Article

Comparative Studies of Enforcement and Compensation of Securities Cases and Lessons for the Chinese Securities Law 2019

Mo-Qi Zi *

ABSTRACT

China just introduced its version of private securities class action rule in the Securities Law of the PRC 2019. It combines an opt-out rule with a public agency as the representative of plaintiffs' groups, which intends to control frivolous litigation. This article argues that this rule is inefficient and proposes a new public-and-private-convergence enforcement model based on the following studies. Firstly, from the history of the regulation of securities market in the US, UK, and Australia, this article finds out that neither the private class action nor the public enforcement should be used alone as the primary enforcement method. Because a full-scale class action tends to over-deter and public enforcement tends to under-deter. Also, the compensation rate is low and the resolution time is long. Secondly, based on the experiences of private securities class action cases in the US, Australia, Japan, South Korea and Taiwan, this article finds out that it is hard to adjust the incentives of private securities class action to achieve balance. Moreover, since the optimal deterrence level is hard to ascertain, so without this benchmark we could not know what the right number of cases is, which makes the theory of using a full-scale US-style private securities class action to increase deterrence level questionable. Then, this article turns to examine ADR in the US and the Netherlands--Arbitration and Settlement to see if they can be alternatives to the

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private class action, but finds out they are not suitable to resolve cases on a large scale. Lastly, due to the above failures, this article proposed that a new enforcement style combining private enforcement with public enforcement should be built. To rebuild the enforcement model, we should reconsider our policy indicators, and turn to focus on increasing the compensation rate and decreasing enforcement costs rather than increasing the numbers of cases. Based on this policy choice, this article proposes a new enforcement style combining private enforcement with public enforcement from the experiences of different jurisdictions, including the UK, Australia, Denmark, where the resolution, especially the compensation regime is led by the securities regulator instead of the court.

Keywords: *China, Private Class Action, Public Enforcement, Private-and-Public Collaboration, Comparative Studies*

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INTRODUCTION

China just revised its Securities Law on December 28, 2019, and the new law introduced the Chinese version of securities class action rule by combining an opt-out rule with a public agency as the representative of plaintiffs' groups,[1] which intends to control frivolous litigations.[2] This article will examine if this rule is appropriate from a comparative study standpoint. Firstly, in Part II, this article will first introduce the brief history behind the US enforcement and compensation schemes and shows that in the US there was a trend of increasing public enforcement and, at the same time controlling the usage of private securities class actions. Secondly, in Part III, this article will explain the reasons behind this trend, which is the over-deterrent effect of the private securities class action and the under-deterrent effect of public enforcement. Thirdly, in Part IV, due to these effects, this article will do a comparative study and discuss some jurisdictions' efforts to control the side effects of securities class actions when they adopted securities class actions into their legal systems, and finds out that most of them failed. Since to control the side effects, they also controlled the incentives making it so popular in the US, thus creating chilling effects, so there can hardly be a middle ground satisfying all parties.[3] Moreover, the policy choice behind the deterrence theory is also problematic since there is no way to measure the optimal deterrent level.[4] Fourthly, in Part V, due to these failures, this article will look into several other jurisdictions' measures and introduce a new model by combining the private enforcement with the public enforcement, making compensation faster and enforcement less costly. Lastly, in Part VI, this article will make a conclusion based on the above analysis and offers some suggestions for China.

1. Zhengquan Fa (证券法) [Securities Law] § 95 (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 2010, effective Mar. 1, 2020), http://www.csrc.gov.cn/tianjin/tjfzyd/tjjflfg/tjgjfl/201912/t20191231_368792.htm.

2. *Xin Zhengquanfa Touzizhe Baohu Zhidu De Sanda "Zhongguo Tese"* (*新证券法投资者保护的三大"中国特色"*) [*Three "Chinese Characteristics" of the New Securities Law Investor Protection System*], China Securities Regulatory Commission (Apr. 15, 2020), http://www.csrc.gov.cn/pub/shenzhen/xxfw/mtzs/202004/t20200415_373868.htm.

3. Christopher Hodges, *Collective Redress: A Breakthrough or a Damp Squibb?*, 37 J. CONSUM POLICY 67 (2014) (discussing the near impossibility by adjusting incentives to reach a balanced effect in a private class action proposed by European Commission's Recommendation on Collective Redress); Commission Recommendation 2013/396/EU of 11 June 2013 on Common Principles for Injunctive and Compensatory Collective Redress Mechanisms in the Member States Concerning Violations of Rights Granted under Union Law, O.J. (L 201) 60.

4. *Infra* discussions in Part IV. G.

I. BACKGROUND

China just revised its Securities Law on December 28, 2019, and the new law took effect on March 1, 2020. One of the most significant changes is that it introduced the Chinese version of the securities class action rule in Art.95. It stipulates that

> When an investor files a lawsuit for civil compensation on securities against false statements, among others, the subject matter of the lawsuit is of the same kind, and the parties on one side of a lawsuit are numerous, they may legally elect a representative to participate in legal proceedings.
> For a lawsuit filed according to the provisions of the preceding paragraph, if there may be many other investors who have the same claim, the people's court may issue an announcement to state the case facts of the claim, and notify investors to register with the people's court within a certain period. The judgments or rulings rendered by the people's court shall be valid for the registered investors.
> An investor protection institution may, as entrusted by 50 or more investors, participate in legal proceedings as a representative, and shall register the obligee confirmed by the securities depository and clearing institution at the people's court in accordance with the provisions of the preceding paragraph, unless the investors have clearly expressed their unwillingness to participate in legal proceedings.

Zhengquan Fa (证券法) [Securities Law] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 2010, effective March 1, 2020), art. 95, http://www.csrc.gov.cn/tianjin/tjfzyd/tjjflfg/tjgjfl/201912/t20191231_368792.htm.

There are two changes. The first one is that it stipulates if the numbers of plaintiffs are over fifty, then the Investor Service Center (ISC) *could* be the representative of class action on behalf of private parties.[5] It means, on the other hand, private parties could still choose to continue the class action

5. "Zhongzheng Zhongxiao Touzizhe Fuwu Zhongxin Youxian Zeren Gongsi (中证中小投资者服务中心有限责任公司) [China Securities Investment Services Center Co., Ltd.] (ISC), is a non-profit securities and financial public institution established and directly managed by the China Securities Regulatory Commission and was registered and established on December 5, 2014. The main business includes the non-profit exercise of shareholders' rights on behalf of shareholders, non-profit dispute mediation, non-profit litigation support, and non-profit investor education." *See* Investor Services Center (中证中小投资者服务中心), *Guanyu Women* (*关于我们*) [*About ISC*], http://www.isc.com.cn/html/zxjs/ (last visited May 21, 2020).

on their own without the ISC's representation. The second one is that it introduced the opt-out rule. However, this opt-out rule only applies if the ISC acts as the representative in a securities class action.[6] The unchanged part is that only misstatement could be sued in a class action, not including other types of market abuse.[7] Before 2016, China generally held a negative attitude toward private securities class actions. In 2001, the Supreme Court of the PRC made a judicial interpretation.[8] It stipulated that only cases receiving public enforcement results could be brought by private parties in civil procedure in court. It means that unless a securities case is punished by an administrative penalty or a criminal sanction, that case cannot be brought to civil procedure. This rule was discouraged to follow in 2016 by a new guidance of the Supreme Court of the PRC.[9] Therefore, it paved the way for the introduction of the new securities class action rule. This public representative model is meant to balance the over-deterrence problem in the US-style securities class action.[10]

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6. *Securities Law*, *supra* note 1, § 95.

7. *Id.*; Also, compare the Zuigao Renmin Fayuan Guanyu Shenli Zhengquan Shichang Yin Xujia Chenshu Yinfa De Mingshi Peichang Anjian De Ruogan Guiding (最高人民法院关于审理证券市场因虚假陈述引发的民事赔偿案件的若干规定) [Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market] § 6 (promulgated by the Sup. People's Ct., Jan. 9, 2003, effective Feb. 1, 2003), http://www.csrc.gov.cn/pub/newsite/flb/flfg/sfjs_8249/200802/t20080227_191604.html, CLI.3.44458(EN) (PKULAW). This interpretation is the previous rule regulating the securities class action in China. In this rule, only the misstatement is allowed to be sued by individuals in civil court.

8. "Where a lawsuit for civil compensation brought by an investor against the false statement maker in accordance with a decision on administrative penalty by a relevant organ or in accordance with a criminal order or judgment by the people's court with the reason that he has been infringed upon by the false statement, conforms with Art. 108 of the Civil Litigation Law, the people's court shall entertain the lawsuit."
"Where an investor brings a lawsuit for civil compensation arising from false statement in securities market, he shall, in addition to submitting the decision or announcement on the administrative penalty, or the criminal order or judgment by the people's court, submit the following evidence . . . " *See Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market*, *id*.

9. "[S]econd, a court should accept and review civil compensation cases arising from false statements, insider trading and market manipulation in accordance with laws, and protect the legitimate rights and interests of investors in the securities market. According to the Judicial Interpretation of Regulation of Case Registration, the administrative penalty of the regulatory authority and the effective criminal judgement will no longer be deemed as preconditions in civil compensation cases caused by false statements, insider trading, and market manipulation when the case is accepted." (Translation made by the author). *See* Guanyu Dangqian Shangshi Shenpan Gongzuozhong De Ruogan Juti Wenti (关于当前商事审判工作中的若干具体问题) [Supreme People's Court Working Documents on Several Specific Issues of the Supreme People's Court on the Current Trial of Commercial Cases] (promulgated by the Sup. People's Ct., Dec. 24, 2016, effective Dec. 24, 2016), CLI.3.262008 (PKULAW). This is actually a working document of the Supreme Court of PRC and acts as the guidance for all the courts to follow when handling similar cases. Although it is not legally binding and the old rule is still effective, not following the guidance can bring some negative political evaluations on the courts.

10. *Three "Chinese Characteristics" of the New Securities Law Investor Protection System, supra* note 2.

Also, China introduced several new techniques to increase the efficiency of public enforcement. Firstly, China took a step toward regulatory redress.[11] China invented an "Advance-Compensation" mechanism, which is an administrative-led holistic approach. It means that if the documents issued by an issuer contain misstatement, misleading information or material omission, which causes losses of investors, then the issuer's controlling shareholders, actual controllers, and sponsors need first to pay compensation to investors.[12] The ascertainment of liabilities should be resolved later in the court among different parties liable after compensation paid to investors in advance.[13] This "Advance-Compensation" mechanism was first invented by the China Securities Regulatory Commission (CSRC) to address two major cases related to fraudulent issuances in IPOs, where the CSRC acts as an ombudsman to mediate the case.[14] These two cases received a 95 per cent compensation rate.[15] Due to the excellent performance of the compensation rate in these two cases, the CSRC issued the Announcement No. 32 to officially make the "Advance-Compensation" mechanism into the CSRC's administrative regulations.[16] Moreover, in response to many criticisms,[17]

11. Li Dong Fang (李东方), *Lun Zhengquan Xingzheng Zhifa Hejie Zhidu* (*论证券行政执法和解制度*) [*On Regulatory Redress*], 3 ZHONGGUO ZHENGFA DAXUE XUEBAO (中国政法大学学报) [JOURNAL OF CHINA UNIVERSITY OF POLITICAL SCIENCE AND LAW] 35 (2013) (arguing that there is a historical trend to expand the discretional powers of administrative agencies due to the complexities of economic activities and regulatory redress has more flexibility than judicial system and is suitable to quickly solve complicated cases based on comparative analysis of several jurisdictions, and showing that although China has passed a law to establish a regulatory redress mechanism led by CSRC, the law is extremely rough without useful operation guidelines).

12. "Where an issuer causes any loss to investors due to fraudulent offering, false statements or any other major violation of law, the issuer's controlling shareholder, actual controller or the relevant securities company may entrust an investor protection institution to enter into an agreement with investors who suffer losses on compensation matters to make compensation in advance. It may legally claim compensation from the issuer and other parties jointly held liable after making compensation in advance." *See Securities Law*, *supra* note 1, § 93.

13. "It may legally claim compensation from the issuer and other parties jointly held liable after making compensation in advance." *See Securities Law*, *id*.

14. Liu Yu Hui & Shen Lian Jun (刘裕辉 & 沈梁军), *Jingwai Zhenquan Shichang Touzizhe Buchang Jizhi Yanjiu* (*境内外证券市场投资者赔偿补偿机制比较研究*) [*Comparative Studies of Investor Compensation Mechanisms of Foreign Jurisdictions*], 8 ZHENGQUAN SHICHANG DAOBAO (证券市场导报) [SECURITIES MARKET HERALD] 13 (2017).

15. *Id*.

16. "[T]he title page of the prospectus should contain the following statement and commitment: the sponsor promises that if the documents produced or issued for the issuer's initial public offering of shares have false records, misleading statements, or major omissions and cause losses to investors, the sponsor will be compensated for the losses first . . . " *See* (中国证券监督管理委员会公告(2015)32号—公开发行证券的公司信息披露内容与格式准则第1号—招股说明书(2015年修订)) [Announcement No. 32 [2015] of the China Securities Regulatory Commission--Prospectus (2015 Revision)] § 18 (promulgated by China Securities Regulatory Commission, Dec. 30, 2015, effective on Jan. 1, 2016), http://www.csrc.gov.cn/pub/zjhpublic/G00306201/201512/P020151231644520317946.pdf.

17. There are generally three criticisms. The first one is that the legal hierarchy of the Art. 93 of Announcement 18 of the CSRC is too low, so it does not have the right to make such significant

this "Advance-Compensation" mechanism was officially made into the newest Securities Law of the PRC 2019.[18] Secondly, China also permitted the administrative reconciliation power of the CSRC, which is in the newly made Implementation Measures for the Pilot Program of Administrative Reconciliation in 2015.[19] In Art.6, it says that the CSRC can initiate reconciliation procedure if, after investigation, the facts and legal relationships are not clear.[20] This administrative reconciliation power is different from the above "Advance-Compensation" mechanism since, in that mechanism, the liabilities of different parties will be investigated later after payment to investors.[21] However, the administrative reconciliation is initiated after the investigation fails to give a clear result, which means ascertainment of liabilities is pursued beforehand. Currently, this reconciliation power has only been put to use once after its introduction six years ago,[22] and its rare usage is probably due to the extremely high success rate for the CSRC in court, where until 2018, it only lost on one case in

changes such as the "Advance Compensation" mechanism. The second one is that Announcement 18 requires the sponsor to insert a statement promising "Advance Compensation" in the Prospectus. However, such a statement should be a voluntary issue, and the CSRC does not have the right to make it mandatory. The third one is that whether the sponsor could pursue compensation from other relevant parties after advance compensation is not clear. Also, sponsors argue that the issuers and their controlling parties and shareholders should also bear joint liability for "Advance Compensation" since they are the primary wrongdoers. For detailed discussions, *see* Yao Yi Fan (姚一凡), *Baojianren Xianxing Peifu Zhidu De Jiedu Yu Fansi* (*保荐人先行赔付制度的解读与反思*) [*Analysis and Rethinking of Sponsor-Pays-First Mechanism*], 96 JINRONG FAYUAN (金融法苑) [FINANCIAL LAW FORUM] 62 (2018); Chen Jie (陈洁), *Zhengquan Shichang Xianqi Peifu Zhidu De Yinru Ji Shiyong* (*证券市场先期赔付制度的引入及适用*) [*The Introduction and Application of "Advance-Compensation" System in the Stock Market*], 8 FALV SHIYONG (法律适用) [JOURNAL OF LAW APPLICATION] 25 (2015); Yang Chen (杨城), *Lun Woguo Xugia Chenshu MinShi Zeren Zhuti De Kunjing Yu Chuangxin* (*论我国虚假陈述民事责任主体的困境与创新*) [*On the Conundrum and Innovation of the Subjects Bearing Civil Liabilities of Misrepresentation*], 7 ZHENGQUAN SHICHANG DAOBAO (证券市场导报) [SECURITIES MARKET HERALD] 70 (2017); Liu & Shen, *supra* note 14.

Finally, these problems were addressed in the Art. 93 of Securities Law of the PRC 2019. It stipulates that "If the issuer causes losses to investors due to fraudulent issuance, false statements or other major violations, the issuer's controlling shareholder, actual controller, and related securities company may entrust the investor protection agency to reach a compensation agreement with investors. After reaching the agreement, the losses shall be paid in advance. After the compensation is paid in advance, the compensator may recover their losses from other jointly and severally liable persons according to law." *See Securities Law*, *supra* note 1, § 93.

18. *Securities Law*, *id*.

19. Xingzheng Hejie Shidian Shishi Banfa (行政和解试点实施办法) [Implementation Measures for the Pilot Program of Administrative Reconciliation] (promulgated by China Securities Regulatory Commission, Feb. 17, 2015, effective Mar. 29, 2015), http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgz/zhl/201507/t20150731_281986.html.

20. *Implementation Measures for the Pilot Program of Administrative Reconciliation*, *id*. § 6.

21. *Securities Law*, *supra* note 1, § 93.

22. *See* Xie Qing & Wu Man, *CSRC Announces its First Case of Administrative Reconciliation*, Jun He LLP. (May 7, 2019), http://www.junhe.com/legal-updates/940. There was only one administrative reconciliation case till now, and this case involves the Goldman Sachs (Asia).

court.[23] Thirdly, in Art.126 of Securities Law 2019,[24] it builds the Chinese version of "Fair Funds", where the settlement fee will go into a specialized fund management agency,[25] and the investor can receive compensation from the agency.

However, there are several problems in the new class action rule. According to Art. 95, there are two ways that a party could initiate securities class actions. Further, the China Securities Investor Services Center Representative Litigation Rules (for Trial Implementation) (ISC's Representative Litigation Rules) and Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes (SPC's Interpretation on Representative Actions) make details on how these two ways function accordingly, including ISC's special representative proceeding and normal representative proceeding.

Firstly, according to Art. 16 of ISC Representative Litigation Rules, it stipulates that the ISC could initiate special representative proceedings, provided that it meets the following conditions:

> In cases where the court issues a registration notice in accordance with Article 54, Paragraph 1 of the Civil Procedure Law and Article 95, Paragraph 2 of the Securities Law, and the following

23. Xia Dong Xia et al. (夏东霞等), *Shendu Jiexi | Shouli Zhengjianhui Xingzheng Chufa Jueding Bei Chexiao An* (*深度解析|首例证监会行政处罚决定被撤销案*) [*In-Depth Analysis | The First Case of the Administrative Penalty Decision of the CSRC Repealed in Court*], KING & WOOD MALLESON LLP. (July 19, 2018), https://www.chinalawinsight.com/2018/07/articles/dispute-resolution/%E6%B7%B1%E5%BA%A6%E8%A7%A3%E6%9E%90-%E9%A6%96%E4%BE%8B%E8%AF%81%E7%9B%91%E4%BC%9A%E8%A1%8C%E6%94%BF%E5%A4%84%E7%BD%9A%E5%86%B3%E5%AE%9A%E8%A2%AB%E6%92%A4%E9%94%80%E6%A1%88.

24. *Securities Law*, *supra* note 1, § 126.

25. *See* The Securities Investment Protection Fund (SIPF), *Guanyu Women* (*关于我们*) [*About Us*], Securities Investment Protection Fund, http://www.sipf.com.cn/gywm/gsjj/index.shtml (last visited June 9, 2020). This fund was originally created to protect investors from the bankruptcy of securities firms in China and is not involved in the compensation of losses of investors due to securities misconducts or crimes. *See* Zhengquan Touzizhe Baohu Jijin Guanli Banfa (证券投资者保护基金管理办法) [Measures for the Administration of Securities Investor Protection Fund] § 19 and § 20 (promulgated by China Securities Regulatory Commission, Ministry of Finance, and People's Bank of China, Apr. 19, 2016, effective June 1, 2016), http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgz/jjl/201701/P020170110523274213079.pdf. However, it was used as a "Fair Fund" in the first three "Advanced-Compensation" cases, since Art. 19 also stipulates that "this fund could be used for other purposes specified by the regulations of the State Council of the the PRC." *See* SIPF (投资者保护基金), *Zhuanxiang Buchang* (*专项补偿*) [*Cases of Advance-Compensation*], Securities Investment Protection Fund, http://www.sipf.com.cn/zxbc/index.shtml (last visited June 9, 2020). However, because the definition of other purposes is not clear, there was criticism that investor compensation function of the fund should be written explicitly into laws, *see* Pan He Lin (盘和林), *Touzizhe Baohu Jijin Gai Zenyang Zhenzheng Baohu Touzizhe?* (*投资者保护基金该怎样真正保护投资者？*) [*Investor Protection Fund, How to Really Protect Investors?*], The Beijing News (Oct. 15, 2018), https://finance.sina.com.cn/stock/stocktalk/2018-10-15/doc-ifxeuwws4293089.shtml.

> circumstances are met, the Investor Services Center may participate in the special representative proceedings.
> (1) The relevant authorities have issued administrative or criminal penalties;
> (2) The case is typical, significant, socially detrimental and exemplary;
> (3) The defendant is solvent;
> (4) Other circumstances deemed necessary by the Investor Services Center.

Zhongzheng Zhongxiao Touzizhe Fuwu Zhongxin Tebie Daibiaoren Susong Yewu Guize (Shixing) (中证中小投资者服务中心特别代表人诉讼业务规则(试行)) [China Securities Investor Services Center Representative Litigation Rules (for Trial Implementation)] (promulgated by China Investor Services Center, Jul. 31, 2020, effective on July 31, 2020), art. 16, para. 2, https://www.investor.org.cn/home/Investor_hotnews/202007/P020200731655187830071.pdf.

Secondly, according to Art. 5 of Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes, it stipulates conditions applicable to normal representative proceeding, and it reads that

> Where the following conditions are met, the people's court shall conduct trial by applying the ordinary representative action procedure:
> (1) There are not less than dozens of plaintiffs, and the action conforms to Article 119 of the Civil Procedure Law and the conditions for joint action.
> (2) 2 to 5 proposed representatives are determined in the written complaint and meet the conditions for a representative specified in Article 12 of these Provisions.
> (3) Plaintiff submits the prima facie evidence of the facts of securities tort such as the relevant administrative punishment decision, criminal adjudicative documents, defendant's admission materials, and disciplinary action or self-regulatory measures taken by a stock exchange or any other national securities trading venue approved by the State Council.
> If the provisions of the preceding paragraph fail to be met, the people's court shall conduct trial by applying the non-representative action procedure.

Guanyu Zhengquan Jiufen Daibiaoren Susong Ruogan Wenti De Guiding

(关于证券纠纷代表人诉讼若干问题的规定) [Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes] (promulgated by Sup. People's Ct., Jul. 23, 2020, effective on July 30, 2020), art. 5, para. 3, http://www.court.gov.cn/zixun-xiangqing-245501.html.

However, according to the analysis of the famous law professor Peng Bing of Peking University, there are two problems in these rules. Firstly, both rules still require public enforcement as a prerequisite, and the only difference between them is that the scope of public enforcement in ISC's Representative Litigation Rules is narrower than the SPC's Interpretation. The SPC's Interpretation includes sanction from stock exchanges and brokers-dealers associations, but the ISC's Representative Litigation Rules does not recognize sanctions from these SROs.[26] Although there is no official interpretation of the intention behind these rule-making, it is believed that this is due to the shortage of resources of ISC, especially when comparing the scope of the definition of public enforcement in the ISC's Representative Litigation Rules with that of SPC's Interpretation, we can clearly see that the ISC really do not want too many cases.

Secondly, another problem is that there is not enough incentive for the ISC to initiate litigation, since it enjoys a monopoly in the market and there is no financial incentive as lawyer to bring litigations.[27] Some scholars propose that the ISC should carefully select cases to best use its resources,[28] while other scholars believe that the ISC should not do this, since it is not fair to other cases that are not selected, and this means there is no equal protection of investors.[29]

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26. Zhongzheng Zhongxiao Touzizhe Fuwu Zhongxin Tebie Daibiaoren Susong Yewu Guize (Shixing) (中证中小投资者服务中心特别代表人诉讼业务规则(试行)) [China Securities Investor Services Center Representative Litigation Rules (for Trial Implementation)] § 16, para. 2 (promulgated by China Investor Services Center, July 31, 2020, effective on July 31, 2020), https://www.investor.org.cn/home/Investor_hotnews/202007/P020200731655187830071.pdf; Guanyu Zhengquan Jiufen Daibiaoren Susong Ruogan Wenti De Guiding (关于证券纠纷代表人诉讼若干问题的规定) [Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes] § 5, para. 3 (promulgated by Sup. People's Ct., July 23, 2020, effective on July 30, 2020), http://www.court.gov.cn/zixun-xiangqing-245501.html.

27. Peng Bing (彭冰), *Guanyu Zhengquan Daibiaoren Susong Fadong Jizhi De Sange Wenti* (*关于证券代表人诉讼发动机制的三个问题*) [*Three Issues in the ISC's Securities Representative Litigation*], Beijing Daxue Jingjifa Yanjiu Zhongxin (北京大学经济法研究中心) [Peking University Financial Law Center] (Nov. 30, 2020), http://article.chinalawinfo.com/ArticleFullText.aspx?ArticleId=116821.

28. Guo Li (郭雳), *Toufu Zhongxin Canjia Tebie Daibiaoren Susong De Xuanan Biaozhun* (*投服中心参加特别代表人诉讼的选案标准*) [*Criteria of Selection of Cases by the ISC*], Xinhua News, (Sept. 4, 2020), http://www.xinhuanet.com/finance/2020-09/04/c_1126452943.htm; *Toufu Zhonxin Buneng "Bao Da Yi Qie", Xu Shaixuan Anjian* (*投服中心不能"包打一切"，须筛选案件*) [*The ISC Should not Represent All Types of Cases*] (www.legaldaily.com.cn, Sept. 11, 2020), www.legaldaily.com.cn › content › content_8304041.

29. Peng, *supra* note 27; Peng Bing (彭冰), *Zhongguoban Jiti Susong De Fadong* (*中国版集体*

However, as explained above, there are two ways to initiate securities class action. Apart from the ISC's representative litigation, the second one is to go through normal private class action procedure. The threshold of this normal procedure is lower than the ISC's representative action. Firstly, 10 plaintiffs can initiate this procedure instead of 50, and secondly, sanctions from SROs are enough to fulfill the mandatory prerequisite public enforcement procedure.[30] So, does this mean that the plaintiffs can use this procedure if they are excluded from the ISC's representative action?

The result of analysis made by professor Peng Bing is still miserable, and the reason is that the ISC has the final decision power to decide if a normal class action procedure can be changed to the special ISC's representative procedure and the court does not have right to object according to Art. 32 of SPC's Interpretation.[31] And if a normal procedure did change to the ISC's representative procedure, since the ISC fully acts as the sole representative for the whole plaintiffs' group, the previous lawyers have no choice but to withdraw from the cases as representatives, and this will become a negative incentive for lawyers to represent securities action using the normal procedure from the very beginning.[32] This means the ISC will fight with lawyers to get cases with high possibilities to win, and this public power will unnaturally distort the securities litigation market. Therefore, there are several proposals to amend this situation in Chinese academic circle.

The first proposed solution is to increase the supply of judicial resources in the market. One solution is to establish multiple "ISCs" in the market to increase the shortage of resources of the single ISC and this can also create regulatory competition among them to generate incentives to bring litigations.[33] However, this proposal has several problems. Firstly, if there is possibility to establish more "ISCs", then the current ISC will not face a shortage of resources in the first place. Secondly, regulatory competition can help but only to a limited extent, and this will be discussed in details from the experience in US in Section B of Part III.

The second proposed solution is to lift up the restrictions of public enforcement as a prerequisite and also restrict the power of ISC to cherry pick cases in order to increase the supply of private enforcement in the

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诉讼的发动) [*The Initiation of Chinese Version Securities Class Action*], FALV YU XINJINRONG (法律与新金融) [LAW AND NEW FINANCE] (Aug. 1, 2020).

30. *China Securities Investor Services Center Representative Litigation Rules (for Trial Implementation)*, *supra* note 26. with *Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes*, *supra* note 26, § 5 para. 3.

31. *Provisions of the Supreme People's Court on Several Issues Concerning Representative Actions Arising from Securities Disputes*, *supra* note 26, § 32.

32. Peng, *The Initiation of Chinese Version Securities Class Action*, *supra* note 29.

33. Peng, *supra* note 27.

market. Actually, from the spirit of the previous working document of the SPC[34] and the historical debates in the Chinese academic circle,[35] repealing the mandatory prerequisite requirement of public sanction before private securities litigation is always the mainstream voice before the passage of the new Securities Law. Although there are some concerns as to whether the judicial system has the ability to deal with a sudden increase of large numbers of litigations, scholars try to reform the court system itself to solve this problem,[36] which means they want to solve the problem within the current framework rather than jumping outside the box. However, in the following, this article will show that embracing the US-style class action is not the way out. Because, firstly, even in the US, it is gradually restricting the private class action, and then it is gradually turning to give more resources to the public enforcement, and has built a new public-and-private collaboration model using the SEC-led Fair Fund, which will be discussed in details in Section A of Part VI. And secondly, in several selected jurisdictions examined in the following Part IV, including Japan, South Korea, Taiwan, and Australia, their experience all show the difficulties to balance the negative sides in US-style private class action, so the US-style class action is not recommended by this article.

The third proposed solution is to use out-of-court mediation or arbitration as an alternative to class action, and many scholars believed that this solution should not be supplementary to the securities class action, but rather, it needs to play a relatively primary role to alleviate the shortage of the supply of judicial resources.[37] However, this situation will still face multiple problems as shown in Part V below in the experiences in US and Netherlands. In recent years, the US and Netherlands all try to establish a collective action mechanism under the framework of arbitration or

34. *Supreme People's Court Working Documents on Several Specific Issues of the Supreme People's Court on the Current Trial of Commercial Cases*, *supra* note 9.

35. *See* several publications by famous professors in China, *e.g.*, Zhang Wu Sheng (章武生), *Woguo Zhengquan Jituan Susong De Moshi Xuanze Yu Zhidu Chonggou* (*我国证券集团诉讼的模式选择与制度重构*) [*Mode Choice and System Re-construction of Securities Group Litigation in China*], 2 ZHONGGUO FAXUE (中国法学) [CHINA LEGAL SCIENCE] 276 (2017); Chen Dai Song (陈岱松), *Shilun Zhengquan Minshi Susong Zhidu Zhi Wanshan* (*试论证券民事诉讼制度之完善*) [*On the Improvement of Securities Civil Litigation System*], 1 ZHENGQUAN FAYUAN (证券法苑) SECURITIES LAW REVIEW 258 (2009).

36. Huang Hui (黄辉), *Zhongguo Zhengquan Xujia Chenshu Mingshi Peichang Zhidu: Shizhen Fenxi Yu Zhengce* (*中国证券虚假陈述民事赔偿制度：实证分析与政策建议*) [*Civil Litigation Against Misstatement in Chinese Stock Market: Empirical Analysis and Policy Suggestions*], 9 ZHENGQUAN FAYUAN (证券法苑) [SECURITIES LAW REVIEW] 967 (2013).

37. Shen Wei & Jin Si Yuan (沈伟 & 靳思远), *Xin Zhengquanfa Shijiao Xia De Zhengquan Jiufeng Tiaojie Jizhi Ji Wanshan Jinglu* (*新《证券法》视角下的证券纠纷调解机制及完善进路*) [*The Dispute Settlement Procedure and its Improvement under the New Securities Law*], 102 JINRONG FAYUAN (金融法苑) [FINANCIAL LAW FORUM] 154 (2020).

settlement, which means they also try to level up the importance of arbitration or settlement to solve disputes in a large scale rather than small amount cases, but their efforts still face many challenges as will be discussed below in Part V, so this approach will also not be recommended by this article.

In conclusion, the structure of this paper will be as follows. This paper will discuss if the new version of the Chinese securities class action rule and the new public enforcement regime is appropriate. In Part II, it will introduce a very brief history of the development and changes in the enforcement model in the US. It is found out that there was a trend of restricting private class action while at the same time increasing public enforcement intensity in the US history. This shows that even US is gradually transforming its enforcement model and this should be a warning sign for China to follow the footsteps of the US. In Part III, in order to figure out reasons behind such a trend in the US history, it will discuss some problems in the public and private enforcement model by concluding an under-deterrent effect of the public enforcement and an over-deterrent effect of the private enforcement. In Part IV, in order to solve the above-mentioned problems, it will discuss several jurisdictions' attempts to contain the adverse effects of private securities class action. It is found out that most of these attempts were not successful. The result shows that restricting incentives of private class actions suffocates the development of private class actions, and it is nearly impossible to find the right balance by adjusting these incentives. This means that we need to search for other mechanisms. Therefore, in Part V, this article looks at ADR, including class arbitration and mass settlement, and discuss if they can be substitutes to the private class action regime and provide the right cure to investors. It concludes that both of them failed to do so due to the lack of legal certainty and the lack of parties' aggregation power. So in Part VI, this article abandons the conventional approach that mainly relies on the court or quasi-court regime to solve the investor's compensation issue, but instead introduces a new collaborative model between the private and public enforcement, and introduces the merits of building an administrative institution-led holistic approach by discussing the current approaches adopted in some European and Commonwealth jurisdictions. Finally, in Part VII, based on the above experiences, this article will evaluate the reform of the private class action clauses and some public enforcement clauses in the Securities Law of PRC 2019, and offer some suggestions to China and make the conclusion.

II. WAX AND WANE OF PRIVATE ENFORCEMENT AND INCREASED INTENSITY OF PUBLIC ENFORCEMENT IN THE US

In this part, we will first study the history and development of US enforcement mechanism, since in China there are many suggestions to follow the US model, so the US experience can enlighten the policy decision in China. However, the result suggest that even the US is gradually restricting private litigation and at the same time increasing the intensity of public enforcement.

A. *Private Securities Class Action*

In the US, previously, Section 23 in Federal Civil Procedure Law generally allowed class action, but due to the three types categorized under Section 23, sometimes the decision in one class-action suit does not have a binding effect on other parties not participating in the suit.[38] During the 1950s to 1960s, there was a wave of civil rights movement in the US. Following the ruling of Supreme Court case *Brown vs. Board of Education of Topeka, Kansas*[39] Many white extremists opposed the ruling of the Supreme Court, which made the application difficult.[40] In this background, in order to protect the rights of minorities, the Civil Procedure Law was revised in 1966.

Although the private rights of action [41] was not explicitly recognized under Section 10(b) of the 1934 Securities Exchange Act, lower courts long relied on tort theory and voidability and compensation theory to fashion implied private rights of action.[42] From the perspective of different remedies provided, there are three types of clauses under 1933 and 1934 Acts.[43] The first one is clauses providing explicit private rights of action, the second one is clauses affecting relationships of private parties but without explicit private rights of action, and the third one is clauses requiring or prohibiting certain acts but also without explicit private rights of action. From 1941 to 1946, several district court cases were made in support of implied private

38. Arthur R. Miller, *The American Class Action: From Birth to Maturity*, 19 THEORETICAL INQUIRIES L. 1, 3 (2018); Suzette M. Malveaux, *The Modern Class Action Rule: Its Civil Rights Roots and Relevance Today*, 66 U. KAN. L. REV. 325 (2016).

39. Brown v. Board of Education of Topeka, Kansas, 347 U.S. 483, 873 (1954).

40. Miller, *supra* note 38; Malveaux, *supra* note 38.

41. Private rights of action allows a private plaintiff to bring private litigation based on a public statute, *see* Caroline Bermeo Newcombe, *Implied Private Rights of Action: Definition, and Factors to Determine whether a Private Action Will Be Implied from a Federal Statute*, 49 LOY. U. CHI. L.J. 117, 120 (2017).

42. William F. Schneider, *Implying Private Rights and Remedies under the Federal Securities Act*, 62 NC. L. REV. 853, 861-62 (1984).

43. *Id.*

rights of action under different clauses. One of the seminal cases was the 1946 case *Kardon v. National Gymsum Co.*[44], for the first time acknowledging private rights of action under rule 10b-5. The reason is that the clauses empowered with explicit private rights of action were so few and with many limitations, either having a short period of the statute of limitations or narrower scope of application.[45] In order for the newly passed law to work, the court had to find a way by using other clauses with fewer restrictions but with no explicit private rights of action. However, such a method and interpretation used by the court was very controversial because it confused "implied remedy" with "implied private rights of action".[46] The discretion of the court to grant different types of remedies have long been recognized under US case laws.[47] However, whether private rights of action can be deemed as a form of remedy was not so clear, and the US Supreme Court also did not make this matter clear.[48] With the new class-action clause, throughout the years, the US court system gradually adapted to the securities class actions, in 1971, the US Supreme Court in the case *Superintendent Insurance v. Bankers Life Casualty Co.*[49] finally certified implied private rights of action under 10b-5 and only acknowledge this in a footnote.[50] However, such ruling was also very controversial, because in the footnote it justified its decisions by citing the works of the godfather of US securities law professor Louis Loss as if he held the same opinion, but in fact, he held the exact opposite opinion believing that the expansion of implied private rights of action was too much.[51] Finally, in 1975, the US Supreme Court in the case *Cort v. Ash* formulated a four parts test[52] setting

44. Kardon v. National Gypsum Co., 69 F. Supp. 512 (ED Pa. 1946).

45. Section 11 and 12 sets statute of limitation to one year after discovery but no more than three years. Section 9 limits the restriction of manipulation in stocks listed on a national stock exchange. Section 18 has a very strict "reliance on statement" requirement when seeking liability for sale and purchase of stocks, and the defendant was provided with "innocent defense." *See* 15 U.S.C. § 77 (m) and 78i(e). *See also* Schneider, *supra* note 42, at 860-62.

46. Schneider, *supra* note 42, at 858.

47. It is a common law tradition, not statutory law, but this tradition has not been challenged, *see* Newcombe, *supra* note 41, at 124-25, and JI Case v. Borak, 377 U.S. 426 (1964). The *Borak* Court cited many cases to support this tradition, *see* Schneider, *supra* note 42, at 855, note 27.

48. Newcombe, *supra* note 41, at 124-25; Schneider, *supra* note 42, at 858.

49. Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6 (1971).

50. *Id.*

51. *Id.*; Louis. Loss, Securities Regulation 3869-73 (1969 Supp.).

52. "First, . . . does the statute create a federal right in favor of the plaintiff? Second, is there any indication of legislative intent, explicit or implicit, either to create such a remedy or deny one? Third, is it consistent with the underlying purpose of the legislative scheme to imply such a remedy for the plaintiff? . . . And finally, is the cause of action one traditionally relegated to state law, in an area basically the concern of the states, so that it would be inappropriate to infer a cause of action based solely on federal law?". *See* Cort v. Ash, 422 U.S. 66, at 78 (1975). Although this is not a securities law case, it is a Section 610 case of the 1948 Election Act, which discusses the prohibition of donations or expenditures related to the presidential election, but it set the standards for all subsequent cases, *see* Schneider, *supra* note 42, at 874; John A. Maher, *Implied Private Rights of Action and the*

the parameter of the implied private rights of action and called halt for the overenthusiasm for expansion of its inference.[53]

After 1975, the US Supreme Court started to restrict the expansion of implied private rights of action.[54] In the 1980s, there were growing concerns that the securities class action was primarily driven by lawyers, and many class actions were meritless. They were merely initiated in order to exhort money from listed companies and get attorney fees.[55] Moreover, many critics believed that such compensation by class action was merely to transfer wealth from a group of innocent shareholders to another group of active trading shareholders, in effect punishing inactive shareholders who do not trade in stocks.[56] Also, in the 1980s, there were several attempts of SEC to expand lawyers' aiding and abetting liabilities in cases involving financial misstatement, causing panic in the legal community.[57] Against these backgrounds, in order to control the ever-increasing securities class action suits in the US and ease the feelings of the legal community, the US Supreme Court in *Central Bank of Denver, NA. v. First Interstate Bank of Denver, N.A.,3* case[58] in 1994 ruled that there were no implied private rights of action for aider and abettor liability, and the court reasoned that from the language of the text, it only applies to the primary offender. If the Congress wanted it to apply to the secondary offender, then it would explicitly expressed it.[59] After this case, the accountant or lawyer has to be a primary actor or gives substantial assistance to the primary actor in order to be found liable.[60] However, the definition of substantial assistance has not reached

Federal Securities Laws: A Historical Perspective, 37 WASH. & LEE L. REV. 783, 784-86 (1980).

53. *Id*. Schneider, at 796-804; Maher, at 877-903.

54. *Ash*, 422 U.S. 66; Schneider, *supra* note 42.

55. Amanda M. Rose, *Reforming Securities Litigation Reform: Restructuring the Relationship between Public and Private Enforcement of Rule 10b-5*, 108 COLUM. L. REV. 1301, 1315-24 (2008); John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 726 (1986); John C. Coffee, Jr., *The Future of the Private Securities Litigation Reform Act: Or, Why the Fat Lady Has Not Yet Sung*, 51 BUS. LAW. 975, 1008 (1995); Joseph A. Grundfest, *Disimplying Private Rights of Action under the Federal Securities Laws: The Commission's Authority*, 107 HARV. L. REV. 963, 972-73 (1994).

56. John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation*, 106 COLUM. L. REV. 1534, 1538 (2006).

57. Lisa H. Nicholson, *A Hobson's Choice for Securities Lawyers in the Post-Enron Environment: Striking a Balance between the Obligation of Client Loyalty and Market Gatekeeper*, 16 GEO. J. LEGAL ETHICS 91 (2002); Thomas L. Hazen, *Administrative Law Controls on Attorney Practice-A Look at the Securities and Exchange Commission's Lawyer Conduct Rules*, 55 ADMIN. L. REV. 323 (2003).

58. Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994).

59. *First Interstate Bank of Denver*, 511 U.S. at 191; Gregory E. Van Hoey, *Liability for "Causing" Violations of the Federal Securities Laws: Defining the SEC's Next Counterattack in the Battle of Central Bank*, 60 WASH. & LEE L. REV. 249, 258 (2003).

60. *Id*.; Daniel R. Tibbets, *Tarnished Reputations: Gatekeeper Liability after Janus*, 20 FORDHAM J. CORP. & FIN. L. 745, 757-58 (2015); Alexander Marton, *Dodd-Frank's Impact on SEC Enforcement Actions in Light of Janus Capital Group Inc. v. First Derivative Traders*, 3 FORDHAM J. CORP. & FIN.

consensus in courts.[61] In a later development, some lawyers try to circumvent this ban and form a new concept called scheme liability in the *Stoneridge* case,[62] which deems a series of fraudulent acts as a whole scheme with participation of accountant and lawyer and therefore they not only aided and abetted but also directly participated in it.[63] However, this scheme liability was not recognized by the US Supreme Court either.[64] Then, in the US Supreme Court *Janus* case,[65] the court once again asserted its stance that taking primary role means having ultimate control over such fraudulent acts, albeit leaving open the meaning of ultimate control.

Even more, following the restriction of aider and abettor liability through private litigation, such idea was finally reflected in the Private Securities Litigation Reform Act in 1995, which significantly limited plaintiffs' abilities to bring class actions in US[66] and denied the private rights of action under aider and abettor liability, making the pursuit of gatekeepers' liabilities difficult.[67] It lifted the litigation standard, which further restricts private litigation. Before the PSLRA reform, the plaintiff can bring litigation against accounting firm simply by showing that the auditing report is inaccurate and the price of the audited company falls following the release of the auditing report, and hopes to find proof of negligence during the trial. However, now the plaintiff has to prove beforehand the defendant acts knowingly.[68] Moreover, not only was the standard of litigation raised, but also the compensation level was restricted. Under PSLRA, the defendant's liability changed from joint liability to joint and several liability and each defendant's liability was capped to at most 50 per cent.[69] This

L. 636 (2014) (discussing the development of the definition of substantial assistance developed by case laws).

61. *Id*.

62. Stoneridge Investment Partners v. Scientific-Atlanta, 552 U.S. 148 (2008).

63. *Id*.

64. *Id*.

65. Janus Capital Group, Inc. v. First Derivative Traders, 564 U.S. 135 (2011).

66. *Summary: H.R.1058-104th Congress (1995-1996)*, Library of Congress, https://www.congress.gov/bill/104th-congress/house-bill/1058 (last visited June 29, 2018); Tibbets, *supra* note 60, at 761-64; Adam C. Pritchard & Hillary A. Sale, *What Counts as Fraud-An Empirical Study of Motions to Dismiss under the Private Securities Litigation Reform Act*, 2 J. EMPIRICAL LEGAL STUD. 125 (2005) (showing PSLRA heightened pleading standards); John C. Coffee, Jr., *Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms*, 84 BU. L. REV. 301, 318-23 (2004).

67. *Id*.

68. Practical Law, *Private Securities Litigation Reform Act of 1995 (PSLRA)*, Thomson Reuters Practical Law, https://uk.practicallaw.thomsonreuters.com/w-000-3647?transitionType=Default&contextData=(sc.Default)&firstPage=true&comp=pluk&bhcp=1 (last visited Mar. 22, 2019).

69. 15 U.S.C. § 78u-4 (f)(4)(A)(ii); Judson Lobdell & Nicholas Napoli, *Apportionment of Liability Under the PSLRA*, 9 Securities Litigation Report 23, Thomson Reuters (May 2012),

means that previously plaintiffs only need to sue one defendant-the accountant. However, now it needs to sue all the defendants in order to receive enough compensation, which provides the chance for different defendants to blame each other hence severely prolonging the course of litigations. This reform reduces the deterrence level for auditors to engage in financial manipulation. This move has widely believed to be one of the significant reasons for securities analysts' inside trading and massive accounting frauds in the early 2000s since the deterrence for gatekeepers' illegal behaviors decreased.[70]

B. *Public Enforcement of the SEC*

In 2002, the decreased enforcement intensity partially contributed to the Enron Scandal. Enron was an energy trading company in the US,[71] and its accounting firm, Arthur Anderson, was one of the largest accounting firm in the world.[72] Arthur Anderson helped Enron set SPV to hide losses and boost stock prices.[73] However, Enron was already in a bankrupt state at that time.[74] The Enron Scandal revealed many problems in accounting regulations. One of the most important factors is the decreasing deterrence caused by the restriction on private rights of action against gatekeepers.[75]

https://media2.mofo.com/documents/120501-apportionment-of-liability-under-pslra.pdf.

70. Coffee, *supra* note 66, at 320-21; Tibbets, *supra* note 60, at 762-64; Lawrence A. Cunningham, *Book Review of Gatekeepers: The Professions and Corporate Governance by John C. Coffee, Jr.*, 40 BRIT. ACCT. REV. 87 (2008); John C, Jr. Coffee, *Understanding Enron: "It's about the gatekeepers, stupid"*, 4 THE BUSINESS LAWYER 1403, 1407-08 (2002); George B. Moriarty & Phillip B. Livingston, *Quantitative Measures of the Quality of Financial Reporting*, 17 FIN. EXEC. 53, 54 (2001); Theodore Eisenberg & Jonathan R. Macey, *Was Arthur Andersen Different? An Empirical Examination of Major Accounting Firm Audits of Large Clients*, 1 J. EMPIRICAL LEGAL STUD. 263 (2004); JOHN C. COFFEE, JR., GATEKEEPERS: THE ROLE OF THE PROFESSIONS AND CORPORATE GOVERNANCE 103 (2006); United States General Accounting Office, Gao-03-138, *Report to the Chairman, Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Financial Statement Restatements: Trends, Market Impacts, Regulatory Responses and Remaining Challenges*, 6 (Oct. 2002), http://www.gao.gov/new.items/d03138.pdf; Office of the Gen. Counsel, US Sec. & Exch. Comm'n, *Report to the President and the Congress on the First Year of Practice under the Private Securities Litigation Reform Act of 1995*, at 2, 73 (1997), http://www.sec.gov/news/studies/lreform.txt (last visited Nov. 28, 2018).

71. Christopher O'Leary, *Enron-What Happened?*, Encyclopedia of Britannia, https://www.britannica.com/topic/Enron-What-Happened-1517868 (last visited June 15, 2020); Paul M. Healy & Krishna G. Palepu, *The Fall of Enron*, 17 J. ECON. PERSPECT. 3 (2003).

72. *Periscope: How Arthur Andersen Begs for Business*, NEWSWEEK, Mar. 18, 2002, at 6; Coffee, *supra* note 66, at 312, n.21; Denis Collins, *Arthur Andersen*, ENCYCLOPEDIA OF BRITANNIA, https://www.britannica.com/topic/Arthur-Andersen (last visited June 15, 2020).

73. Healy & Palepu, *supra* note 71, at 15-16; *see generally* William W. Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TUL. L. REV. 1275 (2002).

74. Coffee, *supra* note 66, at 316-18.

75. Coffee, *supra* note 66; Tibbets, *supra* note 60; Cunningham, *supra* note 70; Coffee, *Understanding Enron: "It's about the gatekeepers, stupid"*, *supra* note 70.

However, after the Enron Scandal, the US Congress did not restore the private rights of action but instead sought to strengthen the public enforcement and corporate governance of companies.[76] In order to compensate for such loss of deterrence, the Securities Exchange Act 1934 imposed a new obligation on accountants. It required them to report problems identified to the auditing committee[77], and if it fails to take actions, then to the board of directors.[78] If the company still does not address this problem properly, then the accountant is required to further report such problem to SEC or withdraw from their current works and job and also report the problem to the SEC.[79]

However, such clause was rarely used in the first decade after its passage since the SEC was not equipped with enough resources to check if auditors fulfill this obligation, and auditors themselves do not have this incentive to report at all since they do not want to lose clients.[80] This situation only improved after the 2002 Sarbanes- Oxley Act (SOX) Act when PCAOB was established to supervise the accounting industry specifically.[81] The SOX Act strengthened the internal control of the company, rather than focusing purely on the outcome of financial statement, and the process of how the financial statement is made becomes the central focus.[82] Moreover, the PCAOB was established to become a new independent supervisory body for reviewing the auditing quality of the accounting firms and also in charge of making independent auditing standards and several other standards, including professional ethics.[83] Moreover, the SOX Act expanded SEC's power in Section 308(a) by establishing Fair Funds, which provides SEC with the flexibility to distribute disgorgement of ill-gotten profits and civil

76. Coffee, *supra* note 66, at 334-37; John C. Coffee, Jr., *What Caused Enron-A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 303-05 (2004).

77. 15 U.S.C. 78j-1 (b)(1).

78. 15 U.S.C. 78j-1 (b)(2).

79. 15 U.S.C. 78j-1 (b)(3).

80. Francine, *Are Auditors Reporting Fraud and Illegal Acts? The SEC Knows But Isn't Telling*, Re: The Auditors (Feb. 22, 2012), http://retheauditors.com/2012/02/22/are-auditors-reporting-fraud-and-illegal-acts-the-sec-knows-but-isnt-telling/comment-page-1/; *See also Securities Exchange Act: Review of Reporting Under Section 10A*, U.S. Gen. Accounting Office (Sep. 3, 2003), https://www.gao.gov/products/GAO-03-982R.

81. *Id*.

82. Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1, 68 (2002); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1612 (2005).

83. Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking the Federal Securities Laws*, 28 NCJ INT'L L. & COM. REG. 725, 790-94 (2003); George J. Benston, *The Regulation of Accountants and Public Accounting before and after Enron*, 52 EMORY L.J. 1325 (2003) (discussing the historical development of accountants regulation); Raj Gnanarajah, *Accounting and Auditing Regulatory Structure: U.S. and International*, Congressional Research Service (July 19, 2017), https://fas.org/sgp/crs/misc/R44894.pdf.

penalties to injured investors.[84] Previously, for disgorgement of ill-gotten profits, SEC can seek Federal Courts' approval to distribute them to injured investors.[85] However, as to civil monetary penalties, they are required to be paid to the US Treasury.[86]

In 2010, the Dodd-Frank Act further expanded SEC's powers by making two revisions. The first one is the Section 929P(a) authorizes SEC in any administrative "cease-and-deceit proceeding" to impose any civil monetary penalties on "any person" found to have violated federal securities laws, except for those equitable remedies reserved by courts.[87] This is different from the previous requirements that civil monetary fines imposed on persons not directly regulated by SEC can only be pursued in federal courts.[88] After the passage of the Dodd-Frank Act, the SEC began increasing its settlement practices in the administrative proceeding. In 2013, the numbers of fillings of settlements in administrative proceedings surpassed those registered in federal courts and as of 2015, settlements in administrative proceedings were five times those in federal courts.[89] The second revision is that in Section 929O, it makes explicitly clear that SEC can pursue aider and abettor liability without the need to prove actual knowledge, and mere recklessness can suffice.[90] In the post-Dodd-Frank case *SEC v. Apuzzo*, the Second Circuit ruled in favor of SEC that *Apuzzo* should bear aider and abettor liability under the new standard after the passage of Dodd-Frank Act.[91] Moreover, several district courts soon followed suits, in *SEC v. Big Apple Consulting USA* and *SEC v. Landberg*[92] and *SEC v. Mudd*,[93] The Middle District of Florida and the Southern District of New York all ruled in favor of SEC to hold the defendant to bear aider and abettor liability.

Moreover, in the 2010 Dodd-Frank, the appropriation of funds for SEC increased.[94] The Act established a special reserve fund for the SEC, and the

84. 15 U.S.C. § 7246.

85. Verity Winship, *Fair Funds and the SEC's Compensation of Injured Investors*, 60 FLA. L. REV. 1103, 1111-18 (2008).

86. *Id*.; 15 U.S.C. § 77t (d)(3)(A).

87. 15 U.S.C. § 77h-1 (a); Urska Velikonja, *Securities Settlements in the Shadows*, 126 YALE L.J. F. 124, 127 (2016), Yale Law Forum, http://www.yalelawjournal.org/forum/securities-settlements-in-the-shadows (last visited May 24, 2020).

88. *Id*. at 128.

89. *Id*. at 129.

90. Marton, *supra* note 60, at 672; 15 U.S.C. § 78t (e).

91. SEC v. Apuzzo, 689 F.3d 204 (2d Cir. 2012).

92. SEC v. Landberg, 836 F. Supp. 2d. 148, 151 (SDNY. 2011).

93. SEC v. Mudd, 885 F. Supp 2d 654 (SDNY. 2012).

94. Office of Management and Budget, *Budget of US Government Fiscal Year 2012 Appendix*, 1298 (Feb. 16, 2011), https://books.google.co.jp/books?id=OLDjYvhT4k4C&pg=PA1298&lpg=PA1298&dq=section+991+dodd-frank+act&source=bl&ots=jqYcgn7g3j&sig=ACfU3U1Dpk-3f1Tm2gcfMkpXOCbshjpoSA&hl=zh-CN&sa=X&ved=2ahUKEwimyb3Lz9npAhXMzIsBHaF1DjQ4ChDoATABegQIChAB#v=onepage&q=section%20991%20dodd-frank%20act&f=false; 15 U.S.C. § 78d (i)(1).

use of this fund does not need approval from the Congress.[95] The upper limit of the fund is capped at $100 million, and the annual budget from this fund is limited to $50 million.[96]

Furthermore, in the 2010 Dodd-Frank Act, the SEC gained supervisory authority over multiple SROs, including the Financial Industry Regulatory Authority (FINRA) [97] and Municipal Securities Rulemaking Board (MSRB).[98] Before the Act, they were not subject to supervision by any government agency.

In Part III, I will discuss the reasons behind the transformation of the US's private class actions model. These reasons lead many jurisdictions to rely mainly on public enforcement regimes and also made several restraints on the private class actions if private class action rule was adopted. However, both public and private enforcement regimes have their problems, and this article will also discuss these problems in Part III.

III. OVER-DETERRENCE BY PRIVATE CLASS ACTION AND UNDER-DETERRENCE BY PUBLIC ENFORCEMENT

In this part, it will give some theoretical analysis and empirical evidence of the deterrence effect and compensation status in private class action and public enforcement, and will show that neither of them has a satisfactory performance.

A. *US-Style Collective Private Enforcement Tends to Over-Deter*

Private enforcement of securities law can be either pursued individually or collectively. For individual private enforcement in securities law, it will face two obstacles. The first one is that it is not economical for small amount claimants, so small amount claimants will not have enough incentives to bring suits. The second one is that it may drag the issuer to an endless litigation nightmare. In order to solve these issues, a collective private securities enforcement mechanism is needed.

One of the collective private securities enforcement models is the US-style securities class action. This model has many virtues. Since it uses an opt-out system, it can include as many plaintiffs as possible in the lawsuit. In this case, each individual's loss may be small, but the combined compensation for the defendant will likely be huge. However, through decades of practice, the US securities class action exposed several problems.

95. Office of Management and Budget, *supra* note 94; 15 U.S.C. § 78d (i)(4).
96. *Id.*; 15 U.S.C. § 78d (i)(2).
97. 15 U.S.C. § 78d-9.
98. 15 U.S.C. § 78o-4 (a).

The most critical issue is the over-deterrence problem, which imposes a cooling effect on the market.[99] The reasons behind the scene include both legal reasons and economic reasons. The legal reasons are not particularly related to a class action, but they are more connected to the design of the entire litigation system. Three such designs contribute to the frivolous litigation. The first one is the each-party-bears-its own-cost rule, the second one is the contingency fee rule, and the third one is the extensive evidence discovery procedure.[100] Each-party-bears-its-own-cost rule minimizes the risks associated with losing while contingency fee maximizes the payoff of winning. Last but not least, the extensive evidence discovery process in court enhances the plaintiff's ability to secure evidence, thus increasing the possibility of winning. These three reasons shift lawyers' incentives to pursue any possible securities frauds. These reasons created the lawyer-driven model in the US securities class action. The economic reason is that any news of class action will impact the price of the stock on the market, so the listed company will be forced to settle. The securities lawyers are continually patrolling the market and seize any possibilities to bring class actions, even if there is no solid basis. Whether it can be won or not, a class action is nevertheless bad news on the market and will hurt the price of the stock, and therefore many issuers tend to solve the class action suit as soon as possible.[101] Most of the time, they will try to settle outside court. Because of this, many lawyers will use this technique to bring many meritless suits and coerce the issuer to enter into the settlement as soon as possible.

B. *Public Enforcement Tends to Under-Deter*

In order to avoid the above problems, some jurisdictions choose to rely on public enforcement. However, public enforcement has its own problems, and it tends to under-deter. There are two possible reasons for the under-deterrence effect. The first reason is due to resource constraints, and this can be seen from the transformation of the Australian and the UK's securities regulators. Previously, the Australian Securities Investment Commission (ASIC) held cautious attitudes towards private class action,[102] and was reluctant to share information obtained by its investigatory powers

99. *See* John C. Coffee, Jr., *Litigation Governance: Taking Accountability Seriously*, 2 COLUM. L. REV. 288 (2010).

100. *Id*.

101. Rose, *supra* note 55; Coffee, *supra* note 55; Grundfest, *supra* note 55.

102. Jeremy Cooper, *Corporate Wrongdoing: ASIC's Enforcement Role*, Keynote Address at International Class Actions Conference 2005 (Dec. 2, 2005), https://download.asic.gov.au/media/1338470/ICAC2005_speech_021205.pdf; Michael Legg, *Securities Regulation in Australia: The Role of the Class Action*, *in* ENFORCEMENT OF CORPORATE AND SECURITIES LAW CHINA AND THE WORLD 312, 330-31 (Robin Huang Hui ed., 2017).

to lawyers.[103] However, starting from 2012 due to resource constraints, the Chairman of ASIC in an interview said that using private class action can help ASIC use its resources elsewhere.[104] Moreover, in 2014, when the ASIC's budget was cut, the Chairman of ASIC explicitly expressed that ASIC will rely more on private class actions in the future.[105] Finally, according to the government report in 2014, the role of the private class action was officially recognized and was not deemed to undermine the work of ASIC.[106] Furthermore, under limited resources, the institution will rank the priorities of tasks inside the agency, which will result in neglecting some problems. In the UK, before 2012, there was only one single regulator in the financial sector, which is the Financial Services Authority (FSA).[107] During that period, the regulatory strategy of FSA was usually described as a light-touched approach.[108] However, according to the FSA itself, the light-touched approach was not its original intention, and the result was primarily due to conflicts of goals inside FSA.[109] Since it is the single regulator in the UK's financial sector, it has to balance different goals. In order to balance these goals, it uses risk-based regulation, so only those events associated with high risks would be addressed by the regulator.[110] However, risk-based regulation is closely connected to resource allocation.[111] Those deemed as high risks internally get most of the resources while others do not. Therefore, even if the regulator wants to go harder on the securities frauds, it just does not have the capabilities and resources. This is one of the reasons that drives the UK to shift from a single regulator to the Twin Peak Model.[112]

The second reason is due to bureaucracy. From the experience of the

103. Elizabeth Boros, *Public and Private Enforcement of Disclosure Breaches in Australia*, 9 J. CORP. L. STUD. 409, 434-36 (2009); Michelle Welsh & Vince Morabito, *Public v. Private Enforcement of Securities Laws: An Australian Empirical Study*, 14 J. CORP. L. STUD. 39, 71-77 (2014); Legg, *id*.

104. SENATE ECONOMICS REFERENCES COMMITTEE, PERFORMANCE OF THE AUSTRALIAN SECURITIES AND INVESTMENTS COMMISSION 261 (June 2014); Alex Boxsell, *Regulators Praise Private Court Actions*, THE WEEKEND AUS. FIN. REV., 5-9 April 2012, at 59; Legg, *id*.

105. Shaun Drummond, *ASIC Chief Sets Sights on Financial Advisers*, THE SYDNEY MORNING HERALD, June 2014, at 25.

106. Legg, *supra* note 102, at 331.

107. *Finance, United Kingdom*, Encyclopedia Britannia, https://www.britannica.com/place/United-Kingdom/Economy#ref44699 (last visited June 8, 2020).

108. Julia Black, *Regulatory Styles and Supervisory Strategies*, *in* THE OXFORD HANDBOOK OF FINANCIAL REGULATION 218, 225-30 (Niamh Moloney, Ellis Ferran & Jennifer Payne eds., 2015); Julia Black, Martyn Hopper & Christs Band, *Making a Success of Principles-Based Regulation*, 1 L. FIN. MAR. REV. 191 (2007) (discussing how principles make enforcement difficult); Eilis Ferran, *The Break-up of the Financial Services Authority*, 3 OXF. J. LEG. STUD. 455, 471-75 (2011).

109. Black, *supra* note 108, at 226; Ferran, *supra* note 108, at 471-79.

110. Black, *id*. at 222-26; Black, Hopper & Band, *supra* note 108, at 199-201.

111. Black, *id*. at 223-36.

112. *Id*.

SEC in the US, it reacts slowly and is reluctant to pursue hard cases.[113] The SEC has to go through extensive review process before taking enforcement actions.[114] Also, the SEC is a quasi-judicial agency and has enormous rule-making power.[115] Therefore, it needs to be careful with consistency in its decisions, and its powers need to be checked and balanced.[116] This further drags down its willingness of enforcement.

This situation is partially mitigated by the regulatory competition. There are times that the prosecutors brought suits first, and the SEC only followed up after prosecution.[117] The reason is probably that the prosecutor is more flexible while the SEC has to be bound by its internal procedures.[118] Also, the prosecutor faces pressures from election, so in pursuing hard and high profile cases, the prosecutor can get a better career path while the SEC normally cannot.[119] In this case, the prosecutor is more likely to pursue hard cases since it is at the same time associated with high publicity while the SEC is more likely to retreat under the same circumstance.[120] When the prosecutor brings such action previously neglected by the SEC, it creates pressure on the SEC and forces the SEC to initiate investigations.[121] However, the problem of bureaucracy can only be alleviated by regulatory competition to a limited extent, since the standard of proof of criminal case is much higher compared to civil and administrative case, and there has been extensive researches on this topic as to why relying on criminal prosecution of securities violations is not a bright idea.[122] Moreover, the evaluation and

113. Donald C. Langevoort, *The SEC as a Bureaucracy: Public Choice, Institutional Rhetoric, and the Process of Policy Formulation*, 47 WASH. & LEE L. REV. 527, 530 (1990).

114. William R. McLucas et al., *A Practitioner's Guide to the SEC's Investigative and Enforcement Process*, 70 TEMP. L. REV. 53, 57 (1997).

115. James J. Park, *Rules, Principles, and the Competition to Enforce the Securities Law*, 100 CAL. L. REV. 115, 145-59 (2012).

116. *Id*. at 165-67.

117. *Id*. 145-59 (2012).

118. *Id*.

119. *Id*. at 158-59.

120. *Id*.

121. *Id*. at 153-54.

122. For empirical studies, *see* Ana Carvajal & Jennifer Elliott, *The Challenge of Enforcement in Securities Markets: Mission Impossible?*, IMF WP/09/168 (Aug. 2009), https://www.imf.org/external/pubs/ft/wp/2009/wp09168.pdf (concluding that primarily relying on criminal enforcement will result in regulatory failure based on statistical analysis from dozens of jurisdictions); For empirical studies, *see also*, SEC, *Annual Report-Division of Enforcement 2018* (Nov. 2, 2018), https://www.sec.gov/files/enforcement-annual-report-2018.pdf, and Chair Mary Jo White, *All-Encompassing Enforcement: The Robust Use of Civil and Criminal Actions to Police the Markets* (Mar. 31, 2014), https://www.sec.gov/news/speech/2014-spch033114mjw#_ftn3 (showing that the number of criminal cases referred by SEC is significantly lower than the case number in the civil and administrative proceedings by SEC in US, where the former is 136 on average in a five-year period from 2009 to 2013, while the latter is more than 800. This shows that criminal enforcement is difficult in US); For legal-text-based analysis behind the difficulties of prosecution of securities violations in US, *see also* Stephen W. Grafman, Roger M. Adelman & Christian E. Plaza, *Criminal Enforcement of Securities Laws-A Primer for the Securities Practitioner*, *in* SECURITIES

performance of prosecutor are also bound by its success rate in court. Therefore, although there is incentive to pursue cases, the disincentive is just as strong if not higher. In conclusion, just as the 2009 report by the U.S. Government Accountability Office pointed out that the SEC "[e]nforcement staff said a burdensome system for internal case review has slowed cases and created a risk-averse culture."[123] The regulatory competition does not change this risk-averse culture in the SEC in the past, and will not be likely to change it in the future.

C. *Compensation: Not Enough and Waiting Too Long*

In the US, before the passage of the PSLRA, the average compensation rate[124] is around 13.5 per cent and the medium rate is 9.6 per cent,[125] while after the passage of PSLRA, the average rate is around 12.3 per cent, and the medium rate is 5.1 per cent.[126] Also, the compensation rate goes lower when the investor losses become larger. For losses less than $20 million, the compensation rate is 19.2 per cent,[127] and for losses over $20 million, the rate drops 50 per cent to only 8.4 per cent compensation rate,[128] and for losses over $100 million, the compensation rate drops another 50 per cent, so the rate is lower than 4 per cent,[129] and lastly, for losses over $5000 million, the compensation rate is lower than 1 per cent.[130] Moreover, a large portion of compensation is taken away by lawyers. The smaller the compensation is, the larger the percentage. For settlements under $25 million, the average

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ENFORCEMENT MANUAL 391 (K&L Gates LLP. ed., 2007) (depicting that high standard of burden of proof, proof of scienter and grand jury make it difficult to prosecute criminal cases in US); For legal-text-based analysis of difficulties of prosecution in EU and UK, *see* David Kirk, *Enforcement of Criminal Sanctions for Market Abuse: Practicalities, Problem Solving and Pitfalls*, 17 ERA FORUM 311 (2016) (showing that criminal enforcement against market abuse is still difficult in UK after the passage of the new Market Abuse Regulation in EU); For theoretical discussions, *see* Ian Macneil, *Enforcement and Sanctioning*, *in* OXFORD HANDBOOK OF FINANCIAL REGULATION 280, 297-98 (Niamh Moloney, Ellis Ferran & Jennifer Payne eds., 2015) (arguing that criminal enforcement is mostly suitable for cases that are "clear-cut and unpredictable but may not work so well in cases where rule-breaking is episodic, repetitive, or continuous").

123. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-358, GREATER ATTENTION NEEDED TO ENHANCE COMMUNICATION AND UTILIZATION OF RESOURCES IN THE DIVISION OF ENFORCEMENT, Preface (2009).

124. Compensation rate means the amount of compensation received divided by the claimed amount of losses.

125. James D. Cox & Randall S. Thomas, *Does the Plaintiff Matter?: An Empirical Analysis of Lead Plaintiffs in Securities Class Actions*, 106 COLUM. L. REV. 1537, 1627 (2006).

126. *Id*.

127. Stefan Boettrich & Svetlana Starykh, *Recent Trends in Securities Class Action Litigation: 2017 Full-Year Review* 37, NERA Economics Consulting (Jan. 29, 2018), https://www.nera.com/content/dam/nera/publications/2018/PUB_Year_End_Trends_Report_0118_final.pdf.

128. *Id*.

129. *Id*.

130. *Id*.

percentage is over 30 per cent,[131] while for settlements over $1,000 million, the average percentage rate is around 10 per cent.[132] Also, the time for compensation is very long. In the US, the medium time from filling to resolution is around 2.3 years,[133] and 25 per cent of the cases are more than 4 years.[134]

In China, the average compensation rate is around 78.1 per cent[135] and the medium level is 83.1 per cent.[136] This statistic is enormously high compared to the US. In China, the average time from filing to resolution is around 13.5 months,[137] and the medium time is around 11.7 months.[138] This statistic also beats the US.

There are two explanations for the discrepancies between China and the US's statistics. For the compensation rate and time, the reason why China outperforms the US is that firstly administrative or criminal sanction is a prerequisite to bringing lawsuits to courts in China.[139] Since the result has been proved by the CSRC, so it is much easier for a private litigation to become successful. It is the same in the US. From 1990 to 2003, 64 per cent of the cases in US securities class actions have a compensation rate lower than 10 per cent, while brought after the SEC's sanction, only 46 per cent of cases are lower than 10 per cent of the compensation rate.[140] Moreover, 25 per cent of cases have a compensation rate lower than 2 per cent before administrative sanction, [141] while after administrative sanctions, no compensation rate is lower than 2 per cent.[142] Although the compensation rate is high in China, few cases get compensated since neither the CSRC nor the public prosecutors have sufficient resources to process all the securities cases. Therefore, many cases never went to court proceedings.[143]

Secondly, in China, only the misstatement is allowed to be sued in court.[144] In contrast, other two common types of market abuse, insider dealing and market manipulation, are not allowed to be sued in court.[145]

131. *Id*. at 42.
132. *Id*.
133. *Id*. at 26.
134. *Id*.
135. Huang, *supra* note 36, at 979.
136. *Id*.
137. *Id.* at 978.
138. *Id*.
139. *Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market*, *supra* note 7.
140. James D. Cox, Randall S. Thomas & Dana Kiku, *SEC Enforcement Heuristics: An Empirical Inquiry*, 53 DUKE L.J. 737, 769-70 (2003).
141. *Id*.
142. *Id*.
143. Huang, *supra* note 36, at 977-78.
144. *Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market*, *supra* note 7.
145. *Id.*

Since insider dealing and market manipulation are harder to prove than misstatement, but the US also allowed these two types to be sued in court so that they might lower the compensation rate.[146]

Finally, there is another reason that can account for the shorter time in China. One of the possible reasons is that the filling and registration time in China is very long. Before the trials can be started in court, many cases had to wait for two years in which the statute of limitations expired.[147] The reason behind this is that there is no opt-out system in China, so in order to include as many people as possible in the proceeding and also avoid the possible following filing of applications in the future, waiting statute of limitations to be expired becomes the usual practice in China. If these proceedings are also included, then the average time will be over three years.[148]

In conclusion, we can see that in both US and China, either the compensation rate is too low or the cases receiving compensation are too few, and the time to get compensation is also too long, and it does not matter if they choose to rely more on private enforcement or public enforcement. So there begs the question. Can we balance the over-deterrence and under-deterrence effect? Or can we shorten the compensation time and, at the same time, increase the compensation rate? This article will address these problems in the following parts.

IV. A BALANCED PRIVATE ENFORCEMENT MODEL NEEDED? SOME CASE STUDIES AND EMPIRICAL EVIDENCE-THE TWIN EVIL OF COURT DISCOVERY AND PLAINTIFFS' LAWYERS' INCENTIVES

In this part, it will show that the near impossibility to balance the incentives under the US- style private enforcement model due to the existence of extensive evidence discovery procedure and the plaintiffs' lawyers' significant financial incentives.

A. *Introduction of the Model of Private Securities Class Actions*

Since securities class action tends to over-deter and public enforcement alone tends to under-deter, it seems that the right approach is to introduce

146. 17 C.F.R. 240.10b-5; Stephen M. Bainbridge, *An Overview of Insider Trading Law and Policy: An Introduction to the Insider Trading Research Handbook*, *in* RESEARCH HANDBOOK ON INSIDER TRADING 1 (Stephen M. Bainbridge et al. eds., 2013); EMILIOS AVGOULEAS, THE MECHANICS AND REGULATION OF MARKET ABUSE, A LEGAL AND ECONOMIC ANALYSIS 104-05 (2005); Adolf. A. Berle, Jr., *Stock Market Manipulation*, 38 COLUM. L. REV. 393 (1938); *Regulation of Stock Market Manipulation*, 56 YALE L.J. 509 (1947).

147. Huang, *supra* note 36, at 977-78.

148. *Id*.

securities class action into enforcement regime to compensate for insufficient resources of public enforcement on the one hand, and control the incentives for frivolous private securities class action on the other hand. In the late 1990s and the beginning of the 2000s, this approach had happened in many jurisdictions.[149] Under the US and European perspective, the following elements will influence the working of securities class action:[150]

(1)Scope of litigation, meaning what kind of causes are allowed under securities class actions, including misstatements, insider dealing, market manipulation or other types of illegal behaviors;
(2)Litigation costs allocation, meaning whether it is a winner-pays model, loser-pays model or split-the-costs model;
(3)Litigation finance, meaning if contingency fees or outside litigation funding is allowed;
(4)Limitation of settlement fee or lawyer's fees, meaning if fees are controlled in some way, whether by law or by the court;
(5)Aggregation of plaintiffs, meaning if it is opt-in or opt-out model;
(6)Court discovery, meaning if there is extensive court discovery mechanism;
(7)The burden of proof of reliance and causation, meaning whether it is presumed or needs to be proved by plaintiffs;
(8)Standards of proof of intention, meaning the extent to which the intentional aspect is a requirement, whether it is intentionality, recklessness, or negligence.

No matter how each country tries to adjust the model of the securities class action and the incentives in the model, they are pulling the levers among the above eight elements. These eight elements can be further characterized into four groups. Elements 2 to 4 are financial incentives, elements 1, 5, and 6 are procedural incentives, and elements 7 and 8 are substantive standards' incentive.

In the following, this article will use four jurisdictions as examples of case studies to illustrate these points. These jurisdictions include Japan, South Korea, Taiwan and Australia. There are several reasons to examine these jurisdictions. First, Japan, South Korea, and Australia all embrace the US-style class action, but they put different restrictions on it, so it is important to compare these differences to see which approach works. Most importantly, Japan and South Korea are Civil Law jurisdictions and Australia

149. John C. Coffee, Jr., *The Globalization of Entrepreneurial Litigation: Law, Culture and Incentives*, 165 U. PA. L. REV. 1895, 1900-916 (2017).
150. *Id*. at 1917; Christopher Hodges, *Current Discussions on Consumer Redress: Collective Redress and ADR*, 13 ERA FORUM 11, 12-14 (2012).

is a Common Law jurisdiction, so it is worthwhile to compare different approaches between these two legal systems when adopting US-style class action. Second, Taiwan, on the other hand, adopts another model other than the US style class action. Instead, it introduced a public body to represent plaintiffs to initiate civil suits in court. China mimics Taiwan to build a similar model, so it is also worthwhile to compare Taiwan with China.

For the case studies in the following jurisdictions, they exhibited the following patterns. First of all, for jurisdictions other than the US, since they do not have extensive court discovery procedure,[151] and therefore they will try to decrease the level for elements 7 and 8, the substantive law incentive, to compensate for the lack of discovery abilities. Also, all of them will try to control the financial incentives, which is the most direct way to control the agency costs for the self-interested lawyers. Finally, some jurisdictions switch the opt-out approach to an opt-in approach as another way to control the lawyer-driven over-deterrent effect.

Secondly, for the US, the adjustment of incentives is different. Unlike many jurisdictions where the approaches changed the opt-out model into the opt-in model and restraint the financial incentives of lawyers, the US approach focused on the reform of evidence discovery procedure and the apportionment of liability.[152]

In the following, I will use the model mentioned above to discuss cases of securities class actions in different jurisdictions.

B. *United States*

In order to curtail these meritless securities class actions, the US made several changes. Firstly, in 1996 it passed the PSLRA, where the court evidence discovery power is restricted.[153] Specific evidence must be presented for each allegation in the admission stage.[154] The purpose is to restrict the plaintiff's lawyer's strategy of sue-first-discover-evidence-later, thus preventing the meritless suits.[155] Secondly, the US narrowed the scope of compensation for a securities class action, where in principle a person only needs to be liable to the proportion equal to his share of responsibility,[156] unless the plaintiff's net worth is less than $200,000 and

151. Craig P. Wagnild, *Civil Law Discovery in Japan: A Comparison of Japanese and US Methods of Evidence Collection in Civil Litigation*, 3 APLPJ 1 (2002); Elizabeth Fahey & Zhirong Tao, *The Pretrial Discovery Process in Civil Cases: A Comparison of Evidence Discovery between China and the United States*, 37 B. C. INT'L & COMP. L. REV. 281 (2014).

152. *Infra* Part IV. B.

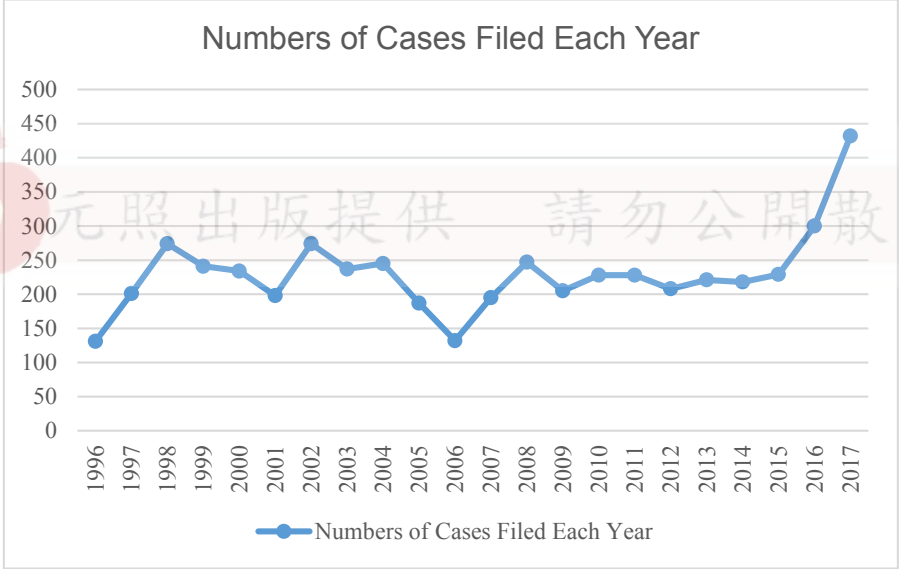
153. 15 U.S.C. § 78u-4 (b)(3).

154. 15 U.S.C. § 78u-4 (b)(1)(B).

155. 15 U.S.C. § 77z-1 (b).

156. 15 U.S.C. § 78u-4 (f)(2).

also the recovered damages are more than 10 per cent of the plaintiff's net worth.[157] While in the past, any liable persons need to take joint and several liability, which means any liable persons can be liable to the entire amount, no matter the share of their responsibilities.[158] Thirdly, the US Supreme Court narrowed the scope of the aider and abettor liability,[159] and the result is that law firms and accounting firms cannot be sued for aider and abettor liability in class actions. Fourthly, the US expands the court's power in approval of settlement fee and lawyer's fee, in order to restrain the financial incentives.[160] However, these efforts may not work. From 1996 to 2016, there were 4762 securities class actions filed.[161] In 2017 alone, there were 432 cases filed.[162] These statistics suggest that the numbers of class actions did not decrease by much.[163]



Statistics from NERA Economics Consulting Report 2017.[164]

Figure 1: Number of Securities Class Action Suits Filed Each Year in US

157. 15 U.S.C. § 78u-4 (f)(4).
158. Lobdell & Napoli, *supra* note 69, at 23.
159. *First Interstate Bank of Denver*, 511 U.S. 164.
160. 15 U.S.C. § 78u-4 (c).
161. Boettrich & Starykh, *supra* note 127, at 2.
162. *Id.*
163. *See, e.g.*, "[T]here are as many, if not more, class actions filed annually after passage of the PSLRA as before" but also that the PSLRA may have improved "overall case quality" Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 915 (2016).
164. Boettrich & Starykh, *supra* note 127, at 3.

C. *Japan*

The scope for Japan's securities litigation is confined to only misstatements.[165] In terms of lawyer's fee-bearing mechanism, Japan is neither a winner-pays nor a loser-pays model, but rather each party bears its own costs.[166] However, for fees payable to the court, it is the loser-pays model.[167] As for litigation finance, Japan allows for contingency fees. However, the percentage is not set at a high level, usually between 10 to 15 per cent.[168] Moreover, most of the time, even with contingency fees, a retainer up to several million yen is usually required due to the often small size of Japan's law firms and its relatively weak financial abilities, thus further restricting the financial incentives of plaintiffs.[169] As for class aggregation, Japan chooses the opt-in model.[170] Lastly, in terms of substantive law, since Japan does not have an extensive court-discovery procedure, in order to compensate for this loss, it lowers the standard to prove intention.[171] Firstly, negligence is sufficient to hold issuers and directors liable,[172] which is different from the US, where it is less likely.[173] Secondly, negligence is presumed, and the burden of proving non-negligence is on the side of the issuer,[174] whereas in the US, the plaintiffs bear the burden of proof for intention.[175] Until 2016, there were 58 decisions against 10 issuers.[176] In these 58 decisions, 30 decisions against issuers were

165. Gen Goto, *Growing Securities Litigation against Issuers in Japan: Its Background and Reality*, *in* ENFORCEMENT OF CORPORATE AND SECURITIES LAW: CHINA AND THE WORLD 416, 416-18 (Robin Huang Hui ed., 2017); Kinyū shōhin torihikihō [Financial Instruments Exchange Act], Law No.25 of 1948, § 21-2 (Japanese Law Translation Database System), http://www.japaneselawtranslation.go.jp/law/detail/?id=2355&vm=02&re=02 (Japan); Supplementary Provisions to the Reform Act of the Securities and Exchange Act, § 5, Financial Services Agency, www.fsa.go.jp/houan/159/hou159.html (Japan) (last visited May 30, 2020).

166. Minjisoshōhiyōtō ni kansuru hōritsu [Act on Costs of Civil Procedure], Law No.40 of 1971, § 2, no.10 (Japanese Law Translation Database System), http://www.japaneselawtranslation.go.jp/law/detail/?re=02&ky=%E8%91%97%E4%BD%9C%E6%A8%A9&page=10 (Japan).

167. Minji soshōhō [Code of Civil Procedure], Law No. 109 of 1996, § 61 and § 67 (Japanese Law Translation Database System), http://www.japaneselawtranslation.go.jp/law/detail/?id=2834&vm=2&re=02 (Japan).

168. Goto, *supra* note 165, at 437-40.

169. *Id.*

170. Goto, *supra* note 165, at 421.

171. *Financial Instruments Exchange Act*, § 21-2, paragraph 2.

172. *Id*.

173. Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), at 672-73 (US Supreme Court ruled that the plaintiff needs to prove scienter of defendant under Rule10b-5); *See also* Jeanne P. Bolger, *Recklessness and the Rule 10b-5 Scienter Standard after Hochfelder*, 49 FORDHAM L. REV. 817 (1981).

174. Goto, *supra* note 165, at 424.

175. 425 US 185 (1976).

176. Goto, *supra* note 165, at 424.

initiated after the passage of Japan's class action clause in 2004,[177] accounting for 50 per cent of decisions and 60 per cent of issuers.[178]

D. *South Korea*

South Korea, just like Japan, only allows misstatement to be brought in securities class actions.[179] However, in other aspects, South Korea takes one step further from Japan, in which it chooses the opt-out model.[180] Moreover, in order to compensate for the lack of discovery, it takes a step further than Japan, in which there is no need at all to prove loss causation in South Korea.[181] Moreover, reliance is not presumed, but it is given, which means it cannot be rebutted.[182] In terms of cost, South Korea uses the loser-pays model.[183] As for finance, South Korea also allows for contingency fees.[184]

However, there are many other restrictions in South Korea. To counterbalance the over-deterrence effect, South Korea bars anyone who participated in three class actions in recent three years to appear in any following class actions,[185] which makes experiences building difficult. Most importantly, it suffocates the securities litigation business model, where no law firms can solely rely on securities litigation to generate profits.[186] This restriction is the most severe restriction of all time on financial incentives for securities class actions. From 2003 to 2016, in thirteen years, there were only nine cases filed for securities class actions.[187]

177. *Id.*

178. *Id.*

179. Hwa-Jin Kim, *Private Enforcement of Company Law and Securities Regulation in South Korea*, *in* ENFORCEMENT OF CORPORATE AND SECURITIES LAW: CHINA AND THE WORLD 444 (Robin Huang Hui ed., 2017).

180. *Id.*

181 . Jeunggwongwanryeon jipdansosongbeob [Securities-related Class Action Act], Act No.7074, Jan. 20, 2004, amended by Act No. 11845, May 28, 2013, § 125 and § 162 (S. Kor.)

182. Kim, *supra* note 179, at 450.

183. *Securities-related Class Action Act*, § 11. For detailed discussions, *see* Benjamin Joon-Buhm Lee, *Saving the South Korean Securities Class Action*, 39 U. PA. J. INT'L L. 247 (2017); Hannuri Law LLP., *Class actions in South Korea* (Nov. 2014), https://www.lexology.com/library/detail.aspx?g=30c700af-4183-4f13-8a21-c31968071283; Quan He Zai (权赫在), *Zhengquan Jituan Susong De Yanjiu: Hanguo De Jingyan* (*证券集团诉讼的研究：韩国的经验*) [*A Study on the Securities Class Action: South Korean Example*], 25 HEBEI FAXUE (河北法学) [HEBEI LAW SCIENCE] 149 (2007).

184. *Id.*

185. *Id.*

186. *See* Lee, *supra* note 183, at 272 (describing hardship for law firms to diversify risks under this rule).

187. Kim, *supra* note 179, at 447.

E. *Taiwan*

Taiwan uses an institution representative model, where an institution called Investor Protection Center (IPC) is used to represent plaintiffs to initiate litigation.[188] Although the Securities Exchange Act clearly provides private rights of action for public offering, issuing, private placement, trading of securities and misstatement of prospectus,[189] people nevertheless choose to exclusively rely on the IPC to take enforcement actions due to its low cost.[190] The IPC has an extensive list of investigatory tools,[191] which helps compensate for the lack of discovery in court procedure. The plaintiffs need to opt-in and sign a contract with the IPC in order to authorize the IPC to bring litigation on their behalf.[192] The costs of litigation are low. Firstly, authorizing IPC to bring litigation is free.[193] Secondly, the lawyers in IPC take a monthly fixed salary the same as government officials.[194] Statistics show that the numbers of cases brought and settlement gains are very nice. Until 2014, there were 187 cases filed,[195] amounting to a total compensation of NT $43.9 billion on behalf of 112,000 investors.[196] However, if we further analyze the statistics, we can see there are many problems.

The first one is that the compensation rate is still low. On average, it is only 8 per cent.[197] Secondly, the time taken for the IPC to initiate proceeding is very long. On average, it takes 300.7 days in its internal process before initiating litigation.[198] Thirdly, although IPC has the ability to investigate, it never independently uses this ability but rely heavily on prosecutor's investigation, and only one case was brought before the finish of criminal proceeding as of 2015.[199] Moreover, IPC never won a single

188 . Wen-Yeu Wang, *The IPC Model for Securities Law Enforcement in Taiwan*, *in* ENFORCEMENT OF CORPORATE AND SECURITIES LAW: CHINA AND THE WORLD 454 (Robin Huang Hui ed., 2017).

189. Zhengquan Jiaoyi Fa [Securities and Exchange Act] 1968, § 20, § 31, para. 2 (Laws and Regulations Database of Republic of China) (Taiwan) https://law.moj.gov.tw/LawClass/LawAll.aspx?pcode=G0400001.

190. Wen-Yeu Wang & Jhe-Yu Su, *The Best of Both Worlds? On Taiwan's Quasi-Public Enforcer of Corporate and Securities Law*, 3 THE CHINESE JOURNAL OF COMPARATIVE LAW 1, 15 (2015).

191. Zhengquan Touziren Ji Qihuo Jiaoyiren Baohu Fa (證券投資人及期貨交易人保護法) [Securities Investor and Futures Trader Protection Act] 2002, § 17 (Laws and Regulations Database of Republic of China) (Taiwan) https://law.moj.gov.tw/LawClass/LawAll.aspx?pcode=G0400038.

192. Wang, *supra* note 188, at 460.

193. *Id*. at 465-66.

194. *Securities Investor and Futures Trader Protection Act*, § 33.

195. Wang, *supra* note 188, at 462.

196. *Id*.

197. Wang & Su, *supra* note 190.

198. Wang, *supra* note 188, at 468.

199. Securities and Futures Investors Protection Center, *Tuanti Susong Anjian Jingxinzhong Anjian Huizongbiao* (*團體訴訟案件進行中案件匯總表*) [*Compilation of On-Going IPC cases*], www.sfipc.org.tw/main (last visited July 2, 2018).

case if the defendant was not convicted in the criminal proceeding.[200]

F. *Australia*

The scope for filling securities class action is very broad in Australia, which includes almost all types of market abuse in all types of financial products.[201] Australia also chooses the opt-out model.[202] However, in order to counterbalance the influence brought by the broad scope and the opt-out model, the cost-bearing mechanism for litigation is neither a loser-pays nor a winner-pays model, but rather is a leading representative fee-bearing model, where the fees are solely borne by the leading plaintiff and are not shared among other plaintiffs.[203] Also, the settlement plan must be approved by the court.[204] As for lawyer's fees, although contingency fee is not permitted, outside litigation funding is allowed.[205] Currently, there were at least seventeen litigation funders active in the market.[206] There was rarely judicial review for the litigation funder's fee.[207] In practice, it ranged from 25 per cent to 40 per cent.[208] However, recently, the court has begun to actively scrutinize the fees paid to litigation funders after 2016.[209] In terms of substantive law, the law does not stipulate the burden of proof for reliance, the causation, and the standards for intention,[210] but recent case laws formed some standards, and generally, reliance and causation are presumed.[211]

The private class actions in Australia have grown very fast in recent

200. Lin Yu Xin (林郁馨), *Touziren De Nuoya Fangzhou: Touziren Baohu Zhongxin Yu Zhengquan Tuanti Susong Zhi Shizheng Yanjiu* (*投資人的諾亞方舟：投資人保護中心與證券團體訴訟之實證研究*) [*The Noah's Ark for Investors: An Empirical Study of Investor Protection Center and Securities Class Actions*], 229 YUEDAN FAXUE ZAZHI (月旦法學雜誌) [TAIWAN L. REV.] 75, 82 (2014).

201. Corporations Act 2001 (Cth), s 674, 675, 1041A-D, 1043A, 1317E (Austl.).

202. Federal Court of Australian Act 1976 (Cth), s 33J, 33X; Corporations Act (Cth), s 670A, 728, 1041H; Australian Securities Investment Commission Act 2001 (Cth), s 12DA.

203. Federal Court of Australian Act 1976 (Cth), s 43(1A); Legg, *supra* note 102, at 315.

204. Federal Court of Australian Act 1976 (Cth), s 33V.

205. Campbells Cash and Carry Pty Limited v. Fostif Pty Ltd (2006) 229 CLR 386 (The High Court of Australia held that litigation funding is not an abuse of process and against public policy).

206. Ewen McKay & Andrew Moore, *How Did We Get Here? The History and Development of Securities Class Actions in Australia* 12, XL Catlin & Wotton + Kearney (May 29, 2017), https://www.legalignglobal.com/writable/files/downloads/securities_class_actions_australia.pdf.

207. Legg, *supra* note 102, at 323.

208. *Id*. at 318-20.

209. *See* Jason Geisker & Jenny Tallis, *Litigation Funding in Australia: A Year of Review and Change?*, Claims Funding Australia (July 24, 2018), https://claimsfundingaus.com.au/news/litigation-funding-australia-year-review-and-change.

210. Michael Legg & Madeleine Harkin, *Judicial Recognition of Indirect Causation and Shareholder Class Actions*, 44 ABLR 429 (2016).

211. P Dawson Nominees Pty Ltd v. Brookfield Multiplex Ltd (No.4) [2010] FCA 1029, [15]-[17]; Pathway Investments Pty Ltd v. National Australia Bank Limited (No.3) [2012] VSC 625, [11]-[12]; Caason Investments Pty Ltd v. Cao [2015] FCAFC 94.

years. From 2000 to 2016, the statistics of class actions in Australian Federal Courts[212] were 206.[213] There was a burst of securities class actions from 2013 to 2016,[214] where there were 31 class actions in these short three years.[215]

G. *Discussion of the above Cases*

One must be curious, why the numbers of securities class actions cannot catch up with the US level after the securities class action mechanism was introduced. When we adjusted the numbers of securities cases by the numbers of companies listed in the jurisdiction, even the best performed Australia is severely dwarfed by the US by nine times.[216] There are the following reasons.

Jurisdictions	Number of Cases	Number of Listed Companies in Domestic Market	Securities Class Actions Filed per (Listed Domestically) Company per 100
US	4762	5204	91.50
Australia	206	1989	10.35
Japan	58	3539	1.57
South Korea	7	1987	0.35
Taiwan	216	892	24.22

Statistics from 1996 to 2016.[217]

Figure 2: Number of Cases in Ten Years

The first reason may suggest that the previous deterrent level outside the US is very close to the optimal deterrent level, and therefore introducing the class action mechanism will not increase that level by much. For example, in South Korea, before introducing the securities class action mechanism, the

212. Except in Federal Courts, three States of Australia also adopted the opt-out securities class actions, including the Supreme Court of New South Wales, the Supreme Court of Victoria, and the Supreme Court of Queensland. See Civil Procedure Act 2005 (Nsw), Part 10 (Austl.); Supreme Court Act 1986 (Vic), Part 4A (Austl.); Civil Proceedings Act 2011 (Qld), Part 13A (Austl.); Beverley Newbold, et al., MinterEllison, *Class/Collective Actions in Australia: Overview*, Thomson Reuters Practical Law (June 1, 2019), https://content.next.westlaw.com/3-617-6440?transitionType=Default&contextData=(sc.Default)&__lrTS=20200208125820974&firstPage=true&bhcp=1.

213. Vicki Waye & Vince Morabito, *Financial Arrangements of Litigation Funders and Law Firms in Australian Class Actions* 155, 157, *in* LITIGATION, COSTS, FUNDING AND BEHAVIOUR: IMPLICATIONS FOR THE LAW (Willem H. van Boom ed., 2017).

214. McKay & Moore, *supra* note 206, at 10.

215. *Id.*

216. *Id.* at 9.

217. For US, *see* Boettrich & Starykh, *supra* note 127; For Australia, *see* Waye & Morabito, *supra* note 213; For South Korea, *see* Kim, *supra* note 179; For Taiwan, *see* Wang, *supra* note 188.

companies were given chances to correct their mistakes, and this time window increased the corporate governance level in South Korea.[218] However, since we do not know the optimal deterrent level, taking into account all social cost and enforcement cost,[219] we will never achieve meaningful conclusions under this discussion. Therefore, we need to look from different angles.

The second reason might lie in the differences in legal rules. The first one is procedure regarding evidence discovery. First, in Civil Law jurisdictions, such as China and Japan, the lawyers do not possess powerful evidence discovery powers, and the evidence discovery is mainly led by judges.[220] Second, in Australia, there is in principle no requirement to apply to court for discovery, and even if required under certain circumstances, as long as the lawyer can demonstrate relevance then the court will generally allow.[221] Third, in Taiwan, the IPC as a public body possesses extensive discovery tools.[222] These differences in discovery can explain the differences in the numbers of cases.

Secondly, the differences in outcome may also be attributed to two other differences. The first one is the opt-in/opt-out model, and the second one is the financial incentive. So which one is more likely to be true?

Firstly, let us take a look at the opt-in vs the opt-out model. In the above cases, it can be found out that both Japan and Taiwan use the opt-in model, while South Korea and Australia use the opt-out model. However, in terms of the compensation rate of securities class actions, Japan performs better than Taiwan, since, in Taiwan, the success rate of not relying on the criminal prosecution procedure is zero.[223] Between South Korea and Australia, Australia performs much better than South Korea, since South Korea only has 7 cases in 10 years,[224] while Australia has 206 cases in 16 years.[225]

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218. Kim, *id*.

219. "The social costs are increases in the cost of capital, reductions in liquidity, inefficient allocation of resources, and additional monitoring costs as confidence in the ability to determine the value of corporate securities is undermined. Enforcement costs may be direct or indirect. Direct costs are the resources consumed in detecting, prosecuting, defending and adjudicating cases. Indirect costs are those associated with over-deterrence. If regulated entities fear an inaccurate determination of liability or an overly broad liability regime, then they may overinvest in precautionary measures or adopt a defensive disclosure policy." *See* Legg, *supra* note 102, at 327 (citing Amanda Rose, *The Multienforcer Approach to Securities Fraud Deterrence: A Critical Analysis*, 158 U. PA. L. REV. 2173, 2179-184 (2010)).

220. Wagnild, *supra* note 151; Fahey & Tao, *supra* note 151.

221. Richard Harris et al., *Litigation and Enforcement in Australia: Overview*, Thomson Reuters Practical Law (Aug. 1, 2020), https://uk.practicallaw.thomsonreuters.com/4-502-1038?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a415056.

222. Wang, *supra* note 188.

223. *Id.*

224. Kim, *supra* note 179.

225. Waye & Morabito, *supra* note 213.

Moreover, between the opt-in Japan and the opt-out South Korea, Japan performs much better.[226] Furthermore, between the opt-in Japan and the opt-out Australia, Australia performs much better.[227] These comparisons suggest that both opt-in model and opt-out model may work or may not work under certain circumstances. It is not necessary that one outperforms the other.

The second reason causing this discrepancy is the financial incentives, where the high costs and relatively low benefits associated with the securities class action hamper people's incentives to bring securities class actions. The bar associations in Japan and South Korea artificially set the contingency fees at a low level,[228] which restricts the financial incentives of the lawyers. Moreover, due to the relatively smaller size of Japanese law firms, a retainer fee is usually required,[229] which further restricts the financial incentives. In South Korea, any law firm being the lead plaintiff or the lead plaintiff's attorney in securities class actions for three times or more in recent three years are barred from being the lead plaintiff or lead plaintiff's attorney,[230] which severely suffocates the securities litigation business model in South Korea. In Taiwan, the lawyers in the IPC as public servants only accept minimal amounts of fixed monthly salary,[231] so it also severely inhibits their incentives to bring litigation, although they have strong investigatory powers.

Jurisdictions	Opt-in/Opt-out	Discovery	Proof of Causation	Financial Incentives**
US	Opt-out	Yes	Presumed, but rebuttable	High
South Korea	Opt-out	Court-led	Given, and unrebuttable	Low
Taiwan	Opt-in	Yes	Plaintiff's role	Low
Japan	Opt-in	Court-led	Presumed, but rebuttable	Medium
Australia	Opt-out	Yes	Unsettled*	High

* According to the High Court of Australia's ruling, causation differs in different cases. Direct reliance, indirect reliance and ECMH may be applicable to different scenario.[232]

** Financial incentives have many components, which will be shown later in Figure 4.

Figure 3: Factors Influencing Class Action

226. *Supra* Part IV. C and D.
227. *Supra* Part IV. C and F.
228. Kim, *supra* note 179; Goto, *supra* note 165.
229. Goto, *supra* note 165.
230. Hannuri Law, *supra* note 183.
231. Wang, *supra* note 188.
232. Michale Legg, John Emmerig & Geogina Westgarth, *US Supreme Court Revises Fraud on the Market Presumption: Ramifications for Australian Shareholder Class Actions*, 43 ABLR 448, 454 (2015).

Among all these examples, Australia performs the best in terms of the numbers of securities class actions initiated. The reasons may still lie in financial incentives. For Australia, although contingency fee is not permitted, litigation funding is allowed.[233] During recent years, there was a burst of specialty litigation funding firms in Australia, and there is a close correlation between the growth of litigation funding firms and the number of cases initiated.[234] Moreover, in Australia, very like the US, although the court needs to approve the lawyer's fees and the settlement plan, as long as they are not too extravagant, the court will generally respect the private arrangements.[235]

The financial incentives for Australia are the greatest among the above mentioned four jurisdictions, probably due to the fact that there is no statutory limitation on the percentage of fees the litigation funder can receive from a settlement.[236] Therefore, it has the most active securities litigation market among the above four jurisdictions. As for Japan, Taiwan, and South Korea, they all put different degrees of restraint on financial incentives, and therefore, even among these three, the degree of activeness of securities litigation is different. Japan has the highest number of securities litigation, while Taiwan and South Korea perform relatively worse.[237] The reason is that Japan has stronger financial incentives, where there is a modest regulation on legal fees by only setting a cap,[238] and also each party bears their own legal costs,[239] which is a better incentive compared to the loser-pays model.[240] However, Taiwan's legal fee in securities class action is not linked to lawyer's performance, and the lawyers of IPC only receive fixed salaries as public officials,[241] while South Korea even lacks the legal environment for law firms to build securities litigation business since law firms as lead plaintiffs or lead plaintiffs' counsels in securities class actions for three times in recent three years are prohibited to act as lead plaintiffs or

233. Legg, *supra* note 102, at 315.

234. McKay & Moore, *supra* note 206; *See generally* Camille Cameron, *Litigation as 'Core Business': Analyzing the Access to Justice and Regulatory Dimensions of Commercially Funded Class Actions in Australia*, *in* CLASS ACTIONS IN CONTEXT 189 (Deborah R. Hensler et al. eds., 2016) (counting at least 11 active litigation funders in Australian market).

235. Legg, *supra* note 102, at 317-23.

236. *Id*. at 323. *See* Geisker & Tallis, *supra* note 209.

237. Kim, *supra* note 179; Hannuri Law, *supra* note 183; Wang, *supra* note 188; Goto, *supra* note 165.

238. Goto, *supra* note 165, at 422.

239. *Id*.; *Act on Costs of Civil Procedure*, § 2, no.10.

240. Multiple researches conclude that loser-pays rule act as a disincentive for lawsuits. *See, e.g.*, Walter Olson & David Bernstein, *Loser-Pays: Where Next?*, 55 MD. L. REV. 1161 (1996); John C. Coffee, Jr., *"Loser Pays": The Latest Installment in the Battle-Scarred, Cliff-Hanging Survival of the Rule 10b-5 Class Action*, 68 SMU L. REV. 689 (2015); Marie Gryphon, *Assessing the Effects of a Loser Pays Rule on the American Legal System: An Economic Analysis and Proposal for Reform*, 8 RUTGERS JL & PUB. POL'Y 567 (2010).

241. Wang, *supra* note 188.

lead plaintiffs' counsels in the next securities class action.[242]

Jurisdictions	Percentage of Lawyer's Fee and Funder's Fee in Compensation	Lawyer's Retainer Fee	Litigation Funding	Fee-Bearing Mechanism	Business Model Restriction
South Korea	12-30% 25% on average (Lawyer only)	None	Not Allowed	Lead Plaintiff	Yes**
Taiwan	Not Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable
Japan	10% or Sliding Scale* (Lawyer only)	2% Requirement	Not allowed	Each Party Bears Its' Own Cost	None
Australia	50% on average (Lawyer + Funder)	None	Allowed	Lead Plaintiff	None

* 16 per cent for amount of up to 3 million JPY, 10 per cent for amount over 3 million to 30 million JPY, 6 per cent for amount over 30 million to 300 million JPY, and 4 per cent for amount over 300 million JPY.[243]

** Participation in representations for three times in recent three years are prohibited to act as lead plaintiff or lead plaintiffs' counsel in the next securities class action.[244]

Figure 4: Financial Incentives

This explanation may stand since there are pulls and pushes in the incentives to bring litigation. The pushes are the financial incentives, while the pulls are the constraints in procedures and substantive standards. According to multiple US studies, the threshold of legal fees for securities litigation is around $2 million.[245] It means if over this amount, the lawyers may feel incentivized to pursue securities class actions actively, and it may bring the over-deterrence effect; However, if under this amount, the small profits may make lawyers reluctant to pursue securities class actions, thus causing the under-deterrence effect. The pull side, including procedural and substantive laws, can only decrease the cost to a minimal extent. However, there is a large room for the increase in payment for securities lawyers. In

242. Kim, *supra* note 179; Hannuri Law, *supra* note 183.

243. Goto, *supra* note 165.

244. Lee, *supra* note 183.

245. CHRISTOPHER HODGES, LAW AND CORPORATE BEHAVIOUR: INTEGRATING THEORIES OF REGULATION, ENFORCEMENT, COMPLIANCE AND ETHICS 78 (2015); James D. Cox et al., *There Are Plaintiffs and . . . There Are Plaintiffs: An Empirical Analysis of Securities Class Action Settlements*, 61 VAND. L. REV. 355, 380-84 (2008); Janet C. Alexander, *Do the Merits Matter: A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 511-13 (1991).

the US, the "aggregate plaintiffs' attorneys' fees and expenses"[246] accounts for more than 50 per cent of compensation if the settlement is less than $1 million.[247] Therefore, by artificially keeping the lawyers' fees under a certain level, and also making other procedures hard, such as a lack of extensive court discovery procedure or a choice of opt-in model, it certainly will significantly diminish the numbers of securities litigations. It means that there is no way to find the right balance in building the mechanism for a securities class action, if we try to control the financial incentives one way or the other. In conclusion, for securities class actions to work, the right way is to keep the lawyer's fee and settlement fee open rather than the other way around as shown by the above jurisdictions' current approaches, since the other elements of securities class action are already at a disadvantage compared to the US, especially in terms of the court discovery procedure.

The third reason causing differences in the numbers of securities litigations is the lack of a robust legal market and the lack of institutional investors, where there is no one willing or capable to be leading plaintiffs or the leading plaintiffs' attorneys. In South Korea, institutional investors do not want to sue each other since they all have deep business connections.[248] Also, securities class action particularly needs a law firm to have substantial resources, but there are no such law firms in some jurisdictions. In Japan, many retail-investors-initiated securities class actions were brought by the US-based securities law firms who have expertise and resources.[249] This is mainly caused by the small size of Japan's legal market. Japan's legal market is mostly dominated by the top-ten law firms in major cases,[250] and there are not many law firms with over a hundred lawyers.[251] From the 1990s to

246. This figure is not limited to attorney fees, but also includes legitimate expenses incurred in the process approved by courts, *see* Boettrich & Starykh, *supra* note 127, at 43.

247. *Id*.

248. Kim, *supra* note 179.

249. Coffee, *supra* note 149, at 1912-914.

250. *See* Asian Legal Business, *Japan Law Awards 2019*, Asian Legal Business, https://www.legalbusinessonline.com/awards/japan-law-awards-2019?qt-conference_quicktab=4#qt-conference_quicktab (last visited June14, 2020).

251. There are only eleven law firms in Japan with more than one hundred lawyers and nineteen law firms with over fifty lawyers. This is bizarre compared to its third largest GDP in the world and its 127 million populations. *See* Jurinavi, *Largest 200 Japanese Law Firms in 2018*, www.Jurinavi.com, https://www.jurinavi.com/market/jimusho/ranking/index.php?id=188 (last visited July 8, 2019).
Japan has a very low number of lawyers per capita compared to other developed countries, *see* Setsuko Kamiya, *Scales of Justice: Legal System Looks for Right Balance of Lawyers*, The Japan Times (Mar. 18, 2008), https://www.japantimes.co.jp/news/2008/03/18/reference/scales-of-justice-legal-system-looks-for-right-balance-of-lawyers/#.XuXP7mr7SL8. This is one of the reasons Japan started to reform its legal education system and introduced the US-style JD education starting from 2004, which intended to level up the passage rate of bar exam in Japan (around 2 per cent before reform) while at the same time maintain the quality of lawyers. *See* Andrew Watson, *Changes in Japanese Legal Education*, 21 JOURNAL OF JAPANESE LAW 1 (2016).

2000s, some prefectures even had no lawyers at all,[252] and even according to the most recent census, except for Tokyo, all the other prefectures have a exceptionally low 10,000-to-1 residents to lawyers ratio.[253] In Australia, the recent burst is closely connected to the growth of outside litigation funding firms,[254] which provides bullets to securities litigation lawyers. All of the examples indicate that the securities litigation market needs a long time to nurture and develop.

However, in the end, there is one crucial question, which is the policy choice behind the nurturing of the securities litigation market. Do we want so many resources devoted to class actions or not? Are there more cases, the better? The deepest logical fallacy to support the growth of numbers of cases in securities class actions is that we acted as if we knew the optimal deterrent level, which means we know how many cases are enough.[255] Undeniably, increasing class actions can increase the deterrence level, but the question is, we do not know which level is appropriate. Also, if we take all social cost into consideration, then it is even more confusing.[256] Evidence has shown that US class actions have increased transaction costs by a significant level,[257] thus also increasing the social cost. Without the optimal deterrence level as the benchmark, it is hard to evaluate if the current situation is under-deterrent or over-deterrent, so there is no way to know whether it needs further reform. Therefore, we should use other standards, instead of numbers of class actions, to evaluate the performance of investor protection, such as a high compensation rate, fast resolutions speed, and low costs of enforcement.

However, when examined in light of these indicators, the results do not show good performance. In Japan, the average compensation rate is around 15 per cent.[258] The average legal fee is "either a fixed rate of 10 per cent (plus value-added tax), or a regressive rate starting from 10 per cent, 16 per cent or 20 per cent, with the highest rate applicable only to amount below 3 million JPY (approximately 25,000 USD)."[259] The time took to close a case

252. Kazuhiro Yonemoto, *The Shimane Bar Association: All Twenty-One Members Strong*, 25 LAW IN JAPAN, *in* JAPANESE LAW IN CONTEXT: READINGS IN SOCIETY, THE ECONOMY, AND POLITICS 50 (Daniel H. Foote trans., Curtis J. Milhaupt, J. Mark Ramseyer & Michael K. Young eds., 2001).

253. *Bengoshi no jisei* (*弁護士の実勢*) [*Actual Situation of Lawyers*], Nihon bengoshi rengokai (日本弁護士連合会) [Japan Federation of Bar Association] (2019), https://www.nichibenren.or.jp/library/pdf/document/statistics/2019/1-2-1_2019.pdf.

254. Legg, *supra* note 102, at 312; McKay & Moore, *supra* note 206; Cameron, *supra* note 234.

255. HODGES, *supra* note 245, at 107-52; Park, *supra* note 117, at 128.

256. Legg, *supra* note 102, at 327.

257. The highest numbers of calculation equals to an 8 per cent tax on consumption and a 13 per cent tax on wages. HODGES, *supra* note 245, at 78-81.

258. Goto, *supra* note 165, at 429-34.

259. *Id*.

is ranging from 3 to 6 years.[260]

In South Korea, the average compensation rate is around 25 per cent.[261] The lawyer's fee is on average 20 per cent of compensation, but it will increase with appeal to higher court, with 30 per cent of compensation at final appeal.[262] The time took to close a case is on average 5 years.[263]

In Taiwan, the compensation rate is usually less than 10 per cent,[264] although the cost is free,[265] the time took to close a case is long.[266] Although no statistics available on this one, the case is usually filed 1 year after criminal indictment,[267] so the whole process can be easily over 3 years.

In Australia, the compensation rate ranges from 20 per cent to 30 per cent.[268] The legal cost including lawyer's fee and funder's fee combined is usually above 50 per cent of compensation.[269] The time to close a case is between 1 to 5 years with most of them above 3 years.[270]

Jurisdictions	Compensation Rate	Cost/Compensation Ratio	Time Took to Resolve a Case
Japan	15%	10% or Sliding Scale	3-6 years
South Korea	25%	20%	5 years on average
Taiwan	Less than 10%	Free	Filed 1 year after criminal indictment
Australia	20-30%	Over 50%	1-5 years, usually over 3 years

Figure 5: Compensation Rate, Cost/Compensation Ratio & Time took to Resolve a Case

V. ALTERNATIVE DISPUTE RESOLUTION: ARBITRATION AND SETTLEMENT

The other two commonly used outside-of-court procedures that are designed to provide quick and cheap alternatives to private class action are arbitration and settlement. Although outside of court, these two obtain some quasi-court features, so they still face some similar obstacles as encountered in the traditional court procedure, and this has become one of the reasons

260. *Id.*
261. Hai Jin Park, *Class Action Scarcity: An Empirical Analysis of the Securities Class Action in Korea*, 21 EBOR 665, 680 (2020).
262. *Id.*
263. *Id.*
264. Wang, *supra* note 188, at 460-64.
265. *Id.*
266. *Id.*
267. *Id.*
268. Legg, *supra* note 102, at 318-21.
269. *Id.*
270. *Id.*

hampering full acceptance of these two mechanisms. In the following, this article will use the examples of the US FINRA arbitration and the Dutch mass settlement to evaluate if arbitration and settlement have potentials to provide investors with fast and cheap resolution and sufficient coverage for investors' damages.

A. *US: FINRA Arbitration*

FINRA arbitration was meant to provide a cheap and fast alternative to investors. However, in recent years it has become less so, and has been criticized severely.[271] In the Dodd-Frank Act, the US Congress gave the Consumer Financial Protection Bureau (CFPB) and the SEC the authority to regulate and even prohibit the use of arbitration clauses in consumer finance[272] and investment contracts.[273] There are five reasons for this. The first one is that arbitration is not fast at all. The procedure is very similar to the court procedure, and even worse, pre-trial motion to dismiss is severely limited.[274] There is also the increasingly complicated evidence discovery procedure,[275] and moreover, nearly all kinds of evidence will be allowed since it does not need to follow court's evidence rule,[276] and this further drags the procedure. The average time to obtain an award is 18.2 months in 2016.[277] The second one is that most of the time, the plaintiff lacks legal representation, and it is difficult for investors without counsels' representations to navigate through the complicated procedure.[278] The third

271. Richard A. Roth, *The 'Streamlined' FINRA Arbitration System: Are You Kidding Me?*, Informa LLC. (Jan. 9, 2015), http://www.wealthmanagement.com/commentary/streamlined-finra-arbitration-system-are-you-kidding-me.

272. 12 U.S.C. § 5518(b); Jill I. Gross, *The End of Mandatory Securities Arbitration?*, 30 PACE L. REV. 1174, 1181-185 (2010); Michael S. Barr, *Mandatory Arbitration in Consumer Finance and Investor Contracts*, 11 N. Y. U. J. L. & BUS. 793, 799-804 (2015).

273. 15 U.S.C. § 78o (o).

274. FINRA, RULE 12504 (2008).

275. Paul Radvany, *Recent Trends in Discovery in Arbitration and in the Federal Rules of Civil Procedure*, 34 THE REV. LITIG. 705, 741-44 (2015) (describing the increasing litigious nature of arbitration and the increasing cost of discovery, citing statistics from Thomas J. Stipanowich & J. Ryan Lamare, *Living with ADR: Evolving Perceptions and Use of Mediation, Arbitration, and Conflict Management in Fortune 1000 Corporations*, 19 HARV. NEGOT. L. REV. 1, 4-5 (2014)); Jennifer J. Johnson, *Wall Street Meets the Wild West: Bringing Law and Order to Securities Arbitration*, 84 N.C. L. REV. 123, 138 (2005) (citing NAT'L ASSOC. OF SEC. DEALERS, SECURITIES ARBITRATION REFORM: REPORT OF ARBITRATION POLICY TASK FORCE (1996)).

276. FINRA, RULE 12604 (2008); Paul Radvany, *The Importance of the Federal Rules of Evidence in Arbitration*, 36 REV. LITIG. 469, 494-97 (2016).

277. Securities Arbitration Commentator, *FINRA Stats*, *11/15*, Securities Arbitration Commentator (Jan. 15, 2016), http://www.sacarbitration.com/blog/finra-stats-1115/; FINRA, *Dispute Resolution Statistics*, https://www.finra.org/arbitration-mediation/dispute-resolution-statistics (last updated Jan. 1, 2020).

278 . Press Release, *SEC Announces Pilot Securities Arbitration Clinic to Help Small Investors-Levitt Responds to Concerns Voiced at Town Meeting*s, Sec. & Exch. Comm'n 97-101 (Nov.

one is that arbitrators will sometimes lean toward the industry and make arbitration awards in favor of the securities industry because some of them previously worked in the industry.[279] The fourth one is the high percentage of unpaid arbitration award.[280] The fifth one is that the arbitrator lacks not only independence but also expertise, and sometimes they even fail to understand the arbitration procedure.[281] Under the FINRA Rule, the arbitrators only need to be trained for less than ten hours to be qualified to practice.[282] The sixth one is the non-transparency of FINRA Award, where the arbitrator does not have the obligation to explain an arbitration award.[283]

Despite the above-mentioned shortcomings, another challenge for arbitration is the difficulty of collective arbitration, which means it lacks the ability to solve disputes on a large scale. Collective arbitration faces both theoretical and practical obstacles. Theoretically, an arbitration is bound by a bilateral contract, so it cannot bind parties absent their explicit consent to enter into arbitration. Therefore, collective arbitration lacks the legal power to aggregate a large number of individuals, and this is probably one of the reasons that collective arbitration is so few around the world.[284] This similar opinion was also expressed by the US Supreme Court in the case *Lamps Plus, Inc. v. Varela*.[285] The majority opinion wrote that class arbitration

12, 1997), http://www.sec.gov/newsJpress/pressarchive/1997/97-101.txt.

279. *See* THE SECURITIES ARBITRATION SYSTEM: HEARING BEFORE THE SUBCOMM. ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES OF THE H. COMM. ON FINANCIAL SERVICES, 109th Cong. 105 (2005) (hereinafter as the Hearing); There is also empirical evidence showing that arbitrators with ties to securities industries tend to give lower awards, *see* Stephen Choi, Jill E. Fisch & Adam C. Pritchard, *The Influence of Arbitrator Background and Representation on Arbitration Outcomes* 22 (Faculty Scholarship at Penn Law, No.1546, 2014), https://scholarship.law.upenn.edu/faculty_scholarship/1546.

280. From 2012 to 2014, the unpaid percentage is around 40 to 50 per cent. From 2015 to 2016, the unpaid percentage is 13% and 12%. Andrew Stoltmann & Hugh D. Berkson, *Unpaid Arbitration Awards-The Case for an Investor Recovery Pool*, PIABA (Mar.7, 2018), https://piaba.org/piaba-newsroom/unpaid-awards.

281. *See generally* Johnson, *supra* note 275; To qualify as a FINRA arbitrator, "[N]o previous arbitration, securities or legal experience is required to apply--just five years of paid work experience and two years of college-level credits." *Become FINRA Arbitrator*, FINRA, https://www.finra.org/arbitration-mediation/become-finra-arbitrator (last visited June 21, 2020).

282. *Required Basic Arbitrator Training*, FINRA, https://www.finra.org/arbitration-mediation/required-basic-arbitrator-training (last visited June 21, 2020).

283. *Decision & Award*, FINRA, https://www.finra.org/arbitration-mediation/decision-award (last visited June 22, 2020); FINRA RULE 12904(f) and (g), FINRA RULE 13904(f) and (g).

284. CHRISTOPHER HODGES & STEFAAN VOET, DELIVERING COLLECTIVE REDRESS: NEW TECHNOLOGIES 12-13 (2018).

285. Lamps Plus, Inc. v. Varela, 139 S. Ct. 1407 (2019). This issue of the case is that "Does the Federal Arbitration Act bar a federal district court from compelling arbitration on a classwide basis --rather than an individual basis-- when the parties' ambiguous contract/agreement is ambiguous on the availability of such arbitration?" *See Law School Case Brief Lamps Plus, Inc. v. Varela-139 S. Ct. 1407* (2019), LexisNexis, https://www.lexisnexis.com/community/casebrief/p/casebrief-lamps-plus-inc-v-varela (last visited June 21, 2020).

raises "serious due process concerns" caused by "adjudicating the rights of absent members of the plaintiff class," subject only to "limited judicial review."[286] Moreover, the res judicata issue is another question, which is equal to just adding another complicated layer on top of the already complicated class action system.[287]

Practically speaking, class arbitration will nevertheless face the same issues as the private class action does, such as difficult coordination, costly court discovery, burdensome judicial supervision and review of leading plaintiff, lawyer and settlement plan. This concern was also expressed in the *Lamps Plus, Inc. v. Varela* case, where the majority opinion wrote that "[T]he virtues Congress originally saw in arbitration, its speed and simplicity and inexpensiveness, would be shorn away and arbitration would end up looking like the litigation it was meant to displace."[288] In conclusion, arbitration is not the answer we are looking for due to its inherent deficiencies. In the following, this article will turn to introduce the experience from the Netherlands mass settlement and discuss if it can provide some new insights to the solution.

B. *Netherlands: Mass Settlement*

Although opt-out securities class actions are not encouraged in the EU,[289] the Netherlands has its mass destruction weapon, which is called the Wet Collective Afwikkeling Massaschade (Collective Settlement of Mass Claims) (WCAM).[290] WCAM is essentially a mass settlement procedure, although it is initially designed for product liabilities suit,[291] in recent years it has become one of the most used procedures for resolving mass disputes in

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286. *Id*. at 1417 (quoting Epic Systems Corp. v. Lewis, 138 S. Ct. 1612, 1623 (2018)).

287. The US Supreme Court has not made decision on whether class arbitration can preclude non-contracting parties from future litigations, and the US Court of Appeals also split on this issue. *See* Andrew S. Tulumello & Mark Whitburn, *Res Judicata and Collateral Estoppel Issues in Class Litigation* 605, 614-20, *in* A PRACTITIONER'S GUIDE TO CLASS ACTIONS (Marcy H. Greer ed., 2010); Gilbert A. Samberg, *"Class Arbitration": The Current Law* (June 12, 2017), https://www.mintz.com/insights-center/viewpoints/2196/2017-06-class-arbitration-current-law.

288. *Lamps Plus*, 139 S. Ct. at 1417 (quoting Epic Systems Corp. v. Lewis, 138 S. Ct. 1612, 1623 (2018)).

289. Commission Recommendation 2013/396/EU of 11 June 2013 on Common Principles for Injunctive and Compensatory Collective Redress Mechanisms in the Member States Concerning Violations of Rights Granted under Union Law, O.J. (L 201) 60.

290. Xandra E. Kramer, *Enforcing Mass Settlements in the European Judicial Area: EU Policy and the Strange Case of Dutch Collective Settlements (WCAM)*, *in* RESOLVING MASS DISPUTES ADR AND SETTLEMENT OF MASS CLAIMS 63 (Christopher Hodges & Astrid Stadler eds., 2013); Ianika Tzankova & Deborah Hensler, *Collective Settlements in the Netherlands: Some Empirical Observations*, *in* RESOLVING MASS DISPUTES ADR AND SETTLEMENT OF MASS CLAIMS 91 (Christopher Hodges & Astrid Stadler eds., 2013).

291. *Id*.

securities cases in the Netherlands.[292] One of the most prominent features of WCAM is that the result of WCAM is binding on all parties, even for those absent in the settlement,[293] once approved by the Amsterdam Court of Appeal.[294]

As for financing, in the Netherlands, law firms usually use "stichting"[295] to receive litigation funding, and the rights of claims of the plaintiffs are transferred into the stitching, and each plaintiff holds a certain percentage of his share equal to his percentage in the whole claim.[296] The "stichting" was also used to establish standing in a Dutch court, since Article 3:305a BW of the Dutch Civil Code (Burgerlijk Wetboek) allows incorporated organization or foundation to file claims on behalf of interested persons to protect their rights.[297]

However, curiously, the WCAM is not mandatory, so it means that both parties have to agree to this procedure explicitly.[298] Therefore, there comes the question why parties agree to this procedure. With further analysis, it is found out that this procedure was mostly used in a global settlement, usually following the US class actions and used as a replacement for non-US mechanisms.[299] The Amsterdam Court of Appeal also emphasized many times that "[I]t was acting complementary to the US settlement, where some

292. *See also* Coffee, *supra* note 149, at 1902-912 (discussing two recent securities-related decisions after 2016), and Kramer, *supra* note 290, at 78 (compiling a list of five securities-related decisions before 2013).

293. Kramer, *id*. at 76-77; Tzankova & Hensler, *supra* note 290, at 94; Within the EU, the Brussels I Regulation requires all member states to honor and enforce the judgments of the courts of other member states. Council Regulation 44/2001 of December 22, 2000, Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters, arts. 33-34, 38, 41, 2000 O.J. (L 12) 1 (EC).
However, there is the question whether a settlement can be deemed as a judgment for Brussels I Regulation to apply, since Art.32 of Brussels I Regulation only applies to judgment. The Amsterdam Court of Appeal reasoned that it is a judgment, because the Amsterdam Court of Appeal is actively involved in the settlement process from the beginning to the end and also review issues on a merit basis. Also, granting mass settlement authority is not developed on a contractual basis but rather is based on the Dutch national law. For detailed discussions, *see* Kramer, *id*. at 82-89.

294. Amsterdam Court of Appeal has the exclusive jurisdiction to declare settlement binding. *See* Kramer, *id*. at 75.

295. Coffee, *supra* note 149, at 1903-911; For detailed discussions, *see also* Robert Profusek, Ferdinand Mason, Floris Pierik & Bastiaan K. Kout, *Shedding Light on the Dutch 'Stichting': The Origins and Purposes of an Obscure but Potentially Potent Dutch Entity*, Jones Day Commendatory (Mar. 2016),
https://www.jonesday.com/files/Publication/f4c70f5c-c1b1-4c3b-8141-b515d8eb472c/Presentation/PublicationAttachment/6f54fc41-e25d-404f-8420-5fdf6c80ad04/Shedding%20Light%20on%20the%20Dutch%20Stichting.pdf (giving an overview of the use of "Stichting" in the Netherlands).

296. Coffee, *supra* note 149, at 1903.

297. Art. 3:305a para. 1 BW (Netherlands),
http://www.dutchcivillaw.com/civilprocedureleg.htm (Dutch Civil Law Database).

298. HODGES & VOET, , *supra* note 284, at 12-13, 96; Coffee, *supra* note 149, at 1906.

299. Until 2017, 6 out of 8 WCAM cases were US-related cases. See Coffee, *supra* note 149, at 1902-912 (discussing two recent decisions after 2016) and Kramer, *supra* note 290, at 78 (compiling a list of six decisions before 2013).

of the interested parties had been denied access due to the decision to exclude non-US parties."[300] This has become an ever-pressing concern after the US Supreme Court ruled in the *Morrison* case[301] that the US courts could not hear securities fraud claims of plaintiffs who bought securities abroad.

Moreover, parties "voluntarily" choose this procedure thanks to the "precedents" set in the US securities class actions. Company just wants to quickly settle the problem elsewhere once and for all.[302] It means that the US class action partially transforms the procedure's voluntary nature to a mandatory one, and this procedure can be seen as a free ride on the US system.

However, with its ability to solve mass disputes quick and fast, the WCAM still receives criticisms that it does not give sufficient notice for parties to opt out,[303] and its international jurisdiction without sufficient consideration of conflict of law issue and reasonableness also cause concerns.[304] Arguably, the US court has a high chance for not recognizing the decision of the Amsterdam Court of Appeal.[305] In conclusion, the WCAM's free ride nature, its international jurisdiction and its binding power on absent parties show that the mass settlement is only suitable for limited scenarios, and is not the best solution for all situations.

VI. POSSIBLE WAY OUT: FROM PUBLIC-PRIVATE DIVIDE TO PUBLIC-PRIVATE CONVERGENCE

The above analysis only considers the deterrent level, and the conclusion is that there are no practical comparisons among different deterrent levels.[306] We cannot know if the deterrent level in one jurisdiction

300. Kramer, *id*. at 80-81.

301. Morrison v. National Australia Bank Ltd, 561 U.S. 247 (2010); International Institutional Tort Recovery Association Ltd (IITRA) & Institutional Protection Services Ltd (IPS), *Securities Class Actions around the World after Morrison*, 16 Pensions: An International Journal 115 (June 17, 2011), IITRA & IPS, https://doi.org/10.1057/pm.2011.9.

302. *Id*.

303. Christopher Hodges & Astrid Stadler, *Introduction*, *in* RESOLVING MASS DISPUTES ADR AND SETTLEMENT OF MASS CLAIMS 1, 16-17 (Christopher Hodges & Astrid Stadler eds., 2013) (describing the difficulty to notify all claimants in cross-border settlement).

304. Conflict of law issue was not discussed at all in the decisions of the Amsterdam Court of Appeal. As for reasonableness, in the *Converium* case, 97 per cent of claimants are not Dutch residents, however the Amsterdam Court of Appeal still claimed jurisdiction on this case. *See* Kramer, *supra* note 290, at 79-81.

305. "Thus, if U.S. persons were included in the plaintiff class, but did not receive adequate notice or an opportunity to opt out, they could likely resist the enforcement of the judgment against them in U.S. courts." Coffee, *supra* note 149, at 1907 n.37. However, this may not be a huge concern in practice since, as explained above, the WCAM is usually used as a free ride on the US class action rather than the other way around.

306. *Id*.; Park, *supra* note 117, at 128; Legg, *supra* note 102, at 327.

reaches its optimal level. Moreover, we cannot know between two jurisdictions, when the cases in one jurisdiction are less than the other, if the lesser one indicates optimal level is not reached. In this case, we need to introduce other more practical parameters, which are the cost of redress and enforcement, the time of settlement and the compensation rate. There are two reasons to choose such parameters. The first one is that compared to the numbers of cases being sued, compensation is more important to investors. In the end, investors want their money back. The second one is that even in terms of deterrence level, the higher compensation rate can indicate a higher deterrence level.

Thirdly and more importantly, in the public-private divide, it presumed that only private enforcement could solve the compensation problem, while the primary role of public enforcement is to punish. The logic is that only the court system is capable of solving compensation problems. This logic seems absurd in a world full of ADR, such as arbitration, mediation and outside-of-court settlement. Court system is slow, and sometimes, lacks expertise and even independence. That is why arbitration tribunals, tribunals inside administrative agencies, and other specialized courts are developed all around the world to solve financial and commercial cases.[307] Moreover, ADR should not be only limited to a quasi-court type system, administrative agencies could play a more significant and active role in this process, and they should not be an outsider in solving compensation problems. In the EU and several commonwealth jurisdictions, this practice has been running for a long time. Sufficient cases and evidence have been built and indicate that it can work.[308] Even in the US, some practices of such are in place. In the following, this article is going to introduce these cases.

A. *United States: SEC Fair Funds*

The US is the typical country that adopts the private-and-public divide model. However, even the US has implemented some measures to endorse

307. For example, the Takeover Panel in the UK, Market Misconduct Tribunal in Hong Kong, Specialized Business Law Panel of the São Paulo Court of Appeal and Mergers and Acquisition Committee in Brazil, and the China International Commercial Court of the Supreme Court of the PRC. *See general*, Andrew Johnston, *Takeover Regulation: Historical and Theoretical Perspectives on the City Code*, 66 CAM. L.J. 422 (2007); John Armour & Caroline Schmidt, *Building Enforcement Capacity for Brazilian Corporate and Securities Law*, *in* ENFORCEMENT OF CORPORATE AND SECURITIES LAW CHINA AND THE WORLD 476 (Robin Huang Hui ed., 2017); Wei Cai, *Challenges and Opportunities for the China International Commercial Court*, 68 INTERNATIONAL AND COMPARATIVE LAW QUARTERLY 869 (2019); Huang Hui (黄辉), *Xianggang Zhengquan Shichang Shidang Xingwei Shencaichu Zhidu Ji Qi Qishi* (*香港证券市场失当行为审裁处制度及其启示*)[*The Hong Kong Market Misconduct Tribunal and its Inspiration for Mainland China*], 1 TOUZIZHE (投资者) [INVESTORS] 185 (2018).

308. *Infra* Part VI.

the public-and- private convergence model to address the compensation issue. One of the most important measures is called the the Federal Account for Investor Restitution ("FAIR") Funds provision.[309] The Fair Fund was first introduced in the SOX Section 308.[310] The Fair Fund collects monetary fines ordered by the SEC, and each time the fines collected will be formed as an independent fund.[311] The Fair Fund is used as a complementary method to compensate investors.[312] The Fair Fund has several merits. Firstly, it helps compensate many cases where private class actions are not available to investors. One of such cases is the one against aider and abettor, since the use of private class action against aider and abettor was restricted by the PSLRA and a series of Supreme Court cases.[313] Secondly, the SEC Fair Fund can target a wider range of misconducts and defendants other than issuers and issuers' misreporting and restatement. In private class actions, these are the most profitable cases for lawyers after PSLRA so it contributes to a large portion of private class action cases.[314] While for the Fair Fund compensation cases, they include not only issuers and issuers misreporting and restatement but also many cases involving individuals, investment advisers, broker-dealers, insider trading and market manipulations,[315] which in large part alleviates the circularity problem,[316] since individuals and third parties in replace of issuers compensate the investors. As for performance of

309. Winship, *supra* note 85; Liu & Shen, *supra* note 14; Urska Velikonja, *Public Compensation for Private Harm: Evidence from the SEC's Fair Fund Distributions*, 67 STANFORD L. REV. 331 (2015).

310. 15 U.S.C. § 7246.

311. Liu & Shen, *supra* note 14, at 16; 15 U.S.C. § 7246 (a).

312. Winship, *supra* note 85, at 1104-21.

313. *Id*. at 1132-33; From 2003 to 2012, the SEC sanctioned 18 such cases amounting to 627 million. Velikonja, *supra* note 309, at 381.

314. These cases represent 60 per cent of settlements and 90 per cent of damages. Velikonja, *id*. at 393.

315. "Individuals were sanctioned in 164 of 243 Fair Funds, or 67.5%. Individuals paid monetary sanctions into 145 or 59.7% of Fair Funds." *Id*. at 380. Also, issuers only contributed to 35.2% of all the amounts paid by Fair Funds. *Id*. at 375. Insider trading and market manipulation cases contribute to around 10% of the numbers of Fair Fund cases. *Id*. at 379, table 5.

316. Circularity problem means that if payment is ordered against an issuer/a company defendant, then this costs falls on all the shareholders or insurance paid by shareholders, so eventually the shareholders get compensated by their own money, and the money of compensation just transfers from the parties who do not trade to the parties who trade actively, thus punishing the innocent passive traders and causing a pocket-shifting effect, hence the term circularity. *See*, *e.g*., Janet C. Alexander, *Rethinking Damages in Securities Class Actions*, 48 STAN. L. REV. 1487, 1503-04 (1996); Donald C. Langevoort, *Capping Damages for Open-Market Securities Fraud*, 38 ARIZ. L. REV. 639, 648-49 (1996); Coffee, Jr., *supra* note 56, at 1558.
Moreover, for a shareholder with a diversified investment, the chances of receiving compensation and paying compensation is equal in the long term, so eventually they will offset each other. *See*, *e.g.*, Alexander, *id*. at 1502; Donald C. Langevoort, *On Leaving Corporate Executives "Naked, Homeless and without Wheels": Corporate Fraud, Equitable Remedies, and the Debate Over Entity Versus Individual Liability*, 42 WAKE FOREST L. REV. 627, 633 (2007).

compensation rate, some cases even reach full compensation,[317] which is unthinkable under the private class action.[318]

There are also some criticisms of the Fair Fund, and one of them[319] is that Fair Fund is not cheap compared to private class action, because it needs to hire outside experts to supervise the fund distribution.[320] However, due to the unavailability of data, we do not know how much it costs.[321] In order to increase the compensation rate, the SEC has taken several efforts. In 70 per cent of Fair Fund cases, the fees are borne by the fund, but the other 30 per cent are borne by the defendant companies or individuals.[322] In some cases, the SEC directs the defendants to directly pay compensation to investors without forming Fair Funds.[323] In other cases, where parallel private class action is available, the SEC directed Fair Funds to settlements eliminating the need to create customized distribution plan.[324] These methods could be alternatives to decrease cost, but they certainly cannot be applied to all cases, since sometimes the SEC needs to secure assets from bankruptcy, while other times the damages of victims are not clear,[325] and in these cases it is necessary to establish Fair Funds. Therefore, building a fee shifting mechanism, such as enforcement costs borne by the business side, is crucial for the success of a public and private convergence model, as shown in the cases of Australia and UK below.

317. Velikonja, *supra* note 309, at 363-64 and n.169.

318. *Supra* Part III C.

319. The other most common criticism includes the circularity issue. There are usually three responses to these criticisms. Firstly, not all investors are diversified investors and not all of them trade in a long term, especially for some markets dominated by retail investors. *See*, *e.g.*, William Bratton & Michael Wachter, *The Political Economy of Fraud on the Market*, 160 U. PA. L. REV. 69, 97 (2011). Secondly, we can break circularity by imposing fines on individuals. *See*, *e.g.*, Coffee Jr., *supra* note 56, at 1538, 1562. Thirdly, compensation also means fairness and can increase deterrence, so it can increase compliance to laws and regulations. It is a sign that bad behavior gets punished, and therefore, it also holds deterrent value for the benefit of the society. *See*, *e.g.*, Adam C. Pritchard & Karen K. Nelson, *Carrot or Stick? The Shift from Voluntary to Mandatory Disclosure of Risk Factors*, 13 J. EMPIRICAL LEGAL STUD. 266 (2016); James P. Naughton, et al., *Private Litigation Costs and Voluntary Disclosure: Evidence from the Morrison Ruling*, 94 THE ACC. REV. 303 (2019).
Recently, some new studies began to question the conventional wisdom of circularity, and they argued that both the diversified and undiversified investors are equally likely to suffer from losses. *See*, *e.g.*, Alicia J. Davis, *Are Investors' Gains and Losses from Securities Fraud Equal Over Time? Theory and Evidence* (University of Michigan, Law & Economics Working Papers No.13, 2010) https://repository.law.umich.edu/law_econ_current/art13; Alicia D. Evans, *The Investor Compensation Fund*, 33 J. CORP. L. 223, 225 (2007). Further discussions are beyond the scope of this article.

320. Winship, *supra* note 85, at 1134-38.

321. *Id.* at 1135.

322. *Id.* at 1135; U.S. Gov't Accountability Office, Rep. no. Gao-07-830, *Sec: Additional Actions Needed to Ensure Planned Improvements Address Limitations in Enforcement Division Operations* 29 n.39 (2007), http://www.gao.gov/new.items/d07830.pdf.

323. Velikonja, *supra* note 309, at 390.

324. *Id*. at 392.

325. *Id*. at 342-43, 390, 392.

B. *Australia and Denmark: Financial Ombudsman*

The second more advanced out-of-court dispute resolution aiming to solve compensation is the financial ombudsman model in Australia and Denmark.[326] The Australian model has two characteristics. The first one is that all companies need to establish internal dispute resolution system that meets the standard set by the ASIC.[327] Also, external dispute resolution (EDR) which links to the company's internal dispute resolution must also be provided, which is approved and overseen by the ASIC.[328] In order to be approved, the EDR must meet several standards set by the ASIC, such as "accessibility, independence, fairness, accountability, efficiency and effectiveness."[329] Also, the EDR must be provided free of charge.[330] The EDR must also report any systemic issues to the ASIC, and ASIC defines systemic issues as "issues that have implications beyond the immediate actions and rights of the parties to the complaint or dispute."[331] When reporting, the report must contain procedures to address the problems.[332]

Secondly, the Australian model uses the ASIC's enforcement as the final threat. Apart from private class action on an opt-out basis, the ASIC can also initiate civil proceeding by itself in court on the opt-out basis.[333] Furthermore, the ASIC can also enter into class settlement with defendants.[334] Moreover, the ASIC can seek collective redress order from court, except for monetary compensation for damages, against various behaviors.[335] Lastly, the ASIC has the power to bring prosecution against defendant in court.[336]

Once a problem occurs, the Australian Ombudsman will take an onsite review.[337] In this process, the company is encouraged to cooperate. In

326. For Australian Model, *see* Vicki Waye & Vince Marabito, *Collective Forms of Consumer Redress: Financial Ombudsman Service Case Study*, 12 J. CORP. L. SUD. 1, 4-7 (2012); for Danish Model, *see* CHRISTOPHER HODGES, THE REFORM OF CLASS AND REPRESENTATIVE ACTIONS IN EUROPEAN LEGAL SYSTEMS: A NEW FRAMEWORK FOR COLLECTIVE REDRESS IN EUROPE 27-35 (2008); *See also* HODGES & VOET, *supra* note 284, at 119-23.

327. Corporations Act 2111 (Cth) (Austl.), ss 912A (1)(g), 912A (2) and 1017G; National Consumer Credit Protection Act 2009 (Cth) (Austl.), s 47.

328. ASIC, *Regulatory Guide 139: Approval and Oversight of External Dispute Resolution Schemes* (2011) (RG 139).

329. Waye & Marabito, *supra* note 326, at 4; Corporations Regulations 2001 (Cth) (Austl.), regs 7.6.02(3) and 7.9.77(3); National Consumer Credit Regulations 2010 (Cth) (Austl.), reg 10 (3).

330. Waye & Marabito, *supra* note 326, at 4.

331. ASIC, *supra* note 328, RG 139 114.

332. *Id.* RG 139 133.

333. Australian Securities and Investments Commission Act 2001 (Cth), s 50(d).

334. Australian Securitics and investments Commission Act 2001 (Cth), ss 93AA 93A. Set further in RG 100.

335. Australian Securities and Investments Comnission Act 2001 (Cth), s 12GNB.

336. Australian Securitics and investments Commission Act 2001 (Cth), s 49.

337. Waye & Marabito, *supra* note 326.

exchange, the whole process remains confidential.[338] The Ombudsman will report investigation progress and the following status to the ASIC.[339]

The Australian model is relatively cost-effective, since most of the cost are borne by the company and also it avoids the court procedure, in which the internal investigation, problems correction plan and settlement plan must first be provided by the company, and both the internal dispute resolution and the external dispute resolution system must be provided to investors free of charge. Moreover, it encourages the company to cooperate[340] by using a mixture of carrot and stick approach. This is described as responsive regulation and an escalation of enforcement.[341] The carrot is that it will keep investigation confidential and will adjust enforcement level based on the company's performance. The stick is to use ASIC's enormous enforcement power to coerce defendants into cooperation.

However, this model also receives some criticisms. Critics argue that it lacks consumer representatives in the process of investigation of systemic issues, which raises the lack of accountability problem.[342] Although the Ombudsman needs to report the status to the ASIC, whether the ASIC has enough human resources to supervise is a problem.[343]

Beside the Australian Ombudsman model, there is also the Danish Ombudsman model. The similarity is that both Australia and Denmark established an Ombudsman-an independent agency with a statutory status to solve disputes and compensation. The difference is in the coercion method. Danish Ombudsman uses class action as a last resort to coercing the defendant into a settlement, which has the authority to bring a class action on an opt-out basis.[344] However, because it also has a wide range of redress powers, so it usually does not easily initiate litigation, but will reach a settlement outside court.[345] Compared with the Taiwan IPC model, the Danish model has many significant advantages, including its ability to initiate class action proceeding on an opt-out basis,[346] the ability to form settlement plan on behalf of plaintiffs outside court,[347] and the ability to

338. *Id*. at 27.
339. *Id*. at 19.
340. ASIC, *Cooperating with ASIC*, https://asic.gov.au/about-asic/asic-investigations-and-enforcement/cooperating-with-asic/ (last visited June 27, 2020).
341. IAN AYRES & JOHN BRAITHWAITE, RESPONSIVE REGULATION: TRANSCENDING THE REGULATION DEBATE 35, 39 (1992).
342. *Id*. at 27.
343. *Id*.
344. HODGES, *supra* note 326; HODGES & VOET, *supra* note 284, at 119.
345. Christopher Hodges, *Mass Collective Redress: Consumer ADR and Regulatory Techniques*, 5 EUR. REV. OF PRIV. L. 829, 845 (2015).
346. HODGES & VOET, *supra* note 284, at 119.
347. *Id*.

require the company to form other corrections plans.[348] This method has massive coercion power and flexibility, and therefore, it can avoid court proceedings and reach a settlement. However, there are still criticisms that the Danish Ombudsman may not work in a densely populated country since the numbers of cases might surpass its processing ability.[349] This criticism is similar to the problem occurred under the Taiwan IPC model. However, there is one significant difference between the Danish Model and the Taiwan Model. The Taiwan IPC is used exclusively to initiate class action in a civil proceeding in court, but the Danish Ombudsman only used class action as a last resort to coerce defendants to enter into settlement, since besides the power to bring class action it also obtains many other powers. Nevertheless, this concern is not without merit, and it still points to the necessity of building a fee shifting mechanism and the necessity of requiring collaboration from industries to solve problems, as shown in the Australian model above and the UK model below.

C. *United Kingdom: Regulatory Redress*

The UK takes the ombudsman model one step further, where the Financial Conduct Authority (FCA) itself, is involved in the redress process. The ombudsman is essentially a dispute resolution agency, where the FCA has much broader power than an ombudsman. When facing a massive claim situation, the FCA has the following four powers.[350] Firstly, it can ask the company first to initiate an inside investigation and provide all original data and investigation reports to the FCA.[351] Secondly, it can ask the company to use an outside "approved person" to handle the investigative process, and the fees incurred are borne by the regulated company being investigated.[352] Thirdly, it has the power to issue restitution order to return the status to its original state without specifying how much and to which person.[353] In order to balance the agency's immense power and increase accountability, before initiating the collective redress scheme, the FCA has to consult with the public and make a cost-benefit analysis.[354] After the initial compensation plan is issued to the plaintiffs, any dissatisfied person with the terms offered

348. *Id.*

349. BURTON A. WEISBROD, JOEL F. HANDLER & NEIL K. KOMESAR, PUBLIC INTEREST LAW-AN ECONOMIC AND INSTITUTIONAL ANALYSIS 510-11 (1978).

350. Hodges, *supra* note 345, at 846-48.

351. *Id.*

352. *Id.*; Financial Services and Markets Act 2000, c.8, § 166 (UK); FCA, *Skilled Persons Review*, Financial Conduct Authority, https://www.fca.org.uk/about/supervision/skilled-persons-reviews (last updated Apr. 29, 2020).

353. Hodges, *supra* note 345, at 846-48.

354. Waye & Marabito, *supra* note 326, at 7; Tribunals, Courts and Enforcement Act 2007, § 15 (UK).

by the company will be directed to the Financial Ombudsman Service (FOS) for resolution.[355] The company can also appeal the decision of FCA to the Upper Tribunal.[356] In the end, the coercion power of the FCA's proposed settlement comes from its discretion in making punishment. When making the final decision for punishment, the FCA will take into considerations how the company cooperates with the FCA and how much redress effort they are willing to make.[357]

As can be seen, the most significant merit of this model is that most of the cost and burdens are borne by the defendant company in terms of investigation and organizing the redress scheme. Moreover, even the monitoring of the redress process is borne by the company by hiring outsiders. However, even in this case, there are criticisms. Compared to the Australian model, this system is still costly. The problem is in the public consultant and economic analysis period. To increase public accountability, before initiating a mass redress scheme to the company, the FCA has first to do public consulting, and this process at least takes three months.[358] However, in Australia, there is no such requirement.[359]

D. *Lessons from the above Cases*

There are three lessons that can be learned from the above cases. The first one is that court or quasi-court procedure is slow and costly, and therefore other more flexible systems should be introduced. The slow speed and high cost do not only exist in the part of plaintiffs' aggregation. Moreover, it also exists in the slow process of court discovery and other court procedures, and therefore to accelerate the process, we need more than just an opt-out system, and we also need to shorten the time spent in a court or quasi-court procedure. This is shown by the US private class action and arbitration system. Also, apart from lawyer's contingency fee or outside litigation funding and winner-pays rule, a new fee shifting mechanism should be built. Collaboration from industry can decrease enforcement cost. Therefore, more industry resources should also be utilized, for example, the industry should provide internal or external dispute resolution program free of charge, and third parties experts could also be involved to conduct investigations. The costs incurred in this process should be borne by the business sides, starting from the costs originated from investigation, to

355. Waye & Marabito, *supra* note 326, at 7.

356. *Id*.; Established by Tribunals, Courts and Enforcement Act 2007, § 3 (UK); For principles of judicial review, *see* Financial Services and Markets Act 2000, § 404D (UK).

357. FCA, *Chapter 2 Enforcement Guide, The FCA's Approach to Enforcement, § 2.1.1-2.1.4*, *in* FCA Handbook, Financial Conduct Authority, https://www.handbook.fca.org.uk/handbook/EG/2.pdf (last updated Mar. 21, 2018).

358. *Id*. at 29.

359. *Id*.

negotiation, and to the final reach of settlement plan.

The second one is that in order to compensate for the lack of compulsory power outside the courtroom, other compulsory powers from administrative regulators are necessary, such as the regulator in UK and its counterpart in Australia and Denmark. The mass settlement and collective arbitration can only be applicable to limited scenarios, as shown by the case of the Netherlands and the US. The binding power on absent parties is questionable, and the res judicata question is unclear. Also, the speed is not fast and the cost is not cheap. Therefore, it is preferred to build an administrative agency-led holistic approach.

The third one is that one must think about the policy choice. No model is a perfect model. There are two impossible triangles. The first one is the low cost of business, the low cost of investors, and the low cost of government. If the policy choice is to facilitate the compensation procedure and to decrease the costs of government, then the costs should be borne by the business side. The cost should not only be borne in an ex-post perspective in terms of monetary penalties or compensation, but also should be switched to the business sides from the very beginning, including cost incurred in investigation and negotiation. The second impossible triangle is the low cost, fast speed, and public accountability. If low cost and fast speed are the policy choices, then some sort of public accountability needs to be compromised. The cases of the UK and Australia illustrate these two impossible triangles vividly.

VII. LESSONS FOR CHINA: A MORE COHERENT PRIVATE-AND-PUBLIC COLLABORATION MODEL

In China, there were some recent developments to solve the above problems. Firstly, China established the ISC,[360] which has the power to initiate civil proceedings in a court on behalf of retail investors.[361] Also, it can act as the representative in the securities class action proceeding on an opt-out basis when the numbers of plaintiffs are over fifty.[362] Secondly, China took a further step toward using regulatory redress, an administrative-led holistic approach discussed above, where China invented an "Advance-Compensation" mechanism.[363] Thirdly, China also permitted the administrative reconciliation power of the CSRC.[364] Fourthly, China

360. Lv Cheng Long (吕成龙), *Toubao Jigou Zai Zhengquan Mingshi Susong Zhong De Diwei* (*投保机构在证券民事诉讼中的角色定位*) [*The Role of Investor Services Center in Private Litigation*], 6 BEIFANG FAXUE (北方法学) [NORTHERN LEGAL SCIENCE] 28 (2017).

361. *Securities Law*, *supra* note 1, § 95.

362. *Id.*

363. *Id* § 93.

364. *Implementation Measures for the Pilot Program of Administrative Reconciliation*, *supra*

built the Chinese version of "Fair Fund", where the settlement fee will go into a specialized fund management agency, and the investor can receive compensation from that fund.[365] These efforts can all contribute to the facilitation of the settlement of cases.

We can clearly see that China has possessed a prima facie framework for the public- and-private collaboration model, however; there are still two problems that need to be addressed. Firstly, although China introduced its version of securities class action and the ISC can act as the representative in securities class actions in a court proceeding, it may lead to new problems. The ISC is similar to the IPC model in Taiwan,[366] and because of this, they may face similar problems in the future. The success of IPC's enforcement mainly relies on the success of criminal proceedings in Taiwan, due to the shortage of resources and the lack of incentives.[367] In China, if the overloads of cases surpass the processing capabilities of the ISC, then it may create similar problems like Taiwan. Although the ISC is not acting as the sole representative in securities class actions, the opt-out rule only applies when ISC acts as the representative.[368] This is exactly what has already occurred in Taiwan's history. Although, in Taiwan, the plaintiffs can also initiate private litigation on their own, they nevertheless chose to rely on the IPC to bring litigation due to its low cost,[369] not to mention that the ISC can bring litigation on an opt-out basis, where the IPC cannot. The opt-out arrangement will attract many persons choosing the ISC, so one day the ISC will face similar problems as Taiwan did, not to mention that there will definitely be more cases in China than in Taiwan. In order to make it work, the ISC, instead of just being the representative, should have more coercive powers, and the power to reach monetary settlement and other redress plans on a large scale, or using the CSRC's enforcement as the backup to increase its power of negotiation, such as the cases discussed above. Secondly, although the CSRC built an outside-of-court settlement procedure, and the "Advance-Compensation" mechanism could decrease the costs of enforcement, it still lacks several key ingredients to make these faster and cheaper, for example, the ability to request that the cost are borne by the companies liable and to request the companies liable to form a basket of

note 19.

365. *Securities Law*, *supra* note 1, § 126.

366. According to one official study organized by the SIPF, it proposed to follow the Taiwan Model. *See* Chen Gong Yan et al. (陈共炎等), *Guanyu Sheli Zhengquan Touzizhe Baohu Zuzhi Xiangguan Yanjiu* (*关于设立证券投资者保护组织相关研究*) [*Research on the Establishment of Securities Investor Protection Organizations*] 59, Securities Investor Protection Fund, http://www.sipf.com.cn/images/jyzx/llyj/2009/10/15/1149417489F15A2409BEE8012F53D865.pdf (last updated Oct. 15, 2009).

367. Securities and Futures Investors Protection Center, *supra* note 199; Lin, *supra* note 200.

368. *Securities Law*, *supra* note 1, § 95.

369. Wang, *supra* note 188, at 464, 466.

redress plans first. Based on the above analysis, there are several suggestions for China, and this article proposes to build a framework consisting of three pillars, including (1) gradual escalation of enforcement intensity; (2) encouragement of cooperation backed by coercive power; and (3) including industry resources and building a new fee-shifting mechanism. The three pillars support each other. The first pillar encourage cooperation, the second pillar backs cooperation in the first pillar, and the third pillar supports information flow and provides financial resources to the first and second pillar.

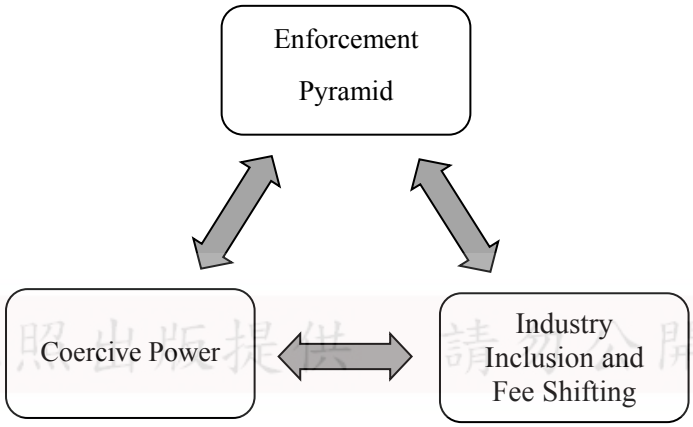

Figure 6: Three Pillars of Public-Private Collaboration Model

A. *Gradual Escalation of Enforcement Intensity*

The first one is that this administrative-led holistic approach running in China could learn more from the concept of enforcement pyramid,[370] where at first cooperation should be encouraged, and the enforcement intensity should be escalated when facing different degrees of opposition. This idea was first developed by the US political science professor John T. Scholtz, where he studied dynamic regulatory game,[371] and his idea was later developed in full by the famous Australian law professor John Braithwaite and the US economist Ian Ayres into responsive enforcement and restorative justice theory,[372] and is usually referred to as enforcement pyramid.[373] Their

370. Neil Gunningham, *Enforcement and Compliance Strategies*, *in* THE OXFORD HANDBOOK OF REGULATION 120, 126-31 (Robert Baldwin, Martin Cave & Martin Lodge eds., 2010).

371. John T. Scholtz, *Cooperation, Deterrence, and the Ecology of Regulatory Enforcement*, 18 LAW & SOCIETY REVIEW 179 (1984); John T. Scholtz, *Enforcement Policy and Corporate Misconduct: The Changing Perspective of Deterrence Theory*, 60 LAW AND CONTEMPORARY PROBLEMS 253 (1997).

372 . JOHN BRAITHWAIT & IAN AYARES, RESPONSIVE REGULATION TRANSCENDING DEREGULATION DEBATE (1992); JOHN BRAITHWAIT, RESTORATIVE JUSTICE & RESPONSIVE

empirical research demonstrates that the goal of justice system is for restoration rather than simple punishment and deterrence.[374] Moreover, a restorative justice system employing responsive enforcement pyramid is far more effective in deterrence than the passive deterrence method using the "sentencing grid", since stricter enforcement can only lead to more intense confrontation rather than cooperation,[375] and enforcement also follows the law of diminishing marginal utility effect, so the marginal deterrence effect of enforcement will decrease following the increase of enforcement intensity rather than the other way around.[376] Also, they use empirical studies and modern game theory illustrating that the empowerment of private and public interest groups in the regulatory process can lead to a better result in terms of restoration.[377] This design can incentivize the companies to first collaborate with regulators, thus lowering costs and facilitating speed of resolution.[378] The approaches taken by Australia, Denmark and the UK discussed above are based on these studies,[379] where their regulatory authorities all change their enforcement intensity in accordance with the defendants' attitudes and efforts made in cooperation and compensation, and they all encourage cooperation first. Even the US that primarily adopts an intensive-deterrence-enforcement-driven approach distinctive from many jurisdictions,[380] has been changing its approach in recent years, and both the Department of Justice and the SEC have been gradually developing programs for cooperation, which advocates more transparency for cooperation program and promote "meaningful" cooperation in exchange of "meaningful" deduction in penalty and sanction.[381] However, in order for this approach to

REGULATION (2002).

373. Gunningham, *supra* note 370.

374. BRAITHWAIT & AYARES, *supra* note 372.

375. *Id.*

376. *Id.*

377. *Id.*

378. *See generally* Christopher Hodges, *Collective Redress in Europe: The New Model*, 7 CIVIL JUSTICE QUARTERLY 370 (2010).

379. *Supra* Part VI. B and C.

380. John C. Coffee, Jr., *Law and the Market: The Impact of Enforcement*, 156 U. PA. L. REV. 229 (2007) (showing that US enforcement actions against securities violations distinctly outnumbered those of UK, Canada, Australia, Hong Kong, Singapore, Germany and France in terms of enforcement resources input and enforcement numbers output). Also, although London is the world's leading financial center, the UK's financial regulators take a persuasion-based enforcement approach, which is significantly different from the US enforcement-driven approach. *See* Eilis Ferran, *Capital Market Competitiveness and Enforcement* (Apr. 2008), http://dx.doi.org/10.2139/ssrn.1127245; Kathryn Cearns & Ellis Ferran, *Non-enforcement-led Public Oversight of Financial and Corporate Governance Disclosures and of Auditors*, 8 J. CORP. LAW STUD. 191 (2008).

381. John Savarese, Wayne Carlin & David Anders, *White-Collar and Regulatory Enforcement: What Mattered in 2019 and What to Expect in 2020* (Harvard Law School Forum on Corporate Governance, Feb.4, 2020), https://corpgov.law.harvard.edu/2020/02/04/white-collar-and-regulatory-enforcement-what-mattered-in-2019-and-what-to-expect-in-2020/; SEC, *Division of Enforcement 2020 Annual Report* (Nov. 2,

work, one crucial element is signal transmission and effective communication between regulator and regulated entities,[382] and this is the exact reason why the third pillar is important in which we should include regulated industry for building the restitution system, since it is not only good for resources utilization but also flow of information.

B. *Encouragement of Cooperation Backed by Coercive Power*

Secondly, the regulator should possess considerable sanction powers to coerce the defendant to enter into a compensation scheme, thus resolving the issue of compensation quickly. The purpose of a gradual escalation of enforcement intensity in the first pillar is to encourage cooperation first, but if things do not proceed as intended, the regulator nevertheless needs strong coercive powers for cooperation, which is the purpose of the second pillar. In the second pillar, the regulator should obtain many tools with strong coercive powers such as a strong administrative sanction power, the power to initiate collective litigation, the power to reach settlement and redress plan, and the power to increase or decrease compensation level based on the performance of the defendant. For example, in UK the FCA is in charge of the regulatory redress scheme. As the conduct regulator in UK, it possesses significant investigation and enforcement power. However, in practice, it will not directly use its power, but rather it will direct the company to make restitution and compensation plan first, and the effort and performance made by the company in this process will be taken into account when issuing final enforcement decision.[383] It is the same situation in Australia and Denmark. The Australian Ombudsman collaborates closely with the ASIC, and in exchange of cooperation, the Australian Ombudsman will keep investigation confidential and the ASIC will also adapt its enforcement intensity to different degrees of cooperation.[384] The Danish Ombudsman will first use multiple powers possessed by itself, and only initiate class action as a last resort to coerce the defendants into cooperation.[385] However, in China, the ISC lacks such powers. It merely acts as a vehicle for bringing litigation. The CSRC in theory has enough coercive powers, but as explained above, it rarely used so.[386] Considering the CSRC acts as the higher authority

2020), https://www.sec.gov/files/enforcement-annual-report-2020.pdf.

382. Christie Parker, *Compliance Professionalism and Regulatory Community: The Australian Trade Practices Regime*, 26 JOUR. L. SOC. 215 (1999); CHRISTIE PARKER, THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY (2002); JOSEPH REES, REFORMING THE WORKPLACE: A STUDY OF SELF-REGULATION IN OCCUPATIONAL SAFETY (1988).

383. FCA, *supra* note 357.

384. Waye & Marabito, *supra* note 326; ASIC, *supra* note 340.

385. HODGES & VOET, *supra* note 284, at 119.

386. Xie & Wu, *supra* note 22.

supervising the ISC, so in the future, there should be reform as to how the ISC can cooperate with the CSRC, utilizing the CSRC's coercive power in making a holistic compensation regime.

C. *Industry Inclusion and a New Fee-Shifting Mechanism*

The previous fee-shifting mechanism in the class action models adopted by the above analyzed jurisdictions mainly focused on who bears litigation costs during the process of litigation, and these include loser-pays/winner-pays/split-the-cost/lead-plaintiff-pays model, contingent fees, litigation funding, opt-out/opt-in model and public representative model. However, in practice, the cost do not only incur from litigations, but also from the beginning of negotiation and investigation and throughout the whole process of resolution.

Therefore, we need to see a bigger picture, and this article suggests that the cost of investigation and negotiation of the redress scheme should be borne by the business side. This proposal will act as a new fee-shifting mechanism. The business sides should first be required to initiate an internal investigation and form a resolution plan. This, on the one hand, can act as a fee-shifting mechanism, and on the other hand can help build a platform for communication between regulators and regulated entities and also help cultivate dispute resolution experts that can facilitate information exchange with regulators. This third pillar is the cornerstone that can make the first pillar and second pillar work.

Also, the CSRC should have the power to hire outside experts to conduct investigations, and the incurred fees should also be borne by the business sides. This approach is adopted in the UK.[387] Rather than relying on the tax-payers money, the social resources should be fully utilized. Moreover, this is nothing new, and it is only a reasonable extension of gatekeeper's function. The most important reason to rely on gatekeeper acting as the frontline patroller of securities market is to relieve the burden of regulators. Finally, this fee-bearing mechanism could expand the businesses of accounting firms and law firms, so it could also serve as a new incentive to cooperate with regulators.[388] Currently, there are many regulations for the supervision of gatekeepers; however, these regulations do not touch the core of the issue of conflict of interest, which is the payment problem.[389] As long as the gatekeeper is paid by the issuer, then there is a

387. Financial Services and Markets Act 2000, c.8, § 166 (UK); FCA, *supra* note 352.

388. Lawrence A. Cunningham, *Beyond Liability: Rewarding Effective Gatekeepers*, 92 MINN. L. REV. 323 (2007).

389. Jennifer Payne, *The Role of Gatekeeper*, *in* OXFORD HANDBOOK OF FINANCIAL REGULATION 254 (Niamh Moloney, Ellis Ferran & Jennifer Payne eds., 2015).

tendency for collusion. Therefore, instead of relying on complicated regulatory design, the most overlooked mechanism is market discipline,[390] and if we can reward gatekeepers for doing good, then the invisible hand in the market can help balance the conflict of interest. Moreover, the issuers' violations will be more likely to be deterred by the fees incurred in the investigative process.

390. Robert R. Bliss, *Market Discipline: Players, Processes, and Purposes*, *in* MARKET DISCIPLINE ACROSS COUNTRIES AND INDUSTRIES 37 (Claudio Borio, William C. Hunter, George G. Kaufman & Kostas Tsatsaronis eds., 2004).

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證券案件執法與賠償的比較研究及對中國2019年版《證券法》的啟示

資 默 奇

摘 要

中國最近在2019年版的《中華人民共和國證券法》中推出了中國版的私人證券集體訴訟規則。中國版集體訴訟在採用「選擇退出」規則的同時，利用投資者保護公共機構作為原告集體訴訟的代表，意圖在降低集體訴訟門檻的同時控制濫訴。本文認為該規則有可能面臨效率低下的問題。為解決該問題，本文在以下研究的基礎上提出了一種新的公私融合的執法和賠償模式。首先，從美國、英國、澳大利亞的證券市場監管歷史來看，本文發現無論是私人集體訴訟還是公共行政執法都不應該單獨作為主要的執法方式。因為全面展開的私人集體訴訟往往容易造成過度執法的問題，並且其還有賠償率低，結案時間長的問題。而公共行政執法則又往往面臨執法力度不足的問題。其次，本文根據美國、澳大利亞、日本、韓國和臺灣的證券集體訴訟案件的經驗發現，各國都很難將證券集體訴訟的激勵機制調整至相對平衡的狀態。此外，由於最佳執法威懾水平這一標準很難確定，所以在該基準缺失的情況下，我們無法知道什麼才是合適的案件數量，這使得利用美國式的私人證券集體訴訟來提高執法威懾水平的理論受到質疑。因此，本文轉而考察美國和荷蘭的ADR——仲裁與和解，用以探討它們能否成為私人集體訴訟的替代方案，但最終結論是它們並不適合解決涉及大規模群體的案件。最後，本文提出應構建私人訴訟與公共執法相結合的新模式。為了重建新模式，我們應該重新考慮政策導向和評價指標，轉而將重點放在提高賠償率和降低執行成本上，而不是增加案件數量上。基於這種政策選擇，本文從英國、澳大利亞、丹麥等不同司法管轄區的經驗出發，提出了一種私人訴訟與公共行政執

法相結合的新模式。該模式主張由證券監管部門而不是法院主導解決案件，尤其是在案件的賠償方面。

關鍵詞：中國、私人集體訴訟、公共行政執法、公私合作、比較研究