analyze how the 2007 CSRC Insider Trading Guidance Provisions do not conform to the statutory delegation of regulatory authority in Article 74(vii) of the 2006 PRC Securities Law. A first critical question is the meaning of the 2006 PRC Securities Law Article 74(vii) statutory authorization which commands and permits CSRC “regulation” or “stipulation” (*gui’ding*) of additional “persons with knowledge of inside information”, especially when contrasted with the allowance granted to the same agency to merely “recognize and confirm” (*ren’ding*) “important information having a significant effect on securities prices” in adjacent Article 75(viii).

a. Hierarchy of “Regulation” (as a Verb) in the 2006 PRC Securities Law

Inside the four corners of the 2006 PRC Securities Law, there is an ascending hierarchy of contemplated regulatory actions, by the CSRC and other departments, as follows:⁴¹

⁴⁰ In fact, the Guidance Provisions are totally unavailable on the CSRC website, which posts all law, regulations and rules applicable to securities issuance and trading.

⁴¹ The CSRC is charged with other kinds of actions in the 2006 PRC Securities Law, noted here to distinguish them from the ascending hierarchy analyzed below. At Article 202, the CSRC is authorized to “issue administrative punishment in accordance with law” (*yifa geiyu xingzheng chufen*), the main type of action which, by its terms, must be done “according to law” which, given that it is “administrative” punishment, could certainly be imposed according to properly established administrative law norms. In Articles 26 and 46, the CSRC is charged with “deciding” or making “decisions” (*jueding*) regarding approval of a proposed securities issuance, the establishment of an exchange for government bonds, and the establishment of securities firms. At Articles 40, 50, 91, 103, 125, 128, 129, 155, 158, 165, 169, 180, and 226, the CSRC (and in the case of Article 180, the senior leadership of the CSRC) is empowered to “approve” (*pizhun*): trading systems other than open unified trading; more onerous listing conditions than those set out in the Law; changes to a takeover offer contained in a report; exchange articles of association; exchange listing and trading rules; establishment of securities firms; the scope of business of securities firms; significant changes, merger, liquidation, etc. of securities firms; the establishment of registration and settlement institutions; the business rules for securities registration and settlement institutions; termination of a securities registration and settlement institution; and securities business undertaken by investment advisors, financial

- recognize and confirm (*ren'ding*)
- formulate (*zhiding*)
- regulate or stipulate in regulation (*gui'ding*)
- stipulate in law (*fa'ding*)

This ascending hierarchy is discussed below slightly out of order, to situate the meaning of “*gui'ding*” (to “regulate” or “stipulate”) specifically as a verb in Article 74(vii) of the 2006 PRC Securities Law, and try to determine what kind of administrative law action is required and sufficient for the “*gui'ding*” action.

i. ren'ding

The characters for the verb form “*ren'ding*” (“recognize and confirm”) appear only a few times in the statute outside of Article 75(viii) relating to definition of important information having a significant effect on securities prices. Article 2 uses the character set to point to other instruments “recognized and confirmed” by the State Council (and not the CSRC) “in accordance with law” (*yifa*) as securities covered by the Law. Likewise, Article 170 states that standards and administrative measures for the qualification of securities industry service firms are to be “recognized and confirmed.” It is not at all clear from the face of the statute if the act of “recognizing and confirming” places a lesser burden on the regulator and the nature of the resulting authorized regulation as compared with “*gui'ding*” and “*fa'ding*” analyzed below; indeed, the modifying phrase “in accordance with law” (*yifa*) in Article 2 might indicate just the opposite, and that the regulator’s burden of “recognizing and confirming” is equivalent to that of “regulating” or “stipulating” (*gui'ding*). Nonetheless, lack of the character “*gui*” in the compound, for Chinese speakers, seems to indicate something less than stipulation in formal regulation or law.

advisors, credit rating agencies, asset appraisal firms and accountancy firms. At Article 131, the CSRC is tasked with another form of “approving” (*hezhen*), in this case of qualifications for those serving as directors, officers or supervisory board members of securities firms. At Article 70 the CSRC is authorized to “designate” (*zhiding*) media organs for mandatory securities disclosure and designate, at Article 148 there is reference to a “designated” (the same “*zhiding*”) time period for submission of materials to the CSRC, and at Articles 153 and 154 it is empowered to “designate” a receiver for failing securities firms. This character set is distinct from the homophonic but different character set “*zhiding*” (to “formulate”) used to describe action in Articles 149, 169 and 170, described *infra*. At Article 127, the CSRC is permitted to “adjust” (*tiaozheng*) minimum registered capital for securities firms. At Article 152, the CSRC has the power to “disqualify” (*chexiao... qi zige*) directors, officers and supervisory board members of securities companies in breach of their duty of care, and “order” (*zeling*) the company to change those appointments. At Articles 153 and 154, the CSRC has the power to “order” (again, “*zeling*”) the closure or reorganization of a securities business, and “designate” a receiver, while in Article 153 it can de-certify (again, “*chexiao*”) the business. At Article 154, the CSRC “notifies” (*tongzhi*) the border service about securities firm personnel who may try to flee the PRC, and “applies to” (*shenqing*) the judiciary to enjoin any disposition of assets by the same. At Articles 180 and 181, the CSRC is authorized to “investigate” (*jiancha*) and “take evidence” (*quzheng*), “freeze” (*dongjie*) or “seal” (*chafeng*) operations and accounts, and even “limit” (*xianzhi*) trading. Finally, Article 222 permits the CSRC to limit (again, “*xianzhi*”) shareholder powers in securities firms that act illegally.

ii. zhiding

At five places in the statute the CSRC is tasked with “formulating” (*zhiding*) different norms. At Article 149, the character set is used to describe what the CSRC will do with respect to “specific measures” (*juti banfa*) for instruction of audit or asset appraisal of securities companies. Article 169 states the CSRC will formulate “administrative measures” (*guanli banfa*) for the examination and approval of securities industry service firms. Article 170 calls for CSRC formulation of the “recognition and confirmation” (*ren ding*) of “qualification standards” and “administrative measures” (*guanli banfa*) for securities industry service firms. And finally, Article 179 (i) & (iv) and Article 184 allude to instances where the CSRC itself will formulate: departmental rules and rules (*guizhang, guize*) for supervision of the securities markets; qualification standards and practice standards for securities professionals; and departmental rules and rules (*guizhang, guize*) – in each case “in accordance with law”.⁴² While Chinese speakers will recognize the “formulation” (*zhiding*) verb as a looser way of saying “stipulate” or “regulate”, it is noteworthy that in each case this verb form is associated with a product that includes “departmental rules” or “rules” (*guizhang, guize*), public standards or qualifications, and “measures” (*banfa*), a type of administrative law enactment with a specific meaning in the Chinese scheme.⁴³

iii. fa ding

The single form of verb-adjective more onerous than “*gui ding*” is “*fa ding*”, which can be translated as “stipulated in law” (as opposed to “stipulated in regulation”). This formulation appears at Article 57 (issuers conforming to conditions for debt issuances stipulated in law), Article 74 (people engaged in administration of securities issuance, or trading), and Article 128 (conditions and procedures for review of securities firm establishment). In addition, Article 139 has the single instance of the phrase that “*fa ding*” is a contraction of, “*falü gui ding de*”, meaning “as stipulated in law” (alluding to other situations regarding the handling of customer securities accounts). While it is again difficult to determine exactly what is meant by the character set, it seems likely that the command or permission is for stipulations contained *in law* and not a lesser form of legal or regulatory enactment.

iv. gui ding

The Chinese characters “*gui ding*” – as a verb -- appear in at least 45 articles in the 2006 PRC Securities Law.⁴⁴ One article of the statute sets forth a slight variation on the verb form,

⁴² The same verb “to formulate” (*zhiding*) is also used in connection with the stock exchanges’ obligation to formulate articles of association, listing rules, trading and settlement rules, trading powers of attorney, and the settlement and clearing institution’s obligation to formulate business rules.

⁴³ See note 49 *infra* and accompanying text.

⁴⁴ See Articles: 2 (items stipulated in other “laws and administrative regulations” (*falü xingzheng fagui*); the State Council to stipulate “administrative measures” (*xingzheng banfa*)); 10 (conformity with conditions stipulated in “laws, administrative laws and regulations”); 11 (other securities stipulated in “laws, administrative laws and regulations”; stipulated qualifications and administrative measures for sponsors); 12 (conditions in conformity with the Company Law stipulated by the CSRC); 13 (other conditions stipulated by the CSRC); 14 (sponsor applications in the form stipulated under the Law); 16 (other conditions necessary for debt issuances

commanding the CSRC to “make regulation” (*zuochu gui’ding*) (regarding the business activities and certain financial ratios applicable to securities firms).⁴⁵ The scope of norm-vehicles or anticipated products for the verb action “*gui’ding*” is limited, and includes only: (i) the Securities Law itself (*ben fa*) or another statute (*fa*) like the 2006 PRC Company Law; (ii) “*faliu*” (“law”); (iii) “*gui’ding*” as a noun (translated as “legislative provisions” (including law, administrative regulations, departmental rules, etc.)); (iv) “*faliu xingzheng fagui*” (usually translated as “laws and administrative regulations”); (v) “*faliu xingzhenggui’ding*” (“laws and administrative regulations”); and (vi) “*guanli banfa*” (“measures for administration”) or “*juti banfa*” (“specific measures”).⁴⁶

Other than in three unrelated articles,⁴⁷ never in the statute is there an association between the act of regulation or stipulation (*gui’ding*), on one hand, and resulting identified legal or regulatory norms, on the other, *via* anything other than specific statute, “regulations,” “laws, administrative regulations,” “measures for administration” or “specific measures.”⁴⁸ Never is the

stipulated by the State Council); 17 (other documents necessary for debt issuance applications); 21 (preliminary disclosure in connection with equity IPO applications); 22 (organization, term of office, working procedures, etc. of the CSRC Listing Council); 30 (items to be included in underwriting agreement); 36 (time period for submission of offering report); 40 (securities forms other than paper securities); 46 (“unified” stock exchange fees, standards and administrative measures); 49 (other securities exchanges using sponsors); 50 (more onerous listing conditions); 52 (other documents for equity listing applications); Article 53 (time period for disclosure of offering documents); Articles 55 and 56 (other situations triggering de-listing); Article 58 (other documents to be included in application to list debt); Article 66 (other matters to be addressed in annual report); Article 66 (other matters to be included in “Major Events” periodic reporting); Article 71 (mandatory public disclosure); Article 87 (reports and announcements mandated in the Securities Law itself); Article 90 (public company takeover report form); Article 101 (specific measures for the takeover of listed companies); Article 108 (people who cannot be responsible officials at securities exchanges); Article 116 (exchange risk fund stipulated jointly by the CSRC and the Ministry of Finance); Article 123 (establishment of securities firms); Article 124 (conditions for establishment of securities firms); Article 128 (time period for business license application by approved securities firms); Article 133 (people prohibited from senior posts at securities firms); Article 134 (securities investor protection fund); Article 135 (levies on trading to fund securities investor protection fund); Article 139 (measures for securities company trading accounts, and other situations with regard to handling customer accounts); Article 140 (time period within which trading power of attorney must be deposited with a broker); Article 141 (financial support for trading accounts); Article 151 (certain shareholders stipulated); Article 156 (other conditions for the establishment of registration and settlement institutions); Article 162 (settlement risk fund measures and funding); Article 166 (nationality requirements for legal and natural persons seeking to open trading accounts); Article 172 (standards and fee schedules for securities industry service firms); Article 179 (other powers for the CSRC); Article 191 (other behavior by underwriters in violation of law); Article 208 (illegal behavior); Article 229 (listing conditions); and Article 239 (specific measures for purchase and trading of domestic securities in foreign exchange).

⁴⁵ 2006 PRC Securities Law, Article 130.

⁴⁶ See 2006 PRC Securities Law, Articles 2, 5, 6, 10, 11, 24, 49, 71, 87, 90, 101, 108, 116, 123, 133, 139, 156, 163, 172, 179, 208, 229, and 239.

⁴⁷ See Articles 52(viii), 55(v), and 58(vii) which reference – exclusively -- stock exchange listing rules (*shangshi guize*) or just exchange rules (*jiaoyisuo guize*) as the result of “*gui’ding*.” The characters “*guize*” which can be translated as “rules,” and which are referenced several times in the statute independently of the act of regulation or stipulation (*gui’ding*), seems associated in the Chinese discourse with rules issued by self-governing bodies or associations, and something less than legal (and perhaps regulatory) norms. See also Article 179, where the CSRC is obligated to “formulate (*zhiding*) securities market administration rules and regulations (*guizhang, guize*) in accordance with law...”

⁴⁸ There are many references to the specific substantive content of those stipulated norms, which do not, however, inform us of the nature of the norms required for the action which is “to regulate” (*gui’ding*). Some of those substantive objects include: (i) “qualifications” (*zige*); (ii) “conditions” (*tiaojian*); (iii) documents (*wenjian*); (iv) preliminary disclosure (*yuxian pilu*); (v) the organization, term of office, working procedures, etc. of the Listing

CSRC to “*gui’ding*” (regulate or stipulate) even “*guizhang*” (departmental rules) or “*guize*” (rules). Said another way, the consistent internal architecture of the 2006 PRC Securities Law indicates that the statutory command or authorization to “regulate” (*gui’ding*) can only be implemented by something which constitutes law, regulation, or (administrative) measures.⁴⁹ Even where the seemingly less strict verb “to formulate” is used at Articles 179 (i) & (iv) and 184, the CSRC is charged with formulating “departmental rules” and “rules” (*guizhang, guize*) and public standards or qualifications, publicly and in accordance *with law*.

b. The Securities Law Requirement that the CSRC Act “Publicly”

Lastly with regard to the internal mandates of the 2006 PRC Securities Law, Article 184 states very clearly that “[the CSRC] in formulating departmental rules and rules (*guizhang, guize*) and its supervisory administration work system shall [do so] publicly (*yingdang gongkai*).”⁵⁰ This constitutes a strong mandate requiring that regulatory and enforcement norms and action be accomplished “publicly.”⁵¹

c. The PRC Law on Legislation

The PRC Law on Legislation (“LL”), passed six years before the 2006 PRC Securities Law, can also inform the present analysis. Article 9 of the LL authorizes delegation by the National People’s Congress (“NPC”) or the NPC Standing Committee to the State Council and its departments the power to formulate (*zhi’ding*)⁵² “*xingzheng fagui*” or “administrative regulations,” the same character set that is often the object of the verb “to regulate” or “to stipulate” (*gui’ding*) in the 2006 PRC Securities Law as detailed *supra*. Importantly, that delegation is only effective when the NPC or its Standing Committee have not yet passed “law” on the various areas within its legislative competence (listed in Article 8 of the LL). Articles 56-62 of the LL address such “administrative regulations” (*xingzheng fagui*), and those articles make clear that these are norms conceived, discussed, and issued only by the State Council. Most importantly for the present discussion, such “administrative regulations” must be signed by

Council mandated at Article 22; (vi) items (*shixiang*) that must be included in agreements; (vii) time periods within which submissions, public reporting or decisions must be made; (viii) forms of securities other than paper; (ix) “situations” (*xingshi*) requiring temporary or permanent de-listing; (x) the “other people” who are to be designated “people with knowledge of inside information” pursuant to Article 74 that is the focus of this inquiry; (xii) reports and announcements; (xiii) levies to fund a risk fund or the securities investor protection fund; (xiv) fee schedules to be charged by securities industry service firms; (xv) articles of association; (xvi) registered capital; (xvii) business and financial ratios; (xviii) finance services; and (xix) behavior.

⁴⁹ “Measures” (*banfa*) are a hold-over appellation for administrative regulation – or what Perry Keller translates as normative documents (*guifanxing wenjian*) -- from the pre-reform and legal construction era. Another normative document appellation still in use is “*tiaoli*” often translated as “regulations.” In 1956, Mao Zedong authorized the use of these normative documents (*zhangcheng, tiaoli, and banfa*) to work in the service of application of “law” or formal legal norms. See Perry Keller, “Sources of Order in Chinese Law,” 42 *Am J. Comp. L.* (1994) 711, 722-3.

⁵⁰ The same Chinese characters as are used to describe the obligation of all administrative agencies with respect to their administrative rule-making and enforcement functions in the Administration According to Law Outline, *supra* note __, at Paragraph 5(iii).

⁵¹ As noted *infra*, the Administrative Punishments Law also requires that administrative enforcement be undertaken pursuant to publicly-promulgated administrative norms.

⁵² This is the same verb form noted above that appears in the 2006 PRC Securities Law, and in the LL is used as a general verb to formulate various kinds of norms, including “law” (*fali*).

the Premier, publicly promulgated (*gongbu*) in a State Council order, and then published in the State Council gazette.⁵³ Articles 71-77 of the LL address yet another *genus* of administrative norm, “*guizhang*”, commonly translated as “departmental rules.” These “departmental rules” are to be formulated (again, *zhiding*) by the State Council’s subordinate departments (including ministries), commissions (including the CSRC), the People’s Bank of China (China’s central bank), the State Audit Commission, and subordinate organs with administrative competence “in accordance with law, and State Council administrative regulations (*xingzheng fagui*), decisions (*jueding*), and orders (*mingling*).” Each of the State Council’s “subordinate departments, commissions, the People’s Bank of China, the State Audit Commission and subordinate organs with administrative competence” are referred to under the global term “departments” (*bumen*).⁵⁴ Most importantly, the LL mandates that any “rules” formulated by such “departments” must be formulated in accordance with law, and must be publicly promulgated (*gongbu*) and published.⁵⁵

Pursuant to the terms of the LL then,⁵⁶ -- which makes no mention of “guidance” (*zhiyin*) or “guidance documents” (*zhidaoxing wenjian*) as a species of “administrative regulation” (*xingzheng fagui*) -- the 2007 Insider Trading Guidance Provisions qualify neither as (i) “administrative regulations” (*xingzheng fagui*), nor as (ii) “departmental rules” (*bumen guizhang*). They are not the former, because they are not formulated and issued by the State Council or made public (nor are they issued in the absence of legal stipulations on the same subject); they are not the latter because they are not formulated within the bounds of the 2006 PRC Securities Law, and are not publicly issued or published. As noted above, the 2007 Insider Trading Guidance Provisions are merely internal “guidance” for the CSRC in enforcement against insider trading, and have never been publicly promulgated and are not published on the CSRC website.

d. Permissible as a “Normative Document” (*guifanxing wenjian*)?

Some scholars will contest the central argument of this paper by asserting that the CSRC’s 2007 Insider Trading Guidance Provisions are an identity of what the Chinese legal and governance system calls “normative documents” (*guifanxing wenjian*), long-standing Chinese Communist Party-led state governance norms not formally recognized in the LL. In the PRC, the term has historically been used for the many non-legal norms deemed enforceable in fact, including everything from line-ministry or local People’s Congress norms to specifically-tailored bureaucratic communications.⁵⁷ Even after the promulgation of the LL, the term is still used in government and departmental pronouncements – like the State Council’s 2004 Administration

⁵³ LL, Articles 61 and 62.

⁵⁴ LL, Article 71.

⁵⁵ LL, Articles 76 and 77.

⁵⁶ The PRC Administrative Litigation Law (“ALL”), promulgated more than a decade before the LL, in describing the kinds of administrative acts or norms that can and cannot be subject to challenge, also refers to “administrative regulation” (*xingzheng fagui*) and “departmental rules” (*guizhang*) with the same terminology (Articles 12(2) and 53). In addition, the ALL refers to “decisions” (*jueding*) and “orders” (*mingling*) “formulated and announced by administrative organs with universal binding force” (Article 12(2)). There is no mention of a norm called “guidance” (*zhiyin*) or “guidance documents” (*zhidaoxing wenjian*) as a species of “administrative regulation” or “departmental rules”.

⁵⁷ See Keller, *supra* note ___, at 722-3.

Under Law Outline⁵⁸ and 2010 Rule of Law Government Opinion⁵⁹ -- in concrete acknowledgement of the fact that many such non-legal, non-regulatory -- norms continue to exist and continue to be understood as enforceable. All of the above being true, the Insider Trading Guidance Provisions are still defective and unenforceable, even as “normative documents”, because (i), the 2006 PRC Securities Law does not authorize issuance of “normative documents” for the further enumeration of insider trading defendants, but “regulations” or “departmental rules”, (ii) the Guidance Provisions do not comply with the basic requirements for issuance of enforceable “normative documents” (that they be issued publicly, and subject to the “file and review” procedure (*beian shencha*))⁶⁰, and (iii) the substantive content of the Insider Trading Guidance Provisions are *ultra vires* or wildly out of conformity with China’s legal stipulations on domestic insider trading.

e. “Guidance Documents” (*zhidaoxing wenjian*)

As noted above, the CSRC’s 2007 Insider Trading Guidance Provisions are self-declared as a species of “guidance document” (*zhidaoxing wenjian*). This self-declaration begs the question as to what exactly such “guidance documents” are, and most importantly in the present context, whether or not they can qualify as “administrative regulations”, “departmental rules” or “rules” that are responsive to the Article 74(vii) mandate, or qualify as enforceable legal-regulatory norms under the LL? There is in fact no reference to such “guidance documents” in any national PRC law or administrative regulation, and certainly not in the LL; instead, there is only the exhortation of the need for “administrative guidance” (*xingzheng zhidao*) in various departmental rules, which exhortations are a reflection of the State Council’s allusion to the same item in its 2004 Administration According to Law Outline.⁶¹ The only other related reference to the concept of “administrative guidance” comes in Article 1(4) of the Supreme People’s Court 2000 interpretation of the 1989 Administrative Litigation Law (“ALL”),⁶² which stipulates that “administrative guidance acts that do not possess coercive force” are not justiciable under the ALL. The negative implication of that statement is that “administrative guidance acts” that do have coercive force are justiciable under the ALL. While that notion may be helpful for a private party wishing to challenge any CSRC enforcement pursuant to the 2007 Guidance Provisions alone (and without any concurrent basis in the 2006 PRC Securities Law),⁶³ it provides no help in making such “administrative guidance acts” (which might include internal issuance of a “guidance document” like the CSRC’s 2007 Provisions) qualify as “administrative regulations”, “departmental rules” or “rules” required under the 2006 PRC Securities Law or the LL.

f. Conclusion

The conclusion of the foregoing analysis is this: the CSRC, by issuing the 2007 Insider Trading Guidance Provisions, has not created a legal or regulatory norm which conforms to the

⁵⁸ See for example Paragraphs 3(ii) and 14.

⁵⁹ See for example Paragraphs 8-10.

⁶⁰ Required under the 2004 Administration Under Law Outline and the 2010 Rule of Law Government Opinion, noted *supra* notes ____.

⁶¹ See Administration According to Law Outline, *supra* note ____.

⁶² See PRC Supreme People’s Court, Interpretation of Certain Issues in the Implementation of the Administrative Litigation Law, *fashi* (2000) No. 8, March 10, 2000.

⁶³ See *infra* note ____ and accompanying text.

statutory authorization to “regulate” or “stipulate” (*gui’ding*) other “persons with knowledge of inside information.” Moreover, the Insider Trading Guidance Provisions would appear to be legally unenforceable, whether by the CSRC or judicial institutions.

At the first level, this is not a problem of the CSRC acting *ultra vires* by exceeding a properly-delegated power to regulate; indeed, the defect would still exist if the CSRC had limited itself merely to a designation of other “persons with knowledge of inside information” in the Insider Trading Guidance Provisions. Why is this so? First, as demonstrated above, the statutory command to the CSRC at Article 74(vii) of the 2006 PRC Securities Law is to issue what the LL calls “administrative regulations” (*xingzheng fagui*) or “departmental rules” (*guizhang*) regarding the other actors who can be identified as “persons with knowledge of inside information.” Instead, the CSRC issued another, different, species of direction called “(provisional) guidance (*zhiyin*) on the recognition and confirmation (*ren’ding*)” of insider trading behavior,⁶⁴ and which self-identifies as a “guidance document” (*zhidaoxing wenjian*) for use by CSRC officials only to “recognize and confirm insider trading”.⁶⁵ Moreover, that guidance – by its own terms – is based in a cluster of norms it is itself supposed to be: “the Securities Law, and the related provisions of other laws, administrative regulations (*xingzheng fagui*) and departmental rules (*guizhang*).”⁶⁶ How one might ask can a specifically-named norm (“guidance”) be based in the superior norm it is supposed to be (“administrative regulation” or “rules”) by the terms of the delegating law? Second, and perhaps more dispositively, the CSRC 2007 guidance is not public, which under the LL all “administrative regulations” (*xingzheng fagui*) and “departmental rules” (*guizhang*), and under the 2006 PRC Securities Law all “departmental rules” and “rules” (*guizhang, guize*), must be. Authorized to “regulate” (*gui’ding*) a very specific norm, in 2007 the CSRC produced something which does not rise to the object of such “regulation.”

At a second level of analysis, the Insider Trading Guidance Provisions, whatever their standing as “administrative regulation” or “departmental rules”, and no matter how public they are, are clearly *ultra vires* to the narrow grant of regulatory authority at Article 74(vii) of the Securities Law (because they address far more than just other “people with knowledge of inside information”), and also *ultra vires* with respect to the entire *legal* understanding of insider trading under the same Law (because they re-define the civil breach and eventually the crime). The Insider Trading Guidance Provisions at Article 1 recite that they are formulated in accordance with “the Securities Law, and the relevant provisions of other laws, administrative regulations and rules.” This is a falsehood. As demonstrated above in some detail, the liability for insider trading as set forth in the Insider Trading Guidance Provisions departs radically and completely from the limited bases for insider trading under the statute. As also noted above, the 2007 Insider Trading CSRC Guidance Provisions provide for (in U.S. securities law parlance) a *Texas Gulf Sulphur* theory of liability (effectively anyone in possession of inside information who trades), whereas the 2006 PRC Securities Law allows only a narrow version of (again in U.S. parlance) *Cady, Roberts* liability (the specific insiders identified in Article 74) and what obviously aspires to be *O’Hagen*-style misappropriation liability.

⁶⁴ Which seems more directly responsive to the 2006 PRC Securities Law Article 75(viii) invitation to “recognize and confirm” (*ren’ding*) price-moving inside information.

⁶⁵ See Insider Trading Guidance Provisions, Article 4.

⁶⁶ See Insider Trading Guidance Provisions, Article 1.

g. “Securities Trading Manipulation” Unaffected

Parenthetically, the issue with respect to the regulation of insider trading in China described here presents some ironies, because the CSRC is perfectly in compliance with the law in providing mere “guidance” for enforcement against the separate breach of a “market manipulation” prohibition described in Article 77 of the 2006 PRC Securities Law.⁶⁷ That is because Article 77(iv) provides a broad catch-all against “other methods of securities market manipulation” with no specific required elements to make out “manipulation” (such as *scienter*, purchase or sale of securities, etc.) and makes no delegation of regulatory power to the CSRC or any other agency. Accordingly, the CSRC is free under the statute to enforce against such manipulation in any way it determines, and without reference to any notified or universally applicable administrative law norm – something I argue it cannot do with respect to insider trading.⁶⁸

V. ENFORCEMENT ABUSE

Unfortunately, the significant problem identified and analyzed above is not just theoretical. That is because the CSRC is actively enforcing insider trading liability under the wide theory promised by the defective 2007 Insider Trading Guidance Provisions, and in situations where the explicit terms of the 2006 PRC Securities Law do not provide for liability. A glance at recent enforcement decisions posted on the CSRC website makes this abundantly clear (summaries of the examples referred to appear in the Appendix):

The 2011 *Liu Yang* enforcement decision shows how liberally the CSRC (mis)applies Article 74 of the PRC 2006 Securities Law, in that the defendant is pronounced “a person with knowledge of inside information” simply because he “participated in... [the reverse merger] related affairs.” This is not the same thing provided for under Article 74(iv) (“persons who are able to obtain relevant inside information concerning the company by virtue of the position they hold in the company”), which is unavailable precisely because the defendant comes into possession of important information about a company – the target -- *different* from the one he is employed at. Nor does the CSRC makes any effort to base his liability in the misappropriation

⁶⁷ Which it did at the same time it issued the defective Insider Trading Guidance Provisions in 2007. See China Securities Regulatory Commission, *zhongguo zhengquan jiandu guanli weiyuanhui guanyu yinfa “zhengquan shichang caozong xingwei rending zhiyin (shixing)” ji “zhengquan shichang neimu jiaoyi xingwei rending zhiyin (shixing)” de tongzhi* [Notice of the China Securities Regulatory Commission Regarding the Printing and Distribution of the “(Provisional) Guide for the Recognition and Confirmation of Manipulative Behavior in the Securities Markets” and the “(Provisional) Guide for the Recognition and Confirmation of Insider Trading Behavior in the Securities Markets”], March 27, 2007, *zhengjian jichazi* (2007) No. 1.

⁶⁸ The analysis in this paper would lead to the conclusion that the CSRC is also free to determine what is price-impacting information for insider trading enforcement without issuing formal regulation or rules, because Article 75(viii) of the 2006 PRC Securities Law only requires that the CSRC “recognize and confirm” (*ren’ding*) what that information is in specific circumstances. In fact, a part of the 2007 Insider Trading Guidance Provisions do set forth ways in which the CSRC is to “recognize and confirm” such information in the context of an insider trading enforcement action. Working against this forgiving conclusion is the general requirement, noted above, in Articles 179 and 184 that the CSRC formulate only “departmental rules” or “rules” (*guizhang, guize*) and they do so publicly.

prong of the statute. Without any doubt, the CSRC is relying upon the wider basis for insider trading liability provided in the 2007 Insider Trading Guidance Provisions.

In the 2011 *Lin Shiquan* enforcement action, the CSRC does not indicate how the defendant qualifies as one of the persons enumerated in Article 74 of the 2006 PRC Securities Law, stating in conclusory terms that he became a “person with knowledge of inside information.” He is not identified as an officer or shareholder of the selling controlling shareholder of the issuer, although he is identified as the top executive of another entity which may be a shareholder of the issuer holding more than 5% of the issuer per Article 74(ii) of the Securities Law. Nowhere in the decision does the CSRC feel the need to articulate how this defendant qualifies as a “person with knowledge of inside information”, or if he is guilty of misappropriation of the information, no doubt because they are relying upon the broader basis for insider trading liability provided for in the 2007 Insider Trading Guidance Provisions.

In the 2010 *Jia Huazhang & Liu Rong* case, a fairly standard husband-wife/tipper-tippee case, the CSRC simply declares the husband/tipper to be a “person with knowledge of inside information” without tying his status to the enumerated persons under Article 74. Nor does the CSRC independently identify him as a misappropriator under Articles 73 and 76. He may be a “tipper” of material, non-public, information, but because he is neither a “person with knowledge of inside information” nor a misappropriator, he is not technically subject to the tipping prohibition under Article 76. Thus, as a person who has merely come into possession of inside information, it is unclear how he is an insider trading defendant under the law, unless the CSRC is using the broad basis for enforcement provided for under the 2007 Insider Trading Guidance Provisions. Second, the wife is a tippee-trader of inside information, and again there is no connection between her possession of the information and any kind of misappropriation. Again, she is not an appropriate defendant under Article 76 of the PRC 2006 Securities Law, and the only way in which the CSRC can accomplish enforcement against her is *via* the 2007 Insider Trading Guidance Provisions.

If nothing else, these examples of extra-legal administrative enforcement demonstrate clear violations of the 1996 Law of the PRC on Administrative Punishments,⁶⁹ which forbids the imposition of administrative punishments without a statutory basis,⁷⁰ makes invalid administrative punishments imposed not in accordance with law,⁷¹ and forbids the imposition of administrative punishment under law other than in accordance with publicly-promulgated norms.⁷²

There remains a question as to whether the PRC People’s Procurator is using the extra-legal coverage of the Insider Trading Guidance Provisions to establish the elements of the crime of insider trading *via* Article 180 of the PRC Criminal Law, thereby resulting in the imprisonment and deprivation of the political rights of certain persons. The real picture of

⁶⁹ *zhonghua renmin gongheguo xingzheng chengfa fa* [Law of the PRC on Administrative Punishments], English translation available at: <http://www.cecc.gov/pages/newLaws/adminPunishmentENG.php>. (hereinafter, “Administrative Punishments Law”).

⁷⁰ Article 55.

⁷¹ Article 3(ii).

⁷² Article 4(ii).

criminal enforcement of the insider trading prohibition and Article 180 of the Criminal Law is obscured because criminal judgments are not publicized or reasoned in the way most civil and administrative law cases are. Instead, criminal defendants are simply reported to be guilty of “insider trading” and subject to criminal punishment.⁷³ Given the CSRC’s very cavalier attitude towards extra-legal insider trading enforcement, it is not unreasonable to think that the People’s Procuratorate – as advised by the expert agency charged with enforcement, the CSRC – also uses the defective Guidance Provisions in the criminal sphere.

VI. CONCLUSION

From the case decisions noted in Section V above and many other like actions which can be reviewed on the CSRC website, it is a fact that the CSRC is in some cases enforcing the 2006 PRC Securities Law prohibitions on insider trading not in accordance with that Law but pursuant to the non-public 2007 Insider Trading Guidance Provisions. It is also highly likely, although impossible to know for sure, that the People’s Procuratorate is using the Insider Trading Guidance Provisions as the sole basis for enforcement of the crime of “insider trading” in certain cases where the actions of defendants do not come squarely within the 2006 PRC Securities Law.

a. Legal Challenges to Administrative and Criminal Enforcement – Abstract and Concrete

I argue here that the Insider Trading Guidance Provisions are void and unenforceable. What does it mean to say that Chinese administrative norms like the Insider Trading Guidance Provisions are “void and unenforceable”, especially when there is ample evidence that they are freely applied in fact? In the end, this analytical conclusion can only be vindicated by the exercise of an external constraint – legal challenges to the existence or application of the norms. Here I outline those possible external attacks pursuant to the following matrix: (i) administrative law and enforcement -- (a) abstract review and (b) challenge to specific enforcement; and (ii) criminal law and enforcement -- (a) abstract review and (b) challenge to specific enforcement. I also offer a significant caveat. Notwithstanding that the State Council’s affirmative encouragement of such challenges to hold administrative agencies accountable or simply in check and promote “administration under law”,⁷⁴ any such challenges would be extremely difficult to bring off given the peculiar architecture of China’s system for the review of administrative norms, abstract or as applied, and issues surrounding criminal appeals in China. Indeed, the serious difficulties of establishing a legal claim to the Insider Trading Guidance Provisions and the enforcement of them could make the cynical legal analyst think that the CSRC purposely designed its basic insider trading enforcement regime so as to insulate that regime from any external, legal, check.

⁷³ See for example the 2007-8 reports of criminal insider trading breaches by New China Life Insurance Chairman Guan Guoliang and Guomei Electronics founder Huang Guangyu at: Yu Ning, Su Dandan and Li Minhua, “*neiburen*” Guan Guoliang [“*Insider*” Guan Guoliang], 186 CAIJING MAGAZINE, May 28, 2007, at 40-50; and Yu Ning, Li Qing and Luo Chanping, *Huang Guangyu miwu* [The Huang Guangyu Fog], 226 CAIJING MAGAZINE, December 8, 2008, at 96-104.

⁷⁴ See Administration According to Law Outline, *supra* note ___, Paragraphs 20, 26, 28 & 30.

Abstract review of administrative norms is permitted pursuant to the administrative “reconsideration” (*xingzheng fuyi*) process under the PRC Administrative Reconsideration Law (the “ARL”).⁷⁵ Article 7 of the ARL allows for reconsideration of certain norms alleged to be illegal (*bu hefa de*). However, abstract reconsideration can only be applied to “legislative provisions of State Council departments” (*guowuyuan bumen de gui’ding*) and not “State Council departmental or commission rules” (*guowuyuan be, weiyuanhui guizhang*). It is very difficult to characterize the Insider Trading Guidance Provisions as even “departmental rules” (*guizhang*) and impossible to see them as “legislative provisions” (*gui’ding*), which would seem to except the Guidance Provisions from abstract reconsideration under the ARL. For administrative litigation, the ALL, as noted above, does not permit abstract review of administrative norms, of whatever character, by the PRC judiciary.⁷⁶

There is an external (abstract) constraint under the LL, but one which does not give rise to a private claim. The LL mechanism is grounded in Article 88(3) of that Law, where the State Council has the power to annul any departmental rules that are “inappropriate.”⁷⁷ The claim is difficult in the present context for at least two more reasons. First, the Insider Trading Guidance Provisions would have to be understood as departmental rules (*guizhang*) under the LL scheme, a notion I have argued against at length in this paper. Equally unhelpful is any proposed argument by analogy to the Supreme People’s Court’s 2000 ALL Interpretation making “administrative guidance acts” possessing coercive force justiciable, because the Guidance Provisions are in essence “departmental/commission” guidance acts of coercive force, and are not conceived or implemented directly by the State Council. Second, the LL does not permit a civil action (in the form of a citizen proposal or otherwise) in connection with State Council review of mere departmental rules. Instead, the State Council is to act *sua sponte*, after filing (*beian*) of a given departmental rule, and examination of it by the State Council. Thus, it seems entirely up to the State Council to declare that the Insider Trading Guidance Provisions are “inappropriate” because they are either not the proper regulatory product of the Securities Law Article 74(vii) instruction to “regulate”, or because they are *ultra vires* to the scheme set forth in the statute -- a weak and not very “external” constraint.

Review of concrete administrative acts (by the CSRC) pursuant to the defective Guidance Provisions holds more promise:

First, pursuant to Article 6 of the ARL, an insider trading defendant can apply for reconsideration of a concrete administrative sanction (including a fine or confiscation of illegal gains or property) or a compulsory administrative measure (including the sealing, seizing or

⁷⁵ *zhonghua renmin gongheguo xingzheng fuyifa*, adopted at the 9th Meeting of the Standing Committee of the Ninth NPC. In July 2010, the CSRC issued its own “measures” for reconsideration, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201005/t20100505_180043.htm. The CSRC measures only address reconsideration of specific administrative acts (per Article 6 of the ARL), and do not countenance the abstract administrative reconsideration authorized in Article 7 of the ARL.

⁷⁶ See ALL, Article 12, and Supreme People’s Court ALL Interpretation, *supra* note __, Article 3.

⁷⁷ Because the Insider Trading Guidance Provisions are created by a department/commission under the State Council, there is no way they can be understood as “administrative regulations” issued by the State Council itself (*xingzheng fagui*) and thus capable of being annulled by the NPC Standing Committee under Article 88(2) of the LL after a citizen proposal under Article 90(2) of that statute.

freezing of property).⁷⁸ Indeed, administrative enforcement of the insider trading prohibitions by the CSRC usually involves both concrete administrative sanctions (disgorgement of unjust enrichment and payment of fines) and compulsory administrative measures (sealing and seizing). The 2008 Open Government Regulations also encourage – but do not provide a legal basis for – administrative reconsideration where “citizens... believe a specific administrative action of an administrative agency in its open government work has infringed their lawful rights and interests.”⁷⁹ Similarly, the Administrative Punishments Law⁸⁰ also provides a legal basis for reconsideration of administrative punishments not agreed with. Of course, any ARL-based claim is hampered by the fact that such reconsideration is effected by the administrative agency challenged, the CSRC.

Second, the ALL provides for private claims against specific administrative acts. In this case, there might be two claims: (i) that the Insider Trading Guidance Provisions are a type of norm that does not have legal force; and (ii) asserting that the concrete act which is any specific administrative enforcement of the Insider Trading Guidance Provisions is in conflict with the 2006 PRC Securities Law structure for insider trading and in violation of the Administrative Punishments Law.⁸¹ As with respect to the ARL, the Open Government Regulations and the Administrative Punishments Law encourage administrative litigation in this situation.

On the “legal force” of the Insider Trading Guidance Provisions, Professor Cui Wei of the China University of Politics and Law has argued that the LL itself provides some theoretical grounds for asserting that legal and regulatory norms not addressed in the LL do not “have the force of law.”⁸² Professor Cui also highlights the judiciary’s largely consistent view of what norms are enforceable before the courts, distinguishing between “formal regulations” (which are and “interpretations for specific application” and “normative documents” (both of which are not), citing the Supreme People’s Court statement from a 2003 national judicial conference in Shanghai to the effect that although “agencies frequently rely on such interpretations... and other normative documents as the basis for specific administrative actions”, they are not “formal sources of law, and do not have the binding force of legal norms.”⁸³ As he concludes: “The message of the Shanghai Meeting Minutes seems clear: government pronouncements with lesser

⁷⁸ As noted above, the CSRC’s own reconsideration measures only address reconsideration of specific administrative acts (per Article 6 of the ARL).

⁷⁹ See Open Government Regulations, *supra* note __, Article 33(2).

⁸⁰ At Article 6.

⁸¹ For the reasons noted at note __ *supra* and accompanying text (forbidding administrative punishments imposed without a statutory basis, invalidating administrative punishments imposed not in accordance with law, and mandating imposition of administrative punishments only in accordance with publicly-promulgated norms).

⁸² See Wei Cui, *supra* note __, at 78 (“While the statute does not state anywhere that no other type of documents issued by government entities have the force of law and that the rules governed by it are the exclusive sources of law, it strongly implies so. This is because the central purpose of the [LL] is to bring consistency and uniformity to the Chinese legal system, and its ability to do so would be severely limited if rules with the force of law are not governed and ordered by it.”)

⁸³ *Ibid*, at 82, citing to *Meeting Minutes Regarding the Application of Legal Norms in Reviewing Administrative Cases* (Supreme People’s Court, May 18, 2004), *fa* (2004) No. 96, Section 1. Cui Wei continues: “Nonetheless, if a court, when adjudicating a case relating to specific administrative actions, determines that such interpretation or normative document possesses “legal validity, effectiveness, reasonableness and appropriateness”, it may give effect to such interpretation or document in determining whether the specific administrative act has a legal basis.”

authority than regulations are not legally binding, and will be given effect only at a court's discretion. This message is also entirely consistent with the [LL's] view of what has the force of law."⁸⁴ A useful adjunct to Professor Cui's argument is the Supreme People's Court October 2009 directive which effectively prohibits a court from citing to norms such as the Guidance Provisions in any decision.⁸⁵ Thus, even assuming for a moment that the Insider Trading Guidance Provisions conform to the regulatory command in the 2006 PRC Securities Law and that they are not *ultra vires* in the manner described herein, there is a weak argument to the effect that, as a species of norm inferior to "regulations", they can be understood as potentially unenforceable or merely enforceable at the discretion of a PRC court. ("Weak" because of the continuing prevalence and enforcement of sub-standard norms, including the large volume of "normative documents", in contemporary China, making the academic and judicial views outlined above somewhat theoretical.)

For the second attack in administrative litigation characterizing any CSRC fine or disgorgement under the Insider Trading Guidance Provisions as inconsistent with the 2006 PRC Securities Law and in violation of the Administrative Punishments Law to work, defendants would argue just the opposite regarding enforcement, and would have to employ the concept articulated in the Supreme People's Court 2000 ALL Interpretation making "administrative guidance acts" possessing coercive force justiciable. Only if penalties levied pursuant to the Insider Trading Guidance Provisions are understood as "administrative guidance acts possessing coercive force" could they be challenged under the ALL.

In the criminal law and enforcement sphere, there seems to be little possibility of abstract review of the Insider Trading Guidance Provisions as a norm inconsistent with law or the Constitution. The abstract review available under the reconsideration process pursuant to the ARL would not be available because there is no administrative norm at issue (instead, the dispute would involve the application of Article 180 of the PRC Criminal Law pursuant to the Guidance Provisions). As noted above, abstract review is not available under the ALL even where there is an identifiable administrative norm being used, and the ALL would not cover criminal enforcement of any norm in any case. Again, an attack against concrete application of the Insider Trading Guidance Provisions in the criminal context looks more promising. If indeed criminal penalties are imposed pursuant to the non-public Insider Trading Guidance Provisions, which norms depart so completely from the statutory prohibition on insider trading, then that criminal enforcement will be in violation of a host of important PRC legal norms, including the LL,⁸⁶ the PRC Criminal Law,⁸⁷ and the PRC Constitution.⁸⁸ Indeed, a specific challenge seeking

⁸⁴ *Ibid.*

⁸⁵ See *zuigaofayuan guanyu caipan wenshu yinyong falu, fagui deng guifanxing falu wenjian de guiding* [Supreme People's Court Regulations Regarding Citation of Laws, Administrative Regulations, Normative Legal Documents, Etc. in Judgment Opinions], (hereinafter "SPC Citation Regulations"), Articles 5 and 9, available at: http://www.law-lib.com/law/law_view.asp?id=300043.

⁸⁶ Articles 8 and 9 state that measures and punishments that deprive citizens of their political rights or restrict their personal freedom can only be established in "law".

⁸⁷ Article 3 provides that "For acts that are explicitly defined as criminal acts in the [Criminal] Law, the offenders shall be convicted and punished in accordance with law; otherwise they shall not be convicted or punished."

⁸⁸ Article 37 holds that deprivation or restriction of citizens' personal freedom must be pursuant to "law".

a declaration that the Guidance Provisions are “void” is not necessary; on appeal, a PRC would simply decline to apply the Insider Trading Guidance Provisions (or overturn their application in the first level adjudication) and reverse the conviction.⁸⁹ The problem for the success of any such challenge arises from the context in which it would be offered – on appeal by an imprisoned defendant who admits some kind of insider trading, just not the insider trading described in statute. The relative lack of legal sophistication, and the radical imbalance of power, understood to persist in the criminal enforcement context in China means that the criminal defendant, or his or her counsel, might have a very difficult time raising such a complex challenge during appeal, much less having it understood and acted upon.

b. The Chinese Legal and Administrative Law System

To this author’s knowledge neither the Insider Trading Guidance Provisions nor enforcement of the insider trading prohibition pursuant to the Provisions in the civil or criminal spheres has ever been subject to the challenges or reversals sketched out above. This reality does not necessarily mean that the possible legal claims are weak, but instead that there is a high tolerance – so far – for the enforcement of defective and illegal administrative/legal norms in the securities regulation sphere (as in other areas of administrative governance).

The basic illegality underlying China’s insider trading prohibitions and enforcement analyzed in this article, the failure of the governing administrative agency to remedy the situation,⁹⁰ and the high level of tolerance shown by market participants subject to such illegal enforcement, all provide important insights regarding China’s efforts to establish (even “thin”) “rule of law” after more than three decades. This is made only more apparent because the rule-making and *ultra vires* defects in this particular case are so egregious, and have been visited upon sophisticated, well-educated, largely urban, property rights-wielding investors, where the regulated transactions are economic and financial, not political. Contrast the situation described here with the distinct circumstance seen throughout China, where local authorities assess specific “fees” or “taxes” pursuant to *ad hoc* commands not based in formal law or regulation, and extract sums from ill-educated, relatively cowed, peasant populations. In this alternate world, we might expect autocratic behavior from the local government, and that behavior to be met by relative passivity, with no mention by either side of a legal basis, conformity with legal/regulatory authorization, due process, transparency, consistency, predictability, or constraints on the law-giver/enforcer; at least until the charges aggregate to an unsustainable burden, whereupon the recourse is not to law, but “mass action.”

From the agency or CSRC side, the phenomenon described here affirms intimations of a continuing top-down, policy-based, enforcement-directed and largely unaccountable orientation among the PRC’s government administration units acting in ways reminiscent of the imperial-era magistrate. At this time, one can only speculate as to why the CSRC – modern China’s most

⁸⁹ Here, any appellate court reviewing a criminal judgment rendered pursuant to the Insider Trading Guidance Provisions could also rely on the SPC Citation Regulations, *supra* note __, which effectively prohibits a court from citing to the Guidance Provisions to convict or uphold a conviction.

⁹⁰ As all administrative agencies have been urged to do since 2004, and as the State Taxation Administration under the Ministry of Finance did in its separate sphere in July 2010. See Administration Under Law Outline, *supra* note __ and Wei Cui, *supra* note __, at 89-94.

“modern”, politically independent and technically competent regulator -- chose in 2007 to establish and then enforce non-public and clearly *ultra vires* non-legal norms like the Insider Trading Guidance Provisions. Perhaps, as implied above, it was precisely so as to insulate them from viable legal challenge by insider trading defendants. Or perhaps, and now focusing on the failure to make “public” the *ultra vires* enforcement norms, it is a throwback to the long-standing attack against the codification of laws in pre-Imperial China, embodied in pre-Confucian Shu Xiang’s alleged 6th century B.C.E. letter to Legalist tradition-law drafter Zi Chan recorded in the 3rd century B.C.E. compilation known as the *Zuo Zhuan* [“Commentary of Zuo”]:

... when the people know what the penalties are, they lose their fear of authority and acquire a contentiousness which causes them to make their appeal to written words [of the penal laws], on the chance that this will bring them success [in court cases]... As soon as the people know the grounds on which to conduct disputation, they will reject the [unwritten] accepted ways of behavior (*li*) and make their appeal to the written word, arguing to the last over the tip of an awl or knife.”⁹¹

Lest this possibility be seen as an over-determined absurdity, and we are able to ignore the very long tradition of discretionary application of secret norms that characterized the entire imperial era and the Nationalist Party and pre-1980 Communist Party national regimes, this same age-old justification was invoked in 2007 by Shenzhen Stock Exchange officials when explaining why standards determining levels of misconduct resulting in public reprimand were not themselves made public: noting that the Chinese market is “not sophisticated”, these officials told interviewers they were concerned that “if the companies were aware of the specific standards, they might manipulate their disclosure so as to avoid sanctions.”⁹²

Regardless of why, the fact that the problem appears under the administration of the CSRC -- once seen as a vanguard in establishing “scientific” administration of (new to China) financial markets but shown here to be a laggard in the march to “administration under law” -- means it can be assumed to exist only more in the approaches taken by older-line departments.⁹³

What does this illegality in the design and actual enforcement of insider trading in China signify more broadly for the Chinese legal system? Carl Minzner and a number of other scholars or journalists have identified China’s “turn against law” in recent years.⁹⁴ In my view, the problem highlighted here does not fit well into the “turn against law” account, even assuming it

⁹¹ Translated (based on Legge’s original translation) by Derk Bodde in DERK BODDE AND CLARENCE MORRIS, *LAW IN IMPERIAL CHINA: EXEMPLIFIED BY 190 CH’ING DYNASTY CASES* (1967), at 16-17. The same ideas made it a crime to have access to, or possess texts of, the penal law in the Song Dynasty (960-1279 C.E.), see Miyazaki Ichisada, *The Administration of Justice During the Sung Dynasty*, in *ESSAYS ON CHINA’S LEGAL TRADITION* (Jerome A. Cohen, R. Randle Edwards and Fu-mei Chang Chen, eds., 1980), at 56-75.

⁹² See Liebman & Milhaupt, *supra* note ___, at 950.

⁹³ And is known to exist in the tax administration sphere. See Wei Cui, *supra* note __.

⁹⁴ See Carl Minzner, *China’s Turn Against Law*, 59 AM. J. COMP. L. 935 (2011) (focusing on central rhetoric about recourse to law and the politicization of legal institutions) and Keith Hand, *Resolving Constitutional Disputes in Contemporary China*, E.ASIA L.REV., Footnote 5 and accompanying text (forthcoming 2012), available at: <http://ssrn.com/abstract=1971955> (citing similar laments by journalist Evan Osnos, human rights advocate Joshua Rosensweig, and PRC law professors/rights lawyers Jiang Ping, Teng Biao and Fu Hualing).

is accurate, for several reasons. First, the insider trading enforcement problem has nothing to do with the major focus of the “turn against law” complaint -- broad central, state or Party rhetoric about law and legal institutions, the desired politicization and/or adherence to a “mass line” of those institutions, or the way in which formal legal institutions are said to operate -- and everything to do with how an expert agency actually applies the law and delegated coercive power in a technically complex area way below the radar of public perception or political legal discourse. Even in application, the insider trading enforcement problem is not a case showing de-legalization or any rejection of law, but instead misapplication of law or legally-delegated authority. Second, the illegal design and enforcement of the insider trading prohibition in China existed long before the perceived “turn against law” presently lamented (almost a decade ago), and therefore seems more firmly rooted in long-held and continuing understandings about the power of administrative actors in China, and the relationship of those institutions to law and legal institutions (thus the reference to the imperial magistrate, above). A slightly more helpful, if still very partial, answer may come from the focus undertaken by Ben Liebman and his work on legal “populism” in China.⁹⁵ Liebman’s emphasis is on how judicial institutions specifically in China can and do submit to populist pressure, and in ways which are directly contrary to substantive law or promised legal procedure. In the present case, my focus is primarily on a different kind of state actor, an administrative agency with enforcement powers (although, as noted above, it is very likely that the judiciary is involved via misbegotten criminal prosecutions of insider trading pursuant to the CSRC Guidance Provisions), acting in a highly technical and opaque area unlikely to attract popular interest. Notwithstanding, the inclination that is responsive to populist pressure may explain how the CSRC (and the Procuratorate in criminal enforcement) feels emboldened to act lawlessly in using “bad law” against “bad actors”. Enforcing against identified securities fraudsters it has populist rage at its back, if not the law.

From the defendant side, these issues, and the paucity of legal challenges directed towards faulty norm-production and baseless enforcement against China’s most sophisticated and empowered civil actors, show us something equally disheartening: a continuing high tolerance for an administrative law establishment that does not act in conformity with law, which means a weak constraint on state (and Party) overreach.

What does this tell us about the “consumers” of rule of law in China today, and their attitudes towards governance in accordance with law, and legal accountability? As demonstrated in the broad and raucous clamor for a private right of action against issuers, underwriters, accountants, directors, officers and controlling shareholders in respect of securities issuance fraud,⁹⁶ this specific area is hardly a sector where retail and institutional market participants, or their legal counsel, have remained passive or ignorant of adequate remedies. Indeed, we see

⁹⁵ See Benjamin L. Liebman, *A Populist Threat to China’s Courts?*, in CHINESE JUSTICE: CIVIL DISPUTE RESOLUTION IN CONTEMPORARY CHINA (Mary Gallagher and Margaret Woo, eds., 2011) at 269-313; and Benjamin L. Liebman, *A Return to Populist Legality? Historical Legacies and Legal Reform*, in MAO’S INVISIBLE HAND (Elizabeth Perry and Sebastian Heilmann, eds., 2011) at 165-200.

⁹⁶ See Nicholas Calcina Howson, *Corporate Law in the Shanghai People’s Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State*, 5 EAST ASIA L. REV. 303, 401-4 (2010); and Donald C. Clarke and Nicholas Calcina Howson, *Pathway to Minority Shareholder Protection: Derivative Actions in the People’s Republic of China*, in THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH (Daniel Puchniak et al, eds., 2012), at 258.

sustained recourse to legal institutions and explicitly legal challenges in the far more sensitive sphere of civil and political rights, in both the rural and urban settings.⁹⁷

Yet, I would argue that here the actors are different, with different kinds of leverage, and different expectations. In addition, the legal challenges to the CSRC's rule making and enforcement practice are highly complex and technical. In the situation analyzed in this article, there is only a single defendant (or a small group of defendants), usually guilty of trading on the basis of non-public, material, information, facing the much more powerful CSRC or People's Procuratorate. Defective enforcement against insider trading in China is therefore characterized by a basic power imbalance between the enforcement agency and insider trading defendants, an *ex ante* understanding of moral guilt in the minds of defendants, a post-investigatory period information asymmetry which works in favor of the enforcement agencies, the strong expectation of deserved fine or punishment, and decidedly "populist" pressure supporting enforcement against individuals manipulating the securities markets. As detailed in Part VI.a above, the available Chinese legal challenges to the Insider Trading Guidance Provisions and their use in enforcement are highly technical. Contrast the problem described here and the other situations in China where vigorous legal challenges to state action are raised, such as eviction from land without legal basis, appropriate process, or compensation, or the inability to access counsel or cross-examine witnesses in criminal proceedings. In each of these latter situations, the legal objection to enforcement is relatively simple and easily invoked by even minimally competent counsel. Is it reasonable that common defendants would think of (or retain lawyers who would counsel) a very sophisticated legal challenge to the insider trading enforcement regime itself? Probably not. In the future, however, it is precisely those kinds of sophisticated legal challenges to state power and enforcement, in any area, and even if the angry "masses" are assembled in condemnation of the alleged wrongdoer, which will prove the effectiveness of external legal constraints generally and real progress towards "rule of law" in China.

⁹⁷ See, for example: CHEN GUIDI AND WU CHUNTAO, ZHONGGUO NONGMIN DIAOCHA BAOGAO [CHINA PEASANTS INVESTIGATION REPORT] (2004); Mary Gallagher, "Use the Law as Your Weapon!" *Institutional Change and Legal Mobilization in China*, in ENGAGING LAW IN CHINA: STATE, SOCIETY AND POSSIBILITIES FOR JUSTICE (Neil J. Diamant, Stanley B. Lubman, and Kevin O'Brien, eds., 2005); Keith Hand, Using Law for a Righteous Purpose: *The Sun Zhigang Incident and Evolving Forms of Citizen Action in the People's Republic of China*, 45 COLUM. J. TRANS. L. 114 (2006); KEVIN O'BRIEN AND LIANGJIAN LI, RIGHTFUL RESISTANCE IN RURAL CHINA (2006); C.K. LEE, AGAINST THE LAW: LABOR PROTESTS IN CHINA'S RUSTBELT AND SUNBELT (2007); Fu, Hualing and Richard Cullen, *Weiquan (Rights Protection) Lawyering in an Authoritarian State: Towards Critical Lawyering*, Working Paper (2008), available at: <http://ssrn.com/abstract=1083925> or doi:10.2139/ssrn.1083925; Xiao Han, *qunti peichang: quanyi yu jiuan [Mass Compensation: Rights and Stability]*, 222 CAIJING MAGAZINE, October 13, 2008, 152-153; and a good deal of other scholarship charting the rise of (legal) rights consciousness and demands on legal institutions in the PRC, and the various forms of state and Party pushback.

Appendix – Selected CSRC Insider Trading Enforcement Actions

Lin Shiquan – Trading in Shares of Yantai Xinchao Enterprise Co., Ltd. (June 29, 2011)⁹⁸

Controlling shareholders of Yantai Xinchao Enterprise Co., Ltd. (“Yantai Xinchao”) began negotiating a sale of equity in Yantai Xinchao on March 22, 2011, and Yantai Xinchao made public disclosure of a possible change of control on May 15, 2011. Defendant Lin Shiquan learned about the negotiations for a change of control transaction on March 24, 2011 (the Decision does not indicate how, or why, Lin learns of the possible transaction, and whether he is a statutory insider under Article 74 or is proven to have misappropriated information under Articles 73 and 76), and on March 25, 2011 purchased 400,000 shares of Yantai Xinchao at RMB 6.69-6.72 yuan per share. After public disclosure of the possible change of control on May 15, 2011, on May 24, 2011, Lin sold his 400,000 shares for RMB 6.85-6.91 yuan per share, for total proceeds of RMB 2.75 million and a trading profit of RMB 55,570 yuan. The CSRC levies a penalty equal to the trading profit, confirming that Lin is being penalized for insider trading pursuant to Article 202 of the 2006 PRC Securities Law. Of interest in the case is the care with which the CSRC identifies the news of a possible change of control as a “major event” for the issuer, qualifying it as “inside information” pursuant to Article 75 of the 2006 PRC Securities Law. Importantly, however, the CSRC does not indicate how Lin qualifies as one of the enumerated persons in Article 74, stating in conclusory terms that on March 24, 2011 he became a “person with knowledge of inside information.” He is *not* identified as an officer or shareholder of the selling controlling shareholder of the issuer, although he is identified as the top executive of another entity which may be a shareholder of the issuer holding more than 5% of the issuer per Article 74(ii). This crucial fact basis is not set out in the Decision. This rendering is a strong indication that the CSRC, for one, may not apply the enumerated insiders requirements of Article 74 as strictly as the statute would seem to require. This is also a case where the defendant affirmatively reports his misdeeds to the Shandong Provincial office of the CSRC and the Shanghai Stock Exchange over a period between May 31 and July 12, 2011. It is perhaps for this reason that the CSRC has access to complete evidence on the case, including the issuer’s public announcements, Lin’s securities account statements and trading records, phone records, evidence provided by the unnamed acquirer, and notes from phone conversations.

Liu Yang – Trading in Shares of ST Zhongwu Co., Ltd. (June 14, 2011)⁹⁹

Liu Yang is a senior officer (chief economist) of Hunan Construction Engineering Group Holdings Company (“Hunan Construction Engineering”) which begins considering a listing by reverse merger into several already-listed entities, including ST Zhongwu Co., Ltd. (“Zhongwu”). Liu Yang is one of the executives in charge of the proposed transaction, and specifically liaison with the Hunan State-owned Assets Bureau (the governing department for each of the reverse merger candidates), which department confirms directly to Liu Yang on

⁹⁸ See *zhongguo zhengquanhui xingzhengchufa juedingshu (Lin Shiquan)* [China Securities Regulatory Commission Administrative Punishment Decision (Lin Shiquan)] (2011) No. 26, issued June 29, 2011, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201108/t20110802_198433.htm.

⁹⁹ See *zhongguo zhengquanhui xingzhengchufa juedingshu (Liu Yang)* [China Securities Regulatory Commission Administrative Punishment Decision (Liu Yang)] (2011) No. 24, issued June 14, 2011, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201107/t20110718_197605.htm.

August 21, 2009 that only Zhongwu is available for the transaction. On September 29, 2009, the Hunan State-owned Assets Bureau formally approves Zhongwu as the target, and on the same day the chairman of Zhongwu's largest shareholder agrees to the same plan with the chairman of Zhongwu. On October 20, 2009, Zhongwu issues a "major event" report to the market, describing the proposed transaction, whereupon its shares cease trading. The CSRC determines that the period between September 29 (government approval of the transaction) and October 20, 2009 (public disclosure of the transaction) is the time period when there is inside information not yet made public, and further demonstrates that Liu Yang, through a friend named Xie and his or her securities account, spent RMB 4,181,624.91 yuan to purchase 421,000 shares of Zhongwu between October 15 and 19, 2009. In the event, Liu Yang fails to make serious gains on Zhongwu stock because on November 16, 2009 Zhongwu issued another "major event" report, detailing the breakdown of the takeover plan, on which day its shares commenced trading again. On the day of the second announcement and the re-start of trading, Zhongwu shares decline 1.61% to RMB 10.38 yuan per share. Liu Yang sells his shares in Zhongwu on November 18, 2009, showing a small net profit of RMB 11,212.83. Most interesting in the Decision, and indicative of how liberally the CSRC applies Article 74 of the PRC 2006 Securities Law, is that Liu Yang is pronounced "a person with knowledge of inside information" simply because he "participated in... [the reverse merger] related affairs." This is not the same thing as what is provided for under Article 74(iv) ("persons who are able to obtain relevant inside information concerning the company by virtue of the position they hold in the company"), which is unavailable precisely because Liu Yang comes into possession of important information about a company (Zhongwu) different from the one he is employed by (Hunan Construction Engineering). By the same token, the CSRC makes no effort to base his liability in the misappropriation prong of the statute.

Jia Huazhang and Liu Rong – Trading in Shares of Xintai Science and Technology Co., Ltd. (December 21, 2010)¹⁰⁰

This Decision addresses a somewhat conventional husband and wife insider trading scheme: On April 26, 2006, the second largest shareholder of listed company Xintai Science and Technology Co., Ltd. ("Xintai") agrees to sell its 26.81% stake in Xintai, which agreement is reported publicly on April 29, 2006. Ms. Liu Rong, the wife of Jia Huazhang, purchases shares of Xintai after the agreement is struck and before it is disclosed to the market, on April 26 (2,300 shares) and April 27 (5,000) shares. Liu Rong later sells 300 shares in Xintai, on May 24, 2006, gaining a net profit of RMB 5,039 yuan. In terms of application of the law, the Decision is problematic in several ways. First, the husband Jia Huazhang is simply declared to be a "person with knowledge of inside information" without tying his status to the enumerated persons under Article 74. Nor is he independently identified as a misappropriator under Article 76. He may be a "tipper" of inside information, but as he is neither a "person with knowledge of inside information" nor a misappropriator, he is not subject to the tipping prohibition under Article 76. Thus, as a person who has merely come into possession of inside information, it is unclear how he is an insider trading defendant under the law. Second, Jia's wife, Liu Rong, is a "tippee" of

¹⁰⁰ See *zhongguo zhengquanhui xingzhengchufa juedingshu (Jia Huazhang and Liu Rong)* [China Securities Regulatory Commission Administrative Punishment Decision (Jia Huazhang and Liu Rong)] (2010) No. 53, issued December 21, 2010, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201103/t20110302_192554.htm.

inside information, and again there is no tie up between her possession of the information and any kind of misappropriation. Again, she is not an appropriate defendant under Article 76 of the PRC 2006 Securities Law. Third, the behavior enforced against is more than four years prior, indicating the absence of any statute of limitations in regard to insider trading liability in the PRC.

Zhang Xiaojian – Trading in Shares of Guilin Jiqi Pharmaceuticals Enterprise Co., Ltd. (December 6, 2010)¹⁰¹

In this Decision, Zhang Xiaojian is the vice-president of a PRC securities firm which agrees to advise on the reorganization of a troubled listed company, Guilin Jiqi Pharmaceuticals Enterprise Co., Ltd. (“Jiqi”). Discussions on the transaction are initiated and settled between the defendant’s securities firm and Jiqi during the week of November 7-14, 2006 in Beijing, with the parties agreeing that the deal will involve a significant change in the capital structure of Jiqi. On December 13, 2006, public disclosure of the transaction and the change in capital structure was effected. In the period after the negotiations and before public disclosure, Zhang Xiaojian used his younger brother’s securities trading account at the same securities firm to purchase shares of Jiqi, on November 14 (493,000 shares) and again on November 22 (32,000 shares). There is no indication in the Decision that Zhang Xiaojian sold the shares purchased during the confidential period, or profited from his purchase based on inside information. As in the CSRC Decision regarding Liu Yang, described *supra*, Zhang Xiaojian is identified as a “person with knowledge of inside information” simply because he met with the chairman of his own securities firm in Beijing on November 13, 2006 and thereafter “participated” in implementation of the transaction regarding “Jiqi.” This style of identification by the CSRC is odd, because Zhang Xiaojian might fit rather comfortably within the terms of 2006 PRC Securities Law Article 74(vi) (“personnel of securities service institutions”). It is yet another example of how the CSRC will rather liberally enforce against people trading on inside information simply by virtue of their access to such inside information, regardless of whether or not they fit neatly into the enumerated class of defendants under Article 74.

¹⁰¹ See *zhongguo zhengquanhui xingzhengchufa juedingshu (Zhang Xiaojian)* [China Securities Regulatory Commission Administrative Punishment Decision (Zhang Xiaojian)] (2010) No. 44, issued December 6, 2010, available at: http://www.csrc.gov.cn/pub/zjhpublic/G00306212/201102/t20110223_192241.htm.